Internal Audit Methodology

Virtual CPE Meeting on Internal Audit

- WIRC

09 January 2021

Background

IA Methodology

Internal Audit in times of COVID-19

Emerging Trends in Internal Audit

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Internal Audit in times of COVID-19

Emerging Trends in Internal Audit

Internal Audit | Definition

*The Institute of Chartered Accountants of India defines Internal Audit as:*

"**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."

The Institute of Internal Auditors defines Internal Audit as:

"**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."

Four Pillars of Corporate Governance

Corporate Governance

Board of Directors	Internal Audit	Executive Management	External Auditors
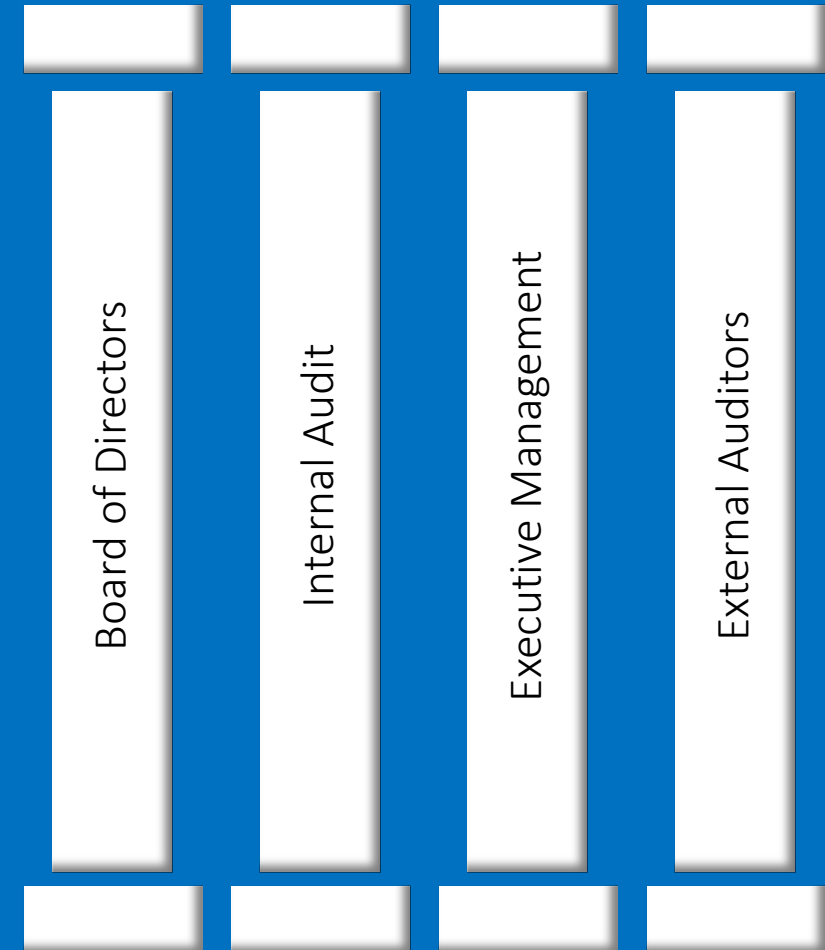
Internal Audit | Objectives

- To strengthen governance
- To enhance internal control system
- To assist strategic risk management
- To assure transparency in reporting – both for internal MIS purposes and statutory purposes
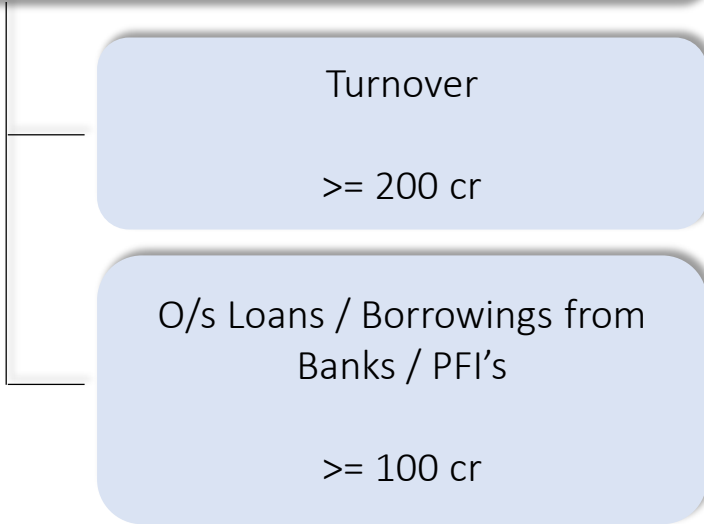- Compliances – external and internal
- Optimization of resources, costs and processes

Internal Audit | Applicability

PRIVATE COMPANIES

- Turnover

  >= 200 cr

- O/s Loans / Borrowings from Banks / PFI's

  >= 100 cr

LISTED PUBLIC COMPANIES

UNLISTED PUBLIC COMPANIES

- Turnover

  >= 200 cr

- O/s Loans / Borrowings from Banks / PFI's

  >= 100 cr

- Paid up Share Capital

  >= 50 cr

- O/s Deposits

  >=25 cr

*During PFY

Internal Audit | CARO 2020
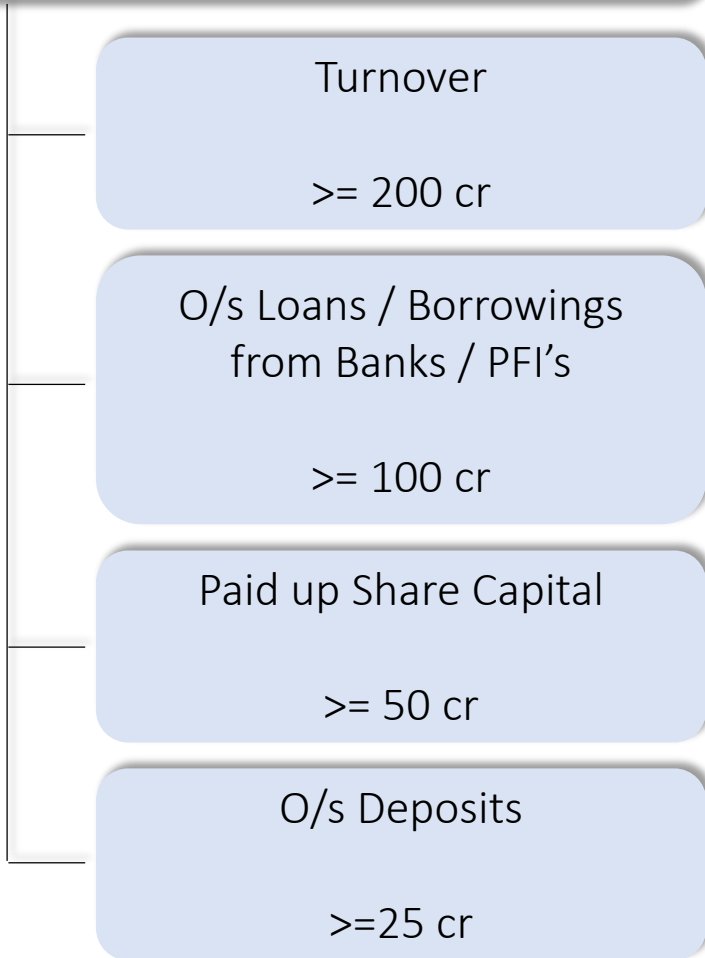
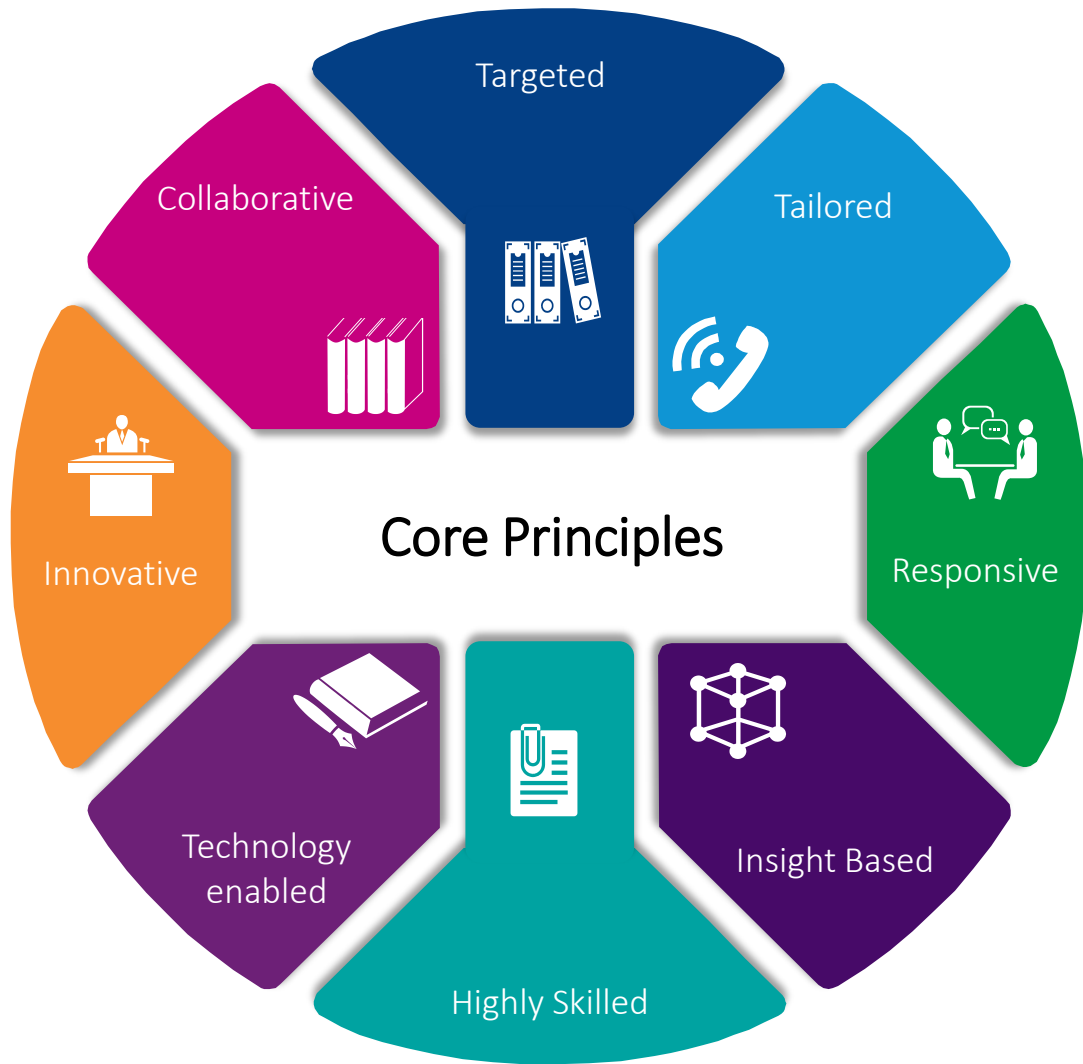| CARO 2020	CARO 2016
	– –
	Key Change
Clause 3(xiv)	CARO 2020 requires the statutory auditor to assess the adequacy of the internal audit system
(a) whether the company has an internal audit system commensurate with the size and nature of its business;	
(b) whether the reports of the Internal Auditors for the period under audit were considered by the statutory auditor.	Further, to ensure cross-leverage of work done by the internal auditor, CARO 2020 requires the statutory auditor to consider the reports of the internal auditor, while performing their own audit work.

Internal Audit | Responsibilities

Core Principles

- Targeted
- Tailored
- Responsive
- Insight Based
- Highly Skilled
- Technology enabled
- Innovative
- Collaborative

Process Assurance	To obtain a level of comfort on their processes
Fraud detection and prevention	To establish that their business is fraud free
Control Framework	To establish a control environment that facilitates segregation of duties and a clear reporting framework
Process Driven Organization	Transform the organization from being people - driven to being process – driven

Internal Audit | Standards on IA

As per SIA background - "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".

230	Objective of Internal Audit	320	Internal Audit Evidence	240	Using work of an expert
220	Conducting Overall Internal Audit Planning	7	Quality Assurance in Internal Audit	17	Considerations of Laws & Regulations in IA
310	Planning the Internal Audit Assignment	360	Communication with Management	18	Related Parties
210	Managing the Internal Audit Function	11	Consideration of Fraud in Internal Audit	370	Reporting Results
330	Internal Audit Documentation	12	Internal Control Evaluation	110	Nature of Assurance
5	Sampling	13	Enterprise Risk Management		
6	Analytical Procedures	14	IA in Information Technology Environment		

Background

IA Methodology

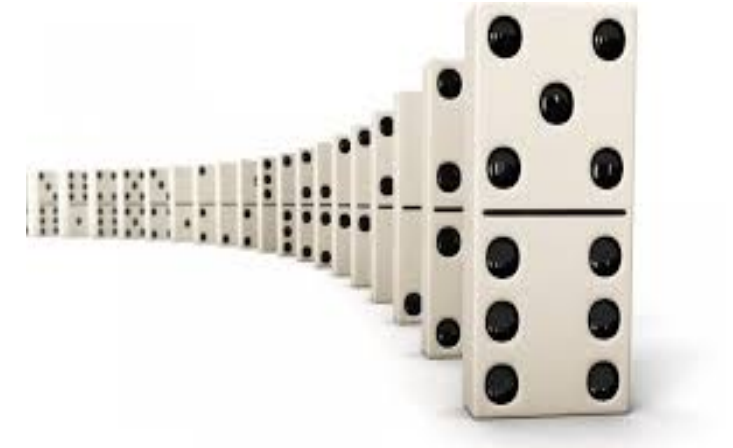Internal Audit in times of COVID-19

Emerging Trends in Internal Audit

IA Methodology | Risk Based Internal Audit

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**

The challenges of today's changing world introduce great opportunities for management and the Board and point to the necessity for competent internal auditing

Especially in these times of constant change, **internal auditing is critical to efficient operations, effective internal controls and risk management, strong corporate governance**, and in some cases, the very survival of the organization

IA Methodology | Life Cycle

- **Understand the business** and identify the key business risks

- Identify the **critical business processes** that mitigate these risks

- **Analyse** these **processes** and assess the risks

- Perform internal audit, with the help of standardised checklists / RCMs and extensive use of data analytics and **assess the effectiveness of operating control**

- Report **observations** to the management on a set frequency

- Present summary of key issues to the **Audit committee**

- Assesses management's progress against the agreed-upon **action plan** and whether its actions were performed adequately and timely

Strategic Analysis

Understand the Business

- Industry information

- Company information

- Sources of industry wide information

- PEST / SWOT analysis

Key Aspects

- Industry wide issues and objectives

- Company's strategic objectives

- Key stakeholders

- Key historical issues

- Business model specific to the company

Strategic Risk Assessment

Discuss the procedure for the following, with client, for Internal Audit roll out:

- Establishment of and agreement on **risk rating criteria**

- Agreement on **approach to risk assessments** and facilitated discussions

- **Identification, assessment and analysis** of risks

- **Performance of control environment** review

- **Selection of key processes** and interviewers- based on existing risk profile (previous internal audits conducted, identification of high-risk areas)

- **Documentation** of results and validation with the management

Management Assurance Plan Creation

The Internal Audit Plan sets out the scope of work to be undertaken by the client's internal audit function

Based on strategic analysis and enterprise risk assessment

- **Determine and prioritize** the areas and business processes to be reviewed

- Identify the **number and types of audit projects** to be performed, along with associated resource requirements

- Obtain **input and approval** of executive management and the Audit Committee, and

- Establish a **process to continually evaluate, update, and maintain** the plan.

Plan should specify the areas to be audited, estimated hours and priority of audits

Process Analysis (1/4)

Process analysis consists of three broad steps:

1. Interviews with process owner(s)

2. Process walkthroughs

3. Mapping of As – Is process maps and buy – in from process owner for As – Is understanding of the process

Process Analysis (2/4)

1. Interviews with process owner(s)

- Discuss process with each process owner, obtain an **in-depth understanding** of the processes/ sub-processes

- Understand the **process objectives** and **critical success factors**

- Discuss and understand how these objectives **relate to the organization's business objectives**

- Perform a **'break-down'** analysis of processes into activities and sub-activities

- **Understand each activity** in detail with focus on:
  - Objectives
  - Frequency
  - Roles and responsibilities
  - System interface, if any
  - Interface with other processes (handover/ takeover points of responsibility & data to/ from other activities or processes)
  - MIS, KPIs etc.

Process Analysis (3/4)

2. Process Walkthrough

Validate process understanding by performing one or two (as necessary) walk-through / reverse walkthrough (negative) tests using transactions representative of the process being audited:

- **Observe the process** as it is being executed
- See how things work and how paper and **information flows**
- Find out if there are any "**work-arounds**" to the process to make sure it works right
- Inspect **existing documents** and observe inputs and corresponding outputs
- Ask for **copies of all documents** and information about the flow of those documents
- Examine the documents and determine **who gets and who actually uses copies of the documents and why do they get the documents**

Process Analysis (4/4)

3. Mapping of as–is process maps and process owner buy – in

- **Document your process understanding** using one or a combination of process diagrams or structured narrative notes
- **Map the 'as-is' process flowcharts** with respect to:
  - Inputs
  - Outputs
  - Key activities
  - Roles & Responsibilities
  - Key System interfaces
  - MIS
  - Performance Metrics
- Submit as–is process documents to process owner / client team / process champion for review and confirm accuracy of the documentation.
- Make changes as required and obtain "buy – in" from process owners

Process Risk Assessment

The ultimate objective of audit execution is to determine the effectiveness of controls over the significant risks within processes

- To achieve this, we should first identify and assess the significant risks
- A risk is an event that has an adverse consequence on the objective of the process / sub – process
- Risks are identified by analyzing the characteristics of the processes with respect to our internal audit focus and identifying what events, actions, or inactions would adversely affect achievement of the objectives
- Perform a 'What can go wrong' analysis to identify risks
- To remove a degree of subjectivity and to ensure consistency, the risks assessed is agreed upon with the Auditee/ Process Owner

Internal Audit Execution (1/6)

Internal audit execution involves the following steps:

- Developing the audit program

- Testing effectiveness of controls and identification of exceptions

- Extensive data analysis (where relevant) using tools such as K-Prism / MS Access / MS Excel to cover a greater sample and to ascertain financial impact

- Root Cause Analysis for exceptions identified and identification of risks originating from operating ineffectiveness / non – existence of perceived controls

- Developing a road map to manage / mitigate identified risks

- Obtaining process owners buy-in for identified risks and recommendations

Internal Audit Execution (2/6)

1. Developing the audit program

Our objective now is to **determine** that the **controls deemed to be effective over significant risks are operating effectively**

- Develop **audit work program**
- Determine the **process objective**
- Determine which **controls to test** and the **test objective**
- Determine the **nature of the tests**
- Determine **documents / data required (and their source)** to test effectiveness of controls and **sample size** for testing
- Determine the **timelines, frequency and person responsible** for the test
- Document and obtain **approval of the audit program**

Internal Audit Execution (3/6)

2. Testing effectiveness of controls and identification of exceptions

Why perform control testing?

To check if:

- Controls are **operating as management understood** they would operate
- Controls **were applied throughout the period** of intended reliance and encompassed all applicable transactions
- Controls **resulted in the timely correction of any errors** that were identified by the control being relied upon

Nature of tests of controls refers to their type:

- Inquiry
- Observation / Walkthrough
- Inspection
- Re-performance
- Audit assertions (CEAVOP)

Internal Audit Execution (4/6)

3. Root Cause Analysis
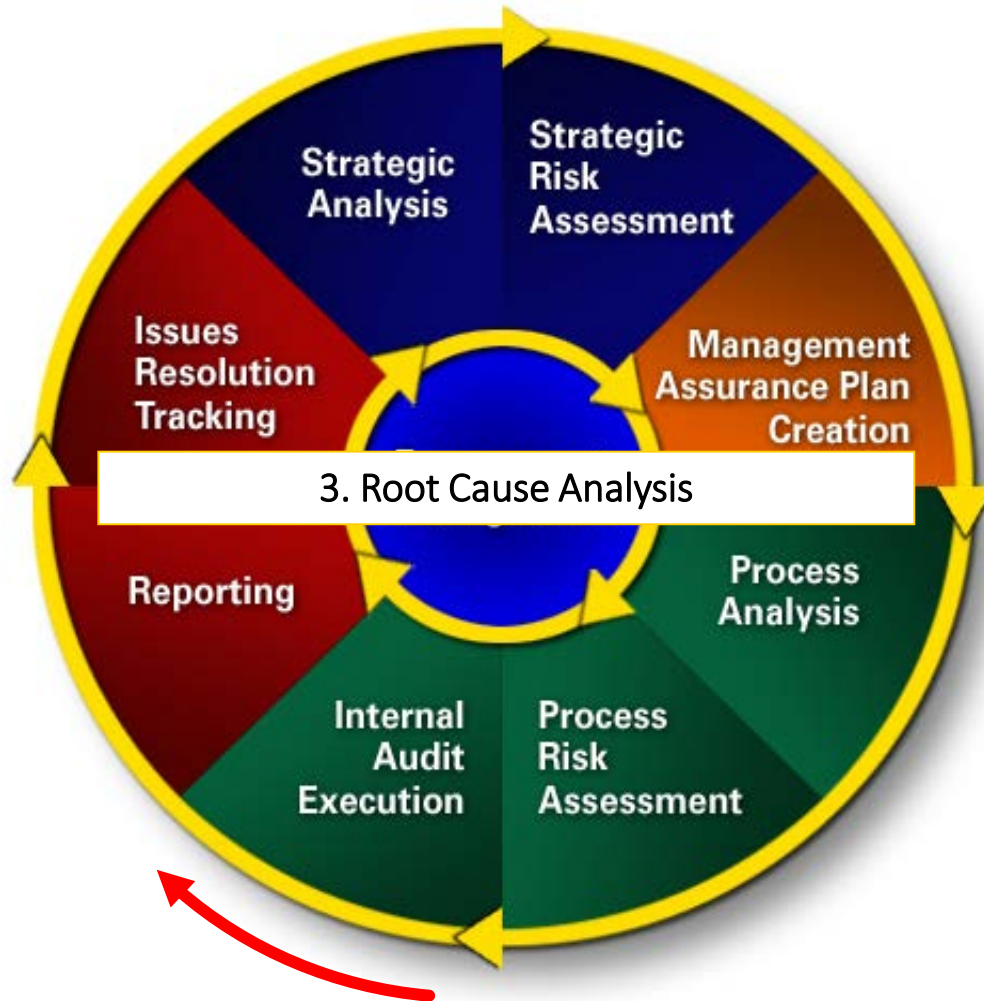
- After identifying risks originating from - operating ineffectiveness and identified design deficiencies, conduct a root cause analysis as given below:
  - Identify probable factors leading to the risk
  - Identify probable causes for occurrence of these factors
- Based on above analysis, identify the source for all identified risks under various processes i.e., "are such risks driven by people, process or technology?"
- Discuss the identified gaps and roots causes with the respective process owners to obtain their buy-ins

Internal Audit Execution (5/6)

4. Road map to manage / mitigate identified risks

- Based on impact and identified root causes, bifurcate identified risks based on **level of effort required to counter risks** through change/ establishment of controls:
- Can be **countered immediately** – minor changes in processes with no / minimal system changes
- Can be **countered in short term** – reasonable changes in key activities within a process along with change in system configurations
- Can be **countered in long term** – significant investments involving process redesigning, system upgradation etc.
- Based on discussions with process owners understand the **mitigation level that the management wants to achieve for every identified risk**

Internal Audit Execution (6/6)

5. Process owner's buy-in for identified risks and recommendations

- **Formulate recommendations** to mitigate the identified risks by suggesting improvements in process and internal control designs and obtain management's buy ins on the same.
- **Define timelines and responsibilities for mitigating each of the significant risk** and implementation of key recommendations based on discussions with management

Reporting

- The audit report is one of the most visible deliverables, providing **feedback to auditee management on the results of our audit**

- The report should include all the **significant issues identified as a result of our audit** procedures

- Gather and review **issues summaries for reportable items**

- Review **management's responses** for inclusion in the report

- **Prioritize observations** (Based on Impact or Level of effort- as agreed in audit plan)

- Review for any **inappropriate language**

- Prepare the **draft report** using the agreed upon format

Issues Resolution Tracking

- Throughout the delivery of our Internal Audit Methodology, issues are uncovered and reported, and ultimately action plans are agreed to by management.
- As part of the follow-up process, monitor the progress of the implementation of agreed-upon management action plans
- Assess management's progress against the agreed-upon action plan and whether its actions were performed adequately and timely

Work Paper Documentation

- Business understanding document
- Minutes of meeting
- Approved audit scope

- Risk Assessment Presentation
- Minutes of meeting

- Updated project completion checklist
- Issue resolution tracker
- Minutes of meeting

- Internal Audit Plan
- Minutes of meeting

- Internal audit report cross referenced to working papers and annexure
- Transmittal letter
- Client feedback form
- Minutes of meeting

- Process Maps
- Narrative Notes
- Walkthrough samples
- Documents / data received from process owner
- Evidence of As-Is buy in from process owner
- Copies of al reviewed documents
- Minutes of meeting

- Approved audit program
- Approved process flow diagrams
- Test summary
- Control test matrix
- Summary of issues and findings
- Process improvement observations with buy in's
- Copy of all samples and data
- Evidence of samples selected from pre -defined universe
- Minutes of meeting

- Analysis of risk and controls in place identified in each core business process
- Existing controls mapped to risk and identified design deficiencies for which controls are inadequate / non-existent
- Impact – Likelihood assessment: Risk Register
- Buy in document from process owner for risks identified
- Minutes of meeting

Center wheel labels: Strategic Analysis · Strategic Risk Assessment · Management Assurance Plan Creation · Process Analysis · Process Risk Assessment · Internal Audit Execution · Reporting · Issues Resolution Tracking · Engagement Management

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Emerging Trends in Internal Audit

Internal Audit in times of Covid 19

Providing insights in the changed risk and opportunity landscape

"Predicting the unpredictable: dealing with risk and uncertainty" has always been a key mantra, and this holds true today with the emergence of COVID-19. There are many associated risks which are impacted by COVID-19, for example: Cyber and Fraud risks, Reputation risks, Supply Chain risks, Health & Safety, etc.

- Provide new insights to top management regarding the impact on your organization's risk and opportunity landscape
- Improve structured reflections on the measures taken and anticipated.

Being Agile

- Discuss with the management how we can best add value in these critical times.
- Not an ideal time to stick to your audit plan or other routines if this does not provide value for your organization at this point.

Promote a strong risk culture

Risk professionals can actively take up the role ensuring that the risk management and business continuity measures:
- are clearly defined and understood,
- are made visible in the organization,
- involve the entire organization,
- **are executable and** are applied by top management,
- can be openly discussed,
- are enforced,
- are continuously improved.

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IA Methodology

Internal Audit in times of COVID-19

Emerging Trends in Internal Audit

Emerging Trends in Internal Audit (1/2)

1. Agile Internal Audit	2. Integrated Assurance	3. Evaluating culture	4. GDPR assurance and advice	5. Cyber Internal Audit

• Adopted by Innovative internal audit
• Directs teams to higher risk areas and higher value work, and helps the function to attract, develop, and retain talent.
• Ensures that:
  • internal auditors work with stakeholders in a collaborative, focused, iterative manner.
  • Audit results are more linked to business risks and relevant to stakeholder needs etc.
	• Integrated assurance aims not only to rationalize assurance activities and achieve efficiencies; it also aims to direct assurance activities to where they will create the most value for the organization.
	• Integrated assurance aims to align assurance activities around the drivers of value in the organization and to create visibility into risks and the effectiveness of risk management, while boosting efficiency.
		• Risks to culture occur when there's misalignment between the organization's values and leaders' actions, employee's behavior or organizational systems.
		• Culture has also become key to success and performance, as well as a source of legal and reputation risks.
		• Internal Audit can help management and the board drive the right culture, which is essential amid today's ongoing digitalization, intense media and regulatory scrutiny, and heightened oversight expectations.
			• General Data Protection Regulation (GDPR) is a risk-based regulation that does not prescribe how to protect customer data; rather, it sets expectations in terms of the data, based on its sensitivity and the potential risks.
			• Instead of a uniform response, the regulator seeks customized approaches that protect the types of data the organization processes, geared to the risks posed to the Data.
				• This entails a shift from IT & compliance-based approaches to a more risk-based approach to cyber.
				• In making this shift, most IA groups find covering all cyber issues challenging, mainly due to lack of resources & depth of skills.
				• As the gap between organizational needs & IA resources grows, the function can feel overwhelmed & unsure how to proceed. Responsibility for cyber security permeates all business units, which means the related governance must span the organization and all three lines of defense must be involved— and their roles and responsibilities clarified.

Emerging Trends in Internal Audit (2/2)

6. Workforce of the future	7. Continuous risk assessment	8. Automating Assurance	9. Robotic process automation	10. Auditing the risk & Disruptive Technologies

6. Workforce of the future
- IA functions have been embracing alternative sourcing models for years, such as guest auditors, co-sourcing, rotational programs, & more recently crowdsourcing; indeed, about 3 quarters of IA groups use some form of alternative sourcing model
- As the larger organization changes the ways in which it sources, engages, and compensates talent and as historical uses of talent evolve into automation opportunities, management must establish an appropriate governance model geared to addressing the risks inherent in these talent models & technologies.

7. Continuous risk assessment
- Continuous risk monitoring, assessment, and tracking can help IA to direct its resources to where they're most needed, a valuable departure from rotational audit plans.
- This approach can change the dynamic with stakeholders, enabling IA to more effectively anticipate risks & advise management.
- Leading functions are moving toward real-time risk monitoring via technology-enabled risk sensing, analytics, and visualization tools.
- Continuous assessment can leverage, but is not limited to, continuous monitoring of controls.

8. Automating Assurance
- Automation leads to higher levels of assurance as larger populations of transactions can be tested and controls can be continuously audited.
- Automated assurance also enables movement of assurance-related activities to the second line, to compliance, cyber security, risk management, & similar functions or to the first line, where the risks should be managed and where people can act on the results.
- There is a secondary benefit of automating assurance activities, reallocation of limited resources & potential cost savings.

9. Robotic process automation
- Many IA groups have started to advance toward robotic process automation (RPA) and cognitive intelligence (CI) tools (collectively RPA&CI) to drive efficiency, expand capacity, boost quality, and extend audit coverage.
- These disruptive technologies are winning acceptance as innovators and early adopters continue to prove their value throughout the internal audit lifecycle.
- This approach enables Internal Audit to plan phases of adoption and to realize improved resource allocation, reduced costs, higher quality, and enhanced value.

10. Auditing the risk & Disruptive Technologies
- Driven by the need to create value and drive efficiencies, organizations continue their rapid adoption of disruptive technologies.
- IA must understand the risks of technologies in the organization, advise management on those risks, and provide assurance that they are being adequately addressed.
- Practical considerations for Internal Audit to add valuable assurance including having access to testing procedures and independently reviewing sampling test cases, results generated, and issues logged.

Questions???

Thank You!

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