

*Presentation on*

*Enterprise Risk Management*

*&*

*Risk Based Audit Plan*

*21<sup>st</sup> April 2018*

# What is Risk

**ISO 31000: The effect of uncertainty on objectives.**

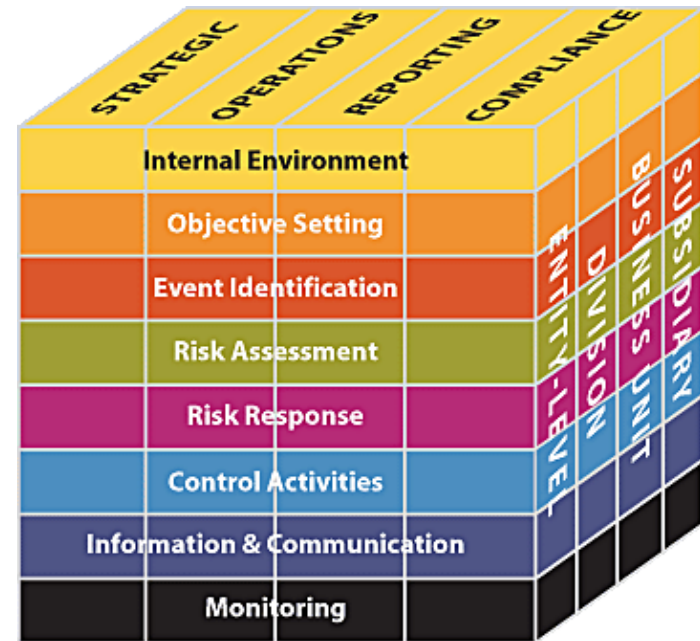
## Important components of Risk

- Uncertain event, but it can happen. **PROBABILITY**
- Will have effect, if occur **IMPACT**
- Can affect me **EXPOSURE**
  
- Exposure = Probability x Impact
  
- Need to take action if I can not afford **RISK APPETITE**

# Enterprise Risk Management (ERM)

ERM is a process applied across the enterprise to:

- Identify potential events that may affect entity
- Manage risks within risk appetite
- To provide reasonable assurance regarding achievement of entity objectives



## What companies do in ERM

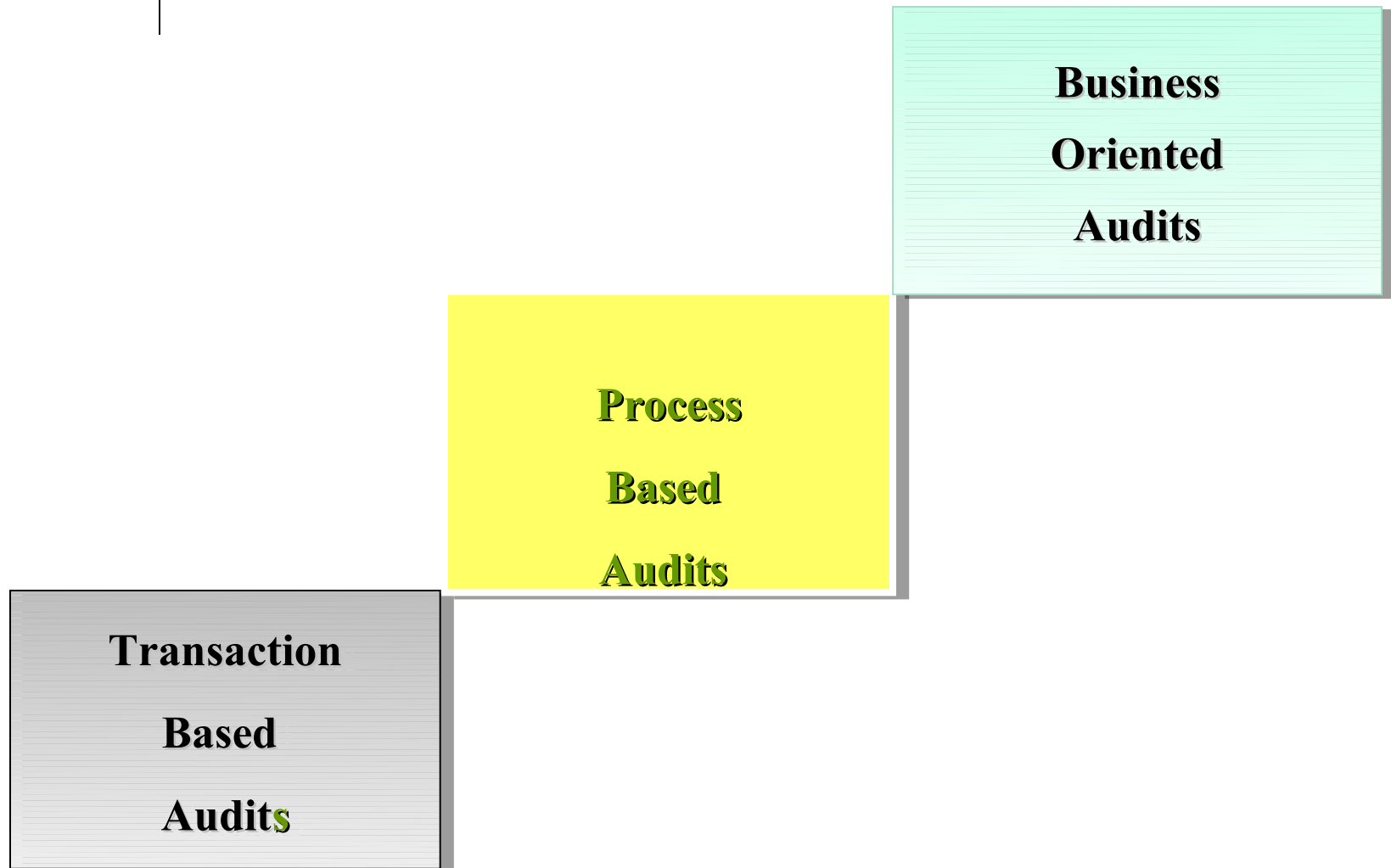
- Identify Risks at Business / Locational /Functional levels.
- Preparation of risk register at Business / Locational /Functional level.
- Fixation of Risk Appetite.
- Prioritization of risks at Business / Locational / Functional level.
- Prepare action plan for risks identified.
- High risks along with risks mitigation measures are reported in Locational Risk Committee Meetings.
- Critical / Top risks along with risk mitigation measures of Business/ Locational /Functional level gets reported in Risk Committee of Directors.

# Definition of Internal Audit

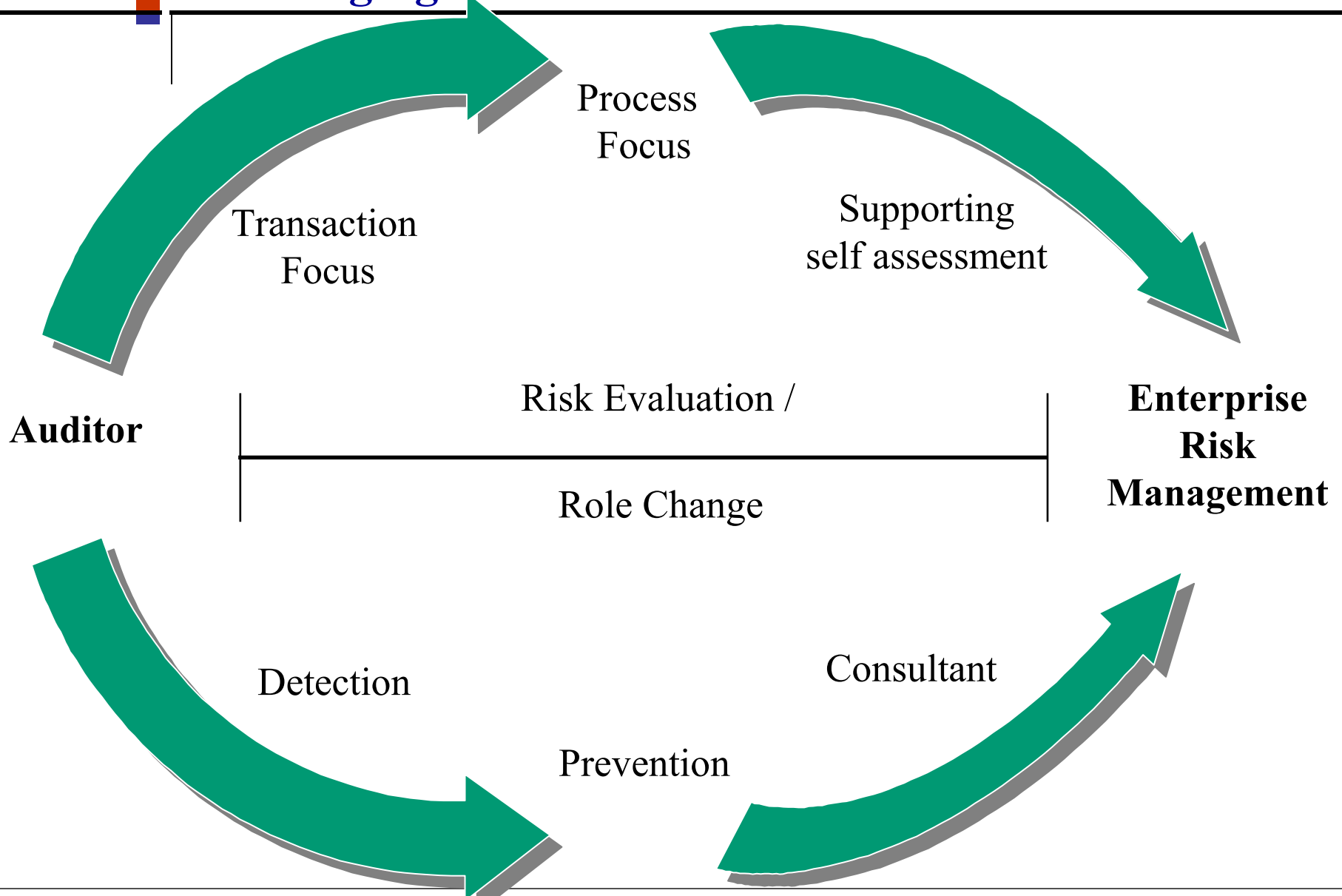
Internal Auditing is an independent, objective assurance and consulting activity designed to **add value** and **improve an organization's operations**. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of **risk management, control and governance processes**.

**Source: The Institute of Internal Auditors 1999 (IIA)**

# Evolution of Internal Audit



# Changing role of Internal Auditor



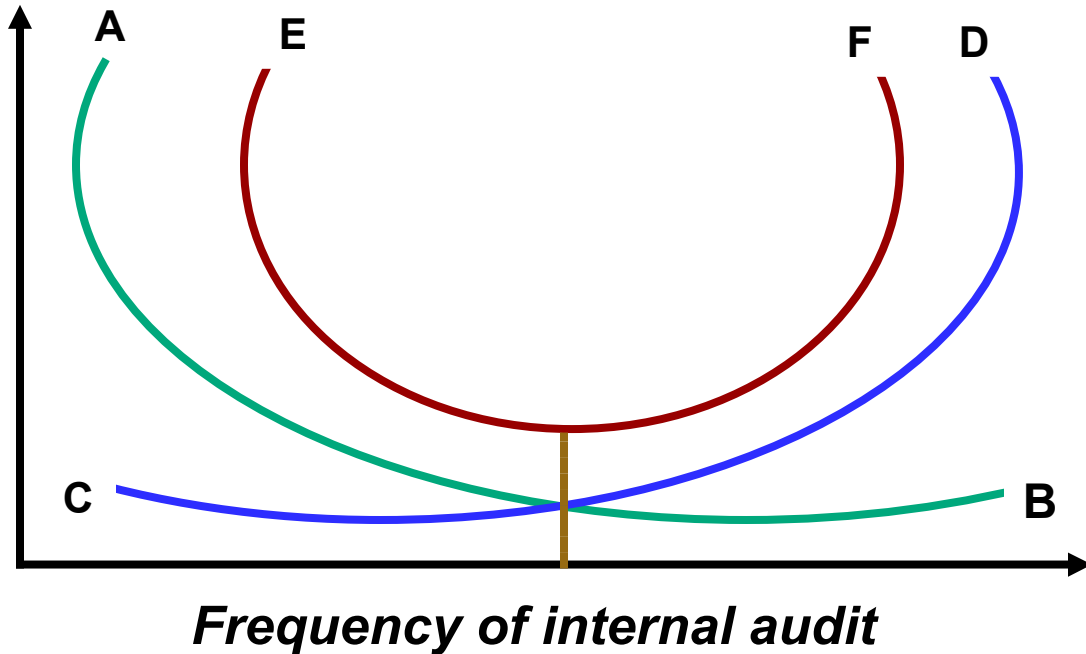
# Management expectations from IA

- Pro active approach, i.e. no last minute surprises
- Business oriented audits
- Value Addition in the form of Cost Reduction
- Feedback on operations instead of processes
- Act as consultant
- Limited resources
- Contribute in Risk Management Framework



# Audit Planning & Resource Rationalization

*Risk of losses  
due to non-audit  
/ Cost of  
Internal Audit  
resources*



**A** ————— **B**  
**C** ————— **D**  
**E** ————— **F**

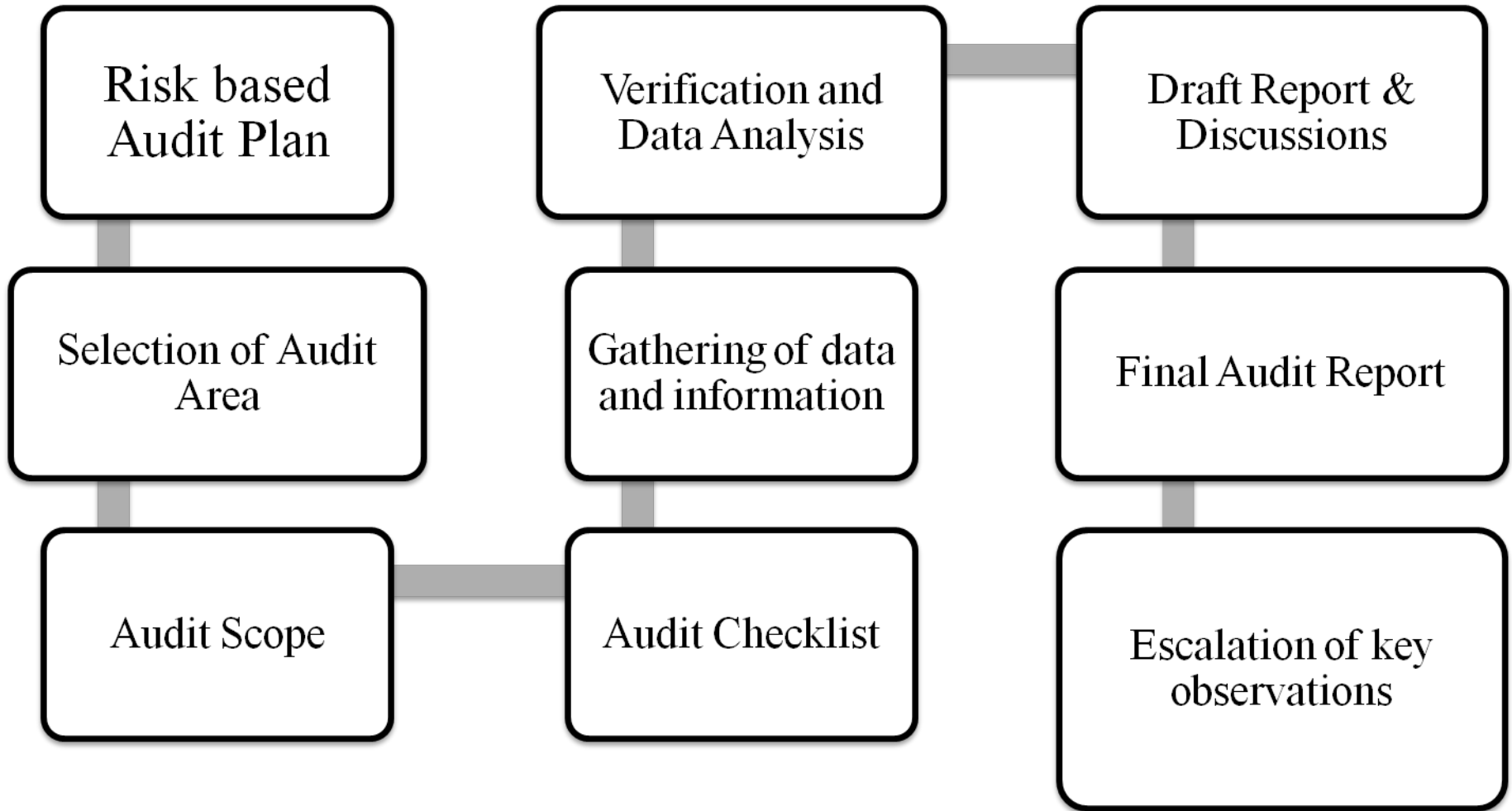
**'Costs due to risk of losses' curve**  
**'Cost of Internal Audit resources'**  
**curve**  
**'Total Cost' Curve**

The more number of audits IA function undertakes, the more is the cost of resources and the less the number of audits, the more the risk of losses.

# Risk Based Audit Plan

- ❑ Audit plan to be based on the risk profile of the Entity
  - Helps in identification of appropriate risk factors to reflect the management concern.
  - Assists in appropriate audit coverage plan by setting out audit priorities clearly.
  
- ❑ Frequency of audit
  - Increased frequency of audits based on risk level of audit area, i.e. more no. of audits for high risk areas.
  
- ❑ Intensity of audit
  - Audit of high risk units much more intensive than low risk units
  
- ❑ Extent of testing
  - Sampling techniques/ 100% checking

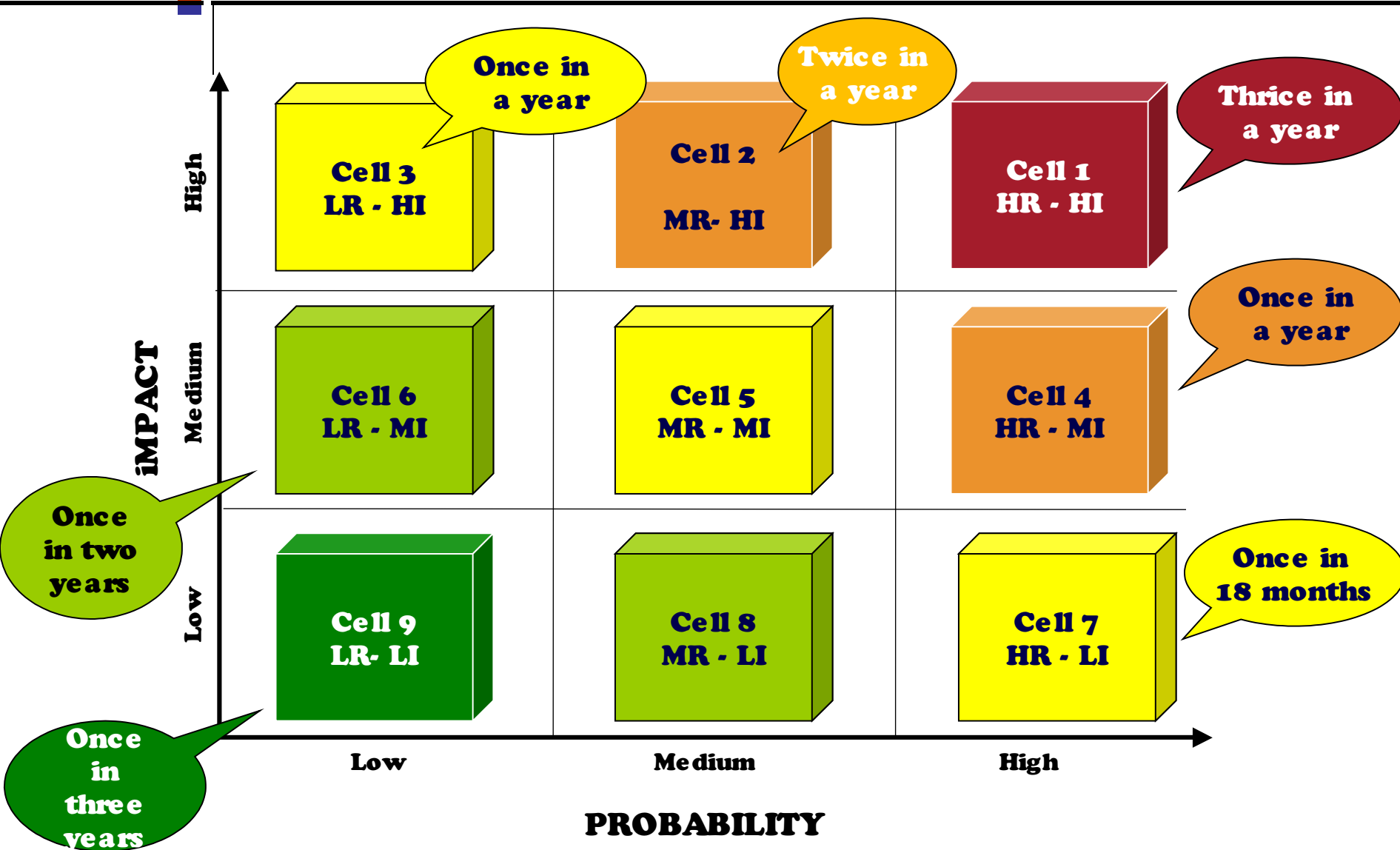
# Audit Methodology





# Case Study-1

# Risk Matrix





# Case Study-2

# Risk Assessment... (1/5)

- Done separately for each business unit / location.
- Done at 2 levels i.e.
  - Business Risks (Impact)
  - Control Risks (Probability of going wrong)
- Rating on a scale of 1 to 5 for both the risks.

## Risk Assessment... (2/5)

### Business Risks:

- i. Based on values i.e. reflects impact.
- ii. Defined Risk Appetite
- iii. Take Location wise financial statements of last year
- iv. Created groups for common accounts e.g. Fixed Assets, Bank Accounts Loans & Advances, Operations, Logistics, Marketing etc.
- v. Rating done based on values of each group

Rating	Criteria
1	< Rs. 1 Crore
2	> Rs. 1 Crore < Rs. 5 Crores
3	> Rs. 5 Crores < Rs. 25 Crores
4	> Rs. 25 Crores < Rs. 125 Crores
5	> Rs. 125 Crores



## Risk Assessment... (3/5)

### Control Risks:

- i. Identified various processes relating to various account heads.  
For example: Preparation of fixed assets register, Addition of fixed assets, Capitalization, Disposal, Physical verification, Charging of depreciation etc. were identified for account group “Fixed Assets”.
- ii. Rated processes based on our past audit experience and inputs from Senior management and the Board.
- iii. The scale of rating : 1 to 5. Rating of 1 for no audit observation while 5 for repeated control failures.
- iv. Calculated average of all the processes in a given account group.

## Risk Assessment... (4/5)

### Frequency of Audits:

- Worked out Exposure = Business Risk x Control Risk.
- Rating scale : 1 to 25
- Frequency of audit based on Exposure.

Frequency	Exposure
Compliance Only	$\leq 5$
1	$5 < \leq 10$
2	$10 < \leq 15$
3	$15 < \leq 20$
4	$> 20$



Microsoft Excel  
97-2003 Worksheet

## Risk Assessment... (5/5)

### Audit plan:

- i. Calculate total man days required after considering frequency of audits.
- ii. Compare man days available with man days required.
- iii. Form strategy either to recruit or outsource
- iv. Prepare Annual Audit Plan and Manpower Plan
- v. Prepare Quarterly / Monthly Plans and monitor Budget v/s Act



Microsoft Excel  
Worksheet



# Benefits

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1. Objective Risk Assessment. Very limited subjectivity.
2. Frequency of audit based on Risk Scores i.e. Exposure.
3. More frequency of audit for areas with High Risk High Impact as against current frequency of once in a year.
4. Limited review for low risk prone areas.
5. Better allocation of resources.



# Cautions

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1. Do not use this methodology for:
  - i. New organizations
  - ii. New locations
  - iii. New internal audit dept.
  - iv. High value low volume business
  - v. 100% coverage required by Statute or Management
  
1. For service industries (ex: Bank Branches, Retail Stores etc.), this methodology requires modification.
  
2. Method in case study shown is only one of method. Other methods can also be used.



## Case study-3

# Risk Assessment

**Business Risks :** Same process as given in Case study -2

**Control Risks:** for new internal audit dept. or new organization

- Based on 5 factors influencing controls in each area.
  - 1) People : Whether person is experienced or new.
  - 2) Place : Whether activities are centralized or decentralized.
  - 3) Inherent : Inherent risk in process / area. E.g. Cash
  - 4) Past : Past Audit observations.
  - 5) Automation: Whether process is automated or manual.
  
- Rating given to each factor.  
Rating of 1 if it can influence controls  
Rating of 0 if there is no influence on controls.
  
- Total up rating of all 5 components.

**Frequency of Audit:** Same process as given in Case Study -2



Microsoft Excel  
97-2003 Worksheet

## Risk rating guidelines for audit observations

Rating	Category	Parameters
<b>High</b>	Efficiency	Financial Impact > Rs. 5 crore
	Process	Repeated observations for more than 2 times
	Compliance	Financial penalty > Rs. 5 lac or Imprisonment
	Others	Risk of loosing reputation
<b>Medium</b>	Efficiency	Financial Impact > Rs. 1 crore but < Rs. 5 crore
	Process	Repeated observations
	Compliance	Financial penalty > Rs. 1 lac but < Rs. 5 lac
<b>Low</b>	Efficiency	Financial Impact < Rs. 1 crore
	Process	Observation reported first time
	Compliance	Financial penalty < Rs. 1 lac



# Audit Report

XYZ PVT. LTD.

Unit	
Process Owner	
Audited By	
Reviewed By	
Review Period	
Report Reference	
Date of Report	
Distribution	

Sr. No.	Observations	Auditee's Comments	Target date	Responsibility
1.	<ul style="list-style-type: none"><li>-Condition</li> <li>-Root cause</li> <li>-Risk rating: Low/Medium/High</li> <li>-Suggestions</li></ul>			

# Factors influencing effectiveness of RBAP



# Success Factors for IA

- Gain understanding of Business
- Focus on the future—take a proactive approach to risk identification.
- Augment skill sets (increasing the role of IT and subject matter professionals) and leverage resources.
- Secure strong and visible support from senior management by doing risk based audits which add value to organization.
- Use audit tools like ACL, Idea, advance Excel etc.
- Take a flexible approach to the work: do not be too constrained by the annual plan; ensure there is flexibility and sufficient unallocated time to address developing issues.

# Skills requirement

- Data Analytic Skills
- Communication skills
- Inter personal skills
- Eye for Detailing
- Business & Process Understanding
- **Diplomatic Skills**



