

# Internal Audit Methodology

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# Disclaimer

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All the contents of the presentation constitute the opinion of the speaker, and the speaker alone; they do not represent the views and opinions of the speaker's employers, supervisors, nor do they represent the view of organizations, businesses or institutions the speaker is, or has been a part of.

# Agenda

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- Definition of Internal Audit
- Types of Audit
- Internal Audit Methodology
- Tools

# Definition

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“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.”

-The Internal Audit Standards Board of the ICAI

“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”

-Definition of Internal Auditing by Institute of Internal Auditors (IIA)

# Types of Audits

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Compliance Audit	<p>A compliance audit is a comprehensive review of an organization's adherence to regulatory guidelines.</p> <p><a href="http://searchcompliance.techtarget.com/definition/compliance-audit">http://searchcompliance.techtarget.com/definition/compliance-audit</a></p>
Operational Audit	<p>Operational Audit is a systematic review of effectiveness, efficiency and economy of operation.</p> <p><a href="http://en.wikipedia.org/wiki/Operational_audit">http://en.wikipedia.org/wiki/Operational_audit</a></p>
Quality Audit	<p>Quality audit is the process of systematic examination of a quality system carried out by an internal or external quality auditor or an audit team. It is an important part of organization's quality management system and is a key element in the ISO quality system standard, ISO 9001.</p> <p><a href="http://en.wikipedia.org/wiki/Compliance_Audit">http://en.wikipedia.org/wiki/Compliance_Audit</a></p>
Functional Audit	<p>An audit that is held prior to software delivery in order to verify that all requirements specified in the software requirements document have been met.</p> <p><b>ICAI</b> : A Functional Audit deals with one or more functions in an organization. It could concern, for example, the payroll function for a division or for the company as a whole. (Para 19.8.4 of chapter 19 of Advanced auditing and professional ethics - CA Final (3))</p>

# Types of Audits

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Financial  
Audit or a  
Typical  
Internal  
Audit

A financial audit, or more accurately, an audit of financial statements, is the verification of the financial statements of a legal entity, with a view to express an audit opinion.

[http://en.wikipedia.org/wiki/Financial\\_audit](http://en.wikipedia.org/wiki/Financial_audit)

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Risk Based  
Audit

Risk based Internal Audit (RBIA) is an internal methodology which is primarily focused on the inherent risk involved in the activities or system and provide assurance that risk is being managed by the management within the defined risk appetite level.[1] It is the risk management framework of the management and seeks at every stage to reinforce the responsibility of management and BOD (Board of Directors) for managing risk

[http://en.wikipedia.org/wiki/Risk\\_based\\_audit](http://en.wikipedia.org/wiki/Risk_based_audit)

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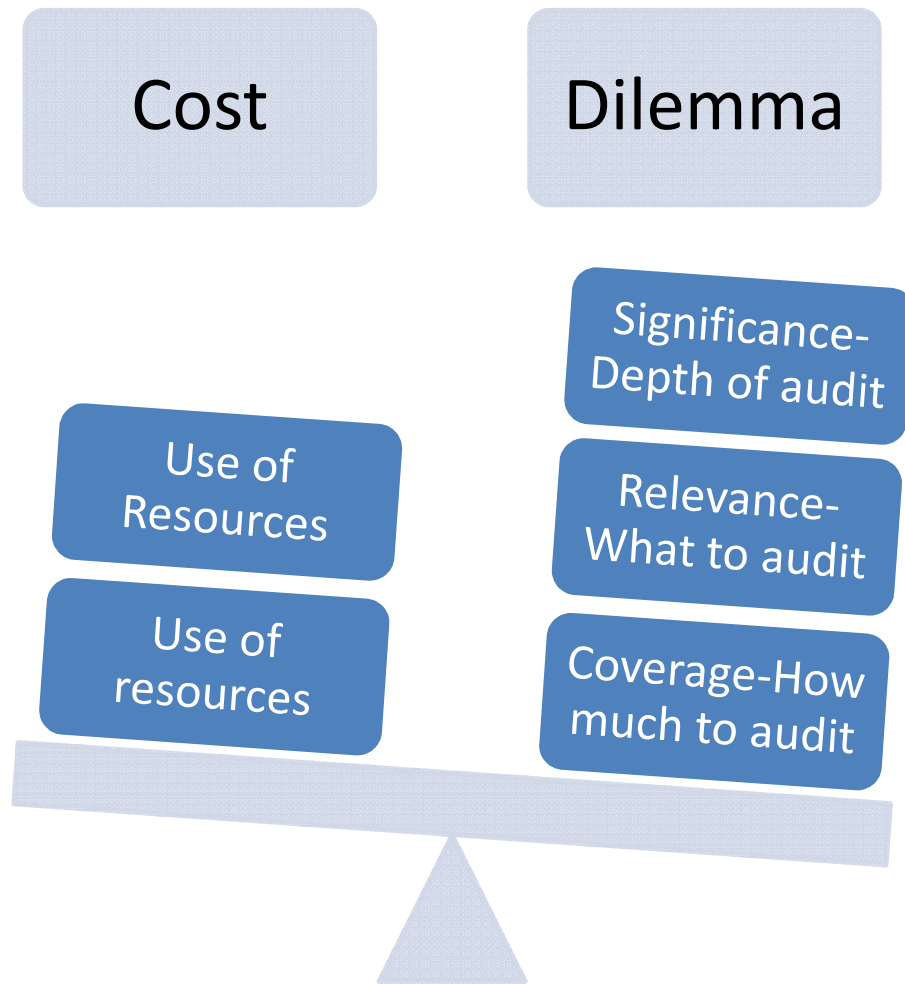
Control  
Based Audit

Audit of Controls

Internal control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives relating to operations, reporting, and compliance. -COSO

# Auditor's Dilemma

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Giving a level of confidence that IA has captured and assessed 'all' material risk that threaten the company

# Risk Based Audit

Type	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Stage 6	Stage 7	Stage 8
RBIA	Framework	Defining Scope	Mapping	Risk Registration/ Identification	Control Identification	Control Investigation	Audit Test	Audit Report
	Risk profiling	Risk taxonomies	Business unit mapping	Risk register Risk evaluation	Control owner			
	Volume Value Complexity Cost SOP SOD Past losses IT	Risk definition card: Description Includes Excludes Driver Impact	Processes Systems KPIs Function boundaries Transactions	All risks Risk type Risk levels Risk Sizes  Statistical tools	Material and potential loss from control weakness	Criteria to assess whether the control has been operated effectively or compromised by staff	What to sample? How much to sample?	



# My Risk Based Audit

Type	Stage 1	Stage 2	Stage 3	Stage 4	Stage 5	Stage 6	Stage 7	Stage 8	
RBIA	Framework	Defining Scope	Mapping	Risk Registration/ Identification	Control Identification	Control Investigation	Audit Test	Audit Report	
My IA	Financial	Scoping	Mapping	Top 3 Risks	Control identification	Checkpoints	Testing	Audit report	
	Trial balance								
	Common size statement	Identification of major items groups	Identification of Major Items with in group						
		Compliance, FA, Bank							
Tools		Pareto Rule	Audit Tracker, Excel (Pivot, Sort, Index, vlookup), Benford Law, Pareto Rule (80:20)						Audit Report

# Tools

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Audit Tracker	<ol style="list-style-type: none"><li>1. Contacts (of auditee/ audit team)</li><li>2. Status Tracker (Scope, Start Date, Completion date, Reason for Pending, responsibility, Population, Sample, Sample methodology, remarks)</li><li>3. Review Notes</li><li>4. Requirement Tracker (Requirement, Area, Responsibility, Request Date, Received date, Time Lag in receipt of data, days lapsed)</li><li>5. Checklist (Scope, Sub scope, Risk, Control, Checkpoints, Population, Sample, Exceptions, Observations, Backup paper)</li><li>6. Query Sheet (Query, Financial Impact, Risk, recommendations, Area, Annexure, Resolved, Response, Responsibility, Reportable/ Dropped, Backup paper)</li><li>7. Audit Completion Checklist</li></ol>
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Control Failure Vs. impact of business control failure

Traffic Light vs. specific financial amounts

# Tools

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Audit Report	<ol style="list-style-type: none"><li>1. Cover letter,</li><li>2. Background and Objective of audit</li><li>3. Scope and approach</li><li>4. Detailed Observation (High, Medium, Low)</li><li>5. Other Points for Management Attention</li><li>6. Positive assurance</li></ol>
Audit Presentation	<ol style="list-style-type: none"><li>1. Audit Summary (Area, Location, Audit Period, Audit Team, Function Head, Scope, Field audit dates/ period)</li><li>2. Scope, Sampling and Limitation to scope</li><li>3. Positive Assurance</li><li>4. Key Observations</li><li>5. Other observations</li></ol>

# Resources

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- Risk Based Audit: <https://drive.google.com/file/d/0B9LJxar8oKPmQ0JxaEpJRmxMaVU/edit?usp=sharing>
- Risk Template: <https://app.box.com/s/p7tns5kbrliny06mnouu>