

# Standards of Internal Audit

*Presentation by:*

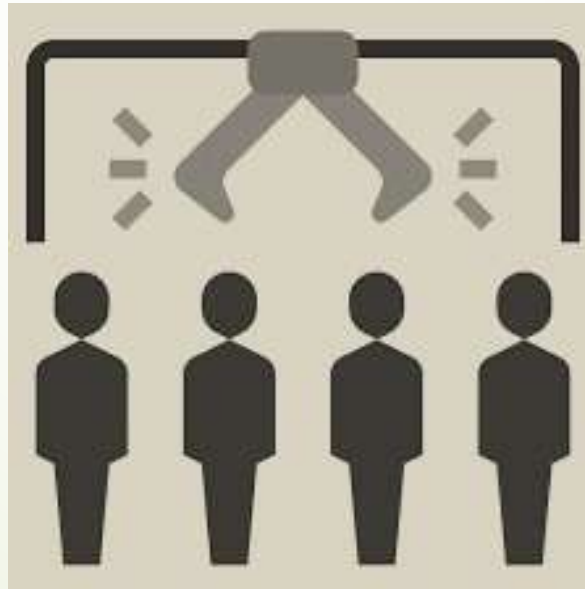
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- **SLA 5 – Sampling**
- **SLA 6 – Analytical Procedures**
- **SLA 130 – Risk Management**
- **SLA 150 – Compliance with Laws and Regulations**
- **SLA 360 – Communication with Management**

# SIA 5 – Sampling



# Purpose

- **Design** and **Selection** of an audit sample
- Use of audit sampling in IA engagements
- **Evaluation** of sample results
- Applies equally to both **Statistical** and **Non-statistical** sampling methods
- Provide **Sufficient** and **Appropriate** audit evidence



# Key Definitions



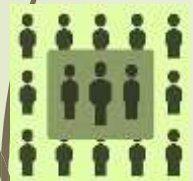
## Audit Sampling:

- **less than 100% of the items**
- To obtain & **evaluate** audit evidence
- Regarding **characteristic of the items selected**
- to form a **conclusion** concerning the population



## Error:

- **Control deviations** – Tests of controls, or
- **Misstatements** – Test of details



## Population:

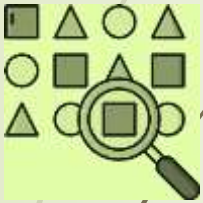
- **Entire set of data** from which the sample is selected
- To draw **conclusions**

# Key Definitions



## Sampling Risk:

- Possibility of IA conclusions - **Different from the conclusion reached,**
- if the entire population - Subjected to **same types of IA procedure.**



## Sampling Unit:

- **Individual items** or **units** constituting a population (Eg: sales invoices, debtor balances etc.,)



## Statistical Sampling:

- Approach to sampling procedure – **random** or **theory of probability** to evaluate sample results

## Tolerable Error:

- **Maximum** error in a population – **willing to accept**



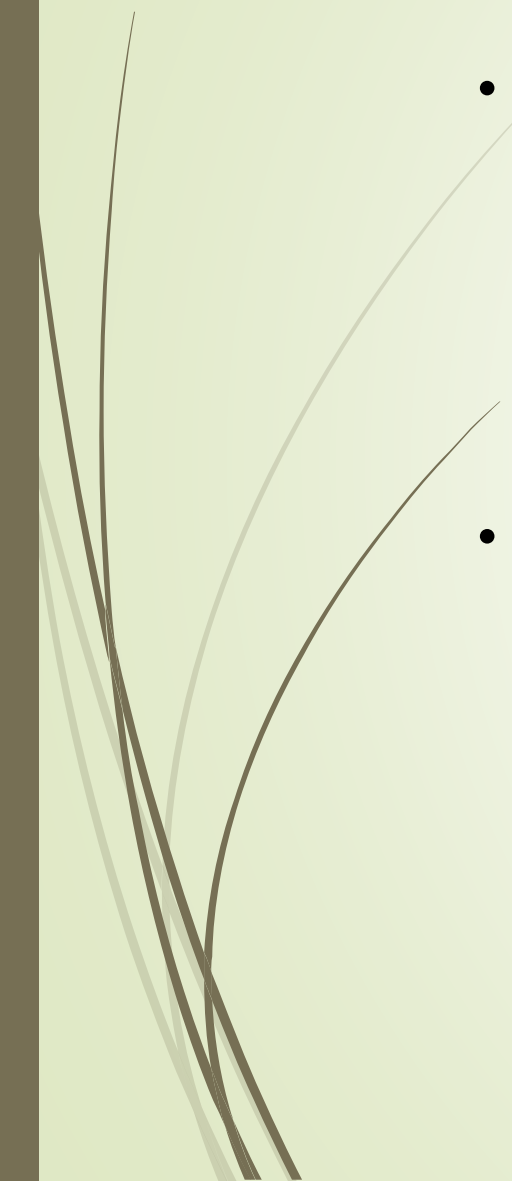


# Use of Sampling in Risk Assessment & ToC

- **Risk assessment procedures**
  - Understanding of **entity, business & its environment**, and **internal control** mechanism
  - Perform **Tests of Controls (ToC)** concurrently for understanding **design of controls** and **examining implementation status**
- **Test of Controls (ToC)**
  - Performed when RA includes an **expectation of the operating effectiveness of controls**.
  - Sampling of **ToC is appropriate** – Eg: Initials of the credit manager on sales invoice indicating formal credit approval



# Use of Sampling in Risk Assessment & ToC

- **Sampling risk**
    - reduced by **increasing sample size** for ToC & Tests of Details (ToD)
    - **Non-sampling risk** – reduced by proper engagement planning, supervision, monitoring and review
  - **Sample Designing**
    - Consider the **specific audit objectives, population & sample size**
- 



# Internal Audit Objectives

- Consider the audit **objectives to be achieved** – **IA procedures** which are likely to best achieve those objectives.
- Factors to be considered on “**what population to use?**” for sampling:
  - ✓ **Appropriateness** of the IA sampling
  - ✓ **Nature of the audit evidence** sought
  - ✓ **Possible error conditions (or) other characteristics** relating to the audit evidence

**Examining the ToC on purchasing procedures are illustrated below:**

Whether the vendor bill was clerically checked and properly approved??

(Test of Control-1)



Whether the amounts of invoices are properly reflected in the financials?

(Substantive Procedure)



Assessment on % of error expected in the population to be tested

(Test of Control-2)

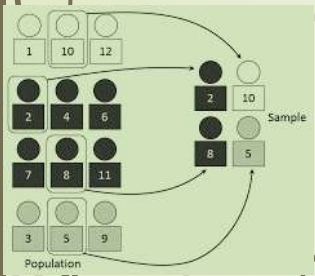
# Population & Stratification

## Population:

- **Appropriate** for specific audit objectives
- **Complete and accurate** – Sampling can give correct test results
- Sampling unit - obtain an **efficient & effective samples**

## Stratification:

- Process of **dividing a population into sub-populations** – Each group of sampling units with similar characteristics (often monetary value)
- **Strata to be explicitly defined** - Each sampling unit belong to only one stratum
- Direct audit efforts towards the items with **greatest potential monetary error**
- Eg. Large value items of account receivables – detect overstated material misstatements



# Sample Size & its Approach

## Sample Size:

- Consider **sampling risk, tolerable error, and expected error**
  - the lower the risk that is willing to accept, the greater the sample size
- Determined by the application of a **statistically based formula (or) through application of professional judgment**

## Statistical and Non-Statistical Approaches:

- **Professional judgment** and **decide** the suitable approach of sampling
- **Non-statistical Approach** – When **Nature and cause of IA analyses** is more important than the statistical analyses of presence (or) absence of errors
- **Statistical sampling procedures** – Sample size may be ascertained using either **probability theory (or) professional judgment**

# Sample Size vs Expected Error Rate

## Direct Relationship

Example: Winemaker is testing 100 bottles of wine to make sure that the wine has not gone bad (sour). Winemaker must determine how many bottles he/she needs to test.

Low Expected  
Error Rate



Lower sample size  
because LOW chance that  
wine has gone bad



High Expected  
Error Rate



Higher sample size  
because HIGH chance that  
wine has gone bad



# Tolerable Error

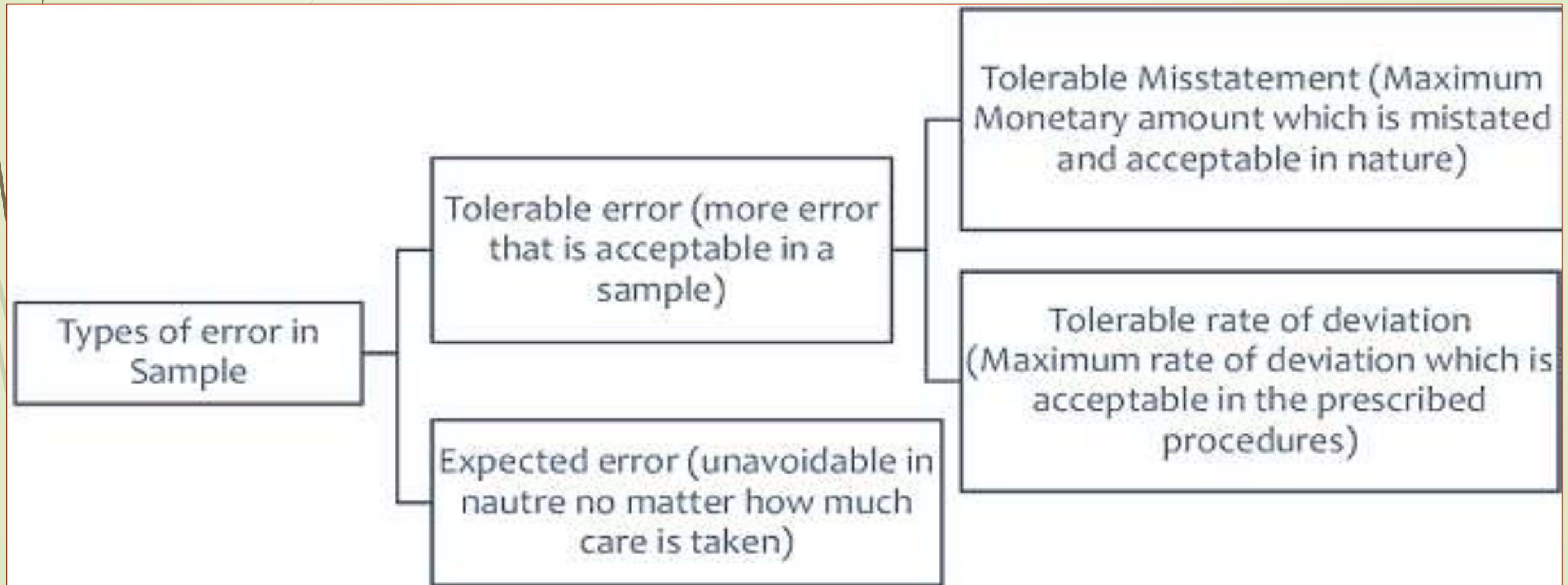
- **Maximum error in the population** – willing to accept and conclude sample to achieve IA objective(s)
- Considered during the **planning stage** (Smaller tolerable error, sample size to be large)
- Tests of controls (ToC) – **Max. rate of deviation from a prescribed control procedure** that is acceptable based on the preliminary assessment of control risk
- Substantive procedures - **Max. monetary error in an A/c balance (or) class of transactions** that is acceptable to **reasonably concluded** that the financials are not materially misstated

# Expected Error

- Errors are expected in the population:
  - **Examine Larger sample** than when no error is expected ordinarily to conclude that the actual error < the planned tolerable error
  - **Smaller samples are justified, when the population is expected to be error-free**
- Determining error in population consider:
  - Error levels identified in previous IA reviews
  - Changes in entity's procedures
  - Evidences available from other procedures



## Tolerable Error & Expected Error (contd..)



# Sample Selection

- To be **representative** of the population
  - equal opportunity of being selected as sampling unit
- Common methods used for sample selection:
  - ✓ **Random selection and use of CAATs (computer assisted audit techniques)** – computer selected random number
  - ✓ **Systematic selection** – No. of sampling units will be divided by sample size to arrive at the sampling interval
    - Eg. Every 20<sup>th</sup> sample (provided the first 20 are haphazard)
  - ✓ **Haphazard selection** – Not following structured approach
    - ✓ Avoid conscious bias or predictability
  - ✓ **Block Selection** – Selection of block of adjacent or continuous items



# Evaluation of Sample Results

- Analyze the nature and cause of any error in the sample results
- Project the errors found in sample in the sample to the population
- Re-assess the sampling risk and consider the possible effects
- Determine whether the assessment of **relevant characteristics** of the population is **confirmed (or) needs revision**

# Evaluation of Sample Results

## Analysis of Error in the Sample

- Need to determine – **Item in question is in fact an error**
- **Conditions that constitute an error (by reference to the audit objectives)**  
(Eg: During the **review of Receivables**, mis-posting between customer accounts does not affect the total receivable value and to be concluded as **not an error**)
- Unable to obtain expected audit evidence – perform **alternative procedures** to obtain sufficient appropriate audit evidence
- **When to treat “Error”**
  - Unable to perform satisfactory alternative procedures or
  - Procedures performed not enabling to obtain sufficient appropriate audit evidence

# Evaluation of Sample Results

## Analysis of Error in the Sample

- Consider **Qualitative aspects** of the errors (including nature, cause, possible effects etc.,)
- **Extension of audit procedures:**
  - Analyses of errors discovered - **Common feature** of all such items are to be identified as **sub-population** and **to be separately analysed**  
(Eg: SAP document type, transaction type, location, product-line or time period etc.,)



# Projection of Error Results

- **Several acceptable methods** of projecting error results.
- Method of projection to be **consistent** with the method used to select the sampling unit.
- Qualitative aspects of the errors also to be considered
- Projection of errors done **separately for each sub-population** and the **results are combined**
- Tests of Controls (ToCs) - No explicit projection of errors is necessary (as the sample error rate = projected error rate for the whole population)



# Reassessing Sample Risk

- **Actual errors discovered > tolerable error** – Sampling risk is to be reassessed
- Reassessed sampling risk is unacceptable – **Extend the audit procedure (or) perform alternative IA procedures**
- Evaluation of sample results - Indicate that the assessment of the relevant characteristic of the population needs revision, the internal auditor, may:
  - ✓ Request management to investigate the identified errors and other error potentials
  - ✓ Request to make necessary adjustments (if management prescribes the sample size)
  - ✓ Modify the nature, timing and extent of internal audit procedure (including extension of sample size, alternate control testing etc.,)
  - ✓ Consider the effect in the IA report

# Documentation Aspects

- i. Relationship between the **design of the sample *vis-a-vis* specific audit objectives**,
- ii. Assessment of the **expected rate of error in the population** vs. auditor's understanding of the **design of the relevant controls**
- iii. Assessment of the **sampling risk and the tolerable error**
- iv. Assessment of the **nature and cause of errors**
- v. Rationale for using a particular **sampling technique** and results thereof
- vi. Analysis of the **nature and cause of any errors** detected in the sample
- vii. **Projection of the errors** found in the sample to the population
- viii. **Reassessment of sampling risk**, wherever appropriate
- ix. Effect of the **sampling results** on the **IA objectives**
- x. Projection of sample results to the **characteristics of the population**

# Factors influencing Sample Size for ToC

Factor to be considered by Internal Auditor	Effect on sample size
An increase in the extent to which the risk of material misstatement is reduced by the operating effectiveness of controls	Increase
An increase in the rate of deviation from the prescribed control activity that the internal auditor is willing to accept	Decrease
An increase in the rate of deviation from the prescribed control activity that the internal auditor expects to find in the population	Increase
An increase in the internal auditor's required confidence level	Increase
An increase in the number of sampling units in the population	Negligible effect

Factor to be considered by Internal Auditor	Effect on sample size
An increase in the internal auditor's assessment of the risk of material misstatement	Increase
An increase in the use of other substantive procedures by the internal auditor, directed at the same assertion	Decrease
An increase in the total error that the internal auditor is willing to accept (Tolerable Error)	Decrease
Stratification of the population when appropriate	Decrease
An increase in the amount of error which the internal auditor expects to find in the population	Increase
An increase in the internal auditor's required confidence level	Increase
The number of sampling units in the population	Negligible effect

# Frequency of Control Activity and Sample Size

Frequency of control activity	Minimum sample size	
	Risk of failure	
	Lower	Higher
Annual	1	1
Quarterly (including period- end, i.e., +1)	1+1	1+1
Monthly	2	3
Weekly	5	8
Daily	15	25
Recurring manual control (multiple times per day)	25	40



# Q & A

# **SIA 6 – Analytical Procedures**





# Introduction

Initially **recommendatory**

Effective Date : **Yet to be announced**

**Purpose** : To establish standards on application of analytical procedures during an Internal Audit





Risk Assessment



Audit Review



Ratio & Trend Analysis

Financial data

Non- Financial data

**Expectations /  
Industry  
Benchmark**

**Exceptions /  
Deviations**



# **Nature & Purpose of Analytical Procedures**

## **Examples of Comparative Information**



**Prior period  
information**

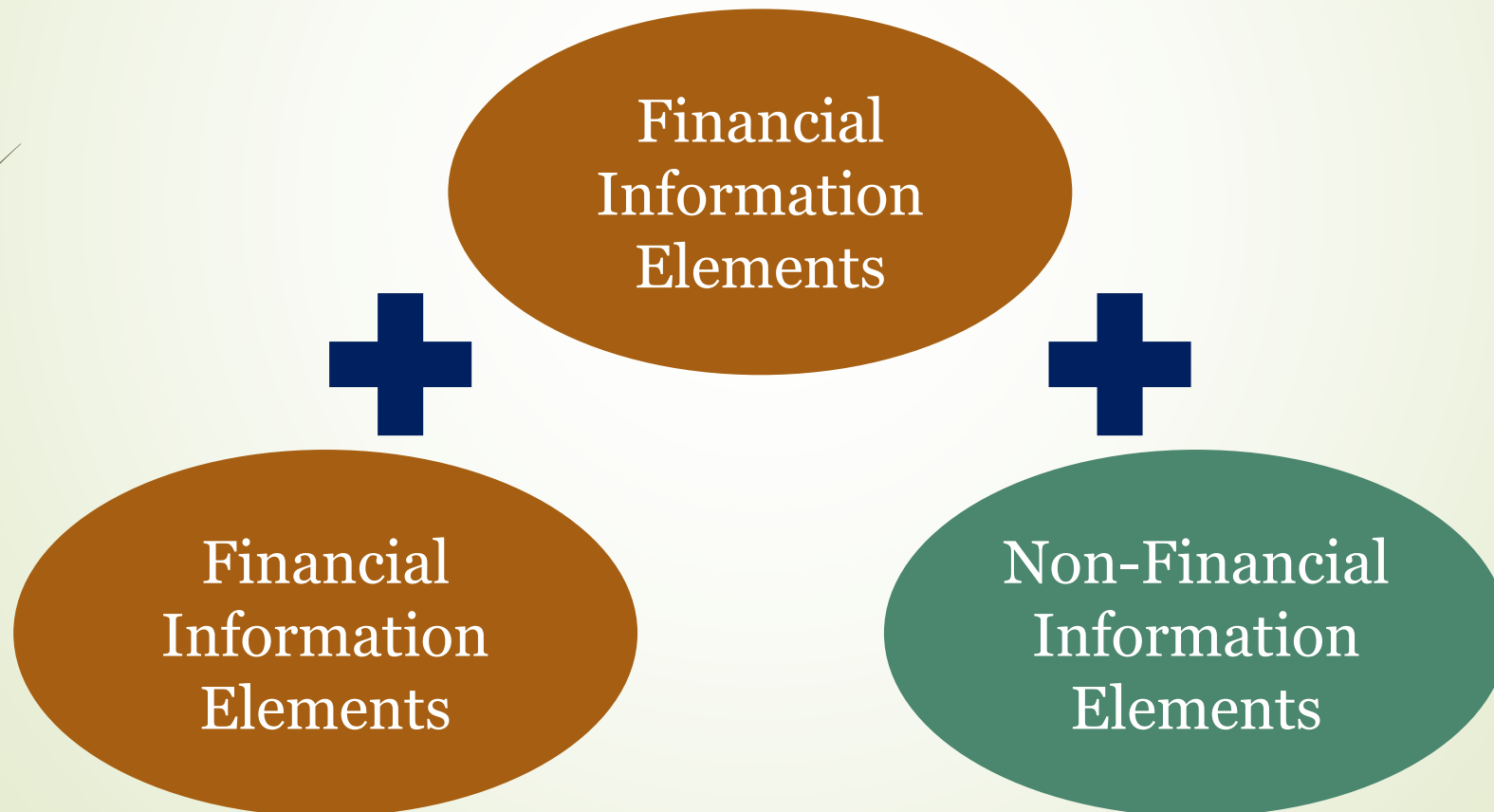
**Budgets / Forecast**

**Predictive  
Estimates**

**Similar Industry  
Estimates**

# Nature & Purpose of Analytical Procedures

Analytical procedures include



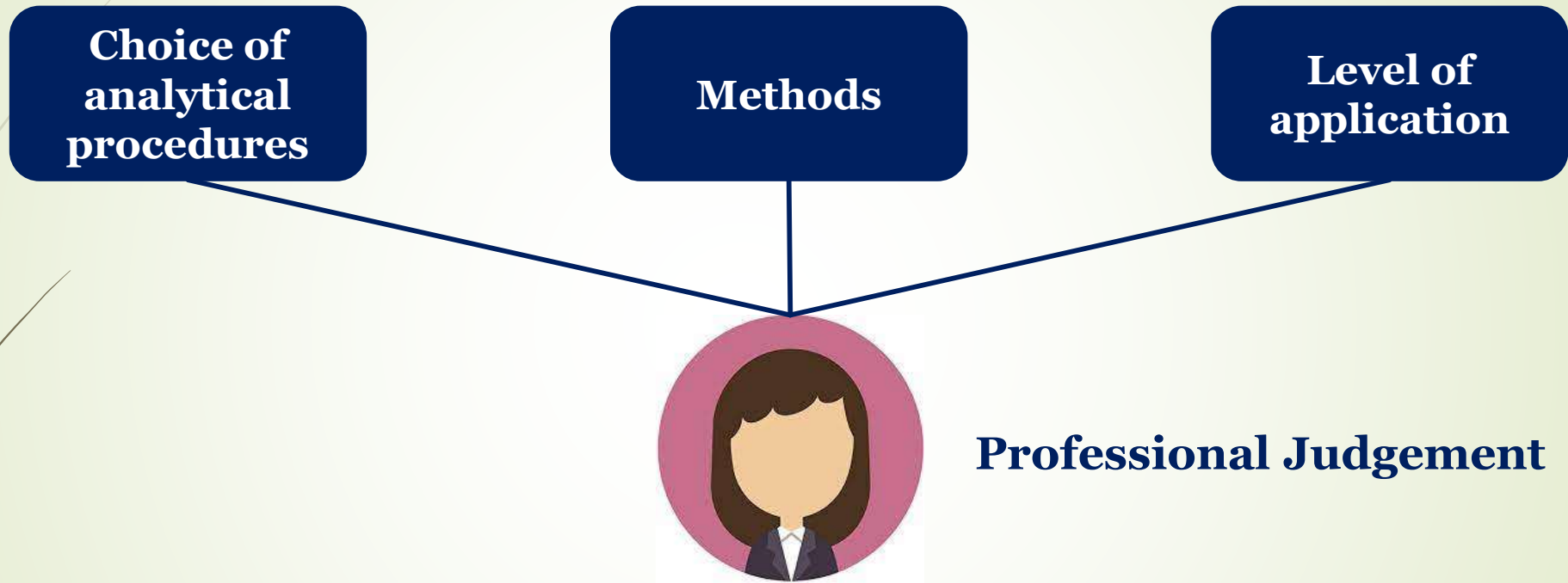


# Nature & Purpose of Analytical Procedures

**Analytical procedures may be applied to**

- Consolidated Financial Statements
- Financial Statements of components
- Individual elements of financial information e.g. net profit, current assets
- Non-financial information e.g. Employee headcount

# Nature & Purpose of Analytical Procedures





# Nature & Purpose of Analytical Procedures

## Level of application

Significance of **area** being examined

Adequacy of **internal control** system

**Availability & reliability** of information

Precision with which **results** of analytical procedures can be predicted

Availability & comparability of **industry data**

Extent of **support** from other audit procedures

Additional audit procedures to support the analytical procedures

# Nature & Purpose of Analytical Procedures

## Use of Analytical procedures





# Nature & Purpose of Analytical Procedures

## Risk Assessment procedure

- To obtain understanding of the business, the entity and its environment in **identifying potential risks**
- Will assist in **determining nature, timing & extent** of other audit procedures

# Nature & Purpose of Analytical Procedures

## Substantive procedure

- To **reduce detection risk** relating to specific financial statement assertions & assertions relating to process, systems and controls may be derived from tests of details or analytical procedures or a combination of both, based on professional judgement
- Analytical data prepared by entity may be used – for efficiency's sake
- Several factors to be evaluated before using analytical procedures as substantive procedure

Objectives

Availability of  
data

Reliability of  
data

Source of data

Past  
experience

Reliability of  
results

Nature of  
business

Relevance of  
data

Data preparation  
controls



# Nature & Purpose of Analytical Procedures

In the Overall Review at the end of IA

- Analytical procedures to be applied **at or near the end** of the internal audit
- **When forming an overall conclusion** as to whether the systems, processes and controls as a whole are robust, operating effectively and are consistent with the internal auditor's knowledge of business
- To **corroborate conclusions** formed during the internal audit
- Areas requiring further procedures to be applied may be identified from analytical procedures

# Extent of Reliance on Analytical Procedures

- Analytical procedures are based on expectation that **relationship exists among data** and continue in the absence of known conditions to the contrary
- Reliance on results of analytical procedures **will depend on internal auditor's assessment of the risk** that the analytical procedures may identify relationships as expected when, in fact, a material misstatement exists
- Extent of reliance on results of analytical procedures depends on:
  - ✓ **Materiality** of the items involved
  - ✓ **Other internal audit procedures** directed towards the same objectives
  - ✓ **Accuracy** with which expected results of analytical procedures can be predicted
  - ✓ **Assessment of inherent and control risks**



# Extent of Reliance on Analytical Procedures

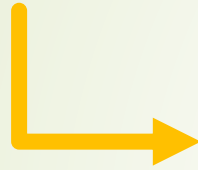
Consider testing **controls used in preparation of information** used in analytical procedures



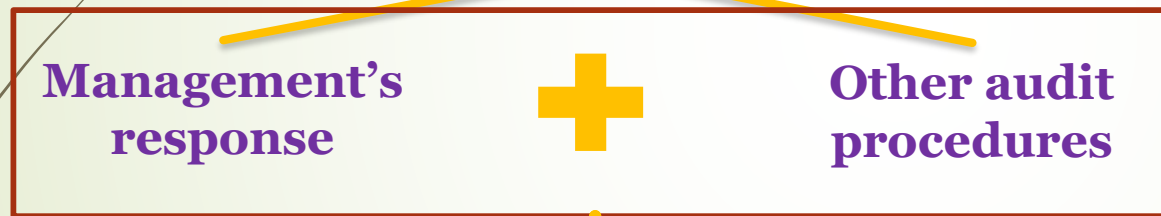
Controls over testing non-financial information may be tested in conjunction with test of accounting-related controls.

# Investigating Unusual Items or Trends

Significant fluctuations /  
inconsistent relationships



Corroborative  
evidence



Sufficient  
explanation



Not sufficiently  
explained



May indicate



**Significant condition such  
as potential error,  
irregularity, illegal act**



**Communicate to  
Management**

# The way forward...



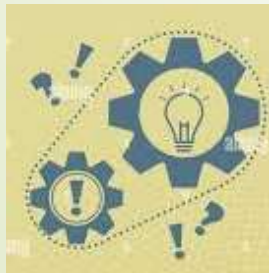
Automation of **exception** reports



**Continuous Control Monitoring** (CCM)



Use of **Artificial Intelligence (AI)** to analyse larger volume of data



Use of **Computer Aided Audit Tools & Techniques (CAATTs)**



# **Question & Answer**

# **SIA 130 – Enterprise Risk Management**



# Purpose & Objective



- ✓ Provide Common terminology of various Risk Management Terms
- ✓ Responsibilities of Board of directors, Risk Management Function and Management
- ✓ Responsibilities of Internal Auditor – Providing assurance on RM framework



# Definition - Risk

## ✓ Risk

- Probability of a **threat exploiting vulnerability** of business assets or processes or controls
- **Occurrence of an event** causing significant **impact** on business operation and continuity
- Prevents Organisation from **achieving its goals and objectives**

***Risk = Probability of occurrence of an event x financial impact of such occurrence***



# **Risk Management**

- ✓ **Identification** – Threats and Vulnerabilities
- ✓ **Assessment** – Severity and likelihood
- ✓ **Mitigation** – Actions to manage risk
- ✓ **Monitor & Reporting**



# Risk Management Framework

- ✓ Provide **Strategy, Leadership** and **Direction**
- ✓ **Risk Culture** – Throughout the Organisation
- ✓ Risk **Organisation**
- ✓ Comprehensive **database of Risks**
- ✓ Continuous **Monitoring** and **Oversight**
- ✓ Periodic **Communication** and **Reporting**

# Responsibility of the Board

## ✓ Companies Act 2013

- Overall responsibility of Board of Directors
- Section 134 (3) clause (n) – Development & Implementation of RM policy and risk that threaten existence of company
- Section 177 (4) (vii) – Audit Committee to evaluates IFC and RM
- Schedule IV Section II Subsection (1) & (4) – Code for Independent Directors
  - Independent Judgement
  - Satisfying on integrity of financial information and controls
  - Robustness of RM

# Responsibility of the Board

- ✓ SEBI LODR – Regulation 17(9) and 21
  - Entity to lay down procedures and report Board of directors about risk assessment and minimization procedures.
  - Framing, implementing and monitoring RM
  - Composition of the Risk Management Committee

IA Scope to cover – Responsibilities of Board, Management and RM Function

# Responsibility of Internal Auditor

- ✓ Plan and conduct Risk Based Internal Audit – Application of RM concepts
- ✓ Nature and Extent of Audit Procedures for RM:
  - Maturity of the RM Framework and processes
- ✓ Evaluation of Design, implementation and Operating Effectiveness of RM
- ✓ Independent Assurance to Management and those charged with Governance
- ✓ Non-existing of RM Framework
  - Highlight exposures – Weak or absent of RM
  - Recommend – Implementation & strengthening processes
- ✓ IA – Not responsible to manage risks and execute RM decision



# Risk Based Internal Audit Plan

Annual Risk Assessment



Plan of Audit Engagements



Reviewed



- ✓ Review of risk assessments performed by the enterprise (strategic plans, competitive benchmarking, etc.)
- ✓ Consideration of prior audits
- ✓ Interviews with senior management

This is only for **identifying internal audit key areas**, and **not for** identifying, prioritizing, and **managing risks** directly for the enterprise

# Scope of Internal Auditor's Work

Assessing the effectiveness of RM would include:

- Assess Organisation ability to identify, assess, respond, monitor and report

## Reviewing RM Framework

- Designed with global recognised framework (COSO and ISO31000)
- RM Policies and Procedures
- Risk Culture
- Organisation Structure
- Risk training programs
- Deployment of Technology
- Within Risk Appetite
- Communication and Reporting

Recommend improvements and Suggestions



# Internal Audit Report



**Internal Auditor**



**Board of Directors  
/ Committee**

- **Independent Assurance**
- **Linking RM framework with CEO & CFO certification of internal controls**
- **Certification of self compliance from owners to support system of continuous compliance**



# **Question & Answer**

# **SIA 150 – Compliance with Laws and Regulations (CLR)**





# Purpose

- Common terminology to prevent ambiguity on subject matter
- Responsibilities of Board of Directors and Management w.r.t compliance
- Responsibilities of Internal Auditor – independent assurance on compliance framework.





# Key Definitions

## Compliance:

- Following applicable laws and regulations - in letter and spirit

## Non- Compliance:

- Acts of omission (or) commission
- Either **intentional** (or) **unintentional**
- Contrary to the **prevailing laws or regulations**
- May result in fines, penalties or litigation



# Compliance Framework

- Refers to the whole structure, systems and processes
- put in place to organize the various compliance activities
- For seamless integration into the organization.



# Compliance Activities

- Provide strategy, leadership and direction on compliances;
- Establish a culture of compliance across the organization;
- Organization structure - Compliance resources with defined responsibilities;
- Comprehensive database of all compliance requirements;
- Risk-based time prioritization for effective adherence;
- Continuous monitoring and oversight
- Periodic communication - Management & those charged with governance (TCWG)

# Responsibility of the Board and Management

**The overall responsibility** for developing, implementing and monitoring the compliance framework **rests with the Board of Directors and Management.**

## **Companies Act, 2013:**

- Clause (f) of Section 134(5) concerning Directors' Responsibility Statement stipulates the compliance requirements as follows:
  - ✓ *the directors had devised proper systems*
  - ✓ *to ensure compliance with the provisions of all applicable laws and*
  - ✓ *that such systems were adequate and operating effectively*
- Section 205 on "Functions of company secretary" includes reporting to the Board about compliance.

# Responsibility of the Board and Management

## Listed companies:

Additional responsibilities defined under “The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR)”

- Chapter II, Regulation 4(2)(f) of LODR – Key functions of BoD
  - Ensuring integrity of accounting and financial reporting systems
  - Establishment of Systems for risk management, financial and operational control, and compliance
- Chapter III, Section 6, states, appointment of qualified company secretary as the compliance officer.
- Chapter IV, Section 17 states:
  - Periodic review of compliance reports by BoD
  - Compliance Certificate to BoD by CEO and CFO



# Responsibility of the Internal Auditor

- The nature and extent of IA procedures depends on the framework in place and the maturity of the processes
- Formal compliance framework exist:
  - Evaluation of design, implementation and operating effectiveness of such framework by IA
  - to provide independent assurance to management and to TCWG
- No formal compliance framework exists:
  - Design and conduct audit procedures
  - Make recommendations to implement and strengthen processes
  - Independent assurance - shall be undertaken in line with the requirements of SIA 110 “Nature of Assurance”



# Responsibility of the Internal Auditor

## Exclusions:

- The Internal Auditor shall not assume any responsibility to manage or operate the compliance framework
  - to act in the capacity of a chief compliance officer,
  - to take ownership of the compliance tracking system (or)
  - to take compliance related decisions
- It is not responsibility of the Internal Auditor to execute or resolve compliance related risks (e.g., engaging directly with regulators)



# Q & A

# **SLA 360 – Communication with Management**



# Purpose & Objective



Applies to all Internal Audit activities & assignments



- ✓ Clarity & consensus on scope, approach, objectives and timing of audit
  - ✓ To inform, persuade and act on important matters
    - ✓ Timely resolution of conflicts



**Internal Auditor**



**Management**

- 2 way communication
- Continuous dialogue at various stages of IA



*Written*

*Oral*



# Communication Process & Protocol

Written communication process & protocol to be agreed upon

- ✓ Modes
- ✓ Channels
- ✓ Periodicity
- ✓ Timelines
- ✓ Essential information



Chief Internal Auditor / Engagement Partner shall spearhead





# Attributes of communication plan & protocol



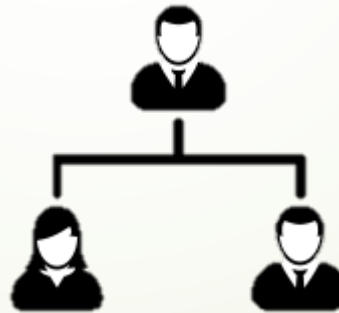
**Accurate**



**Complete**



**Timely**



**Escalations**

# Cross-Reference to other SIAs

**SIA 110**

- **Nature of Assurance** : Consult with Auditee and Assurance user regarding type of assurance

**SIA 210**

- **Managing the Internal Audit Function** :  
Periodic meeting to ensure progress is on track and concerns are addressed immediately

**SIA 310**

- **Planning the Internal Audit Assignment** :  
Discussion with Management to be part of planning process



# Q & A



**Thank You**