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Webinar on Issues and Opportunities in Different Types of Audit

for CA Students

July 2, 2021

Approach Towards

Internal Audit

by

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Definition of Internal Auditing

The Definition of Internal Auditing states the fundamental purpose, nature, and scope of internal auditing.

“Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

Internal audit definition by ICAI

“Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to 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, as a part of good governance.”

Evolution of Internal Audit

- ❑ Internal Audit 1.0 was focused on transactional audit with a standalone approach. The techniques adopted identified procedural shortcomings.

- ❑ Internal Audit 2.0 was focused on risk based audit approach, identifying the control weaknesses and setting constructive measures to strengthen the process. The activities were assessed on the basis of business functional approach.

- ❑ Internal audit 3.0
 - ✓ In this environment, the need for internal audit to play a larger role that expands over risk control procedures to encompass activities related to value creation (a performance focus).
 - ✓ Changing stakeholder expectations to look beyond risk and compliance

Ways to approach IA 3.0

The Value Add approach shall encompass:

- ❑ **Data Analytics:** The upgraded version to uncover hidden patterns, unknown correlations, market trends, customer preferences and other useful information that can help organizations make more-informed business decisions.:
 - ✓ Trend analysis
 - ✓ Comparative analysis
 - ✓ Drawing causal relationships between risks and their causes

Ways to approach IA 3.0

The Value Add approach shall encompass:

- ❑ Benchmarking is comparing one's business processes and performance metrics to industry bests and best practices from other companies. This involves:
 - ✓ Trend analysis
 - ✓ Comparative analysis
 - ✓ Performance analysis
 - ✓ Drawing causal relationships between risks and their causes

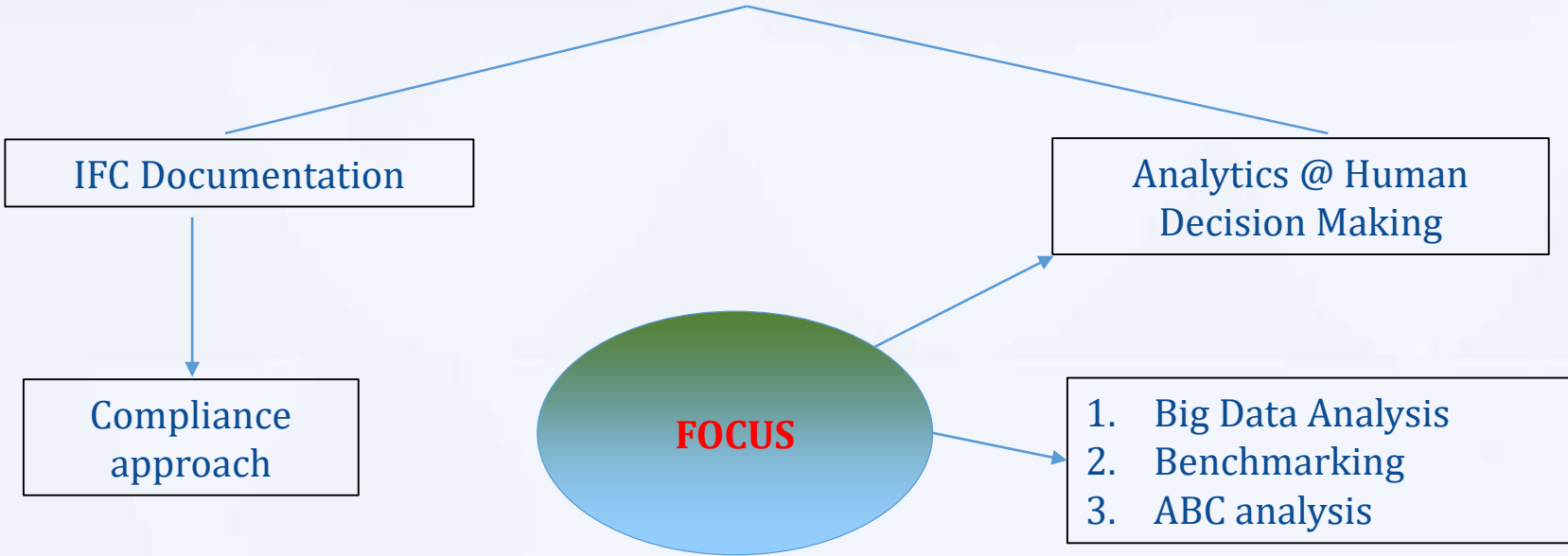
Ways to approach IA 3.0

The Value Add approach shall encompass:

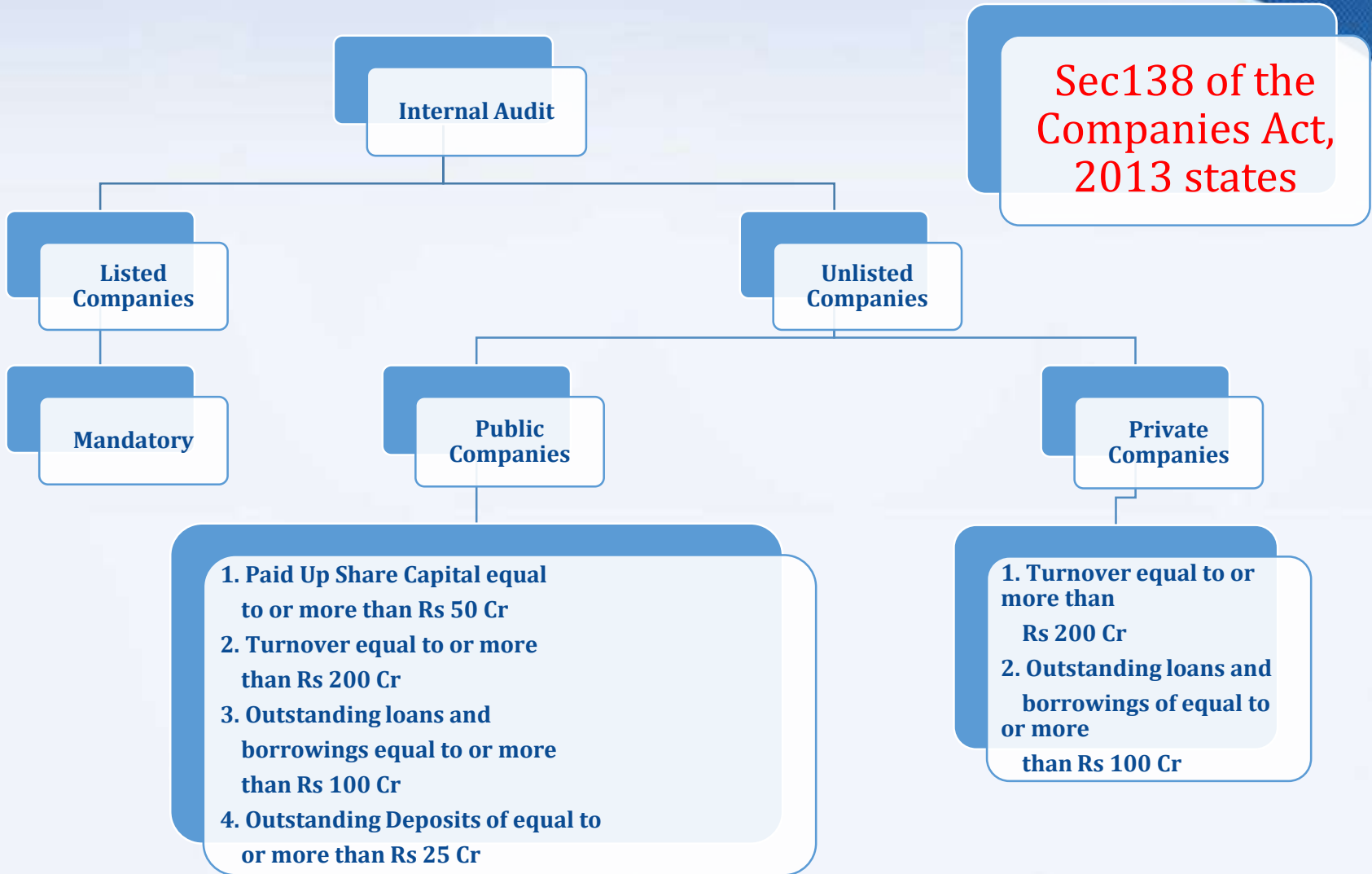
- ❑ **Activity-Based Management (ABM)** is a methodology for more precisely assessing the growth patterns drawn in an organization, based on the market conditions. ABM works best in complex environments, where there are many machines and products, and tangled processes.

Current Approach of Internal Auditor

Internal Audit



Provisions in the Companies Act, 2013



Why Internal Audit?

- ❑ Statutory Requirement
- ❑ Audits help businesses uncover problems and ensure efficiency.
- ❑ For independent and objective assessment of the effectiveness and efficiency of a company's operations, specifically its internal control structure.
- ❑ To review compliance with a multitude of administrative regulations.
- ❑ To instill a sense of confidence in management that the business is functioning well and Organization is prepared to meet potential challenges.
- ❑ To **Add value** by delivering business insight.
- ❑ Risk Assessment, Identification of Fraud, Misappropriation and unethical behavior of employee

Internal Audit Framework

Planning



Performing



Reporting

Planning

Research / Preliminary Preparation of Audit :

- Understanding the Clients Business
- Study of Clients Product / Service
- Understanding the Business Structure and Culture
- Understanding the Scope of Audit
- Understanding the automatic and Operational Controls

Preparation for Audit

- ❑ Pre-audit review
- ❑ Master Files
- ❑ Company Website
- ❑ Previous Audit Reports
- ❑ Checklists of Previous Audits
- ❑ Process Notes



Performing

Risk Assessment:

- Checklist Preparation and Modulation.
- Pre audit discussions with team members.
- Plant / Location visit.
- Identification of system / physical controls established.
- Basis the research and analysis prepare audit strategy.
- Study of SOP's

Performing

Execution:

- System (ERP)
- Bird Eye View (Overview)
- Worm's Eye View (Data Analytics)
- Sample Selection and Resampling
- 5 Why
- End to End Linking
- Query discussions with auditees
- Approval to audit observation

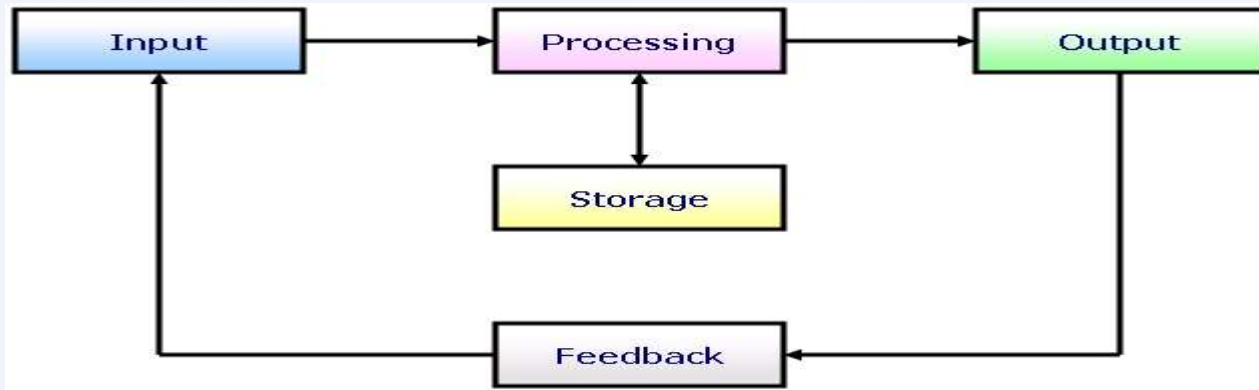
System (ERP)



Microsoft
Dynamics® 365

System (ERP)

- ❑ Understand system flow



I/O Model

- ❑ Types of Reports
- ❑ System Movements

Bird's Eye View (Overview)



- ❑ Also known as Aerial View or Top-down perspective.
- ❑ A "bird's-eye view" is an elevated view of an object from above, with a perspective as though the observer were a bird, often used in the making of blueprints, floor plans and maps.

Worm's Eye View



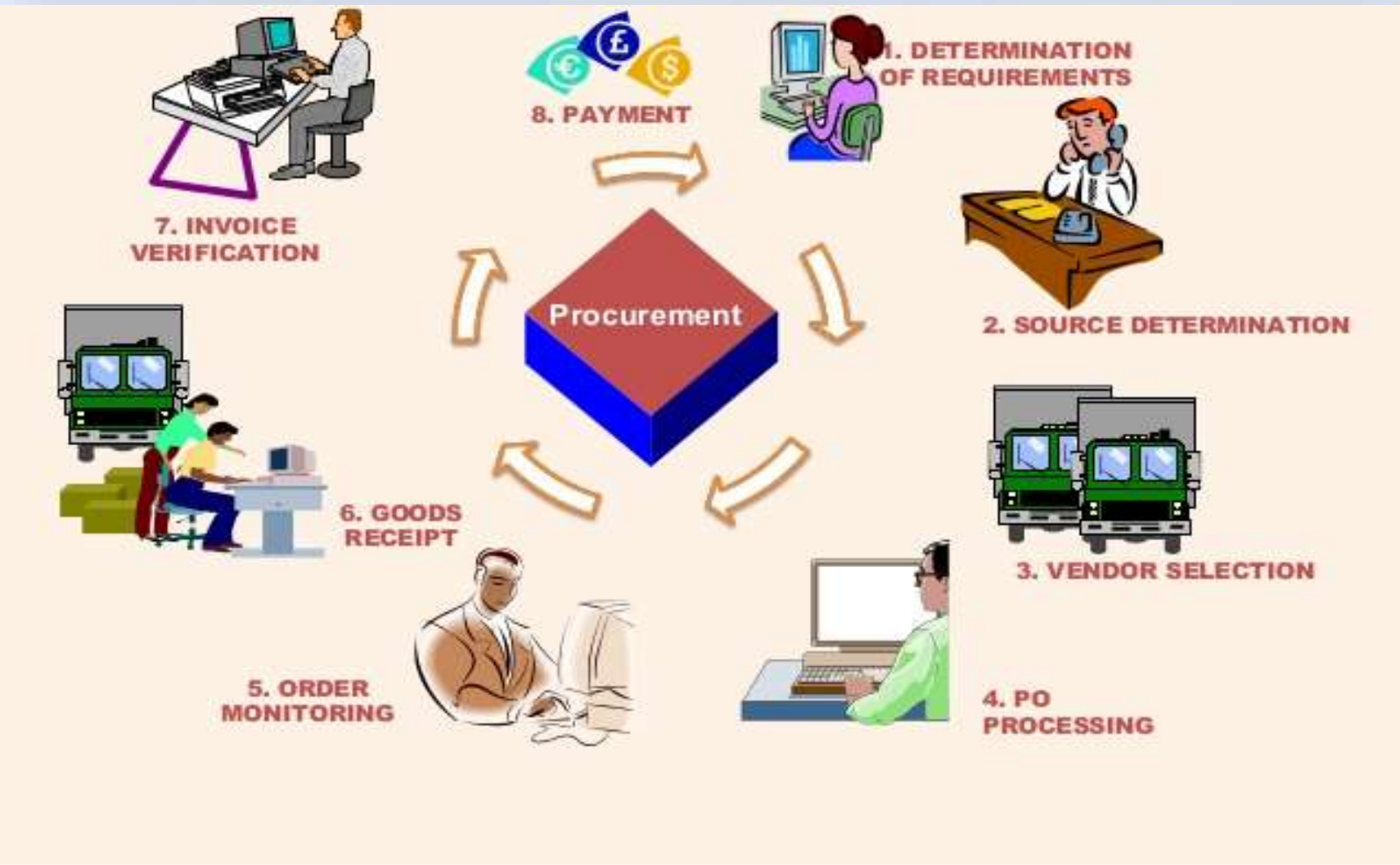
- ❑ A worm's-eye view is a view of an object from below, as though the observer were a worm; the opposite of a bird's eye view.

Discussion on Important Processes in an Organisation

Some Important Processes

- Procurement to Payment (P2P)
- Inventory Management
- Order to Collection (O2C)
- Statutory Compliance
- HR & Payroll
- Fixed Assets and Capital Expenditure
- Product Costing
- Big Ticket Expenses

Snapshot of Procure to Pay Cycle



Overview of Procure to Pay Process

Process	1.0 Sourcing & Supplier Selection	2.0 Contract Management	3.0 Transaction Management	4.0 Accounts Payable Transaction Management	5.0 Vendor Master File Governance	6.0 Supplier & Category Management
	Sub-Process	1.1 Forecasting & Planning	2.1 Contract Review	3.1 Requesting	4.1 Receiving/ 3-Way Match	5.1 Vendor Requests/ Due Diligence
1.2 Category & Supply Market Analysis		2.2 Contract Creation/ Negotiation & Execution	3.2 Bid/ Quote Requests	4.2 PO Invoice Processing	5.2 Vendor Add/ Change/ Archival	6.2 Supplier Performance Management
1.3 Sourcing Strategy Development		2.3 Post Award Administration	3.3 Purchase Order Processing	4.3 Non- PO Invoice Processing	5.3 VMF Data Integrity Management	6.3 Supplier Relationship Management
1.4 Supplier Evaluation & Selection		2.4 Reporting & Analysis	3.4 Expense Management	4.4 Invoice Hold/ Exception Management & Payment Processing	5.4 VMF Data Integrity Management	6.4 Category Analysis & Enrichment

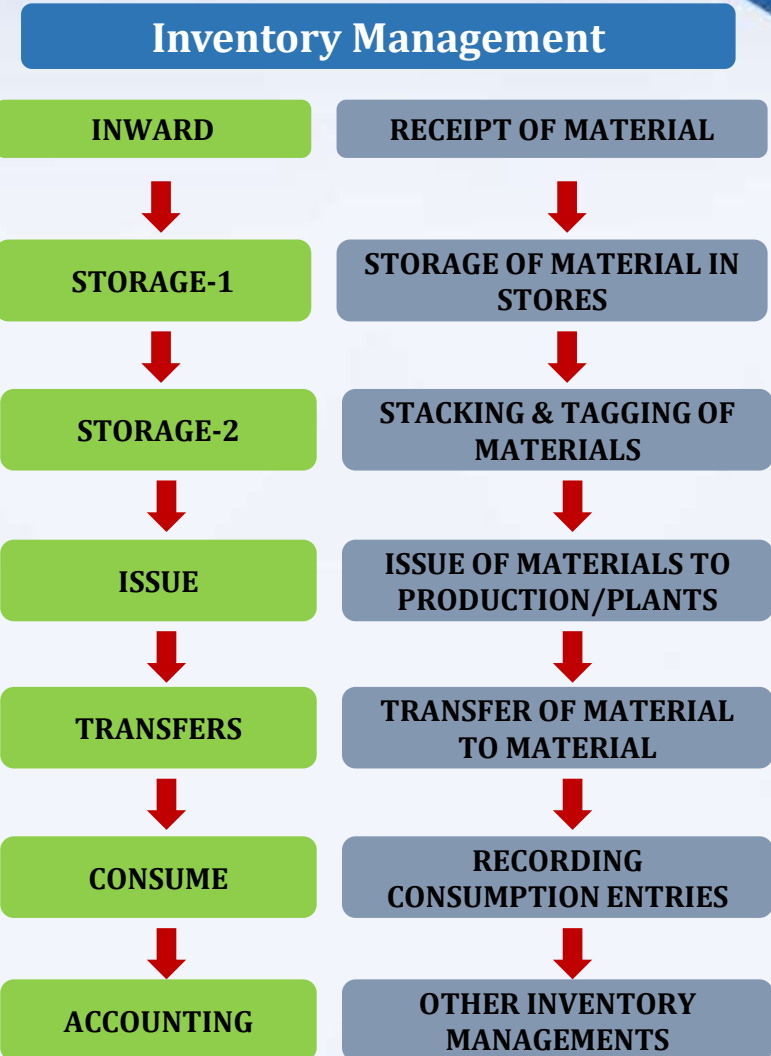
Key Analytics in Procure to Pay Process

The procure to pay process is critical for procuring goods/services from vendors based on Business requirements and making payments as a part of operations in an organisation.

KEY ANALYTICS

- 1) **Vendor Development (Such as, Identification and selection of economical vendor, comparative statement, approvals etc.)**
- 2) **Purchase Requisition and Purchase Order Management (such as, Creation, Modification, Approval, Closer etc.)**
- 3) **Payment to Vendor without PO and/or Contract**
- 4) **Duplicate Vendor**
- 5) **Goods Received Quantity Vs Goods Invoices Quantity**
- 6) **Split Invoicing**
- 7) **Invoice Number Sequence**
- 8) **Duplicate Invoice (Supplier, Invoice Number, Invoice Date and Amount)**
- 9) **Duplicate Payment (Beneficiary Name, Account, Value Date & Amount)**
- 10) **Supplier Performance Evaluation Procedure**
- 11) **Inward Material Quality Assurance Mechanism**
- 12) **Other (You may discuss additional Key Analytics)**

Snapshot of Inventory Management



Overview of Inventory Management

Process	1.0 Material Master Management	2.0 Handling & Storage	3.0 Material Movements	4.0 Consumption & Adjustment Movements	5.0 Inventory Verification	6.0 Other Analytics
	Sub-Process	1.1 Creation and Modification of Material Codes	2.1 In warded Material Storage System	3.1 Issue of Material to Production	4.1 Consumption as per BOM	5.1 Periodic Physical Inventory Verification
1.2 Inventory classification into ABC/VED category		2.2 Tagging and Stacking of Materials	3.2 Batch to Batch Material to Material Transfers	4.2 Manual Consumption	5.2 Documents Maintained for Verification Activity	6.2 Subcontracting Activity
1.3 Costing Method Assigned to the Code		2.3 Maintaining the Stock Levels	3.3 Location to Location Transfers (Including Third Party)	4.3 Stock Adjustment Entries	5.3 Reconciliation and variance analysis	6.3 Slow Moving & Non Moving Inventory
1.4 Periodic Review of Masters		2.4 Hazardous & Critical Materials Storage	3.4 Adjustments, Scrap, Rejection, Returns, Rework etc.	4.4 Reversal Entries for various material movements	5.4 Authorization for Stock Adjustment Entries	6.4 Inventory Valuation

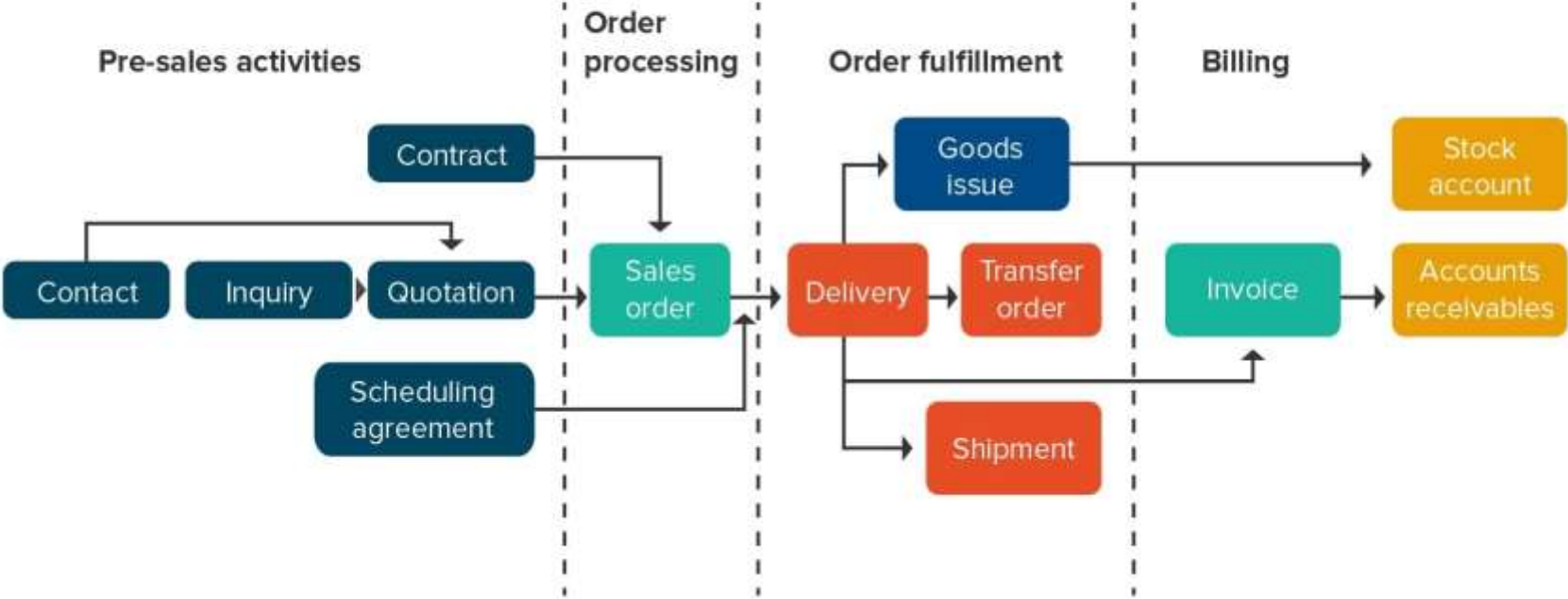
Key Analytics in Inventory Management

An efficient, effective inventory management process is key to making sure your business remains profitable. Since the material has a cost, the organisation like to incur optimum cost on this account and thus there is a need to manage the materials within a store's such that the total cost of maintaining materials remains optimum.

KEY ANALYTICS

- 1) **Discrepancies in Inward Process (Such as, Pending GRN, Variance in GRN Qty vis-à-vis Invoice/Received Qty, Quality Issues etc.)**
- 2) **Inadequacies in storage (Such as, Overstocking, Inappropriate Stacking, Missing Tags, FIFO storage not followed etc.)**
- 3) **Anomalies in Physical Inventory Verification (Such as, Not Conducted, Inadequate coverage, Variances not adjusted/analysd)**
- 4) **Variances/Anomalies in posting various stock movements into ERP system (Variance between Issue Slip vis-à-vis ERP Entry)**
- 5) **Non-Moving and Slow-Moving Inventory Lying in Stores**
- 6) **Shelf Life Expired and/or Idle Inventory piled up in stores.**
- 7) **Inadequate Insurance Coverage (such as, value not covered, third party locations not covered etc.)**
- 8) **Long pending Items Observed in "IN TRANSIT LOCATION"**
- 9) **Shortcomings in Inventory Valuation (Such as, Costs not considered and/or Accounting Standard Not Followed)**
- 10) **Manipulations and/or Variance between BOM Consumption vis-à-vis Standard Consumption**
- 11) **Issues in RGP and NRGP process**
- 12) **Other (You may discuss additional Key Analytics)**

Snapshot of Order to Collection



Overview of Order to Collection

Process	1.0	2.0	3.0	4.0	5.0	6.0
	Enquiry and Quotation Management	Order Confirmation and Master Update	Sales Order Management	Delivery Of Goods	Debtors Reconciliation and Ageing of Receivables	Rejections, Warranty and After Sales Service
Sub-Process	1.1	2.1	3.1	4.1	5.1	6.1
	Record of enquiries and classification of enquiries	Agreement / Contract with customer	SOD w.r.t Sales Order Creation/ Amendments	Packing Slips vs Delivery Schedules vs Sales Order	Balance Confirmation Letters from Customers	Complaint Register and CRM Management
	1.2	2.2	3.2	4.2	5.2	6.2
	SOD w.r.t enquiry and quotation Management	SOD w.r.t customer code creation/ modification	Price List vis-à-vis Sales Order	Delivery Schedule vs Actual Delivery	SOP and/or Guidelines for Ageing of Receivables	Control over replacements/ scrapping of rejected material
1.3	2.3	3.3	4.3	5.4	6.3	
Ascertainment of Selling Price of a product	Essential details in Customer Master	Periodic Review of Open Sales Orders	POD for all dispatches and Insurance for Goods In Transit	Provision for doubtful debts	SOP Guidelines for Warranty Claims and Warranty Provision	
1.4	2.4	3.4	4.4	5.4	6.4	
Payment terms and payment schedule	Credit limit/period & discounts updation in system	Periodic Closer of long pending Sale Orders	E-Way Bill and INCO Terms	Credit Balance in Customer Accounts	Credit Notes and Accounting of After Sales Services related expense	

Key Analytics in Order to Collection

The OTC, process refers to a company's business process for the entire order processing system. The OTC cycle is important for businesses to optimize in order to maintain smooth operations. Activities within OTC can impact supply chain management (SCM), inventory management and required labor.

KEY ANALYTICS

- 1) Duplicate customers created. (based on Address, PAN etc.)
- 2) Sales beyond credit limit to a particular customer
- 3) Overdue accounts receivables and formal reasons for such overdue balances is not maintained
- 4) Proof Of Delivery is not maintained by the Company
- 5) Differences observed in Sales Invoice and Sales Order (billed quantity is more than Sales Order quantity and vice versa)
- 6) Sales Invoices raised before creation of Sales Order
- 7) Critical Details missing in Customer Master
- 8) Formal records w.r.t Rejection, Replacements, Scrapping not maintained by the Company
- 9) Price Per Unit can be modified while creating Sales Order in spite of having a price list in system
- 10) Customer Codes are created in system by unauthorized personnel.
- 11) Sales Orders are open for a long period.
- 12) Non Adherence to SOP or Absence of SOP w.r.t abovementioned processes.
- 13) Other (You may discuss additional Key Analytics)

Documentation



Documentation

SA 230 'Documentation'

Nature and Purposes of Audit Documentation

- (a) Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
- (b) Evidence that the audit was planned and performed in accordance with SAs and applicable legal and regulatory requirements.

Form, Content and Extent of Audit Documentation The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

- The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements;
- The results of the audit procedures performed, and the audit evidence obtained; and
- Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

Documentation

- Final Checklists
- Checklist based Observation Control Sheet
- Working Files
- Supporting
- Screen Shots
- Process Notes
- Flow Charts
- Mail communication

Reporting

SIA 4 “Reporting” lays down that the internal auditor’s report should ordinarily include certain basic elements. An illustrative layout is given below :-

- ❑ Title;
- ❑ Addressee;
- ❑ Period of coverage of the Report;
- ❑ Report Distribution List;
- ❑ Opening or introductory paragraph;
 - (i) Identification of the processes/functions and items of financial statements audited; and
 - (ii) a statement of the responsibility of the entity’s management and the responsibility of the internal auditor;
- ❑ Objectives/Scope paragraph (describing the nature of an internal audit):
 - (i) a reference to the generally accepted audit procedures in India, as applicable;
 - (ii) a description of the engagement background and the methodology of the internal audit together with procedures performed by the internal auditor; and
 - (iii) a description of the population and the sampling technique used.

Reporting

- Executive Summary, highlighting the key material issues, observations, control weaknesses and exceptions;
- Observations, findings and recommendations made by the internal auditor;
- Comments from the local management;
- Action Taken Report – Action taken/ not taken pursuant to the observations made in the previous internal audit reports;
- Date of the report;
- UDIN and
- Internal auditor's signature with Membership Number.



STYLE

CORRECTNESS

READABILITY

SUBSTANCE

Reporting

Generally, the internal audit reports should be drafted taking into account requirements of the various types of readers of the internal audit report which, generally, includes following:

- Board of Directors and Audit Committee
- Senior Management like, CEO, CFO, etc.
- Business Management and Process Owners
- Personnel or Employees tasked with direct implementation of recommendations
- External Auditors
- Other External Stakeholders, like, Regulators

Reporting

SIA 4 mentions that the internal auditor should exercise due professional care to ensure that the internal audit report, inter alia, is:

- Clear
- Factual – Presents all significant matters with disclosure of material facts
- Specific
- Concise
- Unambiguous
- Timely
- Complies with generally accepted audit procedures in India, as applicable.

Internal Audit Dilemmas

Internal auditors face ethical issues during the course of their roles and responsibilities on a daily basis. Some of these issues are:

- Prevention of Lawful Disclosure
- Pressure from Management
- Influencing objectivity and integrity of internal auditors
- Delay by Management in timely completion of audits
- Internal auditors failing to maintain independence

Opportunities as Internal Auditor

- Chief Internal Auditor (World Wide)
- Chief Financial Officer (CFO)
- Chief Executive officer (CEO)
- Practicing as Internal Auditor
- Fraud & Forensic Auditor



Thank You

KIRTANE & PANDIT LLP

Chartered Accountants