The Internal Audit Process

Program on Internal Audit at WIRC office of ICAI

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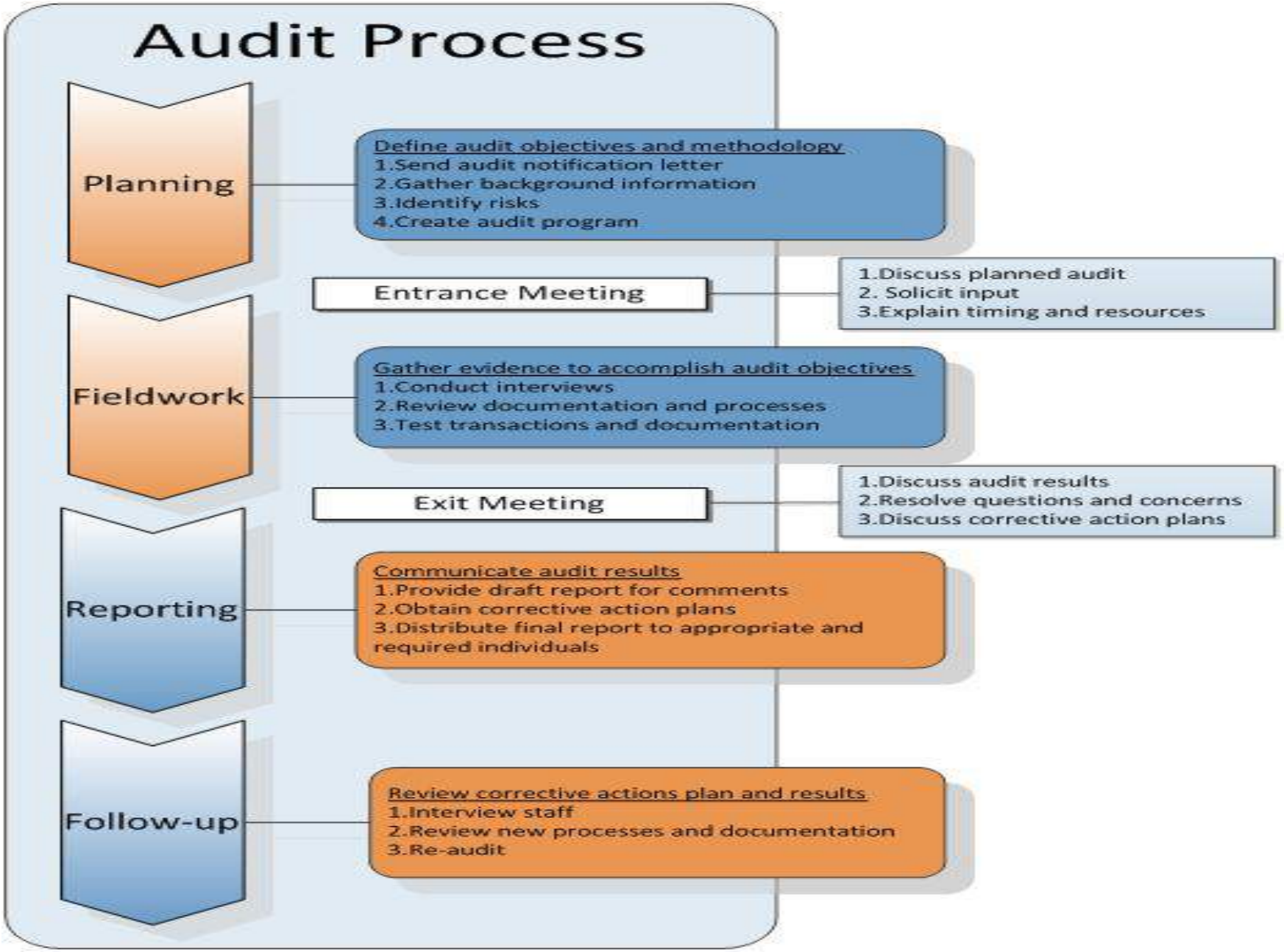
Audit Universe ..

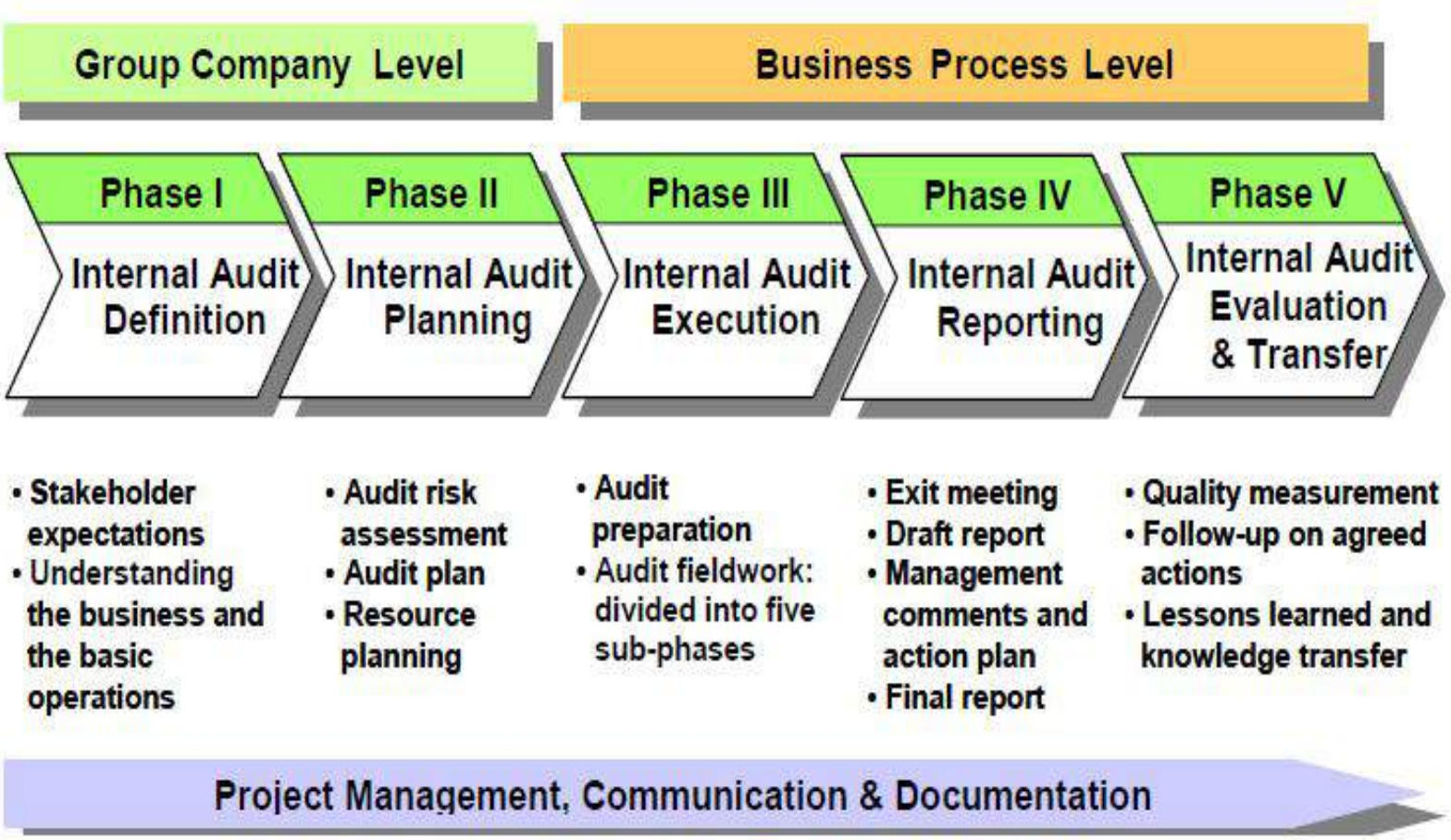
Marketing & Sales Marketing Strategy Pricing & Discount Branding & Promotion Sales Services & Complaints	**Manufacturing** Production Quality assurance Repairs & Maintenance Inventories EHS	**Logistics** Inbound & Outbound Logistics Port Terminal Operations Depot Visits
General Management Legal Compliances Secretarial Compliances Corp Communication Statutory Compliances	**Finance & Accounts** Accounts Payables Accounts Receivables Insurance & Treasury Finance & Accounts	**HR & Admin** Payroll Personnel Records Recruitments Employee Benefits
Purchase Strategy & Policy Procurement Contractual Services Receiving & Returns	**Information Systems** IT Policy Cyber Security Server Security Physical & Logical Access	**Other Areas** Risk Mgmt. ESG M&A IFC/ SOX/ RPTs review

Need to expand any audit universe

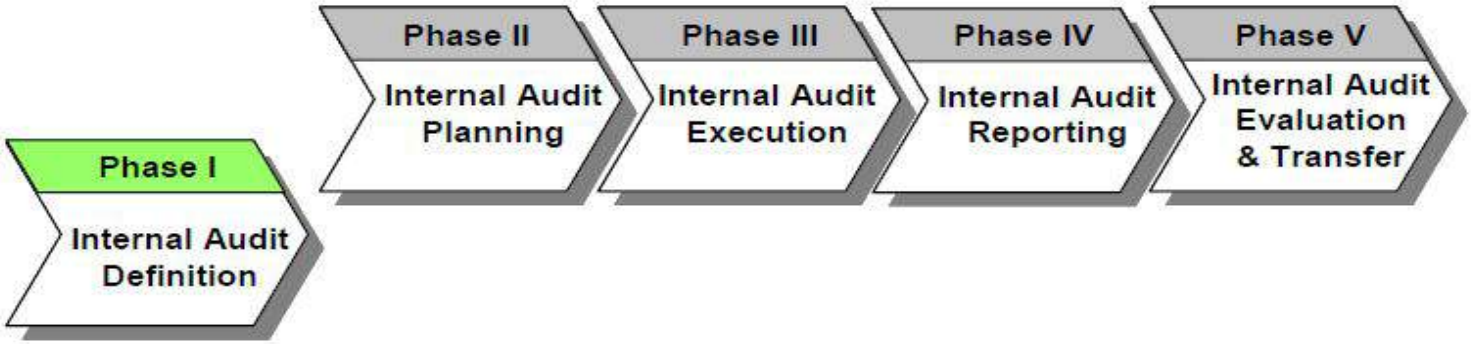
Old world	Current	Future
Processes	Objectives	Emerging risks
Locations	Risks	Customer interactions
Departments	Projects	Key decision making
Regulatory requirements	Regulatory returns	Risk appetite
Systems	Governance framework	Culture
	Risk management framework	Key corporate events
	Other assurance functions	Key suppliers /contractors
		Key agents / distributors


Audit Process
Planning
Define audit objectives and methodology
1.Send audit notification letter
2.Gather background information
3.Identify risks
4.Create audit program
Entrance Meeting
1.Discuss planned audit
2. Solicit input
3.Explain timing and resources
Fieldwork
Gather evidence to accomplish audit objectives
1.Conduct interviews
2.Review documentation and processes
3.Test transactions and documentation
Exit Meeting
1.Discuss audit results
2.Resolve questions and concerns
3.Discuss corrective action plans
Reporting
Communicate audit results
1.Provide draft report for comments
2.Obtain corrective action plans
3.Distribute final report to appropriate and required individuals
Follow-up
Review corrective actions plan and results
1.Interview staff
2.Review new processes and documentation
3.Re-audit

Overall Phases in IA process



Phase I in IA process



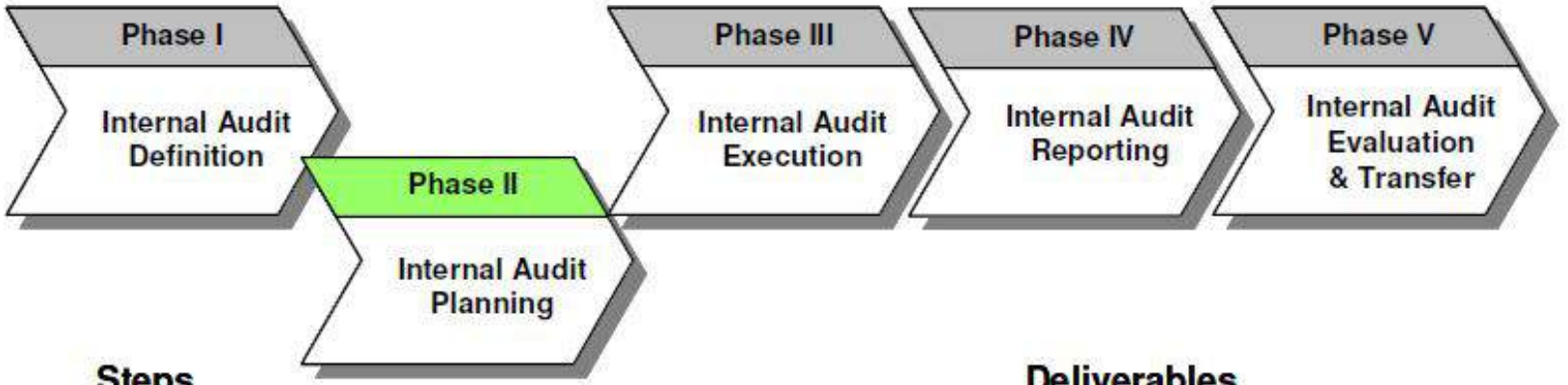
Steps

- Document stakeholder expectations
- Understand the business and the basic operations:
  - Business strategy, objectives and context
  - Relevant business performance measures
  - Relevant business processes (value chain and support processes)
  - Relevant business risks

Deliverables

- An IA permanent file for the Group Company including e.g.
  - Customised business process model for local IA
  - A comprehensive overview of the Company locations and activities
  - Documentation of stakeholder expectations

Phase II in IA process



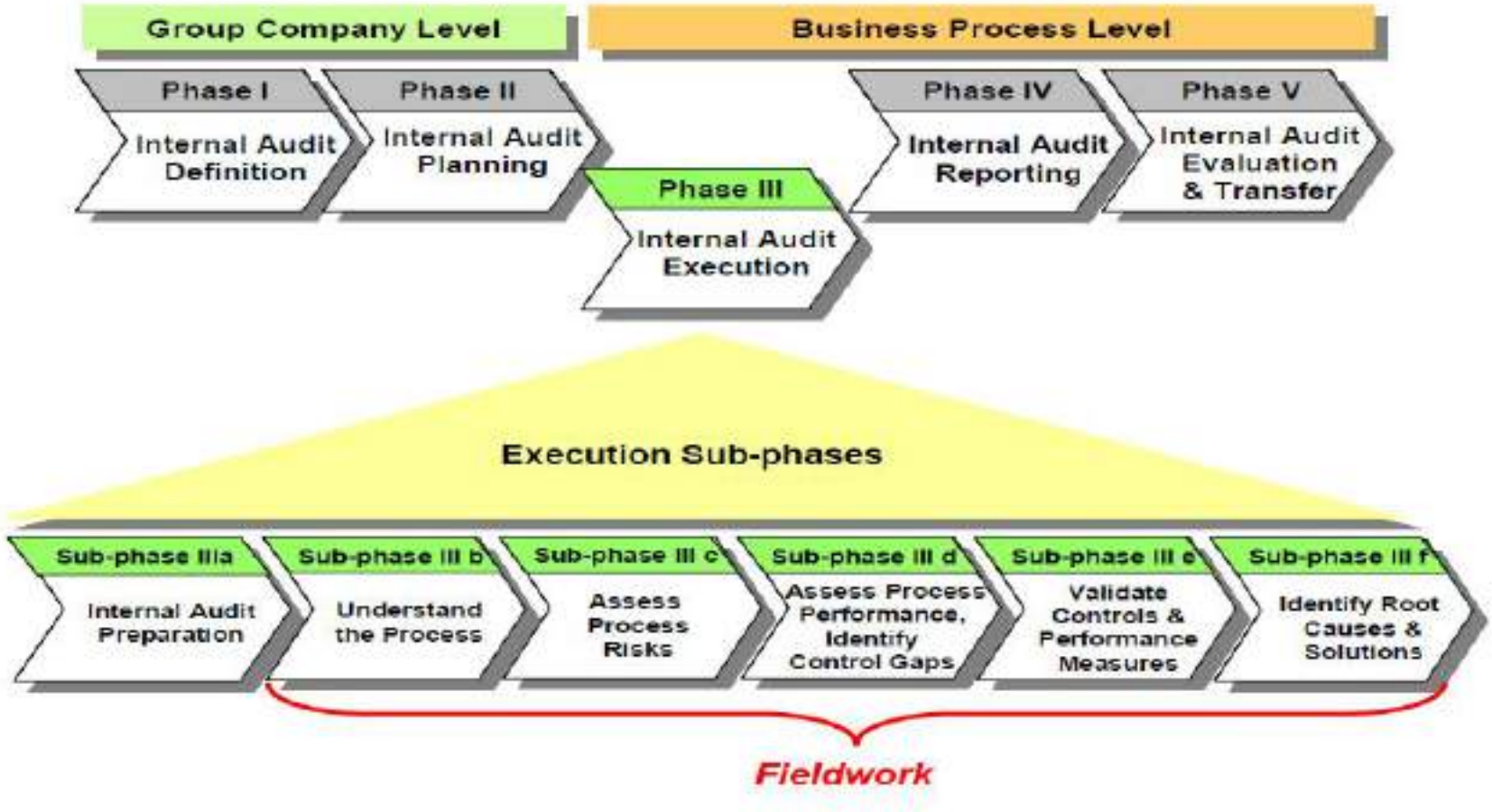
Steps

- Perform IA risk assessment at Group Company
- Validate the IA risk assessment with stakeholders
- Prepare the Annual IA Plan based on the IA risk assessment and key stakeholder requests; set audit project priorities
- Budget time and cost for the needed IA resources
- Obtain required formal approvals for the Annual IA Plan and the corresponding resource plan and budget
- Follow up and report on Annual IA Plan fulfilment

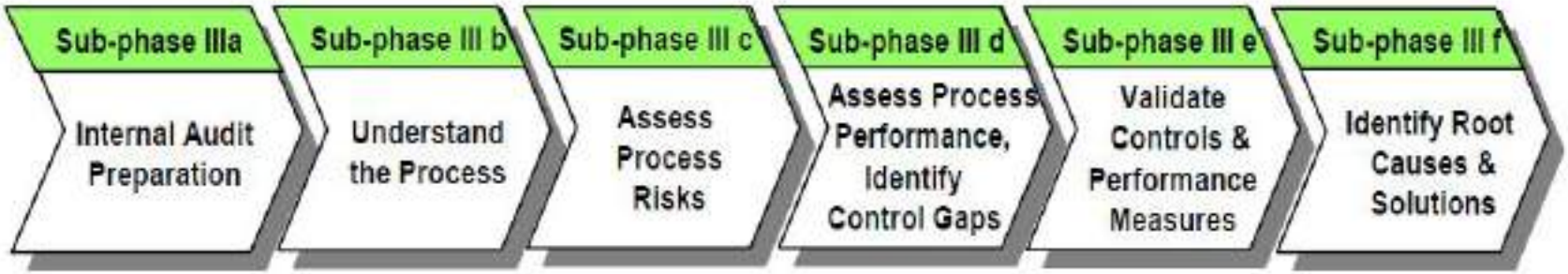
Deliverables

- Validated Audit Risk Assessment
- Annual IA Plan
- IA Resource Plan
- Annual Budget

Phase III in IA process ..



Phase III in IA process



- Revisit IA planning documents and work programs
- Gather and analyse current information relevant to the audit project
- Interview main stakeholders
- Assign adequate resources and prepare work plan and budget (as applicable)
- Co-ordinate audit schedule with auditee organisation, announce audit project
- Conduct opening meeting

- Gather process information
- Receive or draw process flowchart
- Validate process flowchart

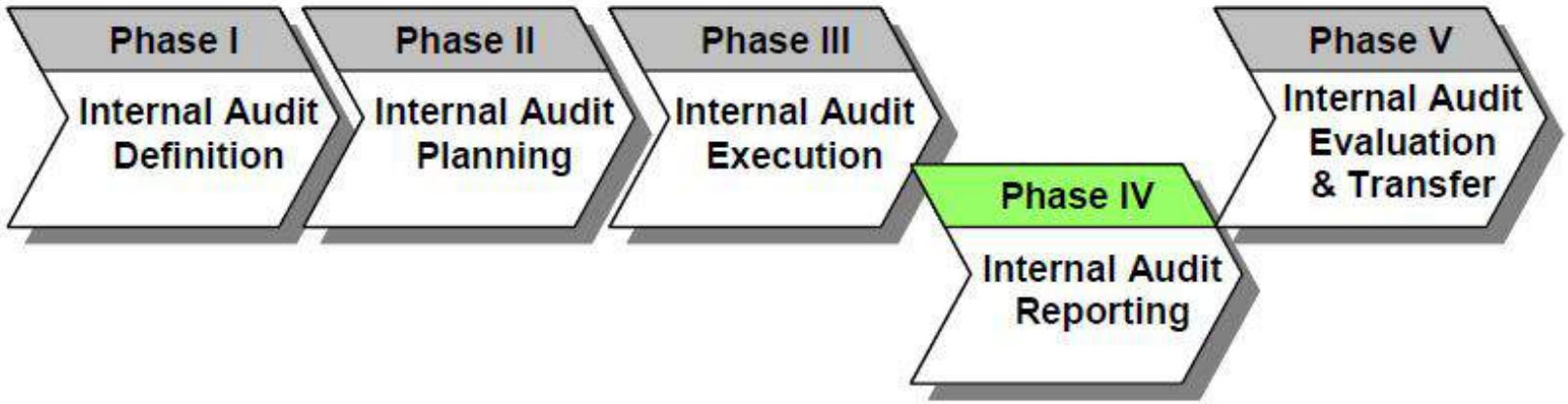
- Identify risks in the process
- Source risks
- Measure and prioritise risks
- Establish process risk list (or optionally process risk map)
- Define risks to be analysed in detail
- Validate process risk list

- Identify controls including performance measures
- Evaluate design of controls and performance measures
- Identify control gaps
- Identify "quick wins"

- Determine type and extent of tests
- Design and perform tests
- Document and analyse results

- Define gaps / observations to be further analysed
- Identify causes of gaps
- Rate significance of gaps / observations
- Identify possible corrective action to control and performance gaps
- Formulate observations and recommendations
- Obtain Process Owner / Management response
- Complete field work, prepare for reporting

Phase IV in IA process



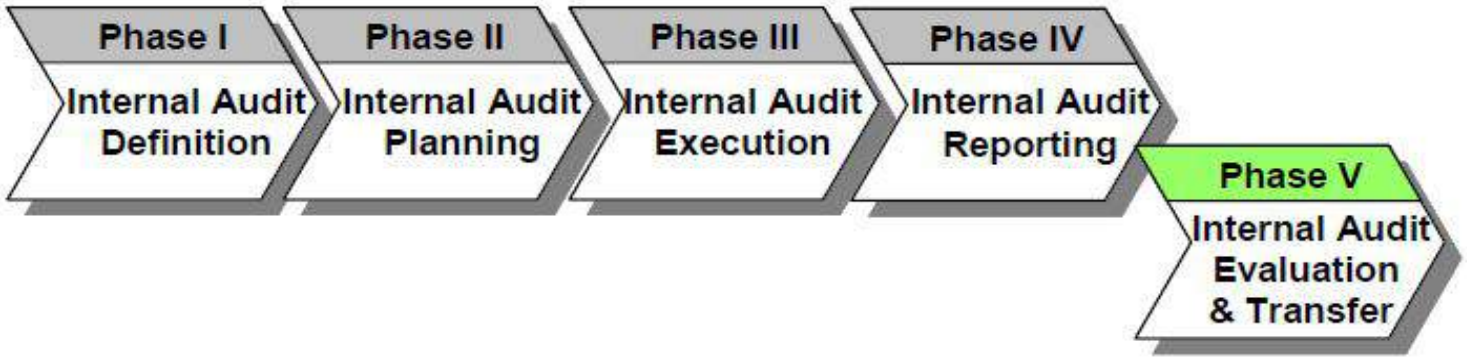
Steps

- Summarise audit results and proposed solutions
- Conduct exit meeting and attempt consensus
- Prepare draft of the IA Company Report
- Receive management comments and action plans
- Issue final IA report

Deliverables

- Exit meeting presentation
- Minutes of meeting
- IA Company Report
- IA Company Exception Report
- IA Annual Summary Report

Phase V in IA process



Steps

- Quality measurement
- Follow-up on agreed actions
- Lessons learned and knowledge transfer

Deliverables

- Stakeholder Satisfaction Survey
- Internal Audit Compliance Report
- Report on Management follow-up
- IA Follow-up Report
- Documentation of Good Practice for controls

Executive Summary – Sample 1

Sr. No.	Audit Observation	Action Plan	Risk Category	Risk Rating	Control Rating	Slide Reference
1						
2						
3						
4						
5						
6						

Risk Category: Financial | Operational | Compliance

Risk Rating: High | Medium | Low

Control Rating: Moderate | Limited

Audit Observation Format

1. CRITERIA = What should be

2. CONDITION = What is; What did you find

3. CAUSE = Why is there a difference between Criteria and Condition

Observation	Risk	Recommendations	Management actions agreed or comments
2. Off-specification waste – testing and follow up	Rating: ☑ High ☐ Medium ☐ Low		
All waste processed in the plant should comply with all contractual specifications and laws and valid permits. At present, the lab does a quick test as part of the acceptance testing and then does a complete test later. Waste may have been processed by the time the complete test results are available. In our review of all test results of tests performed 1.8 – 31.10.200X (n tests) we identified 7 cases of waste that had been accepted for processing based on the quick test. However the complete lab test performed later of these batches revealed that the waste had not been according to the required specification. These cases require follow up monitoring and appropriate notification to the waste generator. Such notification did not take place in the identified cases. The laboratory equipment and testing procedures are partly outdated and have not been updated to meet the requirements of the higher volumes of AFR being processed. No management reporting of test results, which would alert management to potential problems in a timely manner, is in place.	Production quality may be affected particularly in the future when larger quantities of waste are processed. Breach of laws and operating permits. Reputation risk. Collusion with waste generators.	Analyse the test results from the past 6 months in order to assess the reliability of the quick testing method. Identify any waste generators, if any, who systematically deliver out of spec waste. Assess the technical and practical feasibility of performing the full test before the waste is processed. Review the equipment, work flow and the Work Procedures of the lab. Implement regular reporting to management of test results (quick test and full laboratory analysis) and ensure the waste generator is notified of all cases which are out of specification and that all such cases are adequately followed up and resolved.	A special analysis of the test results in the past 12 months will be performed. The reliability of the quick test will be assessed, practical / technical options to improve reliability and timeliness of test results will be assessed. Waste generators supplying out of spec waste will be identified and an appropriate action plan will be developed to correct the situation. A regular reporting of test results will be implemented in order to identify potential problems in a timely manner. Correponding amendments to the Work Procedures of the laboratory will be implemented. Deadline: 31.03.200X Person responsible: D

4. Consequences - What does this mean in terms of risk

5. Corrective Action = What will be Management Action

5Cs of Report Writing

Criteria

What is the standard that was not met?

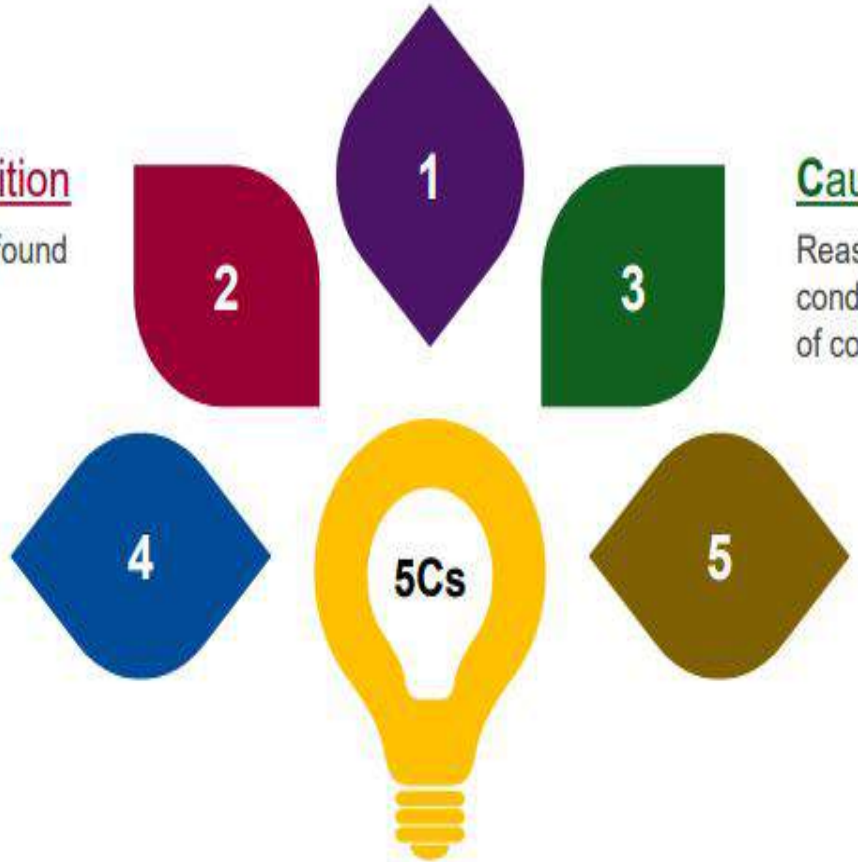
The standard may be a company policy or other regulatory guideline. expectations used in making an evaluation

Condition

The factual evidence as to what was found

Cause

Reason for difference between criteria & condition [lack of controls, circumvention of controls or external influences]



Consequences

Difference between condition and criteria [impact on the individual, business unit and company as a whole, quantify the impact]

Corrective Action

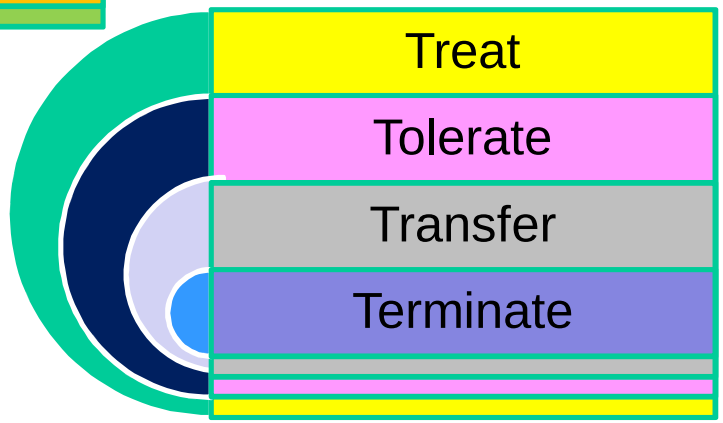
Action that must be taken to correct the cause

5 Cs In Report Writing – Case Study

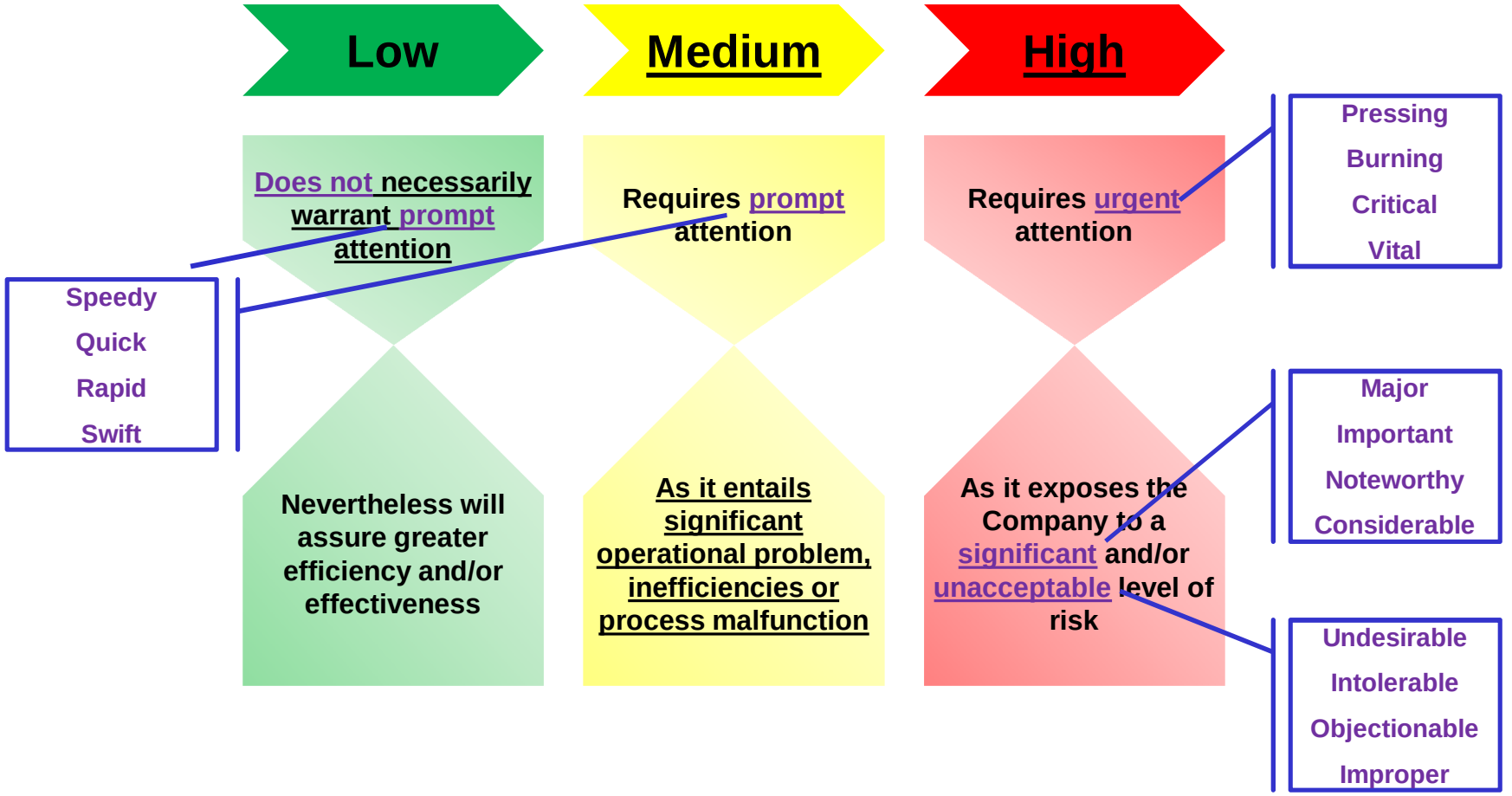
Observation To Contain 5Cs	Observation To Answer The Following	Example
Criteria	What is the standard?	Variation in stock on physical verification with the balance as reflected in the stock register should be NIL.
Condition	What is wrong?	The stock physically verified was short by 5045 units as against the balance shown in the stock register.
Cause	Why is it wrong?	Issues made during the night shift were not recorded.
Consequences	What is the risk / impact?	The stock position in the books is overstated and the possibility of stock pilferage is high due to lack of control.
Corrective Action	What should be done? / How to correct?	Night shift stock keeper needs to be appointed. Alternatively, the requirement of stock for the night shift should be issued at day end as per the requisition of the production in charge for the night shift. The consumption during night shift is verified by counting in the morning the balance stock left out of the lot issued to the floor during the previous days close.

4 Categories of Risk

4 T's of Risk Mitigations



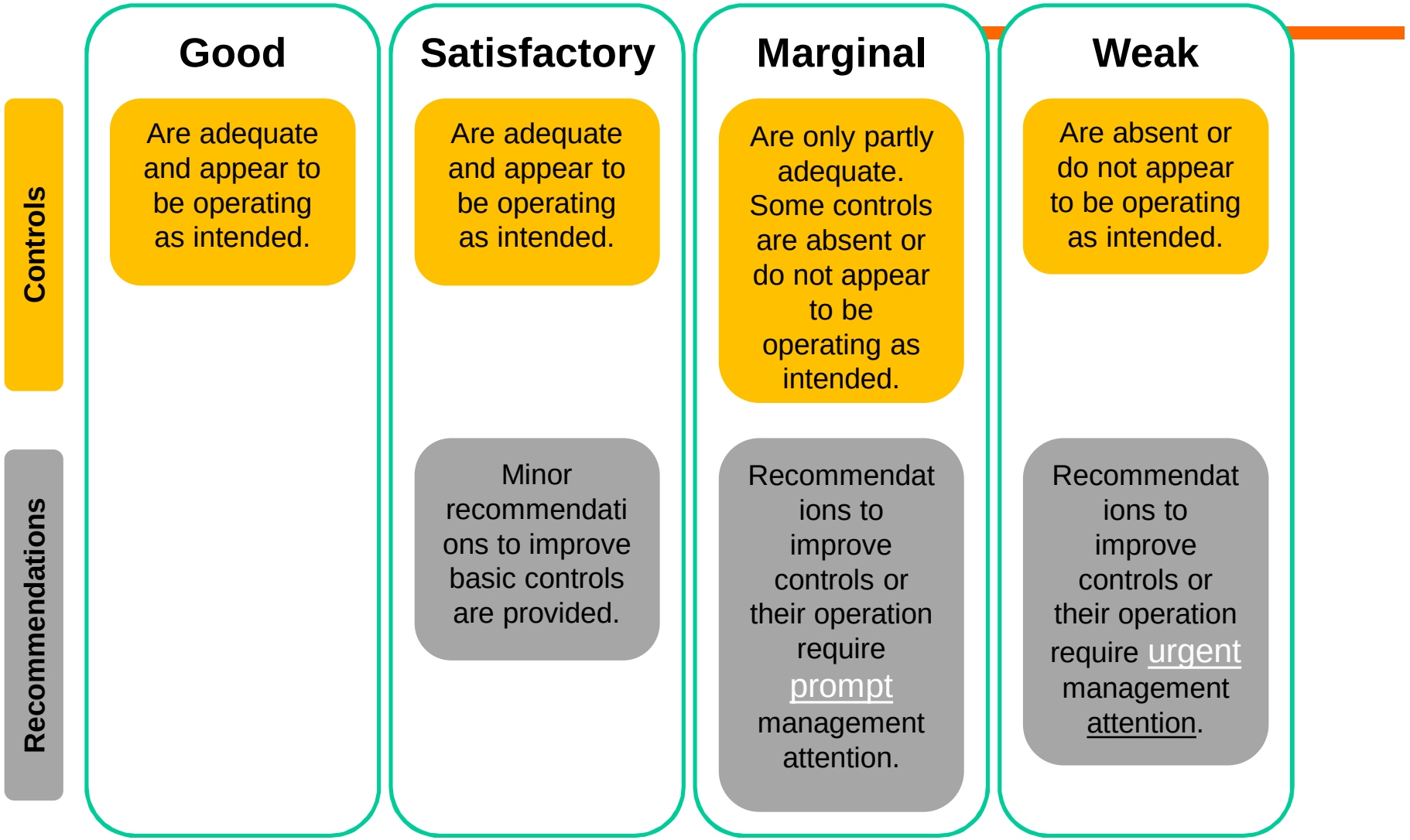
Basis of Individual Rating of Audit Observations



Objective Criteria for Overall Report Rating

Rating	High	Medium	Low
Good	None	None	1-2
Satisfactory	None	1-2	Y
Marginal	None	> or = 3	Y
Weak	> = 2	Y	Y

Objective Criteria for Overall Report Rating




Communicating audit results effectively requires both
knowledge of the subject & knowledge of the audience.

Internal Audit Report Format

- Standards on internal audit do not specify any report format
- Different organizations use different report formats (Word, Excel and PowerPoint)
- The format depends on management expectation and requirements
- The appropriate format should be used with consistency
- Management will feel more comfortable if it becomes accustomed to the report format and can readily turn to whatever is of interest

Report Format	Characteristics
Word Format	▸ Traditional form ▸ Simple to use ▸ Reference to report page / para
Power Point Presentation	▸ Most commonly used ▸ Facilitates use of risk indicators
Excel Sheet	▸ Effective tool for grouping of various observations - especially annexures ▸ Simple to use

Typical Elements In An Internal Audit Report

01

- Title Page
- Addressee
- Report Distribution List
- Period of Audit Covered

02

- Table Of Contents

03

Executive Summary:

- Report Rating
- Audit Issues
- Status of Management Remediation Plan

04

Audit Issues Highlighting:

- Key Finding
- Root Cause of Issue
- Business Impact/Risk
- Issue Severity - Risk Rating
- Recommendation
- Management Comments
- Issue Owner
- Target Date of Action

05

- Assurance Limitation Disclaimer
- Annexures

Common Mistakes In Internal Audit Reports

Flow of Report

- More focus on the transaction rather than the process or system failure
- Lack of pattern or flow in the report – this confuses the reader
- Starts with the most low risk points – can lead to loss of interest of the reader
- Important point gets lost in the volume of pages

Incomplete Information

- Does not contain proper examples, sample size, extent of problem, root cause
- Not quantified for business impact or risk of the observations
- Recommendations (or poorly drafted recommendation)

Drafting Errors

- Spelling mistakes
- Wrong English
- Incomplete sentences
- Long sentences
- Incorrect use of punctuations

Use of Technical Jargons

- Confuses the reader
- Makes report reading more painful

Typical Contents Of An Audit Committee Presentation

Understanding Board Expectations

- Understanding board expectations is critical when determining content.
- By reviewing key documents such as the audit committee charter, internal audit can gain an understanding of the audit committee's risks and needs.
- It is recommended to meet separately with the audit committee (and senior management if deemed appropriate) to determine reporting framework and expectations upfront.

Content Of Audit Committee Presentation

- Dashboard report on current activities
- Critical findings or emerging trends
- Results of special investigations, status of the annual audit plan and any changes done
- Internal audit staffing, impact of resource limitations
- Department performance metrics / scores

Quarterly Audit Committee Presentation

- Summarize for the committee what they need to know about routine findings in a logical summary format and report separately on more important matters such as:
  - Matters that might affect the fairness of financial reporting.
  - Breaches of the company's ethics policies.
  - Details of any frauds discovered, financial values of such frauds.
  - Significant delays in management responding to findings and recommendations.
  - Monitoring and follow-up activities.

Yearly Audit Committee Presentation

- Annual report is typically a summary of the four quarterly reports. Additional items to cover may include:
  - Details of changes in personnel's in the internal audit department.
  - Report on the year in review to include themes or trends identified.
  - Update of the risk assessment and audit plan.
  - Report on the results of the internal quality assurance and improvement program.
  - Discuss the results of the external quality assurance review, timing / frequency of the external assessment and reviewer's background.
  - Review and approve updates to the internal audit department charter.
  - Confirmation of the independence of the internal audit activity.
  - Reporting of any impairments of independence or objectivity.

Audit Committee Dashboard – Sample 1

1) Number of Audits Completed In Q2 (2019-20): XX

Sr. No.	Audit Area / Audit Entity	Region	Audit Rating	Detailed Issue And Action Plan Reference
1		Latin America	Unsatisfactory	Slide no. xx
2		Latin America	Unsatisfactory	Slide no. xx
3		Asia	Improvement Opportunity	Slide no. xx
4		Africa	Improvement Opportunity	Slide no. xx
5		North America	Satisfactory	-
6		Europe	Satisfactory	-
7		Middle East Australia , NZ	Satisfactory	-

Entity Audit Rating / Conclusion

Unsatisfactory	• Financial Loss / Fraud > USD 1 million • Some key controls do not exist, or are not properly implemented, and there are high risk improvement opportunities. • Control environment is impaired.
Improvement Opportunity	• Financial Loss / Fraud up to USD 1 million • Adequate control environment in most areas. • Moderate risk improvement opportunities identified, which require corrective action.
Satisfactory	• Satisfactory overall control environment. • Small number of lower risk improvement opportunities identified, which require corrective action.

Audit Committee Dashboard – Sample 1

2) Remediation Status Of Past Quarters Key Audit Observations

Open Audit Issues (at quarter beginning)	Issue Closed during current quarter	Unresolved / pending issues above 6 months	Global CFO intervention/ support required
7 For details, please refer slide no. xx to xx	4	3 (For details, please refer slide no. xx to xx)	1 (For details, please refer slide no. xx to xx)

3) Significant Audit Issues Summary

Sr. No.	Audit Area / Audit Entity	Audit Observation	Agreed Action Plan	Risk Rating *	Risk Category *	Control Rating *
1				High	Financial	Moderate
2				Medium	Operational	Limited
3				Medium	Compliance	Limited
4				Low	Process Improvement	Limited

Audit Reporting Challenges

- Reporting issues that don't matter to the board and top executives
- Failing to communicate what matters when it matters
- Lengthy cycle times – time taken for formal report writing

  Consequences of lengthy audit cycles are

  - Audit results are not timely
  - Stakeholders dissatisfaction
  - Inefficient use of internal auditors time
- Factually incorrect reports
- Size of the report and maintaining balance
- Implications or risk not being brought out clearly
- Focus only on negative aspects or mistakes
- Projecting process owners as villains or blowing up things out of proportion
- Lack of practical recommendations
- The reader cannot connect with the report


"You never have a second chance to make a first impression"
People begin forming an opinion within seconds
Difficult to reverse first opinion


QUESTIONS
ANSWERS

Happy to connect @ Email: cachetanthakkar@gmail.com # Cell: 9833849934