Internal Audit Methodology
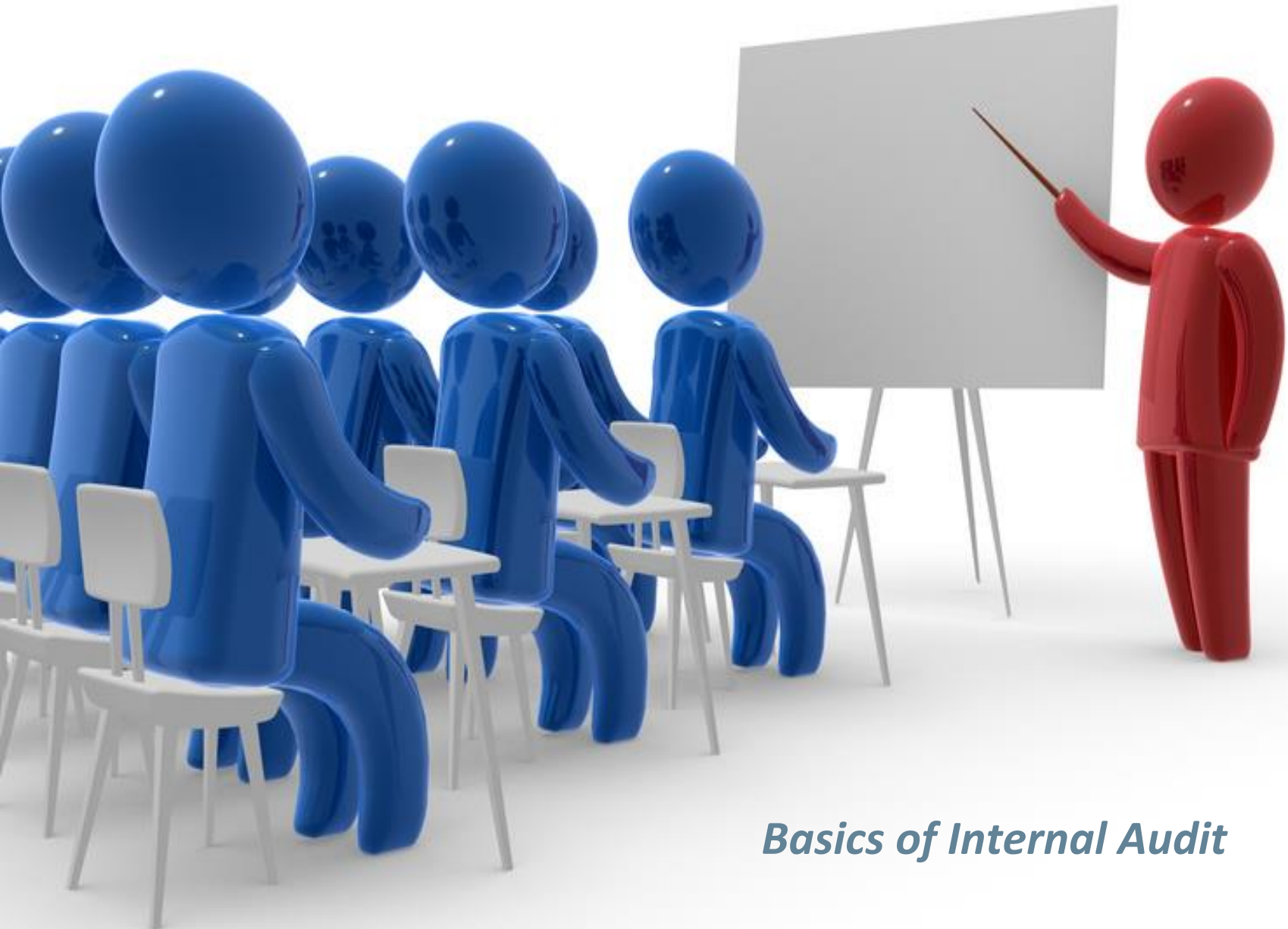## - Akhilesh Thakur

Basics of Internal Audit

A Powerful Mandate – Can You Meet It?

1	*Definition*

ICAI defined internal audit as:

- "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 risk management and internal control system**."

protiviti®

Internal Audit - Definitions

Definition of Risks:

➢ Traditional approach:

    Uncertainty or threat that an event or an action occurs in the future and involves negative effects, not allowing the organization to achieve its objectives.

➢ Business Risk:

    Uncertainty, threat or opportunity that the company must anticipate, understand and manage within the framework of its strategy to achieve its goals and create value.

protiviti®

Internal Audit – Management Expectation

- Compliance to Regulations

- Adherence to Internal policies and Procedures

- Strengthening Internal Control

- Accurate Financial Reporting

- Detection and Prevention of Fraud

- Protect Company's assets

- Benchmarking with best practices

- Return on Investment (ROI)

protiviti®

Internal Audit – Challenges

- Availability of skilled manpower

- Scope of review

- Time to complete the project

- Budget

- New Skills (IT audit, data analytics)

- Retaining People

- Obtaining Management Buy-in on suggestion

- Management perception of internal audit function

- Availability of information / documents for review

protiviti

Internal Audit – Factors impacting Internal Audit

External Factors:

- Changes in regulatory environment

- Changes in economy

- Shareholders expectation

- Technological innovations

- Corporate Governance / Companies Act requirements

- Environment, Health and Safety (EHS) considerations

Internal Factors:

- Management expectations

- Objectives of the company

- Internal Audit budget / cost constrains

- Availability of resources

protiviti®

Objectives of Internal Audit

- Provide an independent opinion to Management on the effectiveness of internal control,

- Assist Management in the evaluation of risks and the implementation of an efficient system for controlling these risks,

- Provide value added suggestions to improve operations / governance of the organization

- Improve overall governance mechanism of the entity, including its strategic risk management and internal control system

protiviti®

IA Methodology

Protiviti's Internal Audit Methodology

Standard & Frameworks	Internal Audit Standards & Professional Frameworks

Infrastructure

Value Drivers → Internal Audit Charter & Policies • Internal Audit Organization Structure & People • Internal Audit Methodologies, Processes and Technologies ← Stakeholder Expectations

Risk Assessment & Planning

Strategic | Operational | Financial | Compliance

Consider Change → Identify Audit Universe → Risk Rank Audit Units → Map Risks and Determine Final Risk Assessment ← Prioritize Business Risks ← Identify Business Risks ← Consider Change

Create Audit Plan

Project Execution

Project Management, Supervision & Review

Understand Activities & Objectives → Perform Project Risk Assessment → Plan Project → Understand & Analyze Activity → Evaluate Design Effectiveness → Test Operating Effectiveness → Validate Findings → Report Results → Follow-Up on findings

Oversight • Insight • Foresight

Stakeholder Reporting

Continuous Improvement

Continuous Monitoring of Internal Audit Function Quality

External Quality Assessment • Internal Quality Assessment • Internal Audit Performance Measurement

Add Value
Return on Internal Audit Investment

protiviti

IA Infrastructure

Internal Audit Methodology – Infrastructure

| Infrastructure | Value Drivers | Internal Audit Charter & Policies | Internal Audit Organization Structure & People | Internal Audit Methodologies, Processes and Technologies | Stakeholder Expectations |
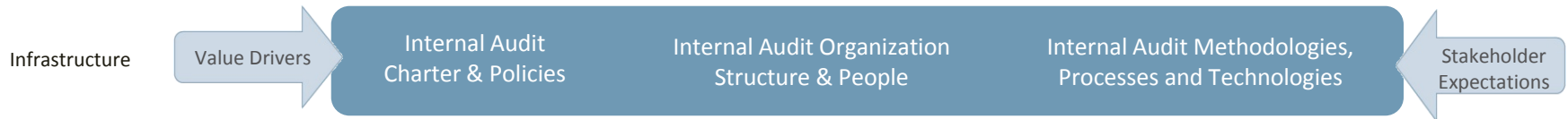
Value Drivers & Stakeholder Expectations

We strive to understand stakeholder expectations and their value drivers so that Internal Audit is focused on a value-added plan that is responsive to the needs of the organization.

Internal Audit Charter & Policies

- IA Mandate

- Authority

- Organization Structure

- Composition of audit committee

- Meeting frequency

- Responsibility

- Code of Conduct and Ethics

protiviti®

Internal Audit Methodology – Infrastructure

Infrastructure → Value Drivers → **Internal Audit Charter & Policies** | **Internal Audit Organization Structure & People** | **Internal Audit Methodologies, Processes and Technologies** ← Stakeholder Expectations
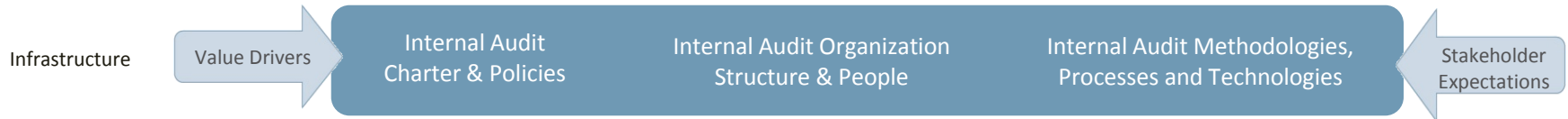
Internal Audit Organization Structure & People

- Composition of IA team

- Geographical Requirement

- Role and Responsibility of IA team

- Specific skill set requirement considering internal audit mandate

protiviti®

Internal Audit Methodology – Infrastructure

Infrastructure → Value Drivers → | Internal Audit Charter & Policies | Internal Audit Organization Structure & People | Internal Audit Methodologies, Processes and Technologies | ← Stakeholder Expectations
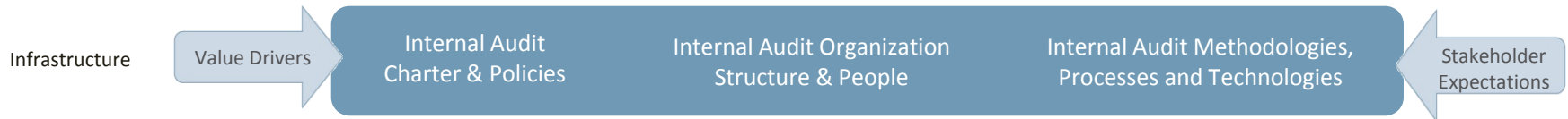
Internal Audit Methodologies, Processes and Technologies

Our Internal Audit Methodology provides a common framework for our people to perform internal audit work. We determine up front what type of reporting and project administration is necessary for each engagement. Our Protiviti Way policy outlines required tasks on our projects in order to realize efficiencies, create high-quality work, add value and facilitate consistent practices.

We utilize the following technologies to perform internal audits:

- Data Analysis – ACL™, Excel®, Protiviti's Spend Risk Assessor^{SM}

- Process Mapping – Visio®

- Audit Work Papers – Protiviti's Internal Audit Portal

- Knowledge Sharing – Protiviti's KnowledgeLeader^{SM}, iShare, Discoveri™

- Self Assessment – Protiviti's The Self Assessor™

We can tailor our technologies and methodologies to organizations' requirements, but we generally follow The Internal Audit Standards at a minimum.

protiviti®

Risk Based IA Plan

Internal Audit Methodology – Risk Assessment & Planning

Risk Assessment & Planning

Strategic | Operational | Financial | Compliance

Consider Change → Identify Audit Universe → Risk Rank Audit Units → Map Risks and Determine Final Risk Assessment ← Prioritize Business Risks ← Identify Business Risks ← Consider Change

Create Audit Plan
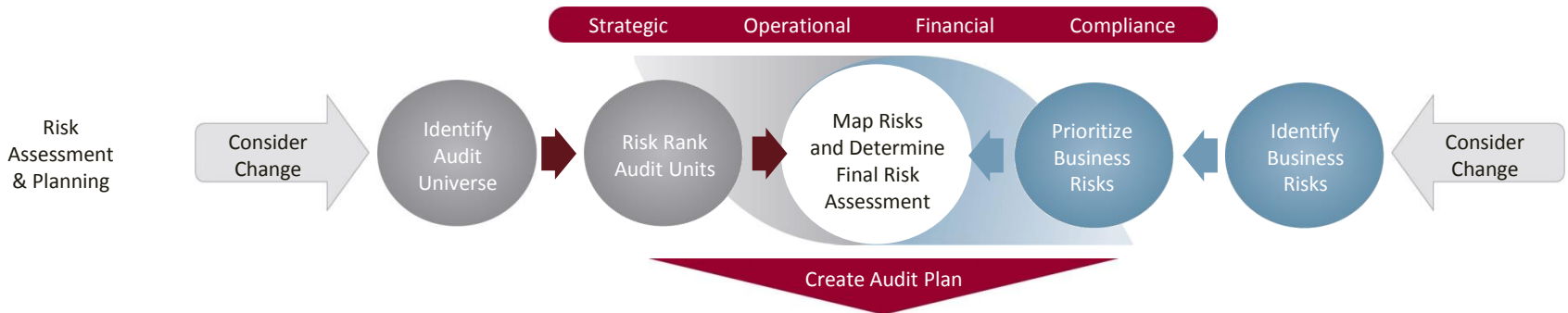
Prioritize Business Risks

- Identify tone at the top

- Gain understanding of business and industry

- Understand the risk faced by the Company

- Review past reports / Incidents

- Understand the Control environment

- Understand the ERP / system used the Company

Map Risks and Determine Final Risk Assessment

We identify the relationship between auditable units and risks to bring forth an integrated risk assessment.

protiviti®

Internal Audit Methodology – Risk Assessment & Planning

Create Audit Plan

- Understand need of the organization

- Consider Internal and external factors impacting business

- Consider stakeholder expectation

- Prioritize high risk areas while creating audit plan

- Get the plan approved by Audit Committee

protiviti®

Internal Audit Methodology – Risk Assessment & Planning

Strategic — Operational — Financial — Compliance

Risk Assessment & Planning

Consider Change → Identify Audit Universe → Risk Rank Audit Units → Map Risks and Determine Final Risk Assessment ← Prioritize Business Risks ← Identify Business Risks ← Consider Change

Create Audit Plan

IMPORTANCE TO BUSINESS STRATEGY (HIGH / LOW)

Secondary Risks
- Lower likelihood but could have significant adverse effect on company's ability to achieve its objectives if risk is realized
- Some monitoring, detective controls are needed

Key Risks
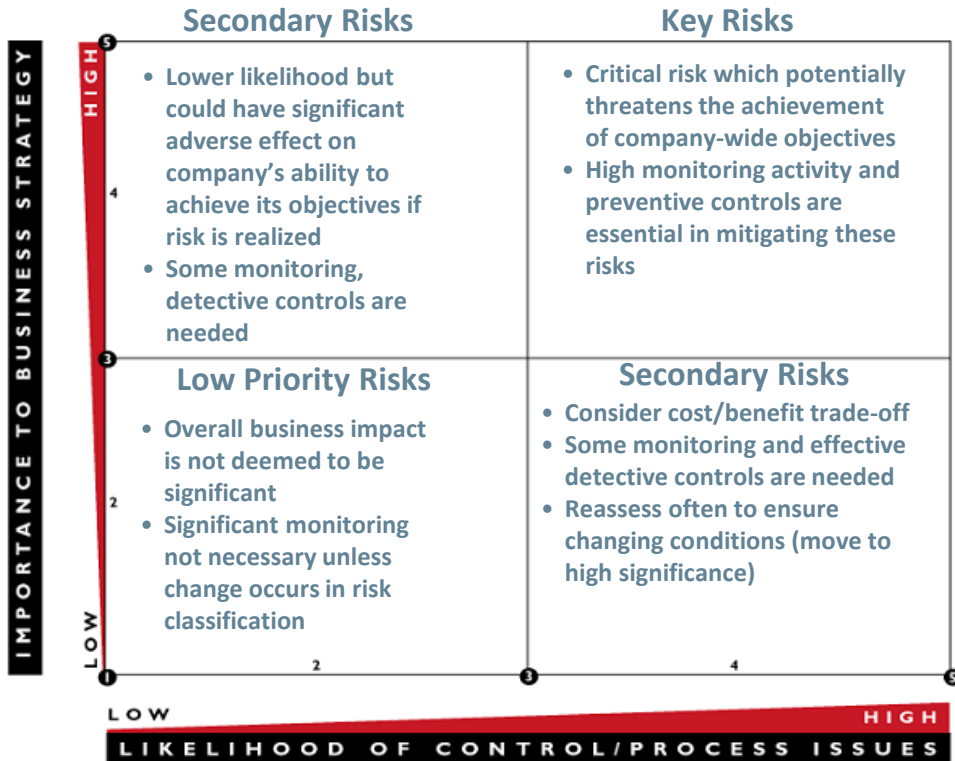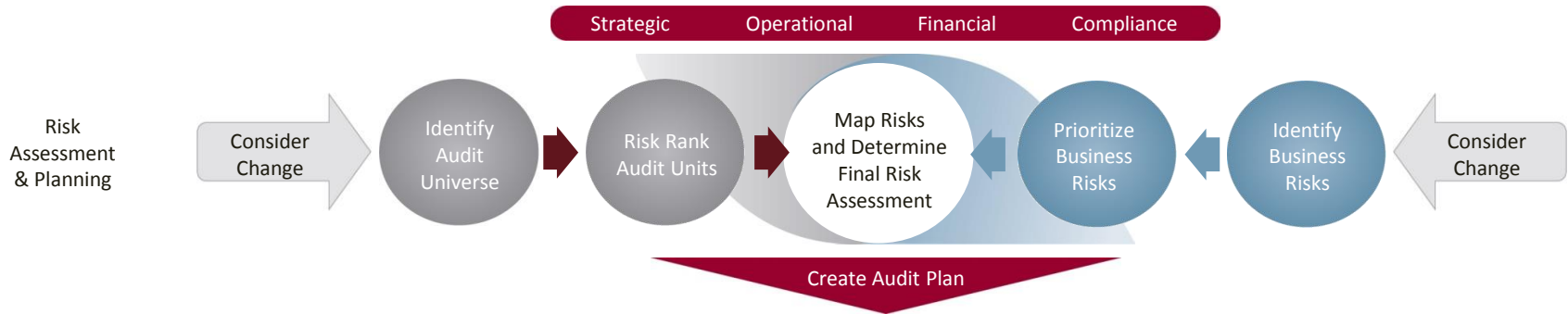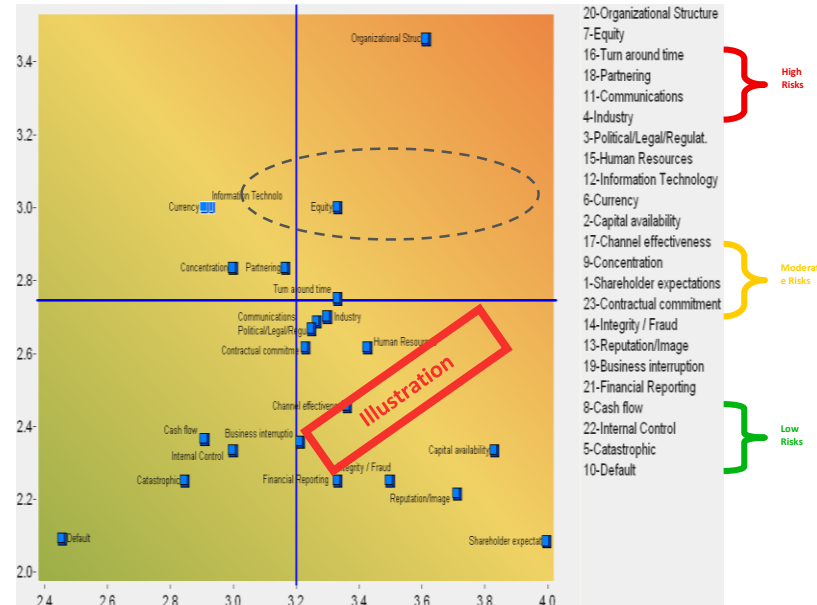- Critical risk which potentially threatens the achievement of company-wide objectives
- High monitoring activity and preventive controls are essential in mitigating these risks

Low Priority Risks
- Overall business impact is not deemed to be significant
- Significant monitoring not necessary unless change occurs in risk classification

Secondary Risks
- Consider cost/benefit trade-off
- Some monitoring and effective detective controls are needed
- Reassess often to ensure changing conditions (move to high significance)

LIKELIHOOD OF CONTROL/PROCESS ISSUES (LOW — HIGH)

Risk Map

Illustration

20-Organizational Structure
7-Equity
16-Turn around time — High Risks
18-Partnering
11-Communications
4-Industry
3-Political/Legal/Regulat.
15-Human Resources
12-Information Technology
6-Currency
2-Capital availability
17-Channel effectiveness — Moderate Risks
9-Concentration
1-Shareholder expectations
23-Contractual commitment
14-Integrity / Fraud
13-Reputation/Image
19-Business interruption
21-Financial Reporting
8-Cash flow — Low Risks
22-Internal Control
5-Catastrophic
10-Default

protiviti®

Internal Audit Process

Internal Audit Methodology – Project Execution

Project Management, Supervision & Review

Project Execution	Understand Activities & Objectives	Perform Project Risk Assessment	Plan Project	Understand & Analyze Activity	Evaluate Design Effectiveness	Test Operating Effectiveness	Validate Findings	Report Results	Follow-Up on findings

Oversight	●	Insight	●	Foresight
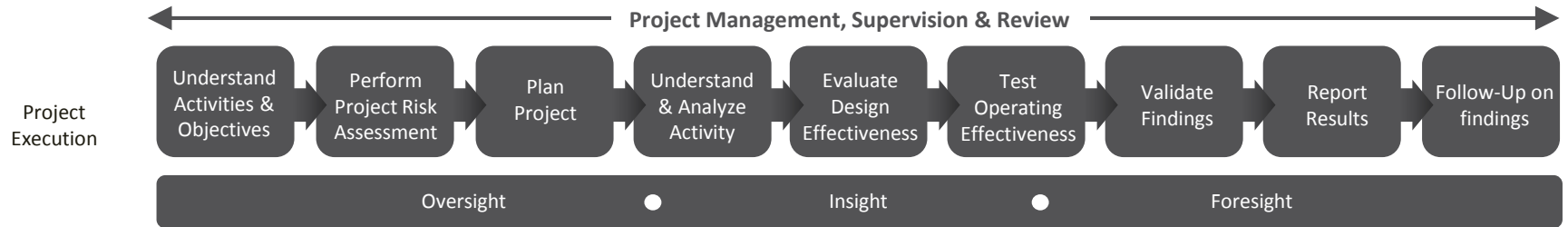
Project Management Supervision and Review

All Internal Audit projects have project management oversight to ensure milestones are met and desired quality levels are achieved. All planning, fieldwork and wrap-up is supervised and reviewed by a manager-level professional or above.
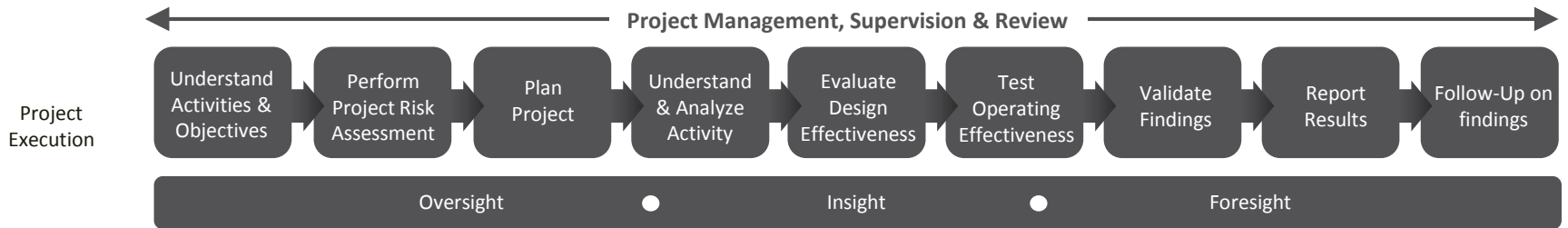
Understand Activities & Objectives

We start out scoping audits by understanding the activities of the process (inputs, outputs and systems) and identifying the audit objectives in collaboration with process owners and senior management. This includes reviewing policies and organizational structure.

Perform Project Risk Assessment

We leverage information gathered in the companywide risk assessment to perform a risk assessment at the project level by understanding the business strategy, objectives and key processes of the area under review and identifying what risks may stand in the way of achieving those business strategies and objectives. Audits can cover any or all of the COSO ERM risk categories (strategy, financial, operations or compliance), or may be customized to meet very unique objectives set out by the organization.

protiviti®

Internal Audit Methodology – Project Execution

Project Management, Supervision & Review

| Project Execution | Understand Activities & Objectives | Perform Project Risk Assessment | Plan Project | Understand & Analyze Activity | Evaluate Design Effectiveness | Test Operating Effectiveness | Validate Findings | Report Results | Follow-Up on findings |

| Oversight | ● | Insight | ● | Foresight |

Plan Project

Our planning and scoping memo contains pertinent information and decisions regarding the project and is approved before fieldwork commences. It delineates "what is in" and "what is out." It narrows the audit focus to specific areas of significance (processes, transactions, locations, activities or systems) for the project objectives. We draft the administrative work program at this time and determine the appropriate resources to perform the work.
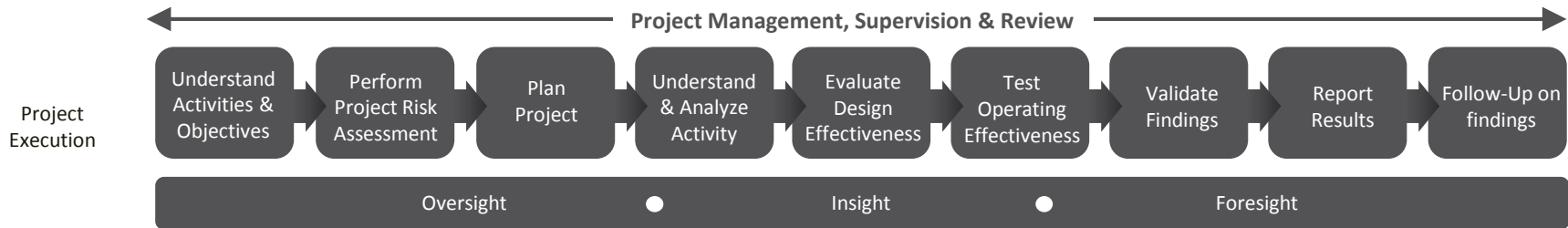
Understand & Analyze Activity

If they are not already documented, we gain an understanding of the activities being audited. This documentation is created in the form of flowcharts or memoranda, and we confirm its completeness and accuracy with process owners.

Evaluate Design Effectiveness

We evaluate the design effectiveness of the collection of controls for each risk before proceeding to testing of controls. In many cases, multiple controls are required to mitigate a risk; in some cases, one control may adequately mitigate multiple risks.

protiviti®

Internal Audit Methodology – Project Execution

Project Management, Supervision & Review

Project Execution	Understand Activities & Objectives	Perform Project Risk Assessment	Plan Project	Understand & Analyze Activity	Evaluate Design Effectiveness	Test Operating Effectiveness	Validate Findings	Report Results	Follow-Up on findings

Oversight	Insight	Foresight

Test Operating Effectiveness

Our work program is further built out when we develop the detailed test plan. We use standard sample sizes to test the operating effectiveness of controls and expand testing on daily controls when the error rate is non-negligible. Testing techniques may include inquiry, observation, inspection and reperformance.
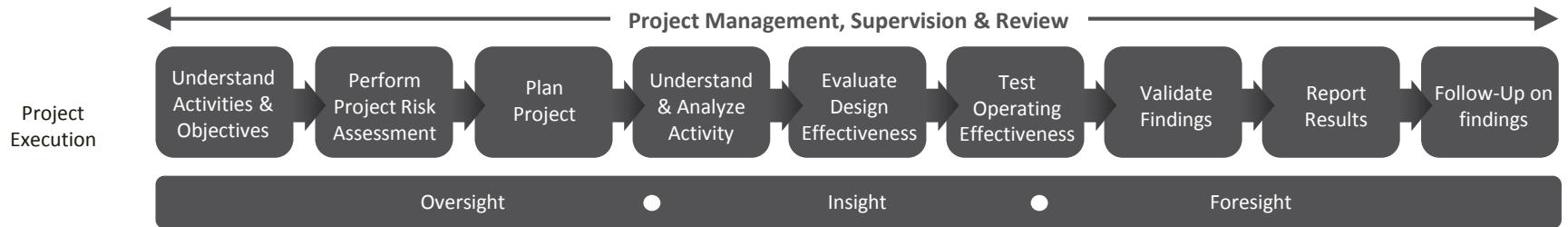
Validate Findings

We confirm all preliminary audit findings with personnel directly involved in the controls or transactions that gave rise to the preliminary issues in order to obtain agreement on the facts and to determine whether all pertinent factors have been considered. We team with process owners to assess the root cause of findings and co-develop action plans to resolve each issue.

Report Results

We communicate factual findings of the design and operational effectiveness of internal controls and provide recommendations for process improvement. Working with management, we develop action plans and agree on owners and implementation dates. We look for and report other findings that may come to our attention along with other recommendations that can add value, such as cycle time reduction, quality improvement, customer satisfaction and efficiency.

protiviti®

Internal Audit Methodology – Project Execution

Project Management, Supervision & Review

Project Execution	Understand Activities & Objectives	Perform Project Risk Assessment	Plan Project	Understand & Analyze Activity	Evaluate Design Effectiveness	Test Operating Effectiveness	Validate Findings	Report Results	Follow-Up on findings

Oversight	Insight	Foresight

Follow-Up on Findings

While ownership of implementation belongs to management, we perform follow-up with management on a timely basis to confirm that the agreed-upon action plans have been implemented.

Oversight / Insight / Foresight

Our Internal Audit Methodology provides oversight as to whether controls and business processes are operating as intended. We strive to provide organizations with insight into the root causes of issues, benchmark their process against other companies, and provide suggestions to improve their process capability according to the Capability Maturity Model. We also provide foresight to think ahead and consider the impact of process changes.

protiviti®

Reporting

Internal Audit Methodology – Stakeholder Reporting

Stakeholder Reporting	

Periodic Reporting and Issue Tracking to Management and the Audit Committee

We report periodically to the Audit Committee and senior management regarding the performance of internal audit relative to its plan, and report significant risk exposures and control issues, corporate governance issues and other matters.

protiviti®

What is Report?

End product of your work

Final deliverable

Image of your own self and the Organization

The only tangible outcome of your work

Differentiator

protiviti®

ICAI Standards on Internal Audit (SIA4): Reporting

Standard:

To establish standards on the form and content of the internal auditor's report.

Basic elements of an Audit Report

- Title

- Addressee

- Report Distribution List

- Period of coverage of the Report

- Opening or introductory paragraph, Objectives & scope Paragraph

- Executive Summary

- Observations, findings and recommendations

- Comments from the local management and Action Taken Report

- Date, Place, Signature of the Internal Auditor.

protiviti®

ICAI Standards on Internal Audit (SIA4): Reporting

Communication to Management

- Communication with the management to ensure that the recommendations in the final report are practical.

- The stages of communication and discussion should be as under :
  - Discussion Draft
  - Exit Meeting
  - Formal Draft
  - Final Report

Limitation on scope and restrictions on usage and report circulation:

- Limitation on Scope
  - When there is a limitation on the scope of the work, the report should describe the limitation.

- Restriction on Usage and Report Circulation Otherwise Than to the List of Intended Recipients

- The Report should contain:
  - It should be used for intended purpose only as agreed upon.
  - The circulation of the Report should be limited to the recipients mentioned in the Report Distribution List.

protiviti®

ICAI Standards on Internal Audit (SIA9): Communication with Management

Standard:

Provides a framework for matters to be communicated with the management

Consideration for Internal Auditor

- Communicate clearly the responsibilities, scope and timing of Audit.

- Obtain relevant Information

- Provide timely observations

- Promote effective two way communication.

Matters to be communicated

1. Planned scope and Timing of Internal Audit

2. Significant findings from the Internal Audit

protiviti®

ICAI Standards on Internal Audit (SIA9): Communication with Management

Stages of Communication:

a) Discussion Draft

b) Exit Meeting

c) Formal Draft

d) Final Report

Communication Process

- Establishing the communication Process
- Forms of Communication
- Timing of Communication
- Adequacy of the Communication Process

Documentation

- In case of Oral communication the internal auditor shall document, when and to whom they were communicated.
- In case of Written communication the auditor shall retain a copy of the communication as part of the internal audit documentation.

protiviti®

Phases in the Reporting Writing Process

Draft

Edit

Submission

protiviti®
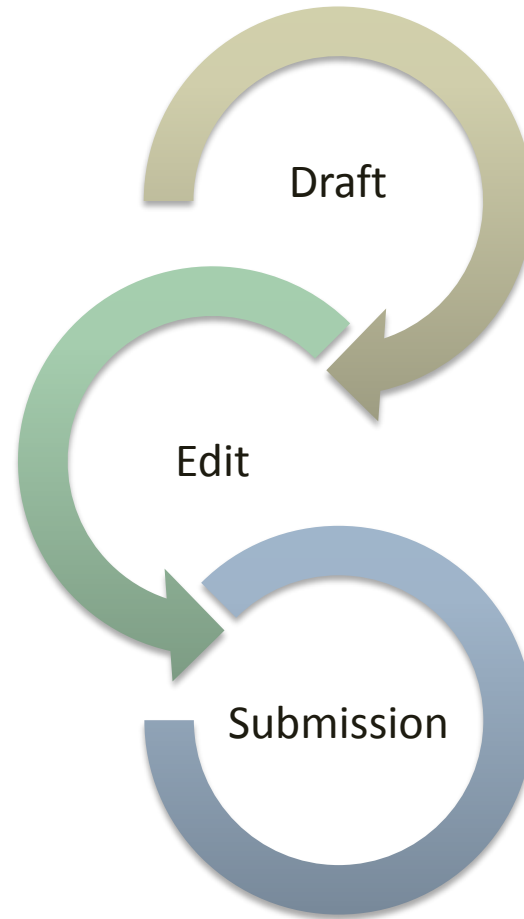
Work Papers and Report Writing

-*Format*
-*Language*
-*To do's / not to do's*

"Baxter...about this report...your punctuation, spelling and grammar are perfect. No one can understand it!"

protiviti

Discussion of Observations

Internal Audit team

Client Team

protiviti®

Discussions with the Process Owner

Once the draft report is complete, the same should be discussed with the process owners to obtain concurrence and discuss recommendations for the identified issues.

Couple of things which should be taken in to consideration:

- Always provide your observations and supporting to the client at least 2 days before the discussion so as to give them ample time to go through the findings.
- Always be on prepared and on time for the scheduled meeting
- Don't express frustration with the client

  - Always maintain your professionalism

  - Talk with your Supervisor / partner (who, through past experiences, may share the same frustration).

  - Internally, develop a game plan on how to handle client communication, expectations, and deliverables.
- Value the client feedback

  - Be willing to learn from the client's feedback to help future work at the same client or elsewhere

protiviti®

Audit Committee Meeting

Key Factors in Determining Content

Understanding Board Expectations

- The audit committee charter
- The internal audit department charter
- Committee members and their backgrounds focusing on any changes since last meeting
- Prior audit committee reports and minutes
- Any arrangements that have been documented concerning report content expectations
- Board communication style

Frequency of Meetings

Allotted Agenda Time

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 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.

protiviti

Typical Contents of an AC Report

- Dashboard report on current activities

- Changes to annual plan

- Status of the annual audit plan

- Critical findings or emerging trends

- Internal audit staffing, impact of resource limitations, and costs vs. budget year to date

- Results of special investigations

- Department performance metrics / scorecard

Typical audit committee reports will include a summary of:

- Reports issued during the quarter showing most important findings and aggregating others.
- Monitoring and follow-up activities.
- Financial values of any frauds that may have occurred.

Audit Committee Reports:

- How reports are summarized should follow agreed-upon reporting arrangements.

- The committee may not want to review all reports, although they have access to all prepared material.

- The goal is to 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.
  - Significant delays in management responding to or acting on findings and recommendations.

protiviti®

Audit Committee Presentation

Once the Process Owners have provided their comments and implementation date, the next step is to present to the Senior Management. Senior Management would usually be the Audit committee in case of a Public limited company and such other body in case of Private limited company.

Couple of points to be noted:
- Be on time and come prepared
- Articulate the scope of the review
- Present only the key points in clear and concise terms
- Keep details handy
- Note the inputs received from the management

Let's go through a sample Audit Committee presentation.

Microsoft Office
werPoint Presentat

protiviti

General Areas

General Areas

There are certain things which we should be cognizant off at all times. These are as follows:

Attire and physical appearance: Although your work will certainly make an impact on how the client perceives internal auditor, remember that a professional attire goes a long way in making the right first impression. Hence ensure that you are always well groomed (clean shaved, ironed clothing, polished footwear, etc) and maintain a professional attitude (no slang language, loose talk, etc.)

Confidentiality:
Maintain client confidentiality (restrict conversations in elevators, restaurants, cubicles, etc.).
Do not have other clients' materials visible, either in hard copy or by saving files on client computers.

Phone:
- Limit personal phone calls and leave shared workspaces while on the phone to avoid disturbing others (go into a conference room, etc.)
- Avoid long distance calls on client phones.

Workspace:
- Keep your work area neat and professional. Keep client documents/work papers organized and in files/binders.
- Limit personal or non-work related items

protiviti®

General Areas

Internet and Computer Use

- Do not connect your office laptop to a client network unless specifically instructed to do so by project management.

- Do not access non-work related websites through a client network. Companies can, and do, track all websites accessed by each user.

  - Even reading on-line news should be saved for home or at least after hours time that is not charged to the client. Any time spent on this type of activity is personal and should not be included in the time reported in PeopleSoft.

- Instant messaging should not be used unless specifically instructed to do so by project management.

- Do not send non-work related items via client's e-mail. They can, and do, read e-mails.

Other

  - Understand and respect client-specific guidelines. If in doubt, consult your Engagement Manager and always err on the conservative.

protiviti®

Thank You!

protiviti®