

Chapter 13 – Internal Audit (Chart 1 – Statutory & Other Provisions)

Statutory Provisions - Sec. 138 of Companies Act, 2013

Other Provisions

1	<p>Appointment of Internal Auditor</p> <p>Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor.</p> <p>Companies prescribed under Rules – Rule 13 of Companies (Accounts) Rules, 2014</p> <p>(1) Every listed company;</p> <p>(2) Every unlisted public company having-</p> <ul style="list-style-type: none"> • paid up share capital \geq ₹50 crore during the preceding financial year; or • turnover \geq ₹200 crore during the preceding financial year; or • outstanding loans or borrowings from banks or public financial institutions \geq ₹100 crore or more at any point of time during the preceding financial year; or • outstanding deposits of \geq ₹25 crore at any point of time during the preceding financial year; and <p>(3) Every private company having-</p> <ul style="list-style-type: none"> • turnover \geq ₹200 crore during the preceding financial year; or • outstanding loans or borrowings from banks or public financial institutions exceeding \geq ₹100 crore at any point of time during the preceding financial year.
2	<p>Who can be Internal Auditor</p> <ul style="list-style-type: none"> • Internal Auditor shall either be a chartered accountant (Whether in Practice or not) or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company. • Internal Auditor may or may not be an employee of the company.
3	<p>Manner for conducting internal Audit</p> <p>The C.G. may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board. Accordingly, the Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity and methodology for conducting the internal audit.</p>

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1	<p>Relationship between Internal Auditor and External Auditor</p> <ul style="list-style-type: none"> • Role of the internal audit function are determined by management and, where applicable, TCWG. While the objectives of the internal audit function and the external auditor are different, some of the ways in which the internal audit function and the external auditor achieve their respective objectives may be similar. • Irrespective of the degree of autonomy and objectivity of the internal audit function, such function is not independent of the entity as is required of the external auditor when expressing an opinion on financial statements. • Therefore, the external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by the external auditor's use of the work of the internal auditors.
2	<p>Review of Internal Audit function by Statutory Auditor</p> <ul style="list-style-type: none"> • It is obligatory for a statutory auditor to examine the scope and effectiveness of the work carried out by the internal auditor. • For this purpose, statutory auditor should examine the Internal Audit function of the organisation, the strength of the internal audit staff, their qualification and powers. • Statutory auditor should study the procedures adopted by internal auditor, refer audit programmes, reports submitted, points raised in audit & ascertain how these had been dealt with subsequently. • The extent of independence exhibited by the internal auditor in the discharge of his duties and his status in the organisation are important factors for determining the effectiveness of his audit. • In a large business, it has been increasingly recognised that, if function of internal auditor and those of statutory auditors could be integrated.

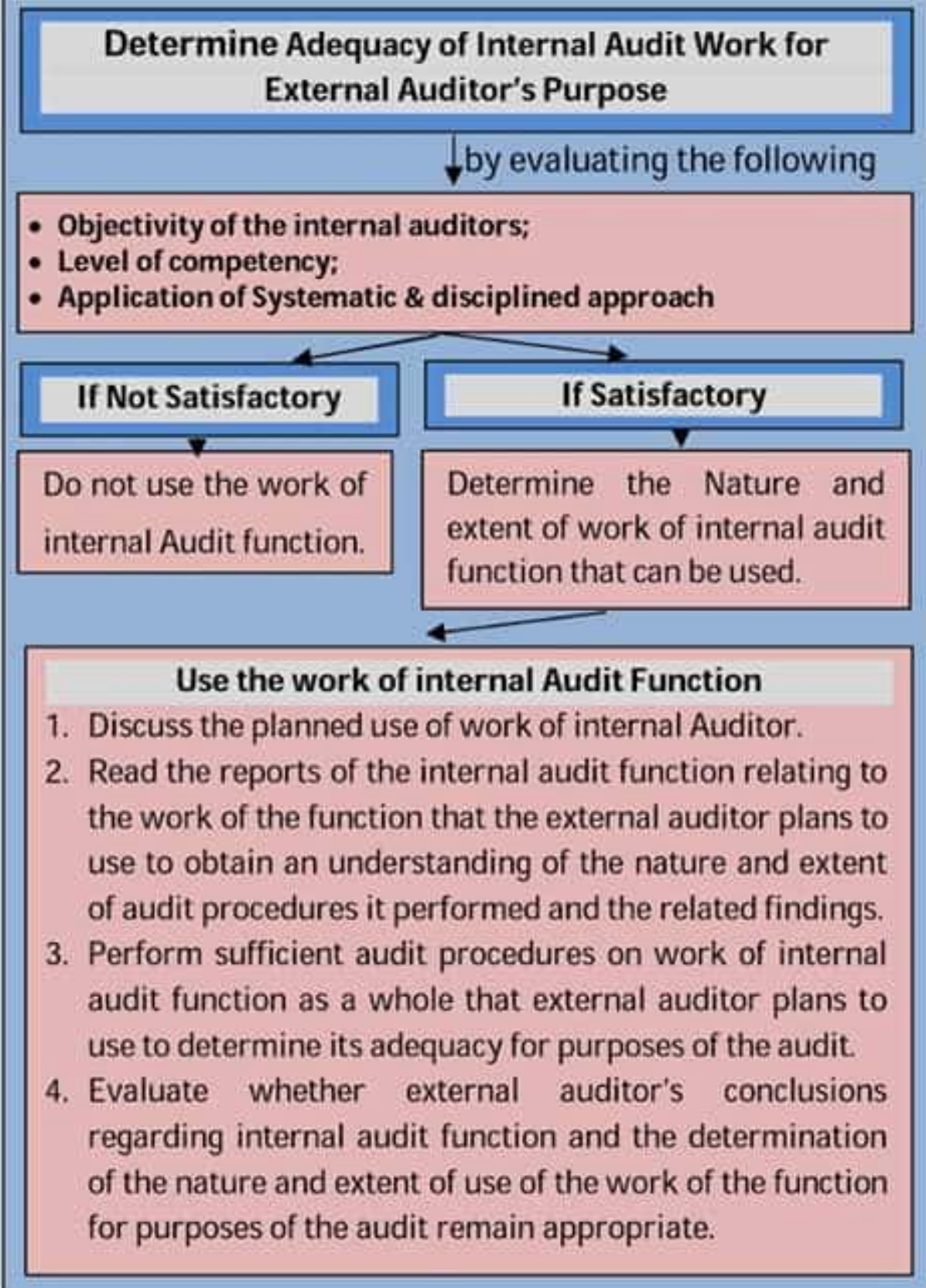
SA 610 (Revised) "Using the Work of Internal Auditors"

Meaning & scope of Internal Audit Function

Meaning
A function of an entity that performs assurance & consulting activities designed to evaluate and improve the effectiveness of the entity's governance, risk management and internal control processes.

Scope of Internal Audit	
1	Activities relating to governance.
2	Activities relating to Risk Management
3	Activities relating to Internal Control <ul style="list-style-type: none"> • Evaluation of Internal Control • Examination of Financial and operating information • Review of Operating Activities • Review of Compliance with Laws and Regulations

External Auditor's Procedures w.r.t. Evaluation of Internal Audit Function



Using Direct Assistance (DA) of Internal Auditors (IA)

- 1 **Determining whether IA can be used to provide DA**
If not prohibited by law or regulation, external auditor may use an internal auditor to provide direct assistance if:
 - (a) There are no significant threats to objectivity of internal auditor; &
 - (b) Internal auditor is sufficiently competent to perform proposed work.
- 2 **Determining Nature & Extent of Work that can be assigned to IA**
IA shall not be used to provide DA to perform procedures that:
 - (a) Involve making **significant judgments** in the audit;

Significant judgments include the following:

 - Assessing the risks of material misstatement;
 - Evaluating the sufficiency of tests performed;
 - Evaluating appropriateness of management's use of going concern assumption;
 - Evaluating significant accounting estimates; and
 - Evaluating the adequacy of disclosures in the F.S., and other matters affecting the auditor's report
 - (b) Relate to higher assessed risks of material misstatement;
 - (c) Relate to work with which internal auditors have been involved; or
 - (d) Relate to decisions, external auditor makes in accordance with this SA w.r.t. internal audit function & use of its work or direct assistance.
- 3 **Using Direct Assistance of Internal Auditor**
 1. Prior to using internal auditors to provide direct assistance for purposes of the audit, the external auditor shall:
 - (a) Obtain written agreement from entity that the IA will be allowed to follow the external auditor's instructions, and that the entity will not intervene in the work the IA performs; and
 - (b) Obtain written agreement from the IA that they will keep confidential specific matters as instructed by the external auditor and inform the external auditor of any threat to their objectivity.
 2. The external auditor shall direct, supervise and review the work performed by IA on the engagement in accordance with SA 220.
 3. The direction, supervision and review by the external auditor of the work performed by the IA shall be sufficient in order for the external auditor to be satisfied that the IA have obtained sufficient appropriate audit evidence to support the conclusions based on that work.

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Standards on Internal Audit (SIA)

List of SIA

SIA – 1	Planning an Internal Audit
SIA – 2	Basic Principles Governing Internal Audit
SIA – 3	Documentation
SIA – 4	Reporting
SIA – 5	Sampling
SIA – 6	Analytical Procedures
SIA – 7	Quality Assurance in Internal Audit
SIA – 8	Terms of Internal Audit Engagement
SIA – 9	Communication with Management
SIA – 10	Internal Audit Evidence
SIA – 11	Consideration of Fraud in an Internal Audit
SIA – 12	Internal Control Evaluation
SIA – 13	Enterprise Risk Management
SIA – 14	Internal Audit in an Information Technology Environment
SIA – 15	Knowledge of the Entity and its Environment
SIA – 16	Using the Work of an Expert
SIA – 17	Consideration of Laws and Regulations in an Internal Audit
SIA – 18	Related Parties

Elements of Internal Audit Report (SIA 4 - Reporting)

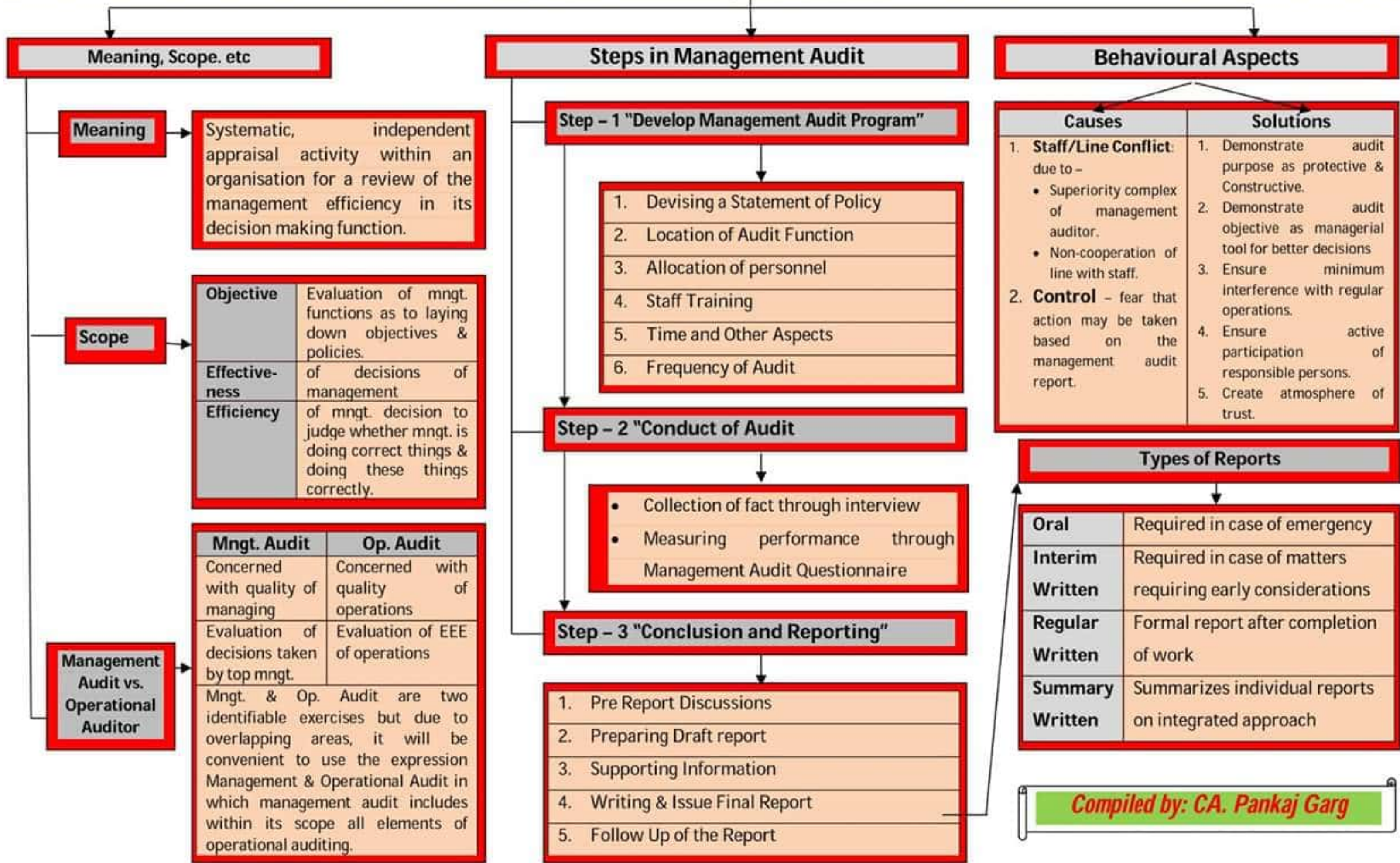
1	Title
2	Addressee
3	Report Distribution List
4	Opening or Introductory Paragraph
5	Scope Paragraph
6	Executive Summary Paragraph
7	Observations (Main Report) Paragraph
8	Comments from Local Management
9	Action Taken Report Paragraph
10	Date of the Report
11	Place of Signature
12	Internal Auditor's Signature

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Essential Features of Internal Audit Report of SIA

Objectivity	Comments and opinions expressed in the report should be as objective and unbiased as possible.
Clarity	The language used should be simple and straight-forward.
Accuracy	The information contained in the report, whether quantified or otherwise, should be accurate.
Conciseness	Important information should not be omitted.
Constructiveness	Destructive criticism should carefully be avoided in the report.
Readability	The reader's interest should be captured and retained throughout. For this, appropriate paragraph heading may be used.
Timeliness	The report should be submitted promptly otherwise opportunity for taking action may be lost or a wrong decision may be taken in the absence of the information.
Findings and conclusions	These may be given either department-wise or in the order of importance.
Recommendations	An internal audit report usually includes recommendations for potential improvements.
Auditee's views	The auditee's views about audit conclusions or recommendations may also be included in the audit report in appropriate circumstances.
Summary	A summary of conclusions and recommendations may be given at the end. This is particularly useful in long reports.
Supporting information	The internal auditor should supplement his report by such documents and data which adequately and convincingly support the conclusions.
Draft Report	Before writing the final report, the internal auditor should prepare a draft report. This would help him in finding out the most effective manner of presenting his reports.
Writing and issuing the Final Report	The final report should be written only when the auditor is completely satisfied with the draft report. Before issuing the final report, the auditor should discuss conclusions and recommendations at appropriate levels of management. The report should be duly signed.

Chapter 14 - Management Audit



Operational Audit

Meaning, Types, Objectives & Need

Meaning

Review and Appraisal of Operations conducted by competent independent person

Types

1. **Functional Audit:** deals with one or more functions.
2. **Organisational Audit:** deals with entire organizational unit.
3. **Special Assignments:** arises at the request of management.

Objectives and Scope

1. Appraisal of Controls
2. Evaluation of Performance
3. Appraisal of Objectives & Plans
4. Appraisal of Organisational Structure.

Need for Operational Audit

- Management requirement for the information in respect of areas beyond their direct supervision.
- Inadequacy of traditional sources of information to provide complete information to management.
- Operational Audit acts as an inexpensive, continuous and objective appraisal of activities, operations and controls to inform the management about achievement of standards and the exceptions if any.

Operational Audit vs. Internal Audit

Operational Auditing	Internal Auditing
It is concerned with the review and appraisal of operations.	Concerned with determining whether other controls are well designed & in place
It is not a part of internal control	It is a part of internal control system
It is a constructive function i.e. to provide suggestions for improvement	It is a protective function i.e. to safeguard the assets of the enterprise.
It analyses all aspects of operations whether they are in tune with management policies, objectives and Goals	It is primarily concerned with financial accounting and internal control
It mainly deals with qualitative aspects	It focuses more on quantitative aspects

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Operational Audit vs. Financial Audit

	Financial Auditing	Operational Auditing
Purpose	Concerned with the opinion that whether the historical information recorded is correct or not.	It emphasizes on effectiveness and efficiency of operations for future performance.
Area	Restricted to matters directly affecting the appropriateness of the presented F.S.	It covers all the activities that are related to efficiency and effectiveness of business operations.
Reporting	Financial audit report is sent to all stakeholders.	Operational audit report is primarily for the management
End Task	Financial audit reports the findings to the persons as its end objectives.	Operational audit is not limited to reporting but includes suggestions for improvements also.