



Risk Based Internal Audit

**Presentation to members , WIRC of
ICAI**

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By: Alok Chawla

Agenda

- Introduction
- Overview
- Stages of Risk Based Internal Audit
- Components of RBIA Activity
- Business Process Analysis and Inherent Risk Assessment
- Audit Execution-Test of Design
- Audit Execution-Test of Effectiveness
- Final Steps.

Introduction

- Alok Chawla FCA,DISA, CIA, Certificate in KYC/AML and Trade Finance-IIBF (Audit professional with experience 20+ years)
 - Present: Chief Internal Auditor-Tata Motors Finance Limited (since Feb 2013)
 - Head Business Process Audits
 - Risk Based Internal Audit –GRC Approach at ING
 - Audit and Risk advisory /Consulting for MNC banks/Corporate houses at New Delhi.
- Former Secretary - IIA Bangalore Chapter

Overview

*The truth is audit gets no respect, quite frankly if audit department in question is using yesterday's approach in today's company , has not maneuvered top management and the Board into **focusing on company's top five or ten risks**, has not caused management to quantify these risks and has not succeeded in developing authorized bounds of risk tolerance , then it does not deserve respect.*

By, Larrie Small , President, Fannie Mae

*Once attending a training abroad for a global audit engagement , the Chief Auditor in his concluding remarks said “ **don't highlight isolated incidences , focus on key risks/controls , systemic gaps and provide effective, long term solutions, I am not interested to hear from you the past incidences**”.*

I think both these statements fairly reflect the importance of Risk Based Audit approach in today's dynamic world !

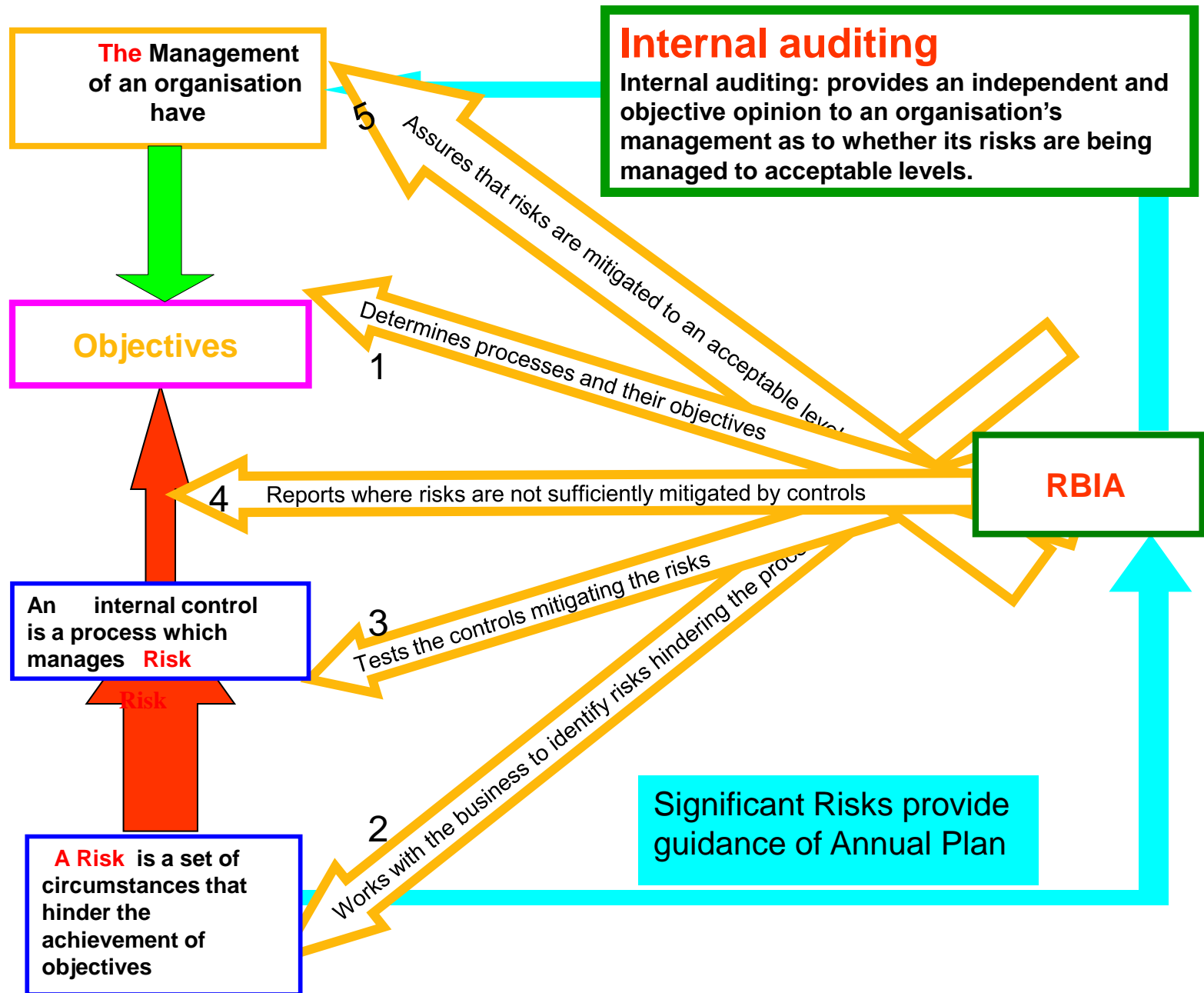
Overview

“Risk Based Approach” focuses on:

- Areas which poses the greatest risk to the sound control environment of Organisations;
- The assessment of management processes to Identify, Measure, Monitor and Control / Manage risks.

The Risk based internal audit process relies on an understanding of the institution, the performance of risk assessment, development of a supervisory plan and examination procedures tailored to the risk profile.

Stages of an Risk Based Internal Audit



Components of RBIA activity

Risk Assessment and Audit Planning(RAAP).

Internal Audit Department should , in close coordination with Business Management and 2nd line of Defence, perform the following main activities during the RAAP process

- A. Identifies and Document Key Risks to Business Objectives,
 - Organisational structure (e.g. by location, product, function etc.), core processes / functions, key strategic business objectives;
 - Validate Business processes and Key risks understanding with 1st and 2nd line of defense
 - Obtain Management’s view of the most significant risks that could negatively/adversely affect the achievement of the Business Objectives, to be challenged by IAD with its own views
- B. Identifies related “auditable units” (i.e., processes, functions, value chains) where identified risks can potentially materialize,
 - Reconcile auditable entities with Business granularities identified by 2nd Line of defense;
 - Define the auditable units where key risks to Strategic Objectives could materialize ;

Components of RBIA activity

Risk Assessment and Audit Planning;(RAAP).....

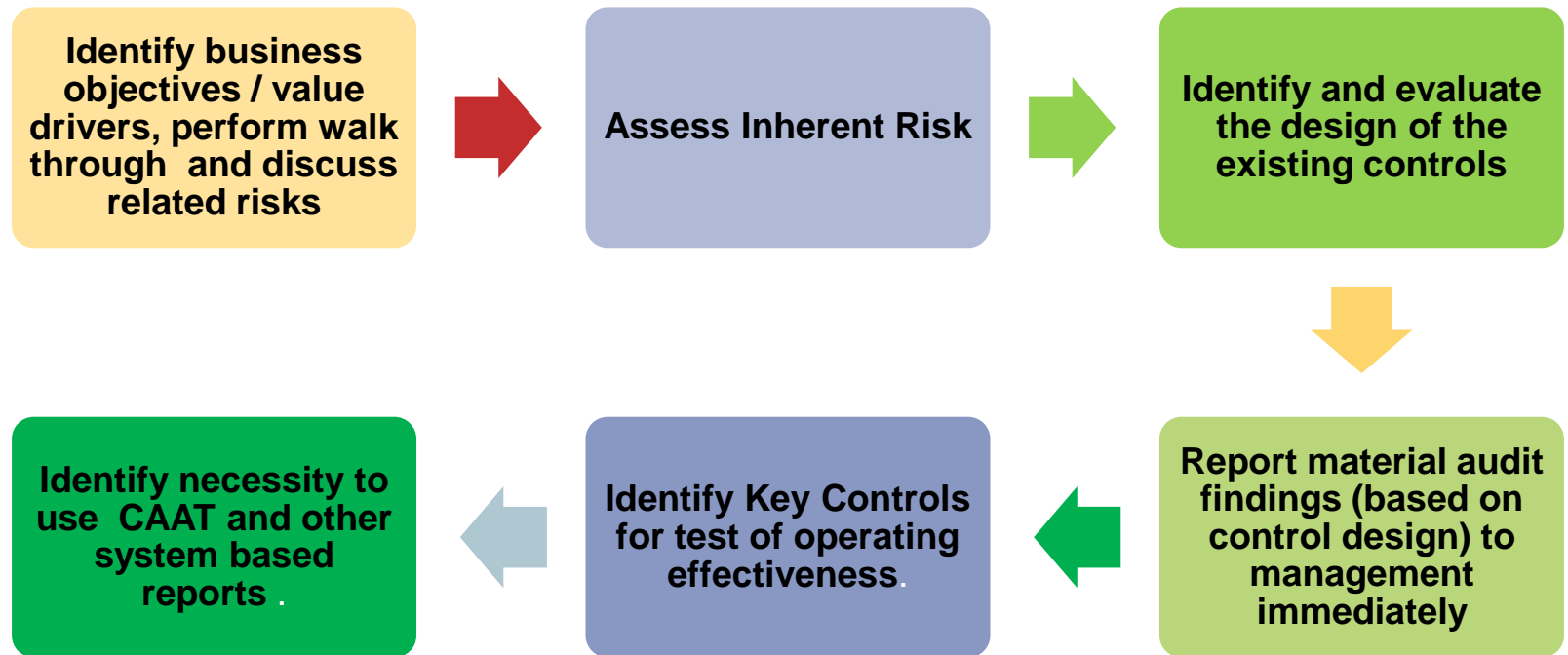
C. Develop an initial prioritization of auditable units based on an assessment of the following Three factors model:

- Strategic objectives of the Auditable Units,
- Inherent Risks, and
- Quality of Internal Control Environment.

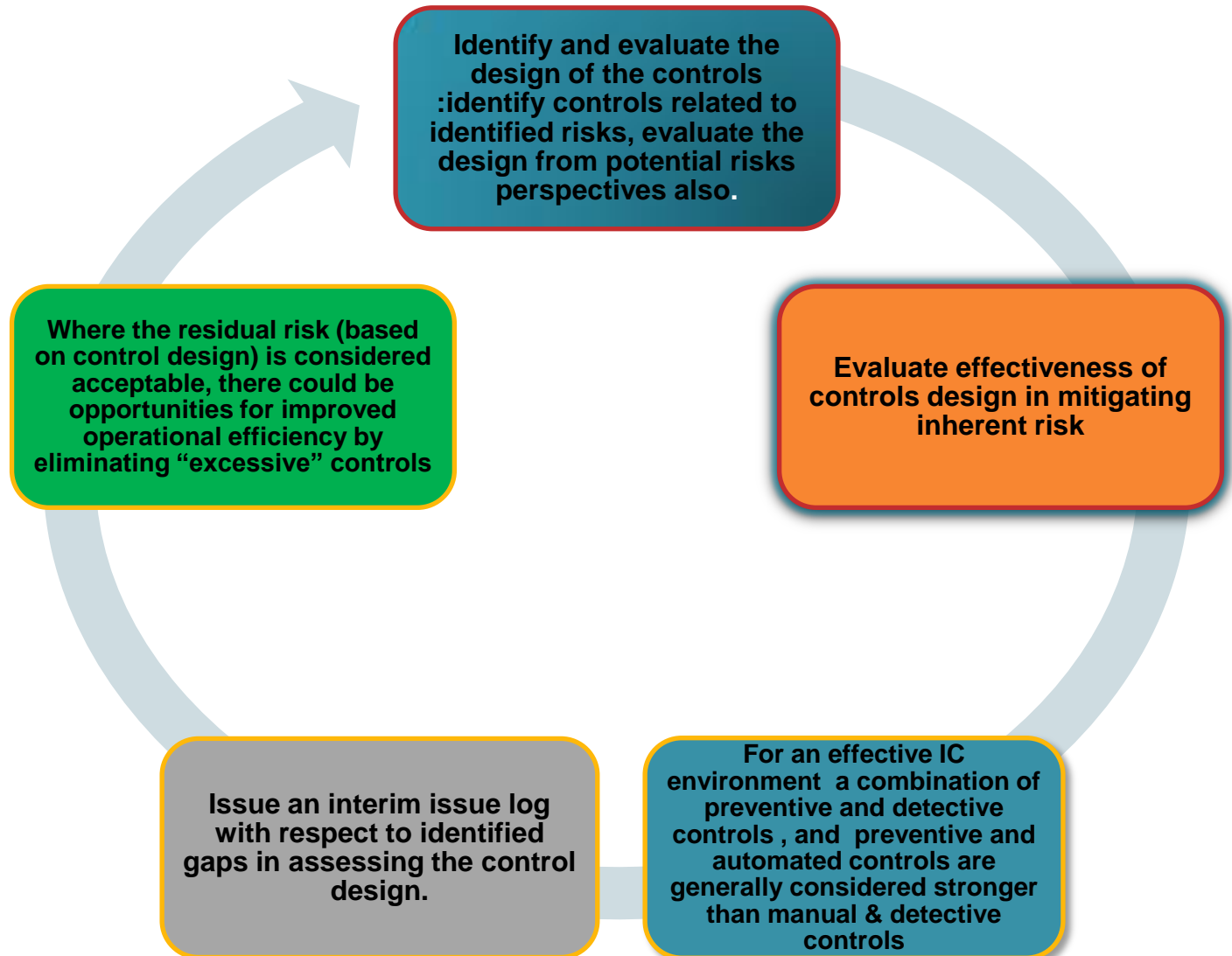
The other important variable to RAAP are :

- Audit Cycle (1-5 years)
- Mandatory (by regulators/management/ major fraud or any industry level incident)
- Audit opinion of past three years.

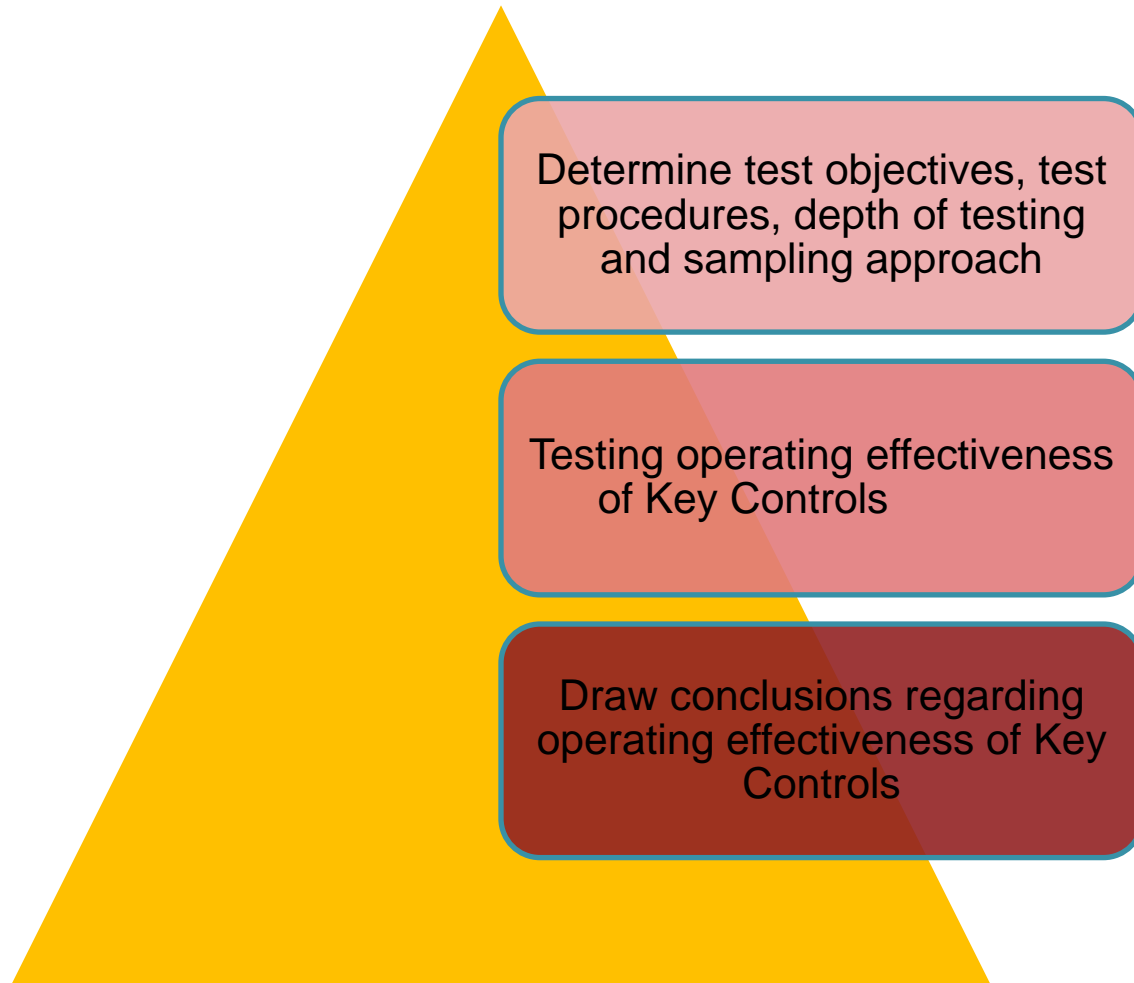
Business Process Analysis and Inherent Risk Assessment: Important Steps



Audit Execution: Test of Design



Audit Execution : Test of Effectiveness



Audit Execution : Test of Effectiveness

Controls Design Effectiveness	Inherent risk			
	Critical	High	Medium	Low
Highly mitigating	Comprehensive TOE	Comprehensive TOE	Reduced TOE	No TOE
Moderately mitigating	Reduced TOE	Reduced TOE	No TOE	No TOE

Audit Execution : Test of Effectiveness

- The auditor should select the testing technique that is most appropriate for collecting evidence (S-R-R-U) to achieve the test objective. Testing can take the following forms:
 - ❑ Corroborative Inquiry
 - ❑ Observation
 - ❑ Inspection and Examination
 - ❑ Confirmation (Internal/External)
 - ❑ Re-performance
 - ❑ Analytical Review Procedures (CAAT and other system based tools)

- Depth of Testing: The depth of testing is influenced by the degree of reliance which the auditor will place on the control(s) when formulating audit conclusions. The following table provides guidance:

Audit Execution: Test of Effectiveness

Which Sampling Approach should I use?

Non Statistical Sampling

Use auditor judgement, sample size depends in the type of control and frequency of the process.

Statistical sampling

Involves the use of probability techniques to determine the sample size and evaluate sample results.

No sampling approach (test 100% items)

Testing all items is not cost efficient; however you can consider reviewing all items in the following cases:

- when evidence is available electronically you can use **CAATs** to review all items and identify exceptions or items below or above certain values for further analysis. This results in better coverage and assurance obtained; or
- when the population is very small (i.e. 3 items) you can decide to review the entire population considering the resources available and time scheduled for the audit.

Final Steps: One

➤ Conduct a formal exit meeting:

- With both operating and senior management;
- An opportunity to clear doubts over understanding and factual status, and reasons for control gaps (root cause analysis) as understood by the auditor;
- Agreement over risk assessment of outstanding risks with which process owner is operating with;
- Discussion over practical and implementable recommendations (must be mapped to root cause);
- Give management due credit for actions already taken and offer consultative advice on those issues that are unresolved;
- Minor exceptions or findings can be discussed verbally, and may not be included in the audit report.

Final Steps: Two

➤ Reporting and Communication:

- Follow the best practices of Report Writing with Criteria, Condition, Root cause, Impact and Recommendation;
- A draft report to be issued to operating management to solicit corrective action plans over findings and recommendations ranked as High, Medium and/or Low risk;
- At this phase of the process, there should be no disagreements on the facts in the report , as these should have been agreed to during the fieldwork and exit meeting stages;
- Evaluate the each Management Action plan to see it addresses the root cause and are in line with recommendation;
- The time line provided to address the control gap should be in line Organization risk appetite;
- A final report is issued to include the internal auditor's findings and recommendations, as well as management's action plans.



Wrap Up

Q&A

Contact Information

Alok Chawla

TATA Motors Finance Limited

CO: I-Think Techno Campus

Building-A 2nd Floor,

Off Pokhran Road 2

Thane West 400607

Ph: 022-61815870,

Mobile: +919029007781

E-mail: alok.chawla@tmf.co.in