



GUIDANCE NOTE ON RISK BASED INTERNAL AUDIT



Internal Audit & Assurance Standards Board The Institute of Cost Accountants of India

(Statutory Body under an Act of Parliament)

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1 INTERNAL AUDIT

1.1 Introduction

Due to globalization and changing trends in the business managements are increasingly getting risk focused, and the expectation from internal auditors shifted from traditional internal audit to risk based internal audit. Audit is no more a post-mortem exercise; rather it a proactive exercise. In the light of this, internal auditors are expected to provide assurance on the adequacy and effectiveness of internal controls with a clear objective whether risks are being managed within acceptable limits. One cannot say that there no risk at all, but risk exists within the acceptable limits as laid down by the management of the enterprise. Such tolerances of risk depend on nature of the business and size of the organization.

1.2 Objectives of this Guidance Note

The objective of this guidance note is,

- ✓ To create understanding on Risk Based Internal Audit (RBIA)
- ✓ To create definition, scope, methodology of RBIA
- ✓ To explain the need for Risk Based Internal Audit
- ✓ To update on latest developments in the fields of RBIA
- ✓ To facilitate members, auditors, and auditees in conducting Risk Based Internal Audit

1.3 Scope of the Guidance Note

With change of the business dynamics, the role and expectations from the internal auditor are also changing. The traditional way of internal audit has to be enhanced to provide value added services to the clients and in this context, the internal auditor can adopt Risk Based Internal Audit. This Guidance Note provides an insight into the Risk Based Internal Audit and also the process of doing it along with the areas in which the Internal Auditor has to be concentrate.

2 OVERVIEW OF INTERNAL AUDIT

2.1 Definition of Internal Audit

Internal Audit as “an independent management function, which involves a continuous and critical appraisal of the functioning of entity with a view to suggest improvements thereto and to add value and strengthen the overall governance mechanism of the entity, including the entity’s strategic risk management and internal control system. Internal Audit, therefore, provides assurance that there is transparency in reporting, a part of good governance”.

2.2 Objectives of Internal Audit

The objectives of internal audit are:

- To provide assurance on compliance,
- To provide assurance on efficiency of systems, processes, and governance,
- To provide assurance on adequacy and effectiveness of internal controls over financial reporting,
- To provide assurance on adequacy and effectiveness of risk management system,
- To provide safeguard against potential fraud, waste, or abuse,
- To provide value adding consultancy to the management, and
- To improve organization's operations.

While attaining these objectives, the three E's of audit i.e., Efficiency, Effectiveness, & Economy, must be followed.

2.3 Scope of Internal Audit

The potential scope of internal audit is the whole system of internal control established by an organization. This may include controls over all the organization’s activities, not just controls over financial accounting and reporting. It should review all significant, operational and management controls, including policies and procedures for the management of risk. It should concentrate on high-risk areas and the most important internal controls.

The scope of audit includes review of

- Internal Control System and Procedures
- Custodianship and Safeguarding of assets

- Compliance with policies, plans, procedures and regulations
- Relevance and Reliability of information
- Organisational Structure
- Utilisation of Resources
- Accomplishment of Goals and Objectives

2.4 Methodology

Internal Audit usually starts with a kick-off meeting with the company.

The Auditor needs to have a discussion with the client regarding the business structure, controls, and standard operating procedures of the company. Technically, it is known as Know Your Client. Before start of the audit, one needs to understand the company's policies, procedures.

Based on his understanding, the auditor needs to prepare an Internal Control Questionnaire with Yes / No responses, which should be answered by the client. A Risk Grading criterion should be prepared before hand to differentiate the level of risk assessment.

After reviewing the Internal Control Questionnaire, a checklist should be prepared by the auditor for conducting the audit of different functionalities.

A Risk Matrix needs to be prepared considering the criteria based on the level of risks identified during audit. This will help to identify high-risk areas and focus on what needs to be addressed first.

Management accordingly needs to take necessary action for the identified and assessed risks and needs to improve the controls in order to reduce the risk in future.

Institute of Internal Audit (IIA) defines risk as "The possibility of an event occurring that will have an impact on the achievement of objectives. Risk is measured in terms of impact and likelihood."

2.5 Risk Based Internal Audit Planning

The Internal Auditor needs to plan the audit to be performed, well before the commencement of the audit. It should include the scope of the audit, personnel and time required.

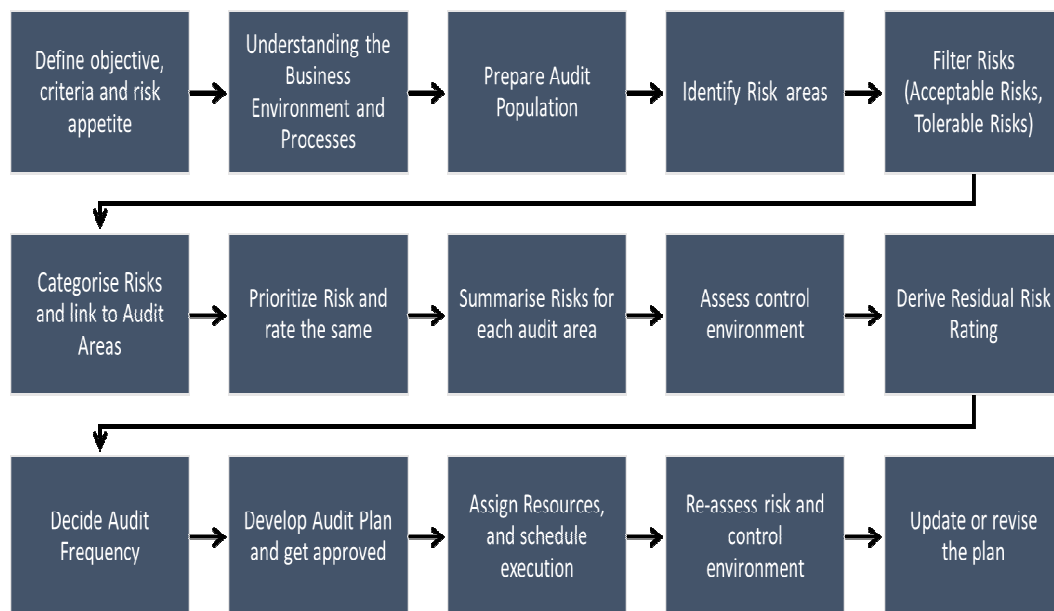
Audit plan is a bird's eye-view, as it provides full information regarding the areas of work to be performed, delegation of work among the personnel. It needs to be comprehensive and definitive to ensure that non-value-added

activities are eliminated. It should be formulated in a cost-effective manner and within a stipulated time.

Internal auditor should, in consultation with those responsible for governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner.

The internal audit plan, which should be approved by the audit committee, should be based on risk assessment as well as on issues highlighted by the audit committee and senior management. The risk assessment process should be of a continuous nature to identify not only residual or existing risks, but also emerging risks. The internal auditor should design the audit work plan by aligning it with the objectives and risks of the enterprise and concentrate on those issues where assurance is sought.

Risk based Internal Audit Plan



2.6 Sampling

Audit sampling is application of audit procedures to less than 100% of items within a population of audit relevance such that all sampling units have a chance of selection in order to provide the auditor with a reasonable basis on which to draw conclusions about the entire population.

The use of sampling in auditing is widely adopted as it facilitates the auditors to obtain minimum amount of evidence to perform maximum level

of audit. In selecting sample auditor must exercise utmost care as selection wrong sample leads to drawing wrong conclusion about the entire audit work. The audit team can follow either statistical sampling or non-statistical sampling or combination of both based on size of the business and the extent of complexity involved. Statistical sampling uses theory of probability on the other hand non-statistical sampling largely depends on auditors' experience and judgemental capacity.

2.7 Evidence

Audit evidence helps the auditors to form a strong opinion of the control system and acts as a proof of the transaction performed. Evidence can be formal or informal, written or verbal. Evidence should be sufficient, reliable, relevant and from a right source. Types of audit evidence are:

- 1) Physical examination which means physical examining of a workplace, inventory asset etc the auditor would like to see or seen;
- 2) Documentation is the verifying documents such as sales invoice, purchase invoice, journal voucher, bank statement etc;
- 3) Analytical Procedures acts as corroborative evidence and helps in forming an opinion and deciding whether an area of operation or function requires auditing in depth or not. Analytics sometimes also helps in judging the internal control system;
- 4) Confirmations are mostly obtained from third parties such as banks, insurance agencies vendors or customers to establish the authenticity of the transactions;
- 5) Observations; and
- 6) Enquiries are another way collecting information from employees, management third parties etc depending on the seriousness of the transactions and risk involved.

2.8 Analytical Procedures

Analytical procedures are evaluation of financial and non-financial, qualitative, and quantitative information to establish a relation between business process, transactions. These are used to assess the risk, to conduct effective tests, to understand the efficacy or otherwise of the internal control system. In the modern-day audit big data and data analytics play vital role performing analytical procedures. With the automated statistical

calculations, data can be uploaded to the application and the system given results drive the conclusion.

2.9 Documentation

Audit documentation is the record of audit program, planning evidence collected, methodology followed, analysis made conclusions drawn, reply received on draft report etc. The documentation can be electronic or physical. Electronic documentation eases the work of documentation, faster communication, and quicker access. Documentation can be divided into master documents and transactional documents.

3 CONTROL & RISK MANAGEMENT

3.1 Risk Identification

Risk identification is the process of identifying all possible risk within the organization and within the audit population. This includes evaluation of 'what can go wrong' in the control environment and within the business of the entity selected for audit. The identification should be the adverse impact on the organization. The adverse impact could be in the form of possible financial loss, operational inefficiency and ineffectiveness, statutory non-compliance, incorrect reporting, etc. Risk identification is key to risk assessment.

3.2 Risk Assessment

The main objective of the risk assessment is to assess the degree of risk in the various business processes. Risk assessment focuses on business environment, regulatory environment, organization structure, organizational and business environmental changes and specific concerns of management and the audit committee to determine the areas of high degree risk. It also helps the internal auditor in evaluating the control design to determine the desired audit scope. Risk assessment includes risk identification and then risk prioritization based on defined criteria.

3.3 Risk Categorization

According to the Internal Control Framework issued by The Committee of Sponsoring Organizations (COSO) of the Treadway Commission, risk can be categorized as Strategic Risk, Operational Risk, Reporting Risk and Compliance Risk.

- Strategic risk includes high-level goals, aligned with and supporting its mission.
- Operations risk includes effective and efficient use of its resources
- Reporting risk means reliability of reporting
- Compliance risk is compliance with applicable laws and regulations

3.4 Risk Prioritization

The identified risk needs to be prioritized based on the pre-defined criteria (Refer step 1 mentioned in audit plan above- Define objective, criteria, and risk appetite). The typical risk periodization is done on the scale of 1 to 5 as mentioned in the subsequent sections below where 1-Low, 2-Minor, 3-Moderate, 4-High, and 5-Extreme. This prioritization depends on many

factors viz., Risk of non-compliance, risk of significant financial loss, risk of Safety, Health and Environment (SHE), risk of organizational reputation, risk of technology etc.

3.5 Risk Mitigation

One of the major challenges the organizations are facing across the globe is risk and how to mitigate the same.

For risk to be mitigated, the risks have to be identified and based on the nature of risk, corrective actions have to be taken. Say in case if the organization is dependent on a single person in marketing or sale, a second line should be developed and a person should be deployed as shadow for the key employee. Addressing only this will not mitigate the risk, how it will be addressed in future in other areas/departments of the organization. For this the HR policies have to be addressed and second of leadership should be developed for all the areas where it is required. In this manner the risk can be mitigated.

As to single size fits all, the risk mitigation will differ from organization to organization or risk to risk. The IA has to come with various options in his report along with the pros & cons. This will help the client to take corrective steps before hand and overcome the risk.

3.6 Risk Monitoring

This step involves reviewing results of MIS / field visits to assess the activities or business processes. Monitoring is a routine activity and risk monitoring and control is required to:

- Risk responses have been implemented as planned.
- Risk response actions are as effective as expected or if new responses should be developed.
- Risk exposure has changed from its prior state, with analysis of trends.
- A risk trigger has occurred.
- Proper policies and procedures are followed.
- New risks have occurred that were not previously identified.
- Ensure the execution of the risk plans and evaluate their effectiveness in reducing risk.
- Keep track of the identified risks, including the watch list.
- Monitor trigger conditions for contingencies

- Monitor residual risks and identify new risks arising during project execution.
- Update the organizational process

3.7 Risk Communication

Risk communication is necessary for the organization to carry out internal control responsibilities to support the achievement of its objectives. Management obtains or generates and uses relevant and quality information from both internal and external sources to support the functioning of internal control. Communication is the continual, iterative process of providing, sharing, and obtaining necessary information. Internal communication is how information is disseminated throughout the organization, flowing up, down, and across the entity. It enables personnel to receive a clear message from senior management that control responsibilities must be taken seriously. External communication is twofold: it enables inbound communication of relevant external information and provides information to external parties in response to requirements and expectations.

3.8 Risk Reporting

Risk reporting is an important factor in risk management. It is also important whom to report, what to report and when to report. Reporting organizational risks should operate on multiple levels to address the needs of diverse audiences, each with their own specific needs, requirements, expectations, agendas, and levels of expertise. It also differs to internal and external audiences for internal and external risk reports. Although internal risk reports aim exclusively at internal audiences, from a broader perspective external risk reporting, including corporate annual reports, may include both external users and interested internal groups.

Some of the risk reports and their reporting is detailed below

- Internal Risk Reports
 - Board of Directors
 - Audit Committee
 - Senior Management
 - Managers
 - Employees
 - Integrated Business Partners
- External Risk Reports
 - Statutory Auditors

- Regulators
- Shareholders
- Creditors
- Customers
- Suppliers
- Media

4 RISK GOVERNANCE & INTERNAL AUDIT

4.1 Role of Board of Directors/Governing Body

The board should discuss with senior management the state of the entity's enterprise risk management and provide oversight as needed. The board should ensure it is apprised of the most significant risks, along with actions management is taking and how it is ensuring effective enterprise risk management.

The board should consider seeking input from internal auditors, external auditors, and Others. Responsibilities of the board and management on ERM are clearly stated in the international frameworks (such as the ERM Framework) and the Corporate Governance Code. Generally, the board should oversee the ERM by:

- Define expectations;
- Set strategy & high-level objectives;
- Resource allocation;
- Adopt risk management policy;
- Knowing the extent of ERM within the organization;
- Reviewing the risk portfolio of the organization and considering it against the risk appetite;
- Understanding the changes and significant risks the organization is facing; and
- Considering whether the risk responses are appropriate or not.

4.2 Role of Audit Committee

Although the monitoring of the risk management process is the responsibility of the Board, recently, it has been delegated to the Audit Committee thereby its role is becoming more important and the scope of its responsibilities and tasks is expanding. Regardless of whether it is the continental system of corporate governance, which is characterized by a two tier governance structure (with Supervisory and Management Board) or the Anglo-American system of corporate governance in which the role of the management and Supervisory Board integrates into a single Board of Directors with executive and non-executive directors, the Audit Committee is a specialized subcommittee which is being delegated with appropriate supervisory functions. The primary functions of the Audit Committee are usually associated with the internal controls and risk management, financial

reporting, compliance with legal and regulatory requirements and the relevant issues related to the process of external and internal audit

The role of Audit Committee is a non-executive function that aims to satisfy itself that Management has properly fulfilled its responsibilities, as well as with:

- The degree to which Management has assumed ownership for risk and control.
- How key business risks are identified, evaluated and managed;
- Whether the controls are fit for purpose and are working as intended.
- The rigour and comprehensiveness of the review process.

4.3 Role of Risk Management Committee

The role of risk management committee is important in the light of the fact that its responsibility is to assist the Board in setting up risk strategies, policies and frameworks, models, and procedures in liaison with management. It acts as a bridge between the Board and Management in mitigating the risk

- To access the company's risk profile and key areas of risk in particular
- To recommend to the board the adaption of risk assessment and rating procedures
- To examine and determine the sufficiency of the company's internal process for reporting and managing key risk areas
- To assess and recommend the board level of risk tolerance levels
- To develop and implement a risk management framework and internal control system
- To have special investigations into areas of corporate risk and weakness in internal control system
- To review management response to the company auditors' recommendations those are adapted
- To report the trends in company's risk profile, reports in specific risks and the status of risk management process
- Propose risk management policy & philosophy
- Establish risk management goals
- Develop & implement a risk management program
- Help managers incorporate risk management into operations
- Convert risk management strategies into operations
- Present annual report to Board

4.4 Role of Senior Management

- Responsible for all activities including assisting in Risk Management Committee
- Sets the tone & influences of the internal environment (principles, values)
- Develop risk management philosophy, appetite & culture
- Coordinates, on an ongoing basis, the implementation of the Risk Management Plan
- Reviews Risk Matrix and reports to the CEO on recommended changes.
- Regularly arranges the Leadership Team to discuss the area of major risks and necessary changes to mitigate the risk
- Develops and implements risk management procedures and training as may be needed

4.5 Role of Executive Functional Heads

- Ensure that risk management controls and processes are included in all planning and research.
- Encourage an organizational climate that supports risk management.
- Ensure that employees understand the importance and consequences of risk management issues in their immediate work areas
- Identify any new risks and report them to the Executive Committee.

4.6 Role of Internal Auditor

Due to the new demands from the board and management, the role of an internal auditor shifts from a control-focus advisor, to a consultant who creates value by supporting the organization's objectives, monitoring enterprise risks and ensuring the effectiveness of the internal control framework. Internal auditors should consider whether the upcoming activities will affect their independence and objectivity or not. The role of internal auditor under ERM below.

Role Internal Auditor in Risk Management



Core Roles

Assurance that risks are correctly stated & evaluated
Assurance that mitigating actions are operating
Evaluate risk management process
Evaluate reporting & management of key risks



Roles with Safeguards

Facilitating Identification & Evaluation of risks
Coaching management in responding to risks
Coordinating ERM activities
Consolidated reporting on risks
Maintaining and developing ERM framework
Leading establishment of ERM
Developing ERM strategy for board approval

4.7 Internal Auditor Skills for Risk Management

- Should be aware of the mission, vision, values, and strategic objectives of the organization;
- Should understand the development & use of standard tools, techniques, latest technologies, and methodologies;
- Should have in-depth knowledge on Accounting, and Audit ;
- Should have knowledge on fraud auditing, forensic and investigation;
- Should have data mining & analysis knowledge with IT & cyber security;
- Should have industry specific knowledge with risk management aptitude;
- Should know how to identify, assess, and evaluate risks & controls;
- Should be able to summarize in and report at an Executive level preferably in dashboards and color coding i.e. Visual Display Analysis (VDA) mode;
- Should be independent approachability to audit comity and top management; and
- Should have strong team building skills;

4.8 Role of External Auditor

- Understanding the business
- Identifying the risk areas
- Analyzing the process and controls

- Communicating and Recommendation through Report

4.9 COSO Framework

In 1992, Committee of Sponsoring Organizations of the Treadway Commission (COSO) developed a model for evaluating internal controls. This model has been adopted as the generally accepted framework for internal control and is widely recognized as the definitive standard against which organization's measure the effectiveness of their systems of internal control. The COSO model defines internal control as "a process effected by an entity's board of directors, management and other personnel designed to provide reasonable assurance of the achievement of objectives in the following categories:

- Operational Effectiveness and Efficiency
- Financial Reporting Reliability
- Applicable Laws and Regulations Compliance

According to COSO, Internal Control –

- Focuses on achieving objectives in operations, reporting and compliance
- It is an ongoing process
- It depends on people's actions and not merely written policies and procedures

Components of COSO:

- **Control Environment:** It describes a set of standards, processes, and structures that provide the basis for carrying out internal control across the organization. It is the foundation on which an effective system of internal control is built and operated.
 - Exercise integrity and ethical values.
 - Make a commitment to competence.
 - Use the board of directors and audit committee.
 - Facilitate management's philosophy and operating style.
 - Create organizational structure.
 - Issue assignment of authority and responsibility.
 - Utilize human resources policies and procedures
- **Risk Assessment:** It forms the basis for determining how risk will be managed. It requires management to consider the impact of possible

changes in the external and internal environment and to potentially take action to manage the impact.

- Create companywide objectives.
 - Incorporate process-level objectives.
 - Perform risk identification and analysis.
 - Manage change
- **Information & Communication:** Information is obtained or generated by management from both internal and external sources to support internal control components. Communication based on internal and external sources is used to disseminate important information throughout and outside of the organization, as needed to respond to and support meeting requirements and expectations. The internal communication of information throughout an organization also allows senior management to demonstrate to employees that control activities should be taken seriously.
 - Measure quality of information.
 - Measure effectiveness of communication.
 - **Monitoring Activities:** These are periodic or ongoing evaluations to verify that each of the five components of internal control, including the controls that affect the principles within each component, are present and functioning around their products.
 - Perform ongoing monitoring.
 - Conduct separate evaluations.
 - Report deficiencies.
 - **Control Activities:** Control activities are actions (generally described in policies, procedures, and standards) that help management mitigate risks to ensure the achievement of objectives. Control activities may be preventive or detective in nature and may be performed at all levels of the organization
 - Follow policies and procedures.
 - Improve security (application and network).
 - Conduct application change management.
 - Plan business continuity/backups.
 - Perform outsourcing.

5 ENTERPRISE RISK MANAGEMENT (ERM)

5.1 Definition of ERM

As per Chartered Global Management Accountant (CGMA) “Enterprise risk management (ERM) is the process of identifying and addressing methodically the potential events that represent risks to the achievement of strategic objectives, or to opportunities to gain competitive advantage”

Enterprise Risk Management is a process, effected by an entity’s board of directors, management and other personnel, applied in strategy setting and across the enterprise, designed to identify potential events that may affect the entity, and manage risk to be within its risk appetite, to provide reasonable assurance regarding the achievement of entity objectives.

ERM is the identification, assessment, and management of a pool of the most significant risks/opportunities that could hamper or enable the achievement of the organizations strategic, operational, compliance, reporting and other important objectives.

Going by the above definitions and understandings, the role of the internal auditor in relation to Enterprise Risk Management is to provide assurance to management on the effectiveness of risk management. Due consideration should be given to ensure that the internal auditor protects his independence and objectivity of the assurance provided. The role of the internal auditor is to ascertain that risks are appropriately defined and managed.

5.2 Attributes of Risk

The attributes of risk are

- Probability of occurrence Risk
- Consequences of occurrence of such Risk

The scope of the internal auditor’s work in assessing the effectiveness of the Enterprise Risk Management would, normally, include:

- a) Assessing the risk maturity level both at the entity level as well as the auditable unit level.
- b) Assessing the adequacy of and compliance with the risk management policy and framework; and
- c) for the risks covered by the internal audit plan:

- Assessing the efficiency and effectiveness of the risk response; and
- Assessing whether the score of the residual risk is within the risk appetite.

The extent of internal auditor's role in enterprise risk management will depend on other resources, internal and external, available to the board and on the risk maturity of the organisation. The nature of internal auditor's responsibilities should be adequately documented and approved by those charged with governance. The internal auditor should not manage any of the risks on behalf of the management or take risk management decisions. Internal auditor has a role only in commenting and advising on risk management and assisting in the effective mitigation of risk.

The internal auditor must review the structure, effectiveness and maturity of an enterprise risk management system. In doing so, he should consider whether the enterprise has developed a risk management policy setting out roles and responsibilities and framing a risk management activity calendar. The internal auditor should review the maturity of an enterprise risk management structure by considering whether the framework so developed, inter alia:

- a) Protects the enterprise against surprises.
- b) Stabilizes overall performance with less volatile earnings.
- c) Operates within established risk appetite.
- d) Protects ability of the enterprise to attend to its core business; and
- e) Creates a system to proactively manage risks.

The internal auditor should review whether the enterprise risk management coordinators in the entity report on the results of the assessment of key risks at the appropriate levels, which are:

- Risk Management Committee.
- Enterprise Business and Unit Heads.
- Audit Committee.

5.3 Activities included in ERM

- Articulating and communicating the objectives of the organisation
- Determining the risk appetite of the organisation.
- Identifying potential threats to the achievement of the objectives

- Establishing an appropriate internal environment, including a risk management framework
- Assessing the risk i.e. the impact and likelihood of the threat occurring
- Selecting and implementing responses to the risks
- Undertaking control and other response activities
- Communicating information on risks in a consistent manner at all levels in the organisation.
- Centrally monitoring and coordinating the risk management processes and the outcomes
- Providing assurance on the effectiveness with which risks are managed.

5.4 Benefits of ERM

All organizations need to set strategy and periodically adjust it, always staying aware of both ever-changing opportunities for creating value and the challenges that will occur in pursuit of that value. To do that, they need the best possible framework for optimizing strategy and performance.

That is where enterprise risk management comes into play. Organizations that integrate enterprise risk management throughout the entity can realize many benefits, including, though not limited to:

- Greater likelihood of achieving those objectives
- Consolidated reporting of disparate risks at board level
- Improved understanding of the key risks and their wider implications
- Identification and sharing of cross business risks
- Greater management focus on the issues that really matter
- Fewer surprises or crises
- More focus internally on doing the right things in the right way
- Increased likelihood of change initiatives being achieved
- Capability to take on greater risk for greater reward
- More informed risk-taking and decision-making

These benefits highlight the fact that risk should not be viewed solely as a potential constraint or challenge to setting and carrying out a strategy. Rather, the change that underlies risk and the organizational responses to risk give rise to strategic opportunities and key differentiating capabilities.

ERM 20 key principles within each of the five components

 Governance and Culture	 Strategy and Objective Setting	 Performance	 Review and Revelations	 Information, Communication and Reporting
1. Exercise Board Risk oversight	6. Analyses Business Context	10. Identify Risk	15. Assess the Substantial Change	18. Leverages Information and Technology
2. Establishes Operating Structure	7. Defines Risk Appetite	11. Assesses Sensitivity of Risk	16. Reviews Risk & Performance	19. Communicate Risk Information
3. Defines Desired Culture	8. Evaluates Alternative Strategies	12. Prioritized Risks	17. Pursues improvement in Enterprise Risk Management	20. Reports Risk, Culture and Performance
4. Demonstrates Commitment to Core values	9. Formulates Business Objectives	13. Implements Risk Responses		
5. Attracts, Develops and Retains Capable Individuals		14. Develop Portfolio Views		

Governance and Culture: Governance sets the organization's tone, reinforcing the importance of, and establishing oversight responsibilities for, enterprise risk management. Culture pertains to ethical values, desired behaviours, and understanding of risk in the entity.

Strategy and Objective-Setting: Enterprise risk management, strategy, and objective-setting work together in the strategic-planning process. A risk appetite is established and aligned with strategy; business objectives put strategy into practice while serving as a basis for identifying, assessing, and responding to risk.

Performance: Risks that may impact the achievement of strategy and business objectives need to be identified and assessed. Risks are prioritized by severity in the context of risk appetite. The organization then selects risk responses and takes a portfolio view of the amount of risk it has assumed. The results of this process are reported to key risk stakeholders.

Review and Revision: By reviewing entity performance, an organization can consider how well the enterprise risk management components are functioning over time and considering substantial changes, and what revisions are needed.

Information, Communication, and Reporting: Enterprise risk management requires a continual process of obtaining and sharing necessary information, from both internal and external sources, which flows up, down, and across the organization.

5.5 Assurance Role of Internal Audit in ERM

- Providing objective assurance that the major business risks are being managed appropriately
- Providing that the risk management and internal control framework is operating effectively
- Giving assurance on risk management processes.
- Giving assurance that risks are correctly evaluated
- Giving assurance that reviewing of risk management process happening frequent intervals
- Providing assurance that key risks reporting to appropriate levels at right time

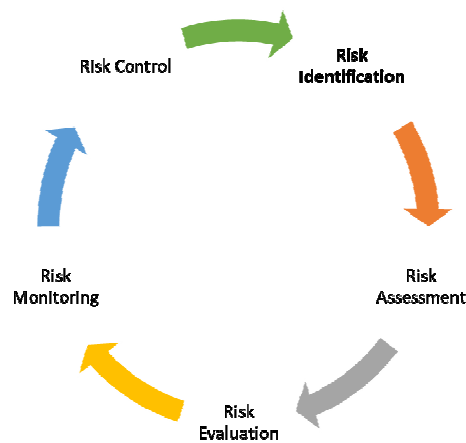
5.6 Consulting Role of Internal Audit in ERM

- Having overall knowledge of the organisation brainstorming the key stakeholders about the benefits of ERM.
- Making available to management tools and techniques used by internal audit to analyse risks and controls.
- Being a champion for introducing ERM into the organisation leveraging its expertise in risk management and control.
- Providing advice, facilitating workshops, coaching the organisation on risk and control, and promoting the development of a common language, framework and understanding.
- Acting as the central point for coordinating, monitoring, and reporting on risks.
- Supporting managers as they work to identify the best way to mitigate a risk.

5.7 Safeguards for Internal Audit in ERM

- The management should be clear that they are responsible for risk management
- The nature of internal audit's responsibilities should be documented in the audit charter and as approved by the Audit Committee
- Internal audit should not manage any of the risks on behalf of management.

- Internal audit should provide advice, challenge and support to management's decision making, as opposed to taking risk management decisions themselves.
- Internal audit cannot also give objective assurance on any part of the ERM framework for which it is responsible. Such assurance should be provided by other suitably qualified parties
- Any work beyond the assurance activities should be recognised as a consulting engagement and the implementation standards related to such engagements should be followed



6 RISK BASED INTERNAL AUDIT

Chartered Institute of Internal Auditors (IIA) defines *Risk Based Internal Auditing (RBIA)* as a methodology that links internal auditing to an organization's overall risk management framework. RBIA allows internal audit to provide assurance to the board that risk management processes are managing risks effectively, in relation to the risk appetite.

Risk-Based Internal Audit means audit around Enterprise Risk Management (ERM). Firms that have not ERM may focus on procurement of critical material that are in short supply, and this may result in production stoppage therefore the purchase team may circumvent some of the procure material on emergency basis. This may affect the bargaining power and the firm may incur financial loss due to higher cost of procurement. It may also result in buying poor quality of material in turn results in producing inferior quality of finished goods. Here the internal audit may focus on sales returns due to customer complaints on product quality. In the risk management model, it must be seen that supply of inferior quality of finished products may affect the firm's reputation, further diminution in market share.

6.1 Why Risk Based Internal Audit

Risk based internal audit is required for the organizations as they will help the organization to identify the risks and address them accordingly based on the risk priority and direction provided by the board. It helps to identify the following

- a) Inherited risks for the organization
- b) Identify the risk appetite
- c) Identify the risks and prioritize them based on the risk sequence
- d) It will help to identify the risks, respond & classify the risks

RBIA also helps board to take decisions effectively as knows the risk appetite and the risk potential while taking the decisions regarding the revenue, new product lines or divisions or upgradation of technology or operational expansions.

6.2 Risk Based Internal Audit Planning

Planning is key element for execution of any project or activity and similarly for RBIA also, planning is the key.

The internal auditor – in-house or outsourced person has to define the audit plan at the beginning of the year with a vision for next three to five years for

the Risk Based Internal Audit as the same cannot be completed in a short span of time. The areas to be worked for each year have to be marked out and executed accordingly.

Once the plan is in place, the same has to be run through the Audit Committee of the organization for approval as it has to be in line with the vision of the organization and should be able to handle the future expansions also. The Audit Committee members will provide direction based on their experience wherever required.

The plan once frozen should be reviewed on annual basis on the actual achievement compared with planned activity. The report has to specify if there any deviations along with reasons.

The board will approve the audit plan as the same is expected to be consumed by the statutory auditor.

The audit plan should consider the following

- Major Risks
- Business Objective
- Risk appetite
- Inputs from key managerial persons
- Business environment,

6.3 Audit Universe

Audit Universe comprises of process, locations, activities, operations subjected to audit during the audit period. A proper audit universe facilitates the internal auditor to complete the risk based internal audit in a systematic manner to assess the risks and how to address the same. The audit universe should be designed to reflect overall business objectives along with planning for conducting the audit. The audit universe and the related audit plan should also reflect the change in the management's course of action along with the objectives. Key Factors of Audit Universe are:

Organizations Objective – the objective of the corporate has to be considered while defining the audit universe. Every organization has its own objective and the audit universe should consider the objectives of the organization. An organization may have an objective of capturing 10% of the market share, in such cases, the audit universe should consider the market share as point and the audit should be focused on the risks related to achieving 10% market share.

Organizations Structure – Organization structure also has be considered in the audit universe. It will lay who should be approached for conducting the audit department / location / unit wise.

Business Process – business process should also be considered as part of the Audit Universe. The business process through a light on the internal controls and also helps to understand the client’s way of working. The business process will help to determine the areas to be audited first and decide the sequence.

Geographic Locations – the audit universe should consider the geographic locations if the entity is based out of different locations. All the locations cannot be audited at a time, the audit universe should specify the locations with the timings and which locations are being audited.

Sr.No	Department	Locations					
		Head Office	Branch Office – 1	Branch Office – 2	Central Warehouse	Factory – 1	Factory – 2
1	Compliances	✓	✓	✓	✓	✓	✓
2	Maintenance					✓	✓
3	Human Resources	✓					
4	Production					✓	✓
5	Procure to Pay	✓			✓	✓	✓
6	Order to Cash	✓	✓	✓	✓		

The above is the illustration for the audit universe for a manufacturing unit. It may differ from client to client, auditor to auditor and industry vertical to vertical.

6.4 Steps for Audit Universe Perpetration

Preparing the audit universe is a key process for Risk Based Internal Audit and it has to be provided with utmost care else there is a possibility for the whole activity going into the drains.

For any new process adoption or implementation blessing of the management is required. Preparation of Audit Universe starts with the discussion with the management as they provide the direction and also validate the process of RBIA and its expected outcome.

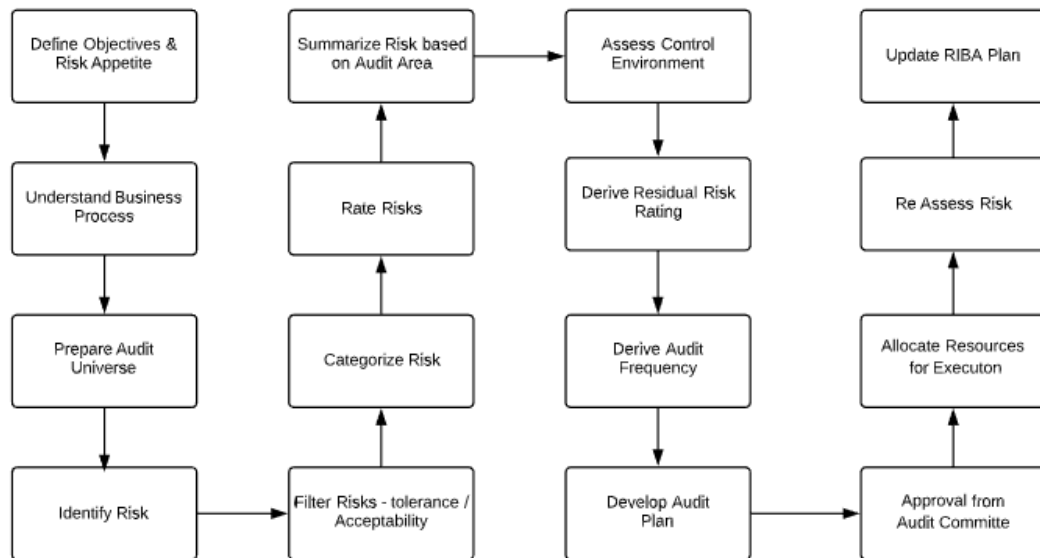
The second step is preparation of audit universe based on the points discussed in the previous section. The audit universe has to be prepared with utmost care as the team will be working based on that and Audit Universe will help in identifying the risk and on who to address the same.



Once the audit universe is prepared, the next step it to assess the objective of the Risk Based Internal Audit and once it is done the same has to be revalidated.

6.5 Process of Risk Based Internal Audit

Process helps to execute the internal audit to execute the risk based internal audit effectively. The process for RBIA is similar to the regular internal audit but the method of auditing is only different.



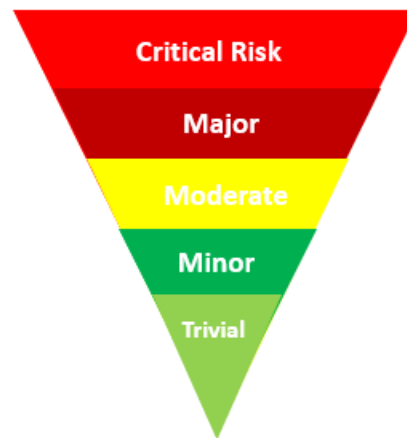
The process is never ending, it starts with defining the objective or the outcome of the audit, then business process has to be understood by the team, then audit universe has to be defined. Once risk is identified, the same is to be categorized if the organization has the risk appetite and other risks have to be rated and, on that basis, the potential risks have to be selected for minimizing them after approval of the Audit Committee. Once they approved the risk is minimized or eliminated the same has to be re-assessed and updated in the audit plan.

6.6 Risk Assessment & Measurement

The Risk Assessment is key as it will determine the organizations risk appetite based on that only. Key aspects of risk assessment are Risk Identification and Risk Prioritization.

The first step is to identify the risk, the IA during the course of the audit has to be verify for the internal controls and as the same time if there are any risks in the business process. In case of cash collection by the collection agent from the customers in the supply chain is critical risk as the collection agent can swindle cash or may not report the cash given by the customers. To mitigate this, the cash collection agent can be provided with a mobile based application as it will provide the means for entry of the same and also update the records accordingly and at the same time the customer will get an authenticated information. Identification of risk is the key and how to fix it another step.

At the same time all such risks have to be measured and resolution has to be arrived accordingly. In any organization all the risks cannot be addressed at a time and resolution for some risks has to be postponed or some risks can be observed as they are inevitable. If there are multiple risks that have to be addressed, the risks have to be classified and priority has to be determined based on it. The risk can be classified or score can be assigned



basis on which the risks can be prioritized and addressed in a sequence. In the bottom of the pyramid, the risks are trivial and they do not have any significance. The risks which are at the top of the pyramid are very critical for the subsistence of the organization and the same has to be addressed on a war footing.

6.7 Tips of Successful Implementation of RBIA

Risk Based Internal Audit is not new to the financial sector but new to the other sectors. As the Internal Auditor will be doing for the first time, the guidance note will provide some tips for the incumbent internal auditor for doing the Risk Based Internal Audit.

Knowledge of Industry – the internal auditor and his key associates should have through knowledge of the industry as it will help them to assess how the competitors are faring and where the client stands in comparison. For example if RBIA is being carried out for a steel company, the key raw materials for steel industry is Low Ash Metallurgical (LAM) Coke and Iron Ore, in case of Low Ash Metallurgical coke, the calorific value, ash content and the moisture content of being used by the competitors and the place of sourcing is required to be identified before the start of the audit. As this will determine the cost of the production and also the potential risk if the LAM coke is being sourced from the same supplier.

Understand Business Process – unlike the regular internal audit, the RBIA is totally different and the way it has to be executed also. Sampling will not help to do the audit, understanding the business process will help in identifying the risks and also measuring the risks along with prioritizing the

same. The lead auditor and the key team members should spend the initial days in understanding the business process in detail including the data being captured for each and every step in the ERP /CRM/SCM software's to analyze the data and come out the risk parameters.

Experienced based Judgement – while doing the RBIA, the team should have blend of experienced and the millennials. The experienced members help the team to take the decisions based on their past experience and the millennials will help in executing the same using technology and help in thinking laterally. It is not possible to verify each and every transaction to identify the risk, based on sampling in some case coupled with experience will help in identifying the risk. Experience backed by data will help to take effective decisions.

80/20 Rule – this rule has to be followed while executing any task as it is a smart way of working. 80% of the risk can be identified if the auditor is experienced when verifies 20% of the transactions. When the critical task is identified, the risk can be assessed and measured accordingly. The left over activity is only to check if the organization has risk appetite or the risk can be prioritized based on criticality.

Use Technology – technology plays a vital role in the RBIA as it is not practically feasible to verify each and every transaction, it can be done using data analytics and the data can be picked up from the underlying tables of the ERP/CRM/SCM by writing simple queries. This process will help in reviewing all the transactions at a go along with proper health check on the data. The IA who is doing the RBIA should ask for the access to the frontend as well as for the backend data of the various software's being used by the client in the view / read only mode. To verify the controls and checks on the transactions, the IA should verify the same while the users are doing the transactions, this will help to identify any potential validations which are missing in the system while processing the transactions.

6.8 Benefits of Risk Based Internal Audit

With the pandemic like situation, the dynamic business environment and new challenges coming up, both the internal auditor and the organizations are forced to look into new horizons to identify the risk and the early stage and fix the same rather the doing a postmortem analysis for the same. Once such thing where organizations can adapt at the earliest is the Risk Based Internal Audit and the benefits of the here which clearly states why organizations have to go for it.

Focused Approach to Achieve Goals – Risk-based auditing covers and correlates all aspects of internal auditing together: objectives, processes, risks, controls, tests and reports. The relevance of any test can be seen in relation to the entire risk management framework because of the relationships set up in the risk and audit universe. This is not always possible where standard audit programmes are used, as it is not always clear why the test is being carried out; what the significance is of a control that is found to be defective; what risk the control is treating; and what objective is being threatened by that risk.

Prioritization of Risk – Once the risk is identified, risk based internal audit helps to prioritize the risk based on the parameters and work on them accordingly.

Determining Risk Appetite – Risk based internal audit will help the organization to determine the risk appetite. This will help the auditor to address the risks which are above the risk appetite of the organization and suggest measures to overcome them.

Effective Risk Mitigation – Risk management processes, including the effectiveness of responses and the completion of actions, are being monitored by management to ensure they continue to operate effectively,

7 INTERNAL AUDIT IN COVID-19 LIKE SITUATION

Till date we are hearing about business disruptions, with the advent of technology. In the transportation sector, like Uber and Ola has revolutionised the commute and have displaced the cab operators. Similarly, a small virus which has disrupted the economies across the globe. Started the spread in Dec 2019 in Wuhan province of China has spread to each and every part of the globe and it has resulted in lockdown of the economies and has resulted in reverse migration of the daily labour.

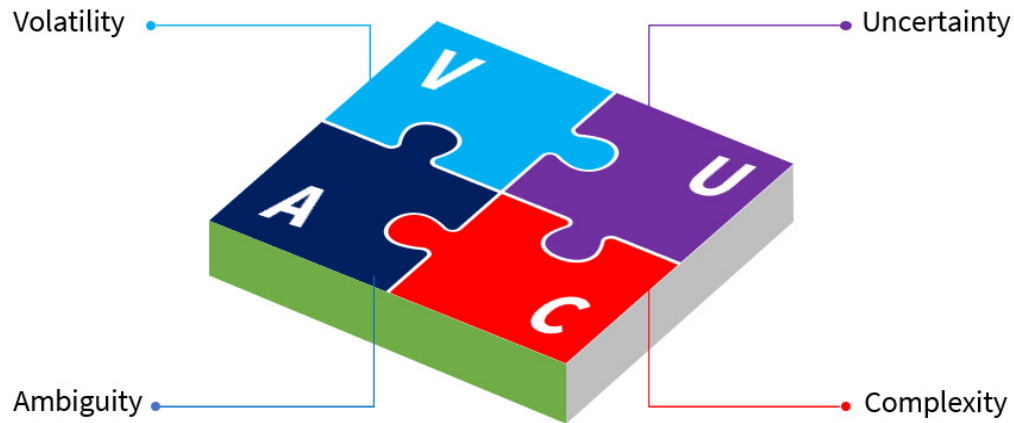
The disruptions have created crisis in the business, and it has created an opportunity for the professionals. No business can withstand the prolonged lockdown as the cash flows have disappeared and the orders have become totally uncertain. This is the time the role of the Cost and Management Accountants comes into picture. The beauty of the Management Accountant is he/she can withstand any storm and help his/her clients to tide over the crisis. One of the areas is Internal Audit, which is carried out to validate the internal controls in the organization are in place and how effectively they are being implemented and followed. In this hour of crisis, the CMAs can do internal audit more effectively and aggressively.

Internal Audit can be used as tool to avert disruptions by following a disruptive approach. The traditional approach of internal auditing must be paused, and new approach must be adopted by the CMAs. They must focus and concentrate more on the Strategy for the next 6 months to one year as they have an edge on the other professionals as they can handle any issues on finance, accounting, marketing, sales, or operations. The approach of taking deviation from the regular process or flow is called Pivoting.

The core areas which an internal auditor is doing has to be revisited and incorporated in the check list with the change in the current situations. In a nutshell the scope of Internal Audit has to be changed and the following areas have to be audited additionally. The change in scope will have confidence to the clients also as it will give them a clear and independent view of the organization and it is polices without any biased approach.

7.1 VUCA

VUCA is started by the US Army War College after the cold war in 1990s to address the uncertainties and complexities that were being created. It is a critical word and VUCA stands for



If the business owner is able to identify and answer the business uncertainties using the VUCA then he/she can address any challenges and attain new heights. Everyone is staring what is going to be my sales? How can I pay my suppliers and salaries? When will customers come and buy? Will customer buy my goods or services? I have orders, but can I get uninterrupted supply of inputs? Answers to these questions can be found by adapting VUCA. Let's understand what is VUCA first and then we will see how it can be used to address the challenges.

Volatility – A volatile situation can be defined as one which is unstable or unpredictable and It need not be a complex situation. It is similar to the current situation like pandemic, where we are not sure when will the demand pick up even after easing the lockdown restrictions or will the lockdown lead to price increases?

Southwest Airways, was also facing a similar situation almost a decade and half back. For any airlines company, fuel is the major cost and it is about 16% of the operating cost of the airlines. Especially for a low frill airway it is a big challenge with the volatile pricing of the jet fuel. To overcome this the company has taken forward hedging for the fuel and it was able to sustain the volatile situation. The situation of price increase or decrease is not complex but unpredictable, to address this vision is required similar the case of Southwest Airways where it has hedged fuel prices and able to beat the blues of price escalation and maintain the pricing.

The best way to handle volatility is to allocate resources and understand the situation, in the above case Southwest Airways could have stockpiled the jet fuel but did not adapt that instead of it has hedged its resources and is able to reduce the costs and it is said that it paid almost 50% less fuel prices compared to the other airlines. This vision has resulted in maintaining about 21 quarters of profit continuously.

Uncertainty - uncertainty is the lack of predictability, in a sense not knowing what will be the outcome of known changes. For example, the sales teams and the management will not be clear on the revenues being generated for a new product launch. There is nothing volatile in this situation but the challenge is lack of understanding of the outcome.

Uncertainty can be addressed by understanding the problem or the situation and can be resolved by pooling of more resources and through analysis of the data captured by the organization from time to time. In the current situation we are all concerned about the future as we are not sure when the covid spread will come to a halt? when will the countries remove travel restrictions between countries? These are some of the questions which people are having but no answers in sight at this point of time. The uncertainty will come to an end only when we have vaccine discovered and administered to all the people of the world.

VUCA

	Drivers	Effects	Demands
Volatility	Change at a brisk pace Change in dynamics Change in Nature	Risk Instability	Vision Investigate Changes Take Actions
Uncertainty	Surprises Unpredictable	Lack of ability to derive direction due to data overload	Understanding Broader Understanding Wider Perspective
Complexity	Influencers Task Correlations	Futile activities Multiplier impact	Clarity Investigate Changes Take Actions
Ambiguity	Misrepresentation Comparison with Actual	Delayed & Likely wrong decisions Impacts Innovation	Agility Investigate Changes Take Actions

Complexity – A complex situation is different from a volatile and uncertain situation. A complex situation is like a complex tax regulatory, local laws or political climates etc.,

A complex situation can be explained in a simple term where a small organization grows leaps and bounds, the single person who has handled the single department like finance, accounts or sales or purchase now has to be handled by multiple people and this will create complexity in understanding and rolling out.

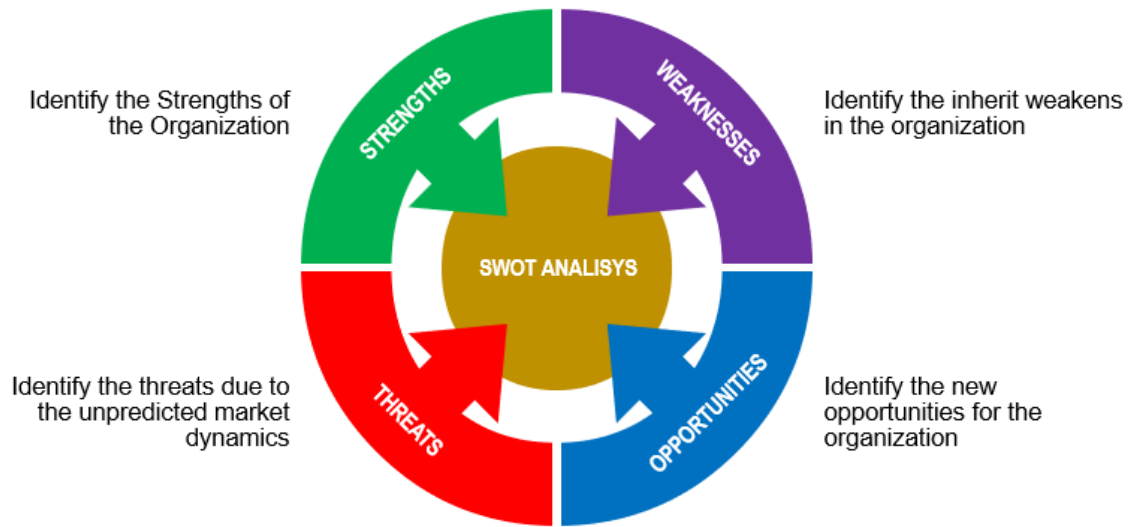
Complexity can be addressed with clarity; the organization should have the clarity on how the departments should be working and coordinating within themselves and for this process documents and SOP will help to overcome the same.

Ambiguity – ambiguity refers to a situation where there is a doubt about the nature of the cause and effect. In uncertainty prediction is possible when information is gathered and analysed but in case of ambiguity this is not possible. Like in the case of pandemic, when will the demand pick up? For this there is no answer due to the situation where there is no information or where people are not aware of the actual output.

Ambiguity can be addressed with agility; this will help in taking steps as when the visibility comes and helps to address it effectively. As there is lack of information, decisions cannot be taken in proper manner and structured. The decisions taken have to be tweaked from time to time and for this agility helps in executing it swiftly.

7.2 SWOT Analysis

Every internal auditor has to do the SWOT Analysis for the organization, this will help him to understand about the organization in a new perspective. The internal auditor in the VUCA world should start his audit with strategy and as a part of it first do the SWOT Analysis. SWOT analysis helps to understand the market dynamics and also plan the business accordingly. SWOT stands for Strength, Weakness, Opportunities and Threats. Strength and Weakness are based on internal factors and Opportunities and Threats are based on external factors.



Strength describes what the organization possess compared to the competitors. These can be intellectual property rights, brand equity, skilled labour, loyal customers, strong financials or any other traits which differentiates from the competitors.

Weakness describes the where the organization lacks compared to the competitors. Weakness can be like access to capital markets or funds for expansions or unskilled resources or high debtors' turnover ratio or not having loyal customers etc.,

Opportunities refer to the new or emerging business opportunities for the organization. With disruptions and new normal being the business as usual provides lot of business opportunities and for this Pivoting can be followed.

Threats refer to the factors which are potential to harm the business continuity or erosion of market share due to a new entrant in the market or likely hood of higher tariff on the products or services.

Every organization should have the SWOT analysis activity performed as part of the IA as he/she can execute it in an unbiased manner and this is the need of the hour in the VUCA world or pandemic like situations.

7.3 How to Do SWOT Analysis

The IA has to do the SWOT analysis in a systematic manner and also cover all the topics else the result shared by the IA can lead to wrong decisions, which in turn can lead to collapse of the organization. The illustrative questions

which the IA should quiz or find out the information for preparing the SWOT Analysis report

Strengths

- Why do customers prefer to have the company's products or services?
- Why the company has better brand value?
- How are the key suppliers and how they are contributing to the products of the company?
- How skilled is the manpower compared to the competitors in the market in different departments of the organization?
- How strong is the company's financial strength?
- What are the Intellectual property rights the company possess?
- Does the company have any Patents?
- What is the selling proposition?

Weakness

- What are the lacunas in the product or services?
- What are the features or attributes which the customers do not like?
- Why are customers cancelling the orders?
- Why are customers switching over to competitors?
- What are the resources which the competitors have which the company does not have?
- Is there any dependency on a single or select suppliers for key components?
- Does the company have access to capital markets or funds at a lower cost for expansions?
- Does the company have skilled manpower? If not in which areas the company lacking?
- Are there any challenges in the sales funnel?
- Why is the cost of customer acquisition being very high?

Opportunities

- Can the company launch new products and variants?
- Is there a possibility to increase the market share?
- Which change in social demographics, can the company enter new markets?
- With supply chain disruptions, are exports more viable compared to domestic supplies?

- Is there is a possibility to improve the margins by substituting key components with a cost effective with value addition?
- Can the company have more skilled manpower at a lower cost due to the change in the job market dynamics?
- Can the company access cheaper funds from the market due to the fiscal stimulus?
- Will there be any reduction in the tax tariff which in turn increase the purchasing power and entitles the customers to buy more

Threats

- With disruptions in market is there any possibility for such a disruption on the company's portfolio?
- Are there any new players entering the market?
- Is there going to be any change in the customers consumption pattern?
- Who are thee existing competitors and their business plans?
- Any potential change expected in the prices of the raw materials in the near future?
- STEEP Analysis have to be carried out.

STEEP refers to Social, Technological, Economic, Environmental and Political has to be done for identifying the threats. Any change in one or many of the above areas will have an impact on the threats of the organization.

The above list is only indicative and based on the client's profile and requirements, the questions can be expanded and SWOT analysis has to be carried out. SWOT analysis helps the organization to keep a vigil on the external and internal forces and is required in the VUCA world to tided over the crisis.

	INTERNAL FACTORS	EXTERNAL FACTORS
POSITIVE	Strength – Opportunity – Strategy The strengths of the organization can be channelized to covert the opportunities	Opportunity – Strength – Strategy The strengths of the organization can be channelized to covert the opportunities
NEGATIVE	Weakness – Strength – Strategy The strengths of the organization can be channelized to over come the weakness	Threat – Strength – Strategy The strengths of the organization can be channelized to covert the Threats and strategy to be formulated accordingly

The job of an IA would be more effective if the IA able to come out with strategies to overcome the threats and bag the opportunities to increase the top line and bottom line of the organization. At the same time, the report should also focus on strategies to overcome the weakness and convert the opportunities available in the market. The strengths of the organization should be used to overcome the threats, convert the opportunities and weakness.

The SWOT analysis is required to carried out in the dynamic world as we are seeing now with the unpredictable demand and changing customer preferences. The organizations will be able to sustain the crisis and have better profitability.

7.4 Process of Risk Based Audit

The new areas or additional scope for the Internal Audit during the Pandemic time are

1. Strategy – Pivoting
2. Review Of Business plans
3. IT Infrastructure & Related Risk Assessment
4. Reverse Migration
5. Strategy for Future Lockdowns
6. Efficient & Effective Management of Working Capital
7. Virtual Internal Audit

7.4.1 Strategy – Pivoting

In order to provide a strategy to the client for overcoming the crisis, the CMAs are recommended to follow the SMART Methodology while following the Pivot approach. Apart from this, the internal auditor is also required to do the internal audit with a separate dimension on the debtors, creditors and procurement policies. The reason to adapt a different approach is required as the organizations are facing cash crunch and this has resulted in salary cuts and retrenchment. This situation can lead to some anxiety in employees and they may tend to commit frauds in the organization resulting in another set of challenges.

As the saying goes, tough times do not last but only tough people do last and, in that process, only, the approach for the internal audit has to be changed and for this we need to reskill and learn new methodologies to be a successful professional.

The concept of pivoting is normally followed in the start-up eco systems. Pivoting is the need of the hour for the CMAs while doing the internal audit. As discussed previously, the approach of internal audit should also have the element of strategy while submitting the internal audit report. The report will help the client to do a soul searching as they are normally involved and held with the daily activities like operations planning, procurement of raw materials or following up with vendor or involved in the process of improving the order book or dousing of the employee dissatisfaction on account of reduction of salaries. In this process, it will not help them to see the opportunities that are coming and they have as their energies are used completely in the day to day issues. The internal audit report will be an eye opener for the entrepreneur. Let's understand what is Pivoting and the what the steps to be considered while drafting the report and suggesting the client.

What is Pivoting?

Pivoting is the process of shifting the strategy and some times it takes a drastic change in the vision and mission of the organization for a short period. During the lockdown we have seen the star hotels delivering food through the food delivery applications like Swiggy or Zomato or the Chefs conducting the online the cookery classes. In some cases, they are also willing to come to the individual's places and serve food or supplying essentials through the hyper local model. The change in the business operations is required to keep the organization stay afloat in the hard times. This will ensure that there is some amount of cash flowing into the system

and also helps in meeting the operational expenses. Another example is many companies like Savlon or Mediker and many more companies launching hand sanitizers or apparel manufacturing companies manufacturing Personal Protection Equipment. One the best example of pivoting is Eventina an event management organization based out of Hyderabad has pivoted and entered into manufacturing of UV boxes as the pandemic has made them out of business. The above are the examples of pivoting and following are not considered to be pivoting

- a) Change in the features of the existing product
- b) Trying to sell in a different geographic location or selling to a new set of customers
- c) Change in the process of delivery like introducing mobile applications in place of websites or vice versa
- d) Change in the marketing strategy, shifting from advertisement-based marketing to offering free products or services
- e) Change in the technology to build a reliable product

From the above it is clear what is pivoting and when we should go for pivoting. The internal audit report should be based on strategy rather than on the controls and operational aspects. The strategy aspects should cover the following aspects

1. When to Do It?
2. What is the Market Potential?
3. Does it provide Opportunity for Growth?
4. What is the Fund Requirement?
5. What is the Rollout Strategy?

Now let's discuss the above points at a high level, this will give an idea on who to work on the strategy portion of the audit, the new component.

7.4.1.1 When to Do It?

Any business will flourish only when there is a demand and business will disappear when the demand diminishes or when there is no demand. Timing determines the success of any business along with the other business. When suggesting pivoting for the client also suggest when the new line of business should be started. In today's world of COVID, there will be a requirement from each and every home for hand sanitizers or usage of automation or robotics in the business operations as there is shortage of labour or skilled workers in many of the segments. In case if automation or manufacturing of hand sanitizers is suggested to start from 2022 then it will not make any

business sense. If manufacturing of hand sanitizers is suggested, then it should be recommended to start immediately.

7.4.1.2 What is the Market Potential?

The report should also consider this point along with the timing of new product or services. The market demand should be assessed at a high level and also it should mention if there are any existing players in the proposed segment. It should also discuss about the potential market share that could be captured over a period of time along with the time span required.

If possible, the report should also discuss on the new entrants in the space and how deep are their pockets. The entrepreneur will always take a risk if there is a market potential and profitability.

7.4.1.3 Does it provide opportunity with Growth?

The most important aspect the strategy section should also contain the opportunity for the future growth. If the idea does not find any room for growth over a period of time, it is not a viable idea as the market will be constant and with entry of new players it becomes even more competitive and they may not be even able to recover the costs or the business will not be sustainable for over a period of time. There should not be exist barriers in such cases, this will help in making a calibrated risk and take the business decision accordingly. The new line being proposed is for a long term or short term, if there is clarity on this, then decision will become easy for taking business decisions effectively.

7.4.1.4 What is the Fund Requirement?

The pivoting idea proposed will also has a requirement for some funds. Already the organization is running short of funds and if they are asked to invest more funds into the new business it will not be appreciated by the client. The idea being proposed should not be capital intensive. There are lot of funding opportunities for the new business requirements specially in the COVID related products and for this SIDBI has also allocated funds separately with lower rate of interest and moratorium. If there are any special funding schemes provided by various banks and Government should be given as part of the report. This will help the client to take the decision effectively and in a timely manner. The available information can be used to assess his risk appetite and take it forward.

7.4.1.5 What is the Rollout Strategy?

The take of any product or services based on pivoting will be successful only when there is a proper rollout strategy. The rollout strategy should cover areas like what is the time required for the launch of the product or services, what is the geographic market to be targeted, what is the go to market strategy, who are the target audience, etc., Without this information it will be challenge for any one to take a decision in a holistic approach. The rollout strategy should be given at a high level in the initial report and when the final report is submitted the same can be given in detail.

The pivoting strategy will be successful only when the CMA knows about the industry insights and also has complete knowledge of the prevailing market and economic conditions in the country and across the globe. The strategy report should also consider any entry barriers along with any restrictions on the export market. In some of the cases, exports will be more viable compared to the domestic sales or vice versa, this point should also be considered.

7.4.2 Review of Business Plans

Every organization has business plans and they are prepared normally well in advance and in some organizations, they are prepared and approved by Dec / Jan. With the lockdown for about 2 months, the sales have impacted a lot and also the sales have been down or falling. The Unlock-1 has been announced and business have started working. The internal auditor is required to assess the new market situation and accordingly they have to revisit the business plans prepared already and they have to be updated accordingly. Most of the economists are stating that year 2020 should be the year of survival and not for scaling new records.

While preparing the revised business plans, the internal auditor also should use his market intelligence and arrive the realistic numbers. At the same time, the internal auditor has to critically evaluate the following areas

7.4.2.1 Review of Business Plans

With lockdown there are business disruptions and many of the business are at the verge of being wiped out. The key raw material and component suppliers should be evaluated on their financial stability and their business continuity plans. As part of value addition, alternative suppliers should be identified and the same should be mentioned in the report.

For the key raw materials and components, if possible alternative or substitutes should be identified and the impact analysis on the final product on the pricing and quality should also be mentioned as part of the revised business plan.

7.4.2.2 Labour Contracts

In case of organizations which are labour intensive, there will be challenge to get same amount of manpower post lock down due to reverse migration. Shortage of labour will also impact the production and there by impacting the sales plans. The internal audit report should also discuss on these lines and also update the business plans accordingly. Alternative strategies should be used for reducing the dependency on labour like automation of process and outsourcing. While preparing the revised business plans these also should be considered in length.

7.4.2.3 Capital Expenditure

Every organization has business plans and accordingly allocate the budgets for increasing the capacities. With a pandemic like situation and also uncertain business, the ideal situation will be to pause the capital expansion plans. The capital expansion plans normally have a huge cash outflow and for this the organizations normally meet this through internal accruals or through borrowings. At this hour of crisis, preserving cash is the best way. Cash is considered to be the life line of business and with a war chest, the raw materials and other supplies can be procured at a very competitive price. The lower the input costs, the higher is the profit margin or alternatively the business can reduce the prices to gain more market share. The internal auditor should do a cost benefit analysis of the same and show it in the internal audit report.

7.4.2.4 Sales Plan

The sales under the pandemic condition will not be as per the previous years, the customers are driving the product and not the marketers. The sales has to be projected accordingly, if there are not project correctly it will lead to unnecessary accumulation of inventories and blockage of funds in form of vendor outstanding. The first quarter of the financial year is over more or less and the next quarter may not be as goods a last year. Keeping in view of these conditions and challenges, projecting the sales is very vital for the business plans as it drives the whole organization. The sales can be maintained or a notch below in very optimistic case but for this value addition for the product has to be planned. The customers are looking for value addition and not for luxury unlike the pre covid days.

7.4.2.5 Cash Flows

The market conditions have become volatile due to the uncertainty and the pandemic condition. The collections from the customers are getting delayed and this is creating a negative cash flow as the vendors have to be paid on time, salaries and wages have to be released to the employees and workers. All this requires cash and in this crisis hours if they are delayed it will have an adverse impact on the morale of the employees. Alternative measure should be planned as part of the business planning based on the rating of the organization and borrowing culture.

7.4.3 IT Infrastructure & Risk Assessment

Information technology or digitalization of the organizations is the key to the success of any organization. With a pandemic like situation and no clarity on how long the pandemic and lockdowns last, digitalization has become the key to day to day working of the organizations.

The new normal being working from home for the non-core functions, requires data access permissions and security of the data. As the world is moving from a WAN to internet, security has to be addressed. Organizations have to adapt or plan for deployment of the applications from servers hosted in their offices and accessed on WAN to a remote hosting or cloud hosting is required. The cloud can be private one in office premises or on third party server. Hosting on a third-party server will give an additional edge in the following areas

7.4.3.1 Continuity of Services

If the servers are hosted on premises, then the IT team has to maintain it in all the conditions including the lockdowns where there are restrictions on the travel and availability of public transportation. In such case maintenance will be challenge and difficult to manage. The persons deployed should have the knowledge of the Dev Ops for deployment and optimising the server from time to time and also taking backups. The backups have to be taken at regular intervals and stored accordingly. It is always recommended to have three generations of backups at any given point of time.



7.4.3.2 Cost Effective

The internal auditor has to make a cost benefit analysis and then conclude on the model being adopted by the organization. If the servers are hosted on premises Disaster recovery also has to be verified. If the DR plan is in place or not has to be verified and should be part of internal audit report. If DR is considered along then the cost will be on higher side as the resources are required for management of servers and also having rental space in a different location. If the servers are not on premises, then it will be shared servers and based on the usage and requirements, the users can take the additional server space and also the maintenance challenges and DR will be eliminated. Though it is cost effective, the IT Security Policy of the organization has to be verified if not there it has to be drafted and followed. While engaging a cloud service provider some the key parameters which needs to be considered are Uptime, SLA, Backups and based on the number of transactions computing power.

With work from home being the new normal, the team has to be provided with proper desktops or laptops. The internal audit report should verify the following as part of the risk assessment for the laptops and desktops issued to the employees

1. **Virtual Private Network** – The laptops and desktops should be having all the official versions of the software and along with them the organization has any Virtual Private Network (VPN) based access only should be provided. VPN will ensure that the users cannot access other websites and security can be maintained from malwares and spam wares.

2. **Data Security** - The USB ports should be disabled so that data cannot be copied to external medium. All the working documents should be saved on the cloud server so that data cannot be leaked.
3. **Communication Tools** – as the employees will be working from, which means that they have to communicate between them to complete the tasks as well as exchange notes or messages. For this a dedicated meeting tool and a messaging tool should be there so that the data is within the office network and cannot be accessed by the third parties. This helps in having continuous interactions as well as monitor the work.

If any of the above are missing then the organization will have a risk of business continuity as well as loss in the efficiency along with data risks. The first report being prepared during the pandemic should list all these points and also should be reviewed from time to time on how effectively they are functioning. Still there is uncertainty as the vaccine is not yet developed and also the previous pandemics has clearly state that the pandemic comes in waves, so work from home will be there for some time and in this context it has to be identified in the report which are all teams can be given the option of working from home and which software can be moved to cloud servers so that the employees have the access to the information and work effectively and also the top management and key stake holders can take decisions accordingly. Even these points should be included in the internal audit report.

7.4.4 Reverse Migration

The lockdown being announced in four different phases and unlock being announced, the migrant labour is the key to many organizations as they employ them for both skilled and unskilled jobs. Most of these workers are paid low wages and they don't have much savings; on account of lockdown they were not able to survive as their main source of income has been stopped and the managements of many organizations have not responded to the Government's call of supporting in the hour of crisis. Though the Government has announced food grains distribution that could not be reached to all the migrant workers. As a result of this many of the migrant labour are moving back to their home towns / villages where they feel they can survive there with some means of living.

The reverse migration has created shortage of labour especially in the MSME Sector and many organizations are not able to start the operations with the full strength. In view of the above challenges and situation the internal

auditor has to report on how the organization is meeting this challenge and what steps are being taken along with the steps being effective or not?

The internal audit report should also deliberate on the process of how to handle the situation in future if the same arises. The following ways should be explored and discussed with the management

1. Maintain the details of the migrant workers – directly employed or through contractors
2. Identify the key roles and jobs and see if the same can be replaced with the local workers
3. Identify and evaluate if the workers from other departments can be used through internal transfers
4. Have a plan for job rotation so that if not all some of them can be used for multiple roles
5. Reach out to the local authorities as there will be labour who must have returned from other states, the State Governments are maintaining the database for all such workers being returned.

The above steps may not solve the problem to 100% but it can be addressed to some extent and also ensure that there is not disruptions in the continuity of the business operations.

Verify and evaluate if training is being provided to the workers at regular intervals, this will ensure that the succession planning is there as skilling and up-skilling will boost the confidence of the workers and employees.

Also verify if the organization has taken any measures to retain the workers during the lockdown period like salary disbursement on time or food grains are being distributed in lieu of salary so that they workers will not be starving of hunger but ensure they survive during the crisis.

The report should also evaluate if the organization has availed the schemes of the Government which are applicable to the workers and also announced separately during the lockdowns. In case of construction industry building welfare cess is being released to the construction workers through distribution of food grains. Also verify if all the workers are registered or not under such schemes.

In most of the cases it is observed that the wages are paid in cash and as a result they do not have any PF /ESI benefits and could not avail the benefits being announced and rolled by the Governments (Central as well as State and in some cases industry specific welfare schemes).

Labour is returning back from state they are working to the native states and when the labour is returning back to the native state, they are maintaining a list of workers returned along with their trade and contact numbers. The HR teams can reach out the concerned departments and recruit the team. This process will save the time and efforts for reaching out to labour and on boarding now.

7.4.5 Strategy for Future Lockdowns

The lockdowns are expected to be with us for some more time till the vaccine is developed and administered to all the citizens. With the increasing of positive cases of COVID, there is uncertainty in the business houses and also there is a low hanging sword of lockdowns being announced again. Another reason could be for the travel by migrant workers to their home towns. In such a case the organizations should always be prepared with the steps to be taken in case if the lockdown will be imposed again.

The first lockdown has been announced always of a sudden with immediate effect to stop the spread of the virus and also this would give leg room for the Government to gear up for the ramping of the health facilities. The lockdown has disrupted the manufacturing and the supply chain drastically. Now the business continuity plan has to be formulated to meet such situations in future. The internal audit report should consider the following

7.4.5.1 Supply Chain

Supply chain is the key to the organizations being profitability as it determines the costs and time delivery backed by quality. The procurement planning should be done in such a manner that organizations should explore alternative suppliers from a different location this will ensure that there is back up plan and also ensures continuity of supplies. The next thing the organizations should do is to ensure that the finished goods are not stocked in single location. This will create an unviable situation when the lockdown is announced once again, the finished goods should be stored in different locations which are logistically optimized for further movement based on goods. Proper planning and execution has to be in place for this. The internal audit report should talk about this point and if the same is not part of the business continuity plan it should be incorporated and discussed with client.

7.4.5.2 Production Planning

The production planning should be optimized in such a manner that will help the organization to meet such shocks with minimal impact. As part of it, the organization should explore the option of opening a satellite facility in

different location or look out for outsourcing so that in case of disruptions, the production could be maintained and this will ensure that there will not be any shortage of its products in the market. This being a critical activity, more time should be spent on this activity and discussed with all the stake holders and concluded at the earliest.

7.4.5.3 Work from Home

In order to maintain the continuity of the business, work from home is also essential. To enable the organization to work smoothly, there should be clearly identified roles which can be carried out from home and all the identified employees should be provided with laptops or desktops. Apart of the data security and cloud services, as discussed previously should be followed.

7.4.5.4 Inventory Management

The lead times are being impacted due to lockdowns and vehicle movement restrictions. The minimum quantity and re order quantity should be re worked keeping in view of the prevailing market conditions, order books and the business plans the optimal inventory should be re determined.

7.4.5.5 Cash Management

Cash is the life line of the organization and it has to be preserved. Proper management of cash is necessary during the pandemic period. The organization should channelize the energies on the collection of the dues from the customers and also explore the options of availing additional loans on a precautionary measure. The same can be used in case of emergency like situations in future. The internal audit report should focus on the cash flow statement at a realistic level and not on the optimistic manner.

7.4.5.6 Service Management

In case if the organization is into services, there should be plan on how the organization will enable the deployment of the service engineers at various locations. Apart from this, the service engineers should be trained and educated on following hygiene as well as follow the social distance while on job or travelling. If possible, the same should be out sourced at major locations as it will reduce the dependency as well as minimize the travel. The SOPs should be re drafted and shared with all the stake holders.

These are some of the points which the internal audit report should focus during the pandemic period. These areas can be covered in detail in the first audit after pandemic and should be revisited at regular intervals.

7.4.6 Efficient and Effective Management of Working Capital

The success of any organization is based on the efficient management of the working capital. Working capital is the need for the hour and it will create crisis if the same is not managed efficiently. Working capital can be managed effectively by way of obtaining working capital demand loans from the banks and the utilization of the same is possible only when the debtors, creditors and inventory is optimized. Once these are optimized effectively, it will result in lower outflow of cash in form of interest. The internal audit report should focus more on the working capital as it will help the organization to save out flow cash and optimize it effectively. In a pandemic like situation, the internal auditor should focus on the following areas

7.4.6.1 Debtors Management

India is predominantly a credit driven market and the realizations happen after a few days of credit period offered. Even the dues from the Government departments and PSUs are in huge. In the time of pandemic there is shortage of funds with the industry and they are not able to honour the payments, this is creating a stress on the working capital. In today's world if credit is not offered, the chances of sales is taking a toll and if credit is offered, there is challenge on realizations. If credit is not offered then sales will be impacted. The organization has to have policy of having sales at the same time safeguarding cash inflows. The internal auditor should explore the option of using TReDS platform or making supplies against letter of credit or reverse factoring. Though these are expensive they will mitigate the risk of bad debts. The additional cost can be built in the sales price.

For the existing dues, the sales and finance teams should be having stringent policy of follow up and plan for realizing the same at the earliest.

The internal audit report should also evaluate the above points and if any gaps are there they should be addressed.

7.4.6.2 Creditors Management

As cash is becoming a scare commodity in the market, payments to creditors have to be made on time else it will impact the future supplies and if they are impacted it will derail the production and sales plans. The creditors have to be paid on time or if there is any delay they should be informed immediately.

If possible, the alternative payments methods should be explored and this will give confidence to the supplier and it will provide an opportunity for a competitive price. The banking facility should be explored and loans should

be obtained by availing the schemes announced by the Government as relief measures.

7.4.6.3 Inventory Management

The internal audit report should also evaluate if the organization is maintaining optimal inventory of all the items. Prices have to be renegotiated and new suppliers and substitutes have to be explored to check the monopoly of the suppliers. As discussed above, the min and max quantities have to be revisited and procurement planning has to be made accordingly keeping in view of the uncertainties.

7.4.6.4 Expense Management

Organizations have to revisit their expenses. There should be a reduction of the expenses on travel and marketing. As on date customers are comfortable on e-meetings. The sales team should be encouraged to conduct more and more e-meetings rather than allowing them to travel. During the travel there is a high possibility for the sales team to get infected by COVID.

The marketing expenses should be minimized as the marketers are not determining the sales but the customers are driving the sales. To retain the brand recall value, nominal amount must be spent.

Where ever possible the expenses should be minimized and spent only if really required. With work from home becoming a new normal, the extra office space if possible, can be surrendered or rent can be re-negotiated. A list of expenses have to be prepared and wherever possible the same should be deferred or reduced.

Above are all the areas where the internal auditor has to focus during the pandemic time or the first audit, he is doing post lockdown. A critical view can be taken and based on that recommendations should be given in the report. These recommendations will add value addition to the customer and he will engage for further activities or assignments.

7.4.7 Virutal Internal Audit

In the VUCA world there is lot of uncertainty and for the models for delivery of assignments have to be revisited as there are restrictions in the movement of people and lack of availability of public transportation. The internal audit is normally carried out at the client's location but with these

challenges the visits to the client's place has to be minimized or avoided if possible. In this context, the best way to conduct the audit virtually.

For conducting the internal audit virtually, the internal auditor's team should have the full understanding of the client's business process and also the modified or updated business process due to the pandemic. At the same the internal auditors team have to be trained first on the process of doing the audit virtually and then the client has to be appraised of the same.

Points to be considered before starting the virtual internal audit

1. Explain the internal audit team of the necessity of virtual audit
2. The internal audit team should have a team member who has IT knowledge
3. The clients point of contact should be established
4. Necessary user access should be provided for accessing the data/systems
5. In case of understanding the business process, e-meetings should be setup with the concerned persons of the client's team
6. The change in the internal audit process also should be updated with the client
7. The draft report should be reviewed by the partner once before sharing with the client team
8. The report should be shared in PDF format if sharing through email
9. All the supporting and working papers should be stored online in with proper security and access
10. All the communication should be carried out through mails and calls. After each and every call minutes of the meeting should be prepared and shared across along with action to be taken on each participant and also the date on which the task has to be accomplished.

As it is being done for the first time, it will be challenge for everyone and it has to be adopted and taken accordingly. There is no proper rules for carrying out the internal audit virtually as it is being done for the first time and the steps and process will change for client to client.

8 COVID TO COMBAT COVID

COVID has taken everyone by surprise as no one had planned for it anticipating the same. Now this is a reality and the same has to be taken and business have to take it forward accordingly. The old ways of business will no longer be applicable post COVID or during COVID era. The business models have changed and new once are coming and displacing the old

models. Now the new normal is online and touch less economy with value addition for the products and services.

To come over the COVID crisis the internal auditor should appraise the client on following COVID methodology. COVID methodology stands for

C – Communicate
O – Outsource
V – Vision
I – Innovate
D – Deliver

8.1 Communicate

Communication is the key to success for building and sustaining relations. In the hour crisis and uncertainty communication helps to gain confidence of the other party and helps in executing the business smoothly.

The management should communicate the changes and likely changes with the team members vocally and the communication process helps as confidence building measure to the employees and also helps to get new ideas or change in business process to accomplish tasks or start new line of business.

Continuous communication with customers by the sales team will help to understand their cash flow situation and take business decisions accordingly. Communication with vendors helps us win their confidence and that will help in getting timely delivery of supplies and in some cases additional discounts or lower prices also.

8.2 Outsource

The key to survival is outsourcing. Outsourcing can be done for part of the manufacturing operations or services or some departments. This will reduce the challenges of following social distance in the office and release extra office space and save some money. Some of the activities which are not core in the line of business can be outsource with proper checks and balances. This will give additional time for the management to spend time on key activities which are critical for the business. Departments which can be outsource can be payroll processing, purchase accounting, follow up with customers etc.,

Even payment processing can be outsourced and RPA wherever possible can be introduced as it will reduce the dependency on manpower especially during the hour of lockdowns.

The economy is moving towards Gig based economy, meaning that even high-end jobs or roles can be outsource rather than having full time employee on case to case basis.

8.3 Vision

The vision of the organization must be clear and the same should be focused. In the pandemic situation, the vision and mission should be kept in mind and if required it should be modified accordingly for the short term but not on the long-term view. In the hour of crisis to run the organization if required they can pivot and explore new business lines to bring in additional cash into the system and also ensure that there is no retrenchment of employees.

There may be cases the vision has to be changed also due to change of the customer requirements and needs. The management has to evaluate all the options and take necessary steps accordingly. For deviating from mission again communication is the key for successful implementation.

8.4 Innovate

In today's world of VUCA, innovation plays a very key role. Innovation helps to overcome time and costs. New innovations should be encouraged for having new product lines or having new features in the existing product line. The customers are looking for value addition as they are running short of cash and not sure of the future incomes. Innovation helps to come out with new features and stand out with the competitors.

8.5 Delivery

Planning and execution are two sides of a coin. The execution should be inline with the plans agreed by the employees and management. The plans have to be revisited and communicated with the teams and all stake holders for delivering the same.

As it is a VUCA world or period there is no rule book which says which method or process is right wrong, Judgement has to be made base do the realistic approach and weighing all the pros and cons. If required external agencies can be engaged or as of the new norm even gig based assignments can be explored by the organization.

In today's agile world the decisions have to be taken at a faster pace and implemented swiftly else the market dynamics or the customer needs will change the delivery of the decision taken will be not effective.

The focus of the internal auditor has changed and the professional have to adapt the change else they cannot meet the expectation of the agile market and end up losing the assignments. This would have very bad implications on the person as well as on the professional front. The challenge with the internal auditor is like a double-edged sword as he/she has to change his team as well as the client's team. Both are a challenging task or the saying of change or perish will be a reality.

The internal auditor will be under tremendous pressure as he has to come out with new approach and communicate the same with all the stake holders and then implement the same. The changes being from the audit approach and new methods being followed. As the audit is being carried out virtually, the best way to check the internal controls are in place or not is the review the contracts and see the same if being followed or not using data analytics. This approach will save time and also the risk assessment can be carried out accordingly.

Cost and Managements have a unique edge over the other professionals as they are taught on all the aspects of the business and they can easily visualize, grasp and adapt to the change on faster pace. The crisis which has been created by the pandemic has given an opportunity for achieving success and reaching new heights. The crisis should be taken as an opportunity and move forward in the professional life. The past crisis have seen new entities being created like GM, IBM etc., and this crisis will also create new giants and the efforts of the CMAs will be remembered in the life of the organization. The value addition that can be given by the CMA while doing the internal audit can be done by implementing one or many of the above points discussed.

9 DATA ANALYTICS AS A TOOL TO INTERNAL AUDIT

Data Analytics is a science of analysing the raw data in a structured manner and making decisions based on it. In the current world it is not possible to go and meet the clients and do the internal audit. The best way is to do remotely and analysis of the data using data analytics and this will help to identify the frauds or areas where internal controls are missing.

With the advent of rapid computerization data capturing and data availability made easier. Data is becoming fuel for analytics and decision making. More so, data is also constantly helping to perform audits efficiently. Data analytics is becoming a game changer for the Internal Audit profession too. It helps to audit using data and verify all the transactions by running queries. As we discussed in the initial chapters, the IA team should also have an IT expert who can help in building queries and verifying the data. The queries can be run and the exceptional records can be verified and this process will reduce the time and also enable to cover all the transactions unlike the physical audit where they do it on random sample basis.

Data Analytics can be effectively used in 3 stages i.e. Audit Planning, Execution and Reporting

9.1 Advantages of Data Analytics

360⁰ view of the business – Data analytics provides deeper view of the business, it helps in 360⁰ profiling of the business and the client.

Early Risk Detection – Data analytics help in developing better understanding of the audit process, as well as answer key questions and identify patterns earlier. This helps internal auditors' early detection of risks in the audit process. Early identification of risks means an organization can implement changes or make decisions quicker than they otherwise would, allowing for a timelier analysis and improvement to internal operations.

Shorter Audit Period – Data analytics helps in all the three stages of audit i.e., planning, execution, and reporting. This in turn lead to completion of audit in a shorter period and in timely manner.

Lesser Audit costs and improved audit productivity – Use of data received from emails or cloud minimizes the physical presence of audit staff. Shorter audit period means lesser cost of travel, stay, and allowance to audit staff which reduces the costs significantly. Also the same audit staff can be used to conduct more audits essentially improving productivity.

9.2 Types of Data Analytics

Descriptive Analytics: Raw data is summarized to describe to know the past. Based on the history, a view can be formed of such transactions what might happened in the future.

Diagnostic Analytics: Based on the past data and after knowing what had happened in the past data a deeper insight can be formed. This will help to know the *cause and effect* relationship of what has happened and why it had happened

Predictive Analytics – They utilize the findings of both descriptive and diagnostic analytics to detect tendencies, clusters, and exceptions. They predict what is likely to happen in the future.

Prescriptive Analytics – Simulation and optimization are used to suggest what action to take in the future. They recommend decision options to mitigate a risk or to take advantage of a trend. They are process-intensive and require highly sophisticated tools and technology.

9.3 5 W's of Data Analytics

The Internal Auditor has to plan and execute the data analytics in a meticulous manner and for this the IT guy in the team plays a very key role. Apart from the IT guy there should be another team member who has complete knowledge of the business process of the organization.

The IT person should be able to understand the ERP the client is using by reviewing the Data Flow Diagrams of the process or flows. Before taking up any activity for the data analytics the following 5 W's have to be answered, this process will ensure to get a big picture of the activity being carried out.

Who – who will be point of contact from the client's side and also the person from the Internal Audit team? Both the members should be in sync to understand the database and execute the query accordingly.

What – what are the process for which the data analytics activity is being performed?

Why – the Internal Auditor is under laying this activity? Is it identify the P2P Flows or O2C flows?

Where – where will the scripts will be executed? Where will the team meet and interact?

When – by when the activity has to be completed?

If the Internal Audit is able to answer all the above 5 W's then the activity can be completed very smoothly and effectively.

9.4 Steps for Data Analytics Activity

Any activity or task can be performed effectively if the task is broken into steps. As steps will ensure proper implementation for accomplishing the task. Similarly the data analytics by the internal auditor can be executed by following the five step process

9.4.1 Define Scope

The scope of the activity being performed has to be defined first. The scope can range any of the following this like over payments to suppliers or identify the purchase orders without price or end date or bottle necks in the production process or materials received without purchase orders or analyze the causes for the breakdown of the machinery etc.

Once the scope is decided, it will help the internal auditor to deploy the team accordingly and work with the technical team for gathering the data.

9.4.2 Gather Data

Once the scope is finalized, the next important step is to gather data. Data gathering is the key step as the technical team member has to refer to the concerned tables and prepare the query/script accordingly.

If the activity is to identify the price of same item for different vendors during the last one year or two years, the query has to be run on the purchase orders tables.

The data gathering will not be successful in the first instance in most of the times, the query has to be fine tuned from time to time and also depends on the columns for the expected output.

In the above case the report output could be having the following columns

- Item name
- Supplier Name & ID
- PO Number
- PO Date
- Qty
- Price per unit
- Discount offered
- Landed Cost

- QC Rejections

The above may be the columns of the report when planned and query has to be built accordingly.

9.4.3 Validate Data

Once the query is executed for the above stated requirements, there is a need to verify the output generated. This verification is very important as it will help in identifying the correct records. Some of the records shown in the report may not be required like PO is cancelled, in such a case the PO status has to be added. The output has to be verified if correct data is being shown based on the query or any gaps are there in the output compared to the intended output.

Also, there could be substitutes for the item, in such a case it is worth to verify the price of substitutes also.

An extension for the said could be checking the output quality of the item being purchased from different suppliers, if this to be verified, the underlying query should be modified accordingly.

9.4.4 Data Analysis

The important step is data analysis and for the output has to be verified in details. If required the query has to be modified. If there is trend that the same item is being purchased for a higher price from a particular supplier or in a specific location or by a specific purchasing team member. The trend has to be established before reporting as it will give authenticity of the data being generated.

If trend is established say a particular person is involved with purchase of the same item at a higher price, the next step is verify at what intervals the same are being purchased or in cases where there is sudden spurt in the demand for the finished goods or it is seasonal etc.

9.4.5 Interpret & Report

If the Internal Auditor is able to understand and do a detailed analysis, he/she will be able to give correct report backed by data, which in turn will help the client to take corrective action in case of frauds or proper planning of procurement. This type of analysis not possible in a manual manner, data has to be analysed and for this data analytics is one of the best options read millions of records.

The trend or pattern has to be interpreted correctly and consistently, then only there will be value for the report else it does not carry any importance. The queries / script built has to be verified time and again and improved if required. This process is a continuous process and the scripts or the queries can be run as background job during the non-business hours as they are resource intensive and time consuming.

Such activity should be carried out during the weekend or after office hours. The data analytics can be started with a specific department of flow and then expanded to all departments.

9.5 Internal Audit of Accounts Payables using Data Analytics

Data analytics can be used in analysing the creditors outstanding, payments. Data Analytics helps in the following

- ✓ Checking duplicate payments if any
- ✓ Checking unauthorized payments
- ✓ Checking the payments made for which material or services not received
- ✓ Checking the payments more than authorization levels
- ✓ Checking whether any credit notes eligible but not received
- ✓ Checking the trend or history of the creditors
- ✓ Checking the repeated purchases made from the same vendors
- ✓ Check the highest value or volume of purchases from single source
- ✓ Checking multiple invoices with same date and same value
- ✓ Checking invoices issued on non-business days
- ✓ Checking the vendor experience whether a new vendor or experienced
- ✓ Checking prices paid greater than standard price
- ✓ Checking high value emergency purchases frequently from same vendor
- ✓ Checking the bid analysis and subsequent bid allotment
- ✓ Checking the payments made to dormant accounts
- ✓ Checking significant amount of cash payments to same parties

9.6 Internal Audit of Accounts Receivables using Data Analytics

- ✓ Checking the duplicate credits given to customers
- ✓ Checking wrong credits into customers account
- ✓ Checking the instrument series (Cheque/DD) differing from previous payments
- ✓ Checking the under receipt of payments from customers

- ✓ Checking wrong credit notes issued to customers
- ✓ Checking debtors ageing analysis and its frequency
- ✓ Checking habitual default customers
- ✓ Checking the end to end profiling of the customers
- ✓ Checking the credit limit exceeding cases
- ✓ Checking the under invoicing instances
- ✓ Checking the payment received one customer and credit given to another customer
- ✓ Checking the correctness of invoice matching with payment received

9.7 Internal Audit of Inventory using Data Analytics

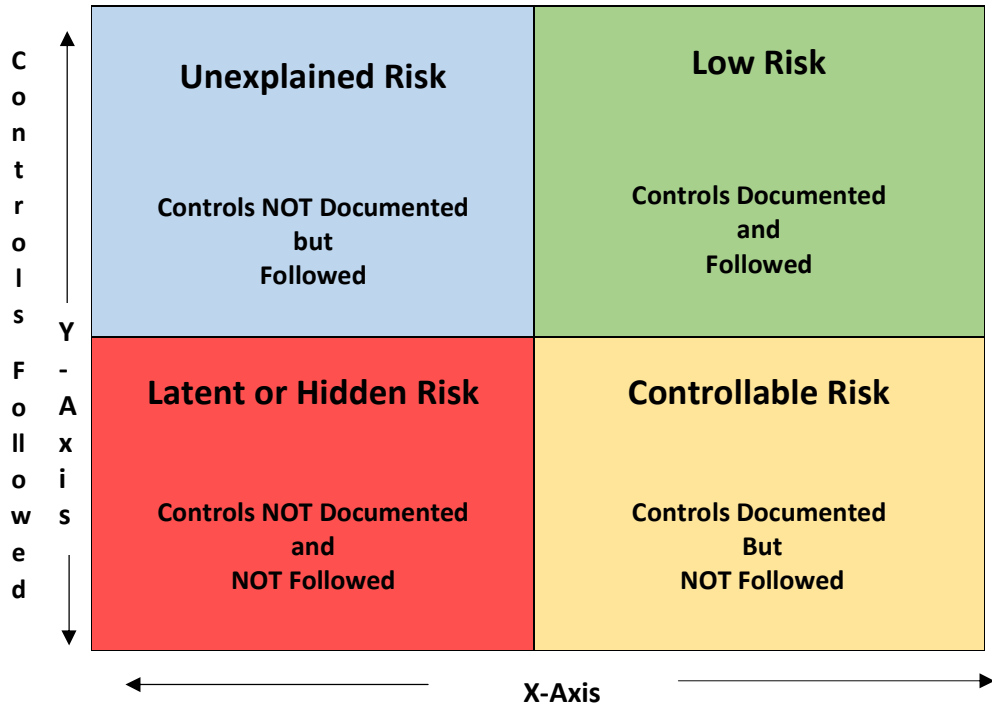
- ✓ Checking the repeated purchase of the same inventory items
- ✓ Checking the items with expiry date still in reflecting in the inventory with full value
- ✓ Checking whether the items of inventory were procured based on the re-ordering levels or based on user indent
- ✓ Checking the velocity of the consumption of the items in the inventory
- ✓ Checking the linkage between Payment Voucher to Goods Receipt Note (GNR) to Purchase Order to Indent to ensure entire cycle is authenticated
- ✓ Checking the items purchased at different location but the same is available in different location of the same entity
- ✓ Checking the inventory located in third party premises and ownership of the same
- ✓ Checking the inventory lying in the location for which GRN not made

9.8 Internal Audit General Accounting and Compliance using Data Analytics

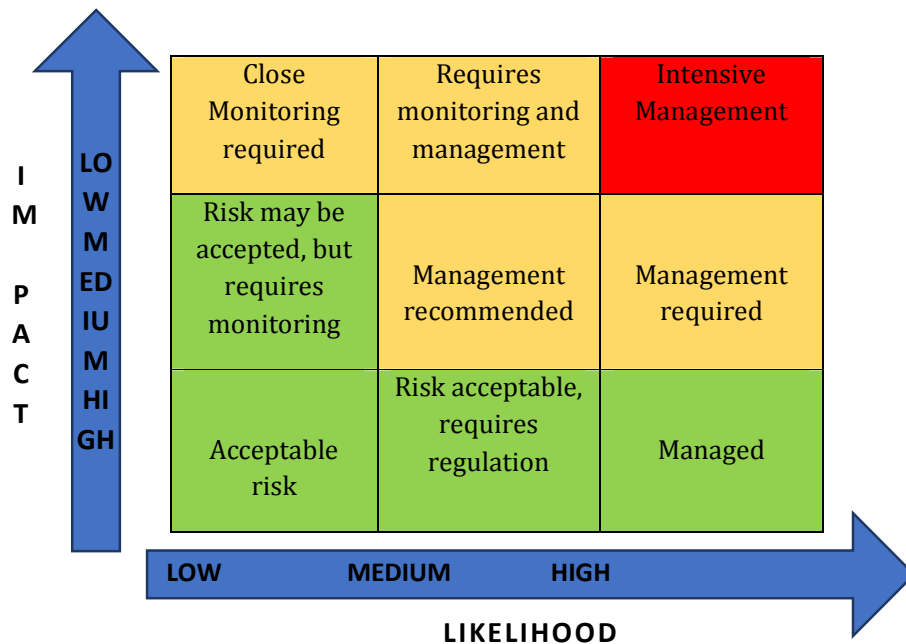
- ✓ To Identify and choose sample documents for audit
- ✓ To check the compliances done or otherwise
- ✓ To check the maximum number of accounting entries passed by one single user
- ✓ To check the high value transactions or journal entries passed
- ✓ To check the anonymous users and any abnormality or unintended entries in the books of account
- ✓ Whether right percentage of tax deductions with amount is made or not

10 APPENDIX

10.1 Format of Risk Mapping Matrix



Format of Risk Matrix



10.2 Procedure for Control Overview and Risk Assessment

RISK ASSESSMENT MATRIX

LIKELIHOOD	CERTAIN	LOW	MODERATE	HIGH	EXTREME	EXTREME
	LIKELY	LOW	MODERATE	HIGH	HIGH	EXTREME
	POSSIBLE	LOW	MODERATE	MODERATE	HIGH	HIGH
	UNLIKELY	LOW	LOW	MODERATE	MODERATE	MODERATE
	RARE	LOW	LOW	LOW	LOW	LOW
		INSIGNIFICANT	MINOR	SIGNIFICANT	MAJOR	CATASTROPHIC
		SIGNIFICANCE				

Rating	Risk Grade	Risk possible description
5	Extreme (Detailed research and management planning required at senior levels)	<ul style="list-style-type: none"> Financial loss of Rupees XX Crores or more Negative media coverage in international market; loss of market share Prosecution and fines, litigation including class actions, incarceration of leadership Significant injuries or fatalities to employees or third parties, such as customers or vendors
4	High (Immediate senior management attention needed)	<ul style="list-style-type: none"> Financial loss of \$X million up to Rs. X crores or more National negative media coverage; significant loss of market share Report to regulator requiring major project for corrective action Insurance required for employees or third parties, such as customers or vendors in visiting workplaces

		<ul style="list-style-type: none">• Significant attrition at senior management level
3	Moderate (Senior management attention needed)	<ul style="list-style-type: none">• Financial loss of Rs. X crores or more.• National short-term negative media coverage• Report of breach to regulator with immediate correction to be implemented• Widespread staff morale problems and high turnover
2	Minor (Management responsibility must be specified)	<ul style="list-style-type: none">• Financial loss of Rs. X crores or more• Local reputational damage• Reportable incident to regulator, no follow up• General staff morale problems and increase in turnover
1	Low (Manage by routine procedures)	<ul style="list-style-type: none">• Financial loss up to Rs. X crores• Local media attention quickly remedied• Not reportable to regulator• Isolated staff dissatisfaction