Compendium of Standards on Internal Audit
(As on February 1, 2020)

Internal Audit Standards Board
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi
In today’s world, globalization, technology, and economic uncertainty are shaking up prior assumptions about the future. At the same time, role of Internal Auditor has undergone a paradigm change in the regulatory landscape brought out by the Companies Act, 2013. Today, Internal Auditors need to demonstrate their expertise in risk management, business process improvement and knowledge, more characteristic of a consultant than of a classic Internal Auditor. Furthermore, Internal Auditors are no longer required to focus solely on financial aspects but also cover operational matters. Increasingly, they are expected to provide value added support to management in areas, such as, strategy and governance.

Emergence of new and complex risks continues to challenge the Internal Auditor’s ability to address the issues being faced by the organizations. Continuous learning with an eye on the future, and a timely application of relevant knowledge to create value will help to increase the Internal Auditor’s credibility and confidence in their enhanced roles.

Keeping this in mind, the Internal Audit Standards Board (IASB) is bringing out this revised Compendium of Standards on Internal Audit. These Standards on Internal Audit are performance benchmarks as they represent the best practices in internal auditing and other assurance services performed by the members. The Board has also initiated the process of making Standards on Internal Audit mandatory for certain class of companies in a phased manner. This Compendium contains new principle-based Standards on Internal Audit as issued by the Board, till date, along with Revised Preface to the Framework and Standards on Internal Audit, Framework Governing Internal Audits and Basic Principles of Internal Audit. The Compendium also incorporates all the earlier Standards which are still applicable and not superseded.

At this juncture, I wish to place my appreciation to CA. Charanjot Singh Nanda, Chairman, IASB, CA. Anil Satyanarayan Bhandari, Vice-Chairman, IASB and other members of the Board for their commitment in bringing out this Compendium as a one stop reference for members practicing in the area of internal audit.
I am hopeful that the members working as Internal Auditors will find these principle-based Standards immensely useful.

February 5, 2020
Mumbai

CA. Prafulla P. Chhajed
President, ICAI
In today’s challenging times, the role of internal audit in effective governance has become highly essential in the functioning of businesses. Internal auditors are delivering much more than providing basic assurances on financial integrity and regulatory compliances. At the same time, internal auditors need to stay abreast of the changes underway in the professional environment to play a vital role in the core areas of risk management and corporate governance.

The Institute continuously strives to stay at the cutting edge of best practice, including those in the field of Internal Audit. Therefore, to be effective, Internal Audit must be conducted in accordance with a set of recognized Standards. Standards on Internal Audit (SIAs) issued by the Institute are aimed to increase the overall quality, credibility, consistency and comparability of the work performed by the Internal Auditors. The members attain a high level of performance and quality in internal audit by applying Standards on Internal Audit and thereby, meet the expectations of all relevant stakeholders.

The Board has brought out various SIAs which, in addition to outlining fundamental principles for the guidance of the members, also serve as performance benchmarks. The Institute has initiated the process of revising SIAs and making them mandatory for certain class of companies in a phased manner. Mandatory status of SIAs will act as a starting point for ICAI to chalk out a road map for enhancing relevance of internal audit profession. Revised Standards have been re-numbered and classified in the categories: Standards on Key Concepts (100 series), Standards on Internal Audit Management (200 series), Standards on the Conduct of Audit Assignments (300-400 series), Standards on Specialized Areas (500 series), Standards on Quality Control (600 series) and Standards on Miscellaneous Matters (700 series). These principle-based Standards provide a framework for internal audit activities, establish the basis for evaluation of internal audit performance, and foster improved organizational processes and operations. The Board is bringing out this Compendium of Standards on Internal Audit containing revised Preface, Framework (including revised definition of Internal Audit), Basic Principles of Internal Audit and all Standards on Internal Audit which are currently applicable (including new and revised).
At this juncture, we wish to place on record our sincere thanks to members of the study group, viz., CA. Surath Mukherjee, CA. Sideshwar Bhalla, CA. Saket Mehra, CA. Naval Bajaj, CA. N. G. Shankar, Shri VGVS Sharma, CA. Sudipta Dey, CA. Ruchi Sadhana, CA. Yukti Arora, CA. Bharat Garg, CA. Sourabh Arora and CA. Harshvardhan Tyagi for sparing time out of their pressing preoccupations and contributing in revising the Standards and providing their valuable comments on draft Standards.

I would also like to express my deep gratitude to CA. Prafulla P. Chhajed, President, ICAI, CA. Atul Kumar Gupta, Vice President, ICAI and CA. Anil Satyanarayan Bhandari, Vice-Chairman, IASB for their continuous support and encouragement to the initiatives of the Board. I must also thank my colleagues from the Council at the Internal Audit Standards Board, viz., CA. Jay Chhaira, CA. Tarun Jamnadas Ghia, CA. Nihar Niranjan Jambusaria, CA. Dheeraj Kumar Khandelwal, CA. Shrinivas Yeshwant Joshi, CA. Dayaniwas Sharma, CA. Prasanna Kumar D., CA. Rajendra Kumar P., CA. M. P. Vijay Kumar, CA. (Dr.) Debashis Mitra, CA. Anuj Goyal, CA. Pramod Kumar Boob, CA. Ranjeet Kumar Agarwal, CA. Pramod Jain, Shri Manoj Pandey, Shri Chandra Wadhwa and Ms. Ritika Bhatia for their vision and support. I also wish to place on record my gratitude for the co-opted members on the Board, viz., CA. Laxmi Narayan Agarwal, CA. Mohit Gupta, CA. Amit Gupta, CA. Rohit Kothari, CA. Akkaiah Naidu Sunkara, CA. Pramod Agrawal, CA. Kailash Agarwal and special invitees, viz., Shri Atma Sah, CA. Manoj Kumar Agarwal, CA. Anil Kumar Sharma, CA. Sanjeev Kumar Sood and CA. Ravi Harihara Iyer for their invaluable guidance as also their dedication and support to the various initiatives of the Board. I also wish to place on record the efforts put in by CA. Arti Bansal, Secretary, Internal Audit Standards Board, Mr. Harish Dua, Advisor- Internal Audit and their team for continuous support in the activities of the Board.

I sincerely wish that this Compendium would support the members in discharging their duties as highly valued, trusted advisors and groom them as stalwarts in the profession.

February 5, 2020

CA. Charanjot Singh Nanda
Delhi
Chairman, Internal Audit Standards Board
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- To review existing and emerging internal audit practices worldwide and identify areas in which Standards on Internal Audit (SIAs) need to be developed.
  - to formulate Standards on Internal Audit (SIAs) which may be issued under the authority of the Council of the Institute.
  - to formulate Guidance Notes on issues relating to internal audit, including those arising from the SIAs, or pertaining to any specific industry, which may be issued under the authority of the Council of the Institute.
  - to continuously review the existing Standards and Guidance Note on Internal Audit and to undertake their revision, if necessary.
  - to formulate and review Implementation Guides, Technical Guides, Practice Manuals, Studies and other papers, which may be issued under its own authority for guidance of the members, as felt appropriate by the Board.

- To undertake research and promote knowledge dissemination in the field of internal audit.
  - to organize conferences, seminars, training programmes, workshops, webinars, e-learning programs, surveys, etc. on the topics related to internal audit, including risk management and governance.
  - to conduct Certificate Courses/Diploma Courses, etc. on topics related to internal audit.
SECTION I

Preface
# PREFACE TO THE FRAMEWORK AND STANDARDS ON INTERNAL AUDIT*

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Preface to the Standards on Internal Audit was, originally, issued in November, 2004, revised in July, 2007, and was recommendatory in nature. The revised Preface to the Framework and Standards on Internal Audit shall become mandatory from such date as notified by the Council.

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* Issued in November 2018.
1 Introduction

1.1 This Preface to the Framework, Basic Principles and Standards on Internal Audit facilitates understanding of the scope and authority of the pronouncements of the Internal Audit Standards Board, issued under the authority of the Council of the Institute of Chartered Accountants of India.

2 Internal Audit Standards Board

2.1 The Institute of Chartered Accountants of India (hereinafter referred as “ICAI” or “the Institute”) constituted the “Committee for Internal Audit (CIA)” in February 2004, which in November 2005 was renamed as the “Committee on Internal Audit”. In November 2008, the Council renamed this Committee as the “Internal Audit Standards Board (hereinafter referred as the Board)”.  

2.2 The objectives and functions of the Board are as follow:

(i) To review existing and emerging internal auditing practices worldwide and identify areas in which Standards on Internal Audit (SIAs) need to be developed.

(ii) To formulate Standards on Internal Audit, which may be issued under the authority of the Council of the Institute.

(iii) To formulate Guidance Notes on issues relating to internal audit, including those arising from the SIAs, or pertaining to any specific industry, which may be issued under the authority of the Council of the Institute.

(iv) To continuously review the existing Standards and Guidance on Internal Audit and to undertake their revision, if necessary.

(v) To formulate and review Implementation Guides, Technical Guides, Practice Manuals, Studies and other papers which may be issued under its own authority for guidance of the members, as felt appropriate by the Board.

(vi) To undertake research and promote knowledge dissemination in the field of internal audit.

3 Framework Governing Internal Audits

3.1 Every standard setting process operates within a pre-defined framework which outlines certain fundamental components inherent to
Preface to the Framework and Standards on Internal Audit

the function or activity of internal audit. This is essential to ensure a consistent application of Basic Principles, Best Practices and Standards to achieve a high level of quality consistent with the objective of internal audit.

3.2 The Framework Governing Internal Audits is an overarching document to be read along with this Preface. It consists of Definition of Internal Audit, Code of Ethics and the following four components of internal audit:

(a) Basic Principles of Internal Audit
(b) Key Concepts
(c) Standards on Internal Audit, and
(d) Guidance

4 Standards on Internal Audit (SIAs)

4.1 The Standards on Internal Audit (SIAs) are a set of minimum requirements that apply to all members of the ICAI while performing internal audit of any entity or body corporate.

4.2 As per Section 138 of Companies Act, 2013, the Board of a Company may, besides a Chartered Accountant, appoint a cost accountant or any other professional to conduct Internal Audits. The ICAI recommends the adoption of the SIAs by non-members of the ICAI who are performing internal audits so as to ensure a consistent approach and quality in the discharge of their professional duties.

5 Mandatory Nature of Framework and Standards

5.1 The Council of the ICAI has decided that the Standards will be made mandatory in a phased manner.

The SIAs shall initially be mandatory for members performing internal audits in all listed companies, as per Section 138 of the Companies

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1 The current law in India permits internal audit to be performed either by an entity’s own employee (i.e., personnel on the payroll of the organization or its group company) or by a professional who is part of an external agency (e.g., a firm of practicing Chartered Accountants undertaking internal audit engagements). These SIAs apply to ICAI members in both situations, irrespective of whether the internal audit is conducted by them in the capacity of an employee or as a representative of an external agency.
Act, 2013, read with Rule 13 of Companies (Accounts) Rules, 2014 from the effective date of the SIA, and all other companies from one year thereafter.

5.2 The mandatory status of a SIA implies that while carrying out an internal audit, it shall be the duty of the members of the Institute to ensure that they comply with the SIAs read with the Preface, Framework Governing Internal Audits and Basic Principles of Internal Audit.

5.3 If, for any reason, a member is unable to comply with any of the SIAs requirements, or if there is a conflict between the SIA and other mandates, such as a regulatory requirement, the internal audit report (or such similar communication) should draw attention to the material departures therefrom along with appropriate explanation.

6 Standard Setting Process

6.1 The Board develops and revises SIAs in consultation with Study Groups (if required). Exposure drafts are thereafter released to various interest groups and public at large for their feedback and comments. The Board reviews the comments and thereafter places the SIA before the Council for its deliberation. The SIAs approved by the Council are issued with the final changes.

6.2 The detailed process is explained under Annexure 1.

7 Contents of the Standards

7.1 SIAs shall be principle based and will clearly outline the objective of issuing the particular Standard along with the essential requirements for its compliance.

7.2 Internal Auditors shall apply their best professional judgement in the implementation of SIAs on a “substance over form” basis. Implementation and Technical guides issued by the Board would help to provide the necessary guidance and clarification in this regard.

7.3 The essence of each Standard is captured under the following key sections:

(i) **Introduction**: To provide a brief background and scope of the Standard and its applicability.

(ii) **Objective**: Reasons for issuing the Standard and why it is required.
Preface to the Framework and Standards on Internal Audit

(iii) **Requirements**: The desired outcome and what is essential to ensure compliance with the Standard.

(iv) **Explanatory Comments on Implementation and Application**: Certain parts of the Standard which needs to be elaborated, including defining key words and terms.

(v) **Effective Date**: Date from which the Standard is to be applied and made mandatory.

7.4 The Standards on Internal Audit, as and when issued, will be classified and numbered in a series format, as follows:

(i) 100 Series : Standards on Key Concepts
(ii) 200 Series : Standards on Internal Audit Management
(iii) 300–400 Series : Standards on the Conduct of Audit Assignments
(iv) 500 Series : Standards on Specialised Areas
(v) 600 Series : Standards on Quality Control
(vi) 700 Series : Other/Miscellaneous Matters

8 **Guidance**

8.1 Guidance Notes on Internal Audit are primarily designed to provide guidance on matters of implementation or clarification on their applicability in certain circumstances.

8.2 The Board may issue the following guides (as appropriate):

(i) **Implementation Guide**: Best practices, methodologies or approach on how best to apply internal audit procedures in order to achieve the objectives of the SIA.

(ii) **Technical Guide**: Clarifications as to what extent the SIA applies in a certain industry or a particular situation, considering the technical or operational uniqueness of the same, and how best to achieve the objectives of the SIA.

8.3 The Implementation and Technical Guides are recommendatory in nature. The Internal Auditor should ordinarily follow these recommendations except where, under particular circumstances, it may not be necessary or appropriate to do so.
9 Effective Date

9.1 The Preface to the Framework and Standards on Internal Audits is applicable for all internal audits beginning on or after a date to be notified by the Council of the Institute.

9.2 In case of SIAs issued by the ICAI for which a Guidance Note is already in existence, the Guidance Note shall stand withdrawn from the date on which the Standard comes into effect.
ANNEXURE 1

DETAILS OF THE STANDARD SETTING PROCESS

1. Selection of Topics and Time-lines: The Internal Audit Standards Board, on a continuous basis, and in consultation with its key stakeholders, keeps identifying the broad areas in which the SIAs need to be formulated (including the review and revision of prevailing SIAs) and prepares a priority list with time lines for the issuance of the SIAs.

2. Formation of Study Group to Draft Standards: In the preparation and drafting of the SIAs, the Board is assisted by a Study Group (SG) of professionals constituted by the Board. In the formation of the SG, provision is made for the participation of a cross section of members of the Institute. In certain situations, the Board may also consider having expert professionals on the SG, who need not necessarily be members of the ICAI. The SG is generally chaired by a member of the Board and convened by the Board. The SG is responsible for preparing and finalising the Exposure Draft of the Standard and make it ready for review and approval of the Board.

3. Review of Exposure Draft of SIA by the Board: The Exposure Draft (ED) of the Standard is put up to the Board for their review, deliberation and approval. On the basis of the deliberations of the Board, changes are made to the draft, and the final ED is made ready for exposure with a wide set of stakeholders.

While formulating the SIAs, the Board takes into consideration the applicable laws, customs, business environment in India. The Board also, where appropriate, takes into consideration the international practices in the area of internal audit, to the extent they are relevant and applicable to the conditions existing in India.

4. Exposure Draft Open for Comments for 30 days: The Exposure Draft of the proposed Standard is issued for comments by the members of the Institute. The ED is also open for comments by non-members, including the regulators and other such bodies as well as general public. The ED is also published in the monthly Journal of the Institute and hosted on the website of the Institute wherefrom it is downloadable free of charge for comments by the professional accountants and the public. The ED is also circulated to all the members of Council of the ICAI, the Institute's past Presidents,
Regional Councils and the branches of the Institute for their comments. The Exposure Draft is also circulated to other external stakeholders as listed in Annexure 2.

The Exposure Draft is normally open for comments for a period of at least 30 (thirty) days from the date of issuance, but this time may be extended if considered necessary.

5. **Finalisation and Submission to ICAI Council**: After taking into consideration the comments received on the Exposure Draft, the Board will update the draft of the proposed Standard, take inputs of the SG (if appropriate), finalise the Standard for consideration by the Council of the Institute.

6. **ICAI Council Deliberates and Approves SIA**: The Council of the Institute will consider the final draft of the proposed Standard on Internal Audit and if necessary, modify the same in consultation with the Internal Audit Standards Board.

7. **SIA Issued with Final Changes**: The SIA will then be issued under the authority of the Council of the Institute.
ANNEXURE 2

LIST OF STAKEHOLDERS FOR INPUTS ON EXPOSURE DRAFTS

1. The Ministry of Corporate Affairs
2. The Reserve Bank of India
3. The Securities and Exchange Board of India
4. The Insurance Regulatory and Development Authority
5. The Comptroller and Auditor General of India
6. The Controller General of Accounts
7. The Central Board of Direct Taxes
8. The Central Board of Excise and Customs
9. The Institute of Cost Accountants of India
10. The Institute of Company Secretaries of India
11. Recognised Stock Exchanges in India
12. The Indian Banks' Association
13. The Standing Conference of Public Enterprises
14. The National Bank for Agricultural and Rural Development
15. The Indian Institute(s) of Management
16. The Telecom Regulatory Authority of India
17. The Central Registrar of Co-operative Societies
18. Various Industry bodies/associations, such as, The Confederation of Indian Industry, The Associated Chambers of Commerce and Industry, The Federation of Indian Chambers of Commerce and Industry, etc.
19. Any other body considered relevant by the Board, keeping in view the nature and requirements of SIAs.
SECTION II

Framework
Framework Governing Internal Audits*

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Framework for Standards on Internal Audit was, originally, issued by the Board in August 2007, which was recommendatory in nature. The revised Framework Governing Internal Audits shall become mandatory from such date as notified by the Council.

* Issued in November 2018.
Compendium of Standards on Internal Audit

1 Introduction and Scope

1.1 The Framework Governing Internal Audits lays down the underlying principles and boundaries for the internal audit function and activity. It provides clarity on key components governing internal audits to ensure standardisation and quality in discharge of Internal Auditors’ responsibilities.

1.2 Scope: The framework covers all aspects of internal audits, from the overall management of the internal audit function to the performance of specific internal audit assignments.

2 Objectives

2.1 The main objectives of a framework are to:

(i) Provide clarity on key components that govern internal audits;

(ii) Outline the manner in which these components are inter-related; and

(iii) Specify how these are essential to the conduct of quality internal audits.

3 Definition of Internal Audit

3.1 Internal Audit is defined as follows:

*Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives.*

3.2 Brief explanation of the key terms used above is as follows:

(i) **Independence**: Internal audit shall be an independent function, achieved through the position, organization structure and reporting of the internal auditor.

   At times, in addition to providing assurance, the internal auditor may adopt an advisory role to help an organization achieve its objectives, provided this does not compromise the independence of the internal auditor.

(ii) **Internal controls and risk management** are integral parts of management function and business operations. An internal auditor is expected to evaluate the design and operating effectiveness of internal controls and risk management
Framework Governing Internal Audits

processes (including reporting processes) as designed and implemented by the management.

(iii) Governance is a set of relationships between the company and its various stakeholders and provides the structure through which the company’s objectives are achieved. It includes compliance with internal policies and procedures and laws and regulation.

(iv) Organizational objectives incorporate the interests of all stakeholders and include the short and medium term goals that an organisation seeks to accomplish.

3.3 This definition forms the underlying foundation of all the Standards on Internal Audit (SIAs) issued by the Board. Internal audit activities shall be conducted in line with the Definition of Internal Audit.

4 The Framework

4.1 The Framework Governing Internal Audits comprises of “Definition of Internal Audit” (as covered above), four components and the most important underlying principle “Code of Ethics”. Each component is inherent to the whole process of internal audit and implicitly forms part of the Standards on Internal Audit, even though they may not be mentioned explicitly in the Standards. Hence, as explained in the Preface, they all are mandatory in nature, except the Guidance which is recommendatory.

4.2 The four components (forming the pillars) of the framework are:

(i) Basic Principles of Internal Audit
(ii) Key Concepts
(iii) Standards on Internal Audit (SIAs)
(iv) Guidance.
A pictorial depiction of the Framework Governing Internal Audit is as follows:

5 Code of Ethics

5.1 Every Internal Auditor is bound by a written Code of Ethics, issued by an organisation and/or the professional institution of which he is a member. This commits the Internal Auditor to ethical Standards applied with utmost integrity and sincerity.

5.2 A member of the Institute of Chartered Accountants of India, carrying out an internal audit activity, is, additionally, governed by:

(a) the requirements of the Chartered Accountants Act, 1949

(b) the Code of Ethics issued by the Institute of Chartered Accountants of India

(c) other relevant pronouncements of the Institute of Chartered Accountants of India.
6 Components of the Framework

6.1 Basic Principles of Internal Audit

The Basic Principles of Internal Audit are a set of core principles fundamental to the function and activity of internal audit. The Basic Principles are critical to achieve the desired objectives as set out in the Definition of the Internal Audit, and therefore, apply to all internal audits.

The principles can be summarised as follows:

1. Independence
2. Integrity and Objectivity
3. Due Professional Care
4. Confidentiality
5. Skills and Competence
6. Risk Based Audit
7. Systems and Process Focus
8. Participation in Decision Making
9. Sensitive to Multiple Stakeholder Interests
10. Quality and Continuous Improvement.

6.2 Key Concepts

There are certain concepts which form integral part of the internal audit activity and, therefore, apply to most internal audits. In fact, some of the concepts are ingrained in the Definition of Internal Audit. The key concepts are in the nature of:

- Internal Controls
- Risk Management
- Governance Processes

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1 Refer Para. 3 of Basic Principles of Internal Audit issued by the Board.
2 The details of Key Concepts are published as separate Standards (SIA: 100 series).
Compendium of Standards on Internal Audit

- Compliance with Laws and Regulations
- Nature of Assurance.

6.3 Standards on Internal Audit (SIAs)

The Standards on Internal Audit (SIAs) establish uniform evaluation criteria, methods, processes and practices. The Standards are pronouncements which form the basis for conducting all internal audit activity. These pronouncements are designed to help the internal auditor to discharge his responsibilities.

6.4 Guidance

These are a set of guidelines, which include Guidance Notes, Implementation Guides and Technical Guides. These guidelines are important for implementation of the SIAs and provide clarification for their applicability under particular circumstances.

7 Effective Date

7.1 This Framework Governing Internal Audits is applicable for all internal audits beginning on or after a date to be notified by the Council of the Institute.
SECTION III

Basic Principles
Standard on Internal Audit (SIA) 2, Basic Principles Governing Internal Audit was, originally, issued by the Board in August 2007 which was recommendatory in nature. The revised Basic Principles of Internal Audit is being issued as overarching document for all the Standards on Internal Audit and shall become mandatory from such date as notified by the Council.

* Issued in November 2018.
1 Introduction and Scope

1.1 There are a set of core principles fundamental to the internal audit function and activities. These basic principles of internal audit are critical to achieve the desired objectives as set out in the Definition of Internal Audit.

1.2 **Scope:** All internal audits shall be performed based on these basic principles, and departures from these principles shall be appropriately disclosed in internal audit report or other similar communication.

2 Objectives

2.1 The main objective of the basic principles is to ensure that:

(i) All internal audits are conducted with certain fundamental features designed to:
   - establish the credibility of the Internal Auditor (principles mentioned under para. 3.1 to 3.5), and
   - outline the elements essential for performance of internal audit activities (principles mentioned under para. 3.6 to 3.10).

(ii) Outcome of internal audits is of quality and is in line with the set objectives.

3 Basic Principles

3.1 Independence

The Internal Auditor shall be free from any undue influences which force him to deviate from the truth. This independence shall be not only in mind, but also in appearance. Also, the internal auditor shall resist any undue pressure or interference in establishing the scope of the assignments or the manner in which these are conducted and reported, in case these deviate from set objectives.

The independence of the internal audit function as a whole, and the Internal Auditor within the organisation, plays a large part in establishing the independence of the Internal Auditor. The overall organisation structure of key personnel, the position and reporting of the Chief Internal Auditor within this structure, along with the powers
Basic Principles of Internal Audit

and authority which is derived from superiors further establishes the independence of the Internal Auditor.

The reporting of the Internal Auditor shall be to the Board of Directors, or the Audit Committee, who are responsible to appoint the Internal Auditors as per Rule 8 of “The Companies (Meetings of Board and its Powers) Rules, 2014”. Many times, the Internal Auditor has a dual reporting responsibility, wherein the administrative reporting is to an executive officer (e.g., MD or CEO), but functional reporting to the Chairman of the Audit Committee, which is the acceptable norm. Therefore, the internal audit function shall be positioned outside the functions which are subject to internal audit (e.g., Finance and Accounts) and the Internal Auditor shall report directly to the highest governing body of the Company as stated above.

At times, the Internal Auditor is exposed to a different type of risk to independence, whereby management seeks active business support from the Internal Auditor. Apart from providing basic assurance and advisory inputs, the Internal Auditor is assigned certain operational responsibilities (such as risk management, compliance, system automation, process re-engineering, etc.). Although some limited operational role may be acceptable with due approvals, and for a short duration, the Internal Auditor shall do so only after communicating his limitations along the following lines:

(a) Unable to assume ownership or accountability of the process; and

(b) Inability to take operational decisions which may be subject to an internal audit later on.

3.2 Integrity and Objectivity

The Internal Auditor shall be honest, truthful and be a person of high integrity. He shall operate in a highly professional manner and seen to be fair in all his dealings. He shall avoid all conflicts of interest and not seek to derive any undue personal benefit or advantage from his position.

The Internal Auditor shall conduct his work in a highly objective manner, especially in gathering and evaluation of facts and evidence. He shall not allow prejudice or bias to override his objectivity, especially in arriving at conclusions or reporting his opinion.
3.3 Due Professional Care

The Internal Auditor shall exercise due professional care and diligence while carrying out the internal audit. “Due professional care” signifies that the Internal Auditor exercises reasonable care in carrying out the work to ensure the achievement of planned objectives.

The Internal Auditor shall pay particular attention to certain key audit activities, such as establishing the scope of the engagement to prevent the omission of important aspects, recognizing the risks and materiality of the areas, having required skills to review complex matters, establishing the extent of testing required to achieve the objectives within specified deadlines, etc.

“Due Professional Care”, however, neither implies nor guarantees infallibility, nor does it require the Internal Auditor to go beyond the established scope of the engagement.

3.4 Confidentiality

The Internal Auditor shall at all times, maintain utmost confidentiality of all information acquired during the course of the audit work. He shall not disclose any such information to a party outside the internal audit function and any disclosure shall be on a “need to know basis”.

The Internal Auditor shall keep confidential information secure from others. Under no circumstance any confidential information shall be shared with third parties outside the company, without the specific approval of the Management or Client or unless there is a legal or a professional responsibility to do so (e.g., to share information with Statutory Auditors). Internal audit reports shall be addressed to specified internal auditees and distributed to only those who appointed or engaged the Internal Auditor and as per their directions.

3.5 Skills and Competence

The Internal Auditor shall have sound knowledge, strong inter-personal skills, practical experience and professional expertise in certain areas and other competence required to conduct a quality audit. He shall undertake only those assignments for which he has the requisite competence.

The Internal Auditor shall either have, or shall obtain, such skills and competencies, as necessary for the purpose of discharging his
Basic Principles of Internal Audit

responsibilities. Continuing Professional Education is a key part of this exercise. In addition to the basic technical skills, the Internal Auditor shall have the softer skills (such as interpersonal and communication skills) required to engage with a multitude of stake-holders.

Where the Internal Auditor lacks certain expertise, he shall procure the required skills either though in-house experts or through the services of an outside expert, provided independence is not compromised. The objective is to ensure that the audit team as a whole has all the expertise and knowledge required for the area under review.

3.6 Risk Based Audit

The Internal Auditor shall identify the important audit areas through a risk assessment exercise and tailor the audit activities such that the detailed audit procedures are prioritised and conducted over high risk areas and issues, while less time is devoted to low risk areas through curtailed audit procedures. Additionally, this approach shall ensure that risks under consideration are more aligned to the overall strategic and company objectives rather than narrowly focused on process objectives.

A risk-based audit shall ensure the following three-fold objectives:

(a) Audit procedures need not cover the whole process and can be limited only to the important controls in the process;
(b) Establish linkage to the aspects relevant and connected with company and functional objectives; and
(c) Findings and issues highlighted are significant and important and time is not devoted to areas with low probability of significant observations.

3.7 System and Process Focus

An Internal Auditor shall adopt a system and process focused methodology in conducting audit procedures. This methodology is more sustainable than the one adopted to test transactions and balances as it goes beyond “error detection” to include “error prevention”. It requires a root cause analysis to be conducted on deviations to identify opportunities for system improvement or automation, to strengthen the process and prevent a repetition of such errors.
Deployment of Information Technology by companies is widely prevalent and should be understood for effective internal audits. This is a more sustainable approach as this helps the Internal Auditor to move away from “people to process” and from “detection to prevention”.

3.8 Participation in Decision Making
In conducting internal audit assignments, the Internal Auditor shall avoid passing any judgement or render an opinion on past management decisions. As part of his advisory role, the Internal Auditor shall avoid participation in operational decision making which may be subject of a subsequent audit.

The focus of the Internal Auditor shall remain with the quality and operating effectiveness of the decision-making process and how best to strengthen it, such that the chance of flawed or erroneous decisions is minimised. However, the Internal Auditor is at full liberty to present the lessons which can be learnt from such past decisions.

3.9 Sensitive to Multiple Stakeholder Interests
The Internal Auditor shall evaluate the implications of his observations and recommendations on multiple stakeholders, especially where diverse interests may be conflicting in nature. In such situations, the Internal Auditor shall remain objective and present a balanced view. This would permit senior management to make a decision using all the information and balance the strategy and objectives of the company with the expectations and interests of its multiple stakeholders.

3.10 Quality and Continuous Improvement
The quality of the internal audit work shall be paramount for the Internal Auditor since the credibility of the audit reports depends on the reliability of reported findings. The Internal Auditor shall have in place a process of quality control to:

(a) ensure factual accuracy of the observations;
(b) to validate the accuracy of all findings; and
(c) continuously improve the quality of the internal audit process and the internal audit reports.
Basic Principles of Internal Audit

The Internal Auditor shall ensure that a self-assessment mechanism is in place to monitor his own performance and also that of his subordinates and external experts on whom he is relying to complete some part of the audit work. A peer review mechanism for quality control shall be followed to adhere to all aspects of the pronouncements issued by the ICAI.

4 Effective Date

The Basic Principles of Internal Audit are applicable for all internal audits beginning on or after a date to be notified by the Council of the Institute.
Standards on Key Concepts
(100 Series)
STANDARD ON INTERNAL AUDIT (SIA) 110*
NATURE OF ASSURANCE

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This Standard on Internal Audit (SIA) 110, “Nature of Assurance” issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

* Issued in May 2019.
1 Introduction and Scope

1.1 In most situations, an Internal Auditor reports the results of his work in the form of his detailed observations, pointing out areas of concern. No formal covering letter is issued with these observations through which the Internal Auditor expresses any form of opinion, along with the nature of assurance being provided. However, in situations where such a formal assurance in the form of an independent opinion is required, minimum requirements need to be fulfilled. This Standard titled “Nature of Assurance” deals with those assignments performed by internal auditors where an opinion is required, and it clarifies the minimum requirements to be in place before an audit opinion report can be issued.

1.2 An “Internal Audit Assurance Assignment” refers to an assignment in which the Internal Auditor expresses an opinion in order to enhance the confidence of the assurance users about the outcome of the internal audit. This assurance is provided by indicating how the Internal Auditor’s evaluation of the subject matter of audit, measures up against a pre-defined criterion. In such situations, the Internal Auditor is asked to provide assurance through a formal internal audit report which includes his opinion.

1.3 This document provides a frame of reference for Internal Auditors and others involved with assurance assignments, specifically, the following:

(a) Members of the Institute of Chartered Accountants of India (ICAI) holding certificate of practice (practitioners) conducting internal audit engagements;

(b) Members of the ICAI in industry, either public or private sector, as part of the internal audit function of an organisation (industry members) conducting internal audit assignments;

(c) Members of other professional bodies conducting internal audit assignments - who are encouraged to adopt this Standard when conducting internal audit assignments; and

(d) Other stakeholders involved with internal audits, such as the users of an assurance report, including executive management and those charged with governance;
Nature of Assurance

Those conducting internal audits [(a) to (c) above] are collectively referred to as “Internal Auditors” for the purpose of this Standard.

1.4 Not all audit assignments performed by Internal Auditors are assurance assignments. Those assignments that do not meet the assurance definition under Para 1.2 above (and therefore not covered by this document) include:

(a) Internal audit assignments where only a summary of observations, along with recommendations of the internal auditor, is presented (each observation may carry a separate audit rating);

(b) Assignments covered by other Standards issued by the ICAI, such as Standards for Related Services (e.g., agreed-upon procedures assignments);

(c) Reviews of statutory filings or compliance reports, where only a report of non-compliance is submitted; and

(d) Consulting (or advisory) assignments, such as operational, technical or strategic reviews, due-diligence and other such assignments where no opinion conveying an assurance is expressed.

1.5 Scope: This Standard covers only those assignments where an opinion is expressed through an internal audit report. An audit rating of an individual audit observation (e.g., for severity of outcome) or a risk rating of the audit observation, is not considered an audit opinion for the purpose of this SIA. An assurance assignment may be part of another project, for example, a Certification on Internal Controls over Financial Reporting. In such circumstances, this Standard is relevant only to the assurance portion of the assignment.

2 Objective of Assurance

2.1 Audit findings identified after completing the internal audit procedures results in a conclusive outcome (e.g., the effectiveness of internal controls) which give an indication of the health of the subject matter (e.g., a process) and may involve an evaluation or measurement of the subject matter by applying a pre-defined criteria (e.g., a framework of internal controls) to the subject matter.
2.2 Any internal audit assignment in which the internal auditor expresses an opinion on the outcome of the internal audit work to give an indication over the subject matter after comparing it with a pre-defined criteria renders it to be an assurance assignment. All three key elements noted above have to be present to allow the internal auditor to express his opinion.

2.3 This Standard identifies the objectives of two types of assurance assignments an internal auditor is permitted to perform. This Standard refers to these as follows:

- Reasonable Assurance assignment; and
- Limited Assurance assignment.

The objective of a reasonable assurance assignment is to provide an opinion over the whole subject matter after conducting an audit of the whole subject matter. The objective of a limited assurance assignment is to express an opinion over the whole or part of subject matter after conducting limited audit procedures over the subject matter. The Internal Auditor may provide some type of evaluation or rating on individual findings (observations) noted during the audit, and/or an overall evaluation or rating on the subject matter, which is only a means of categorising the severity of the opinion. While these ratings may have a pre-defined criterion and enhance the confidence of the assurance users about the outcome of the internal audit, they are not a formal audit opinion for purpose of this standard.

2.4 The main objective of this Standard is to provide clarity on:

(a) Whether the internal auditor can provide any assurance at all;
(b) Essential requirements which must be satisfied to be able to provide the assurance; and
(c) Nature of assurance that can be provided (Reasonable or Limited) and under what circumstances.

3 Components of an Assurance Assignment

3.1 This Standard identifies three components that assurance assignments exhibit:
Nature of Assurance

(a) **A three-party relationship**, involving an Internal Auditor, An Auditee and Assurance User;

(b) **Presence of three key elements**, involving a Subject Matter, a Pre-defined criterion, and a Conclusive Outcome; and

(c) **A written Assurance Report** which expresses an opinion in a standard format.

3.2 **Three Party Relationships**: Assurance assignments involve three separate parties:

(a) **Internal Auditor** is the person appointed by the organisation to conduct an Internal Audit (refer Para 1.3).

(b) **The Auditee** is the person(s) who is responsible for the Subject matter irrespective of whether or not he provides a written representation (a self-certification) with respect to his evaluation of the Subject matter. The Auditee may or may not be the party who engages the Internal Auditor.

(c) **The Assurance User** is the person, (or class of persons, e.g., the Audit Committee of the Board of Directors) for whom the Internal Auditor prepares the Assurance Report. The Auditee can also be one of the Assurance Users, but not the only one. Assurance Users may be identified in different ways, for example, by the Internal Audit Charter, through an Engagement Letter between the Internal Auditor and the engaging party, or by law.

The Auditee and the Assurance Users may be either from the same entity or from a different entity. For example, an entity’s senior management (an Assurance User) may engage an Internal Auditor to perform an assurance assignment on a particular aspect of the entity’s activities that is the immediate responsibility of a lower level of management (the Auditee), but for which senior management is ultimately responsible. Or the Audit Committee of the Parent Company may seek assurance about information provided by the Subsidiary’s management. Hence the relationship between the Auditee and the Assurance Users needs to be viewed within the context of a specific assignment and may differ under each circumstance.
3.3 **Key Elements – Subject Matter:** Internal audit procedures and activities are conducted for achieving stated objectives, as outlined in the scope of the audit, which is also the Subject matter of the assurance assignment.

The Subject matter of an assurance assignment may take many forms:

(a) Financial performance or conditions (for example, the financial position, financial performance and cash flows) for which the Subject matter may be the recognition, measurement, presentation and disclosure represented in financial statements.

(b) Non-financial performance or conditions (for example, operational output of a factory) for which the Subject matter may be key indicators of efficiency and effectiveness.

(c) Physical characteristics (for example, capacity of a facility) for which the Subject matter may be a technical specifications document.

(d) Systems and processes (for example, an entity’s internal controls, or IT system) for which the Subject matter may be an assertion about its design or effectiveness.

(e) Procedural compliance (for example, corporate governance, compliance with regulation, human resource practices) for which the Subject matter may be a statement of compliance or a statement of design or effectiveness.

Subject matters have different characteristics, including the degree to which information about them is qualitative versus quantitative, objective versus subjective, historical versus prospective, and relates to a point in time or covers a period. Such characteristics affect the:

(a) Precision with which the Subject matter can be evaluated or measured against the Pre-defined criteria;

(b) The persuasiveness of available evidence and hence the ability of the Internal Auditor to draw conclusions and form an opinion; and

(c) The nature of Assurance Report which can be provided to the Assurance Users.
Nature of Assurance

An appropriate subject matter is:

(a) Identifiable, and capable of consistent evaluation or measurement against the pre-defined criteria; and

(b) Such that the information about it can be subjected to procedures for gathering sufficient appropriate evidence to support a reasonable assurance or limited assurance conclusion, as appropriate.

3.4 **Key Elements - Pre-defined Criteria:** Pre-defined criteria stipulate the manner in which an evaluation or measurement of a Subject matter can be undertaken using an objective and consistent methodology and within the context of professional judgment.

Pre-defined criteria are the benchmarks used to evaluate or measure the Subject matter including, where relevant, benchmarks for presentation and disclosure. Pre-defined criteria can be in the nature of the following:

(a) Formal, for example in the audit of financial statements, the criteria may be the Accounting Standards issued by the Institute.

(b) A framework, for example, when reporting on internal controls, the criteria may be an established internal control framework or individual control objectives specifically designed for the assignment.

(c) A mandate, for example, when reporting on compliance, the criteria may be the applicable Statue, law, regulation or contract.

(d) Informal criteria may be an internally developed code of conduct or an agreed level of performance (such as the number of work injuries reported).

Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. Pre-defined criteria are context-sensitive, that is, relevant to the assignment circumstances. Even for the same Subject matter, there can be different criteria. For example, one Auditee might select the number of customer complaints resolved to the acknowledged
satisfaction of the customer for the subject matter of customer satisfaction; another Auditee might select the number of repeat purchases in the three months following the initial purchase.

Pre-defined criteria exhibit the following characteristics:

(a) **Relevance**: criteria contribute to conclusions that assist decision making by the Assurance Users.

(b) **Completeness**: criteria is sufficiently complete when relevant factors that could affect the conclusions (in the context of the assignment circumstances) are not omitted. Complete criteria may include benchmarks for presentation and disclosure.

(c) **Reliability**: criteria allow reasonably consistent evaluation of the subject matter and is free from bias.

(d) **Comprehensive**: easy to understand criteria contribute to conclusions that are simple, clear, and not subject to significantly different interpretations.

(e) **Measurable**: criteria can be quantified and compared in an objective manner.

The evaluation or measurement of a Subject matter on the basis of the Internal Auditor’s own expectations, judgments and individual experience would not constitute suitable Pre-defined criteria, unless it has been pre-agreed with the Assurance Users.

The Internal Auditor assesses the suitability of Pre-defined criteria for a particular assignment by considering whether they reflect the above characteristics. The relative importance of each characteristic to a particular assignment is a matter of judgment. Pre-defined criteria can either be established or specifically developed. Established criteria are those embodied in laws or regulations or issued by authorized or recognized bodies of experts that follow a transparent due process. Specifically developed criteria are those designed for the purpose of the specific assignment. Whether criteria are established or specifically developed affects the work that the Internal Auditor carries out to assess their suitability for a particular assignment.

3.5 **Key Elements - Conclusive Outcome**: Following the completion of the audit activities and audit procedures, the Internal Auditor is in a
Nature of Assurance

position to deliver an outcome which may or may not be conclusive in nature.

For an assurance assignment, the Internal Auditor plans and performs an assignment in accordance with the stipulated Standards on Internal Audit to reach an outcome which allows a conclusion to be reached on whether the Subject matter meets the Pre-defined criteria. The Internal Auditor considers assurance assignment risk, materiality, the quantity and quality of available evidence when planning and performing the assignment, in particular when determining the nature, timing and extent of evidence-gathering procedures.

“Reasonable assurance” is a concept relating to accumulating evidence necessary for the Internal Auditor to conclude in relation to the Subject matter taken as a whole. To be in a position to express an opinion required in a reasonable assurance assignment, it is necessary for the Internal Auditor to obtain sufficient and appropriate evidence as part of an iterative, systematic assignment process based on his professional judgement and guided by Standards on Internal Audit and other pronouncements issued by the ICAI.

“Reasonable assurance” is less than absolute assurance. Reducing assurance assignment risk to zero is very rarely attainable or cost beneficial as a result of factors such as the following:

- The use of selective testing.
- The inherent limitations of internal controls.
- The fact that much of the evidence available is persuasive rather than conclusive.
- The use of judgment in gathering and evaluating evidence and forming conclusions based on that evidence.
- The characteristics of the Subject matter when evaluated or measured against the Pre-defined criteria.

In a “Limited assurance” assignment, the nature, timing and extent of procedures for gathering sufficient appropriate evidence are, however, deliberately limited relative to a reasonable assurance assignment. In addition, the subject matter may not be taken as a whole, and the
Compendium of Standards on Internal Audit

The scope of the internal audit work may be limited to part of the subject matter.

3.6 **The Assurance Report:** The Internal Auditor provides a written report expressing an opinion that conveys the assurance obtained about the subject matter.

Standard on Internal Audit (SIA) 380, “Issuing Assurance Reports” establish the basic elements, form and content of assurance reports. In addition, the Internal Auditor considers other reporting responsibilities, including communicating with those charged with governance (SIA 250) when it is appropriate to do so.

Standard on Internal Audit (SIA) 370, “Reporting Results” covers those assignments where no formal assurance report is required, and the Internal Auditors’ report is, generally, in the form of a Summary of Findings or Observations.

4 **Undertaking an Assurance Assignment**

4.1 The nature of assurance which the Internal Auditor needs to provide, if any, will be established in consultation with the Auditee and Assurance user prior to undertaking an assurance assignment.

4.2 An Internal Auditor may undertake an assurance assignment only where the auditor’s preliminary knowledge of the assignment circumstances indicates that:

(a) Relevant ethical requirements, such as independence and professional competence will be satisfied, and

(b) The assignment exhibits all of the following characteristics:

(i) The Subject matter is appropriate, as noted under Para 3.3.

(ii) The Pre-defined criteria to be used are suitable and available to the assurance users;

(iii) The Internal Auditor has access to sufficient appropriate evidence to support the auditor’s opinion;

(iv) The Internal Auditor’s opinion, is to be contained in a written report; and
Nature of Assurance

(v) The Internal Auditor is satisfied that there is a rational purpose for the assignment. Circumstances, such as the following may indicate an absence of rational purpose:

- Significant limitation on the scope of the internal auditor’s work;
- Assurance user intends to associate the auditor’s name with the Subject matter in an inappropriate manner.

4.3 When a potential assignment cannot be accepted as an assurance assignment because it does not exhibit all the characteristics in the previous paragraph, the Assurance user may be able to identify a different assignment that will meet the needs of intended users. For example:

(a) If the original criteria were not suitable, an assurance assignment may still be performed if:

(i) the Assurance user can identify an aspect of the original Subject matter for which those criteria are suitable, and the Internal Auditor could perform an assurance assignment with respect to that aspect as a Subject matter in its own right. In such cases, the Assurance Report makes it clear that it does not relate to the original Subject matter in its entirety; or

(ii) alternative criteria suitable for the original subject matter can be selected or developed.

(b) The Assurance user may request an assignment with no assurance or that is not an assurance assignment, such as an internal audit with no opinion report.

4.4 Having accepted an assurance assignment, an Internal Auditor may not change that assignment to a non-assurance assignment, or from a reasonable assurance assignment to a limited assurance assignment without reasonable justification. A change in circumstances that affects the Assurance users’ requirements, or a misunderstanding concerning the nature of the assignment, ordinarily will justify a request for a change in the assignment. If such a change is made, the Internal
Auditor does not disregard evidence that was obtained prior to the change.

5 Effective Date

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
STANDARD ON INTERNAL AUDIT (SIA) 120
INTERNAL CONTROLS*

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This Standard on Internal Audit (SIA) 120, “Internal Controls,” issued by the Council of the Institute of Chartered Accountants of India (ICAI) should be read in conjunction with the “Preface to the Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

*Note: This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 12, Internal Control Evaluation, issued in February 2009.
1 Introduction

1.1 Internal Controls is a key concept in Internal Audit and this Standard seeks to clarify the concept and the responsibility of the Internal Auditor, Management and other stakeholders, with respect to Internal Controls, keeping in mind their legal, regulatory and professional obligations.

1.2 Internal Controls are systemic and procedural steps adopted by an organisation to mitigate risks, primarily in the areas of financial accounting and reporting, operational processing and compliance with laws and regulations.

1.3 The definition of Internal Audit (refer Para 3.1 in the “Framework Governing Internal Audits”) and SIA 230, “Objectives of Internal Audit”, indicate providing independent assurance on the effectiveness of Internal Controls as a basic expectation from Internal Audit. The definition on Internal Audit elaborates on the term “Internal Controls” by clarifying how these are integral to the management function and business operations.

1.4 Scope: This Standard applies to all internal audits conducted where internal controls are subject of audit review, and are being assessed, evaluated and reported upon.

2 Objectives

2.1 The purpose of this Standard is to:

(a) Provide a common terminology on Internal Controls to prevent ambiguity or confusion on the subject matter;

(b) Define Internal Controls, how they mitigate risks, and also how they are viewed from a legal perspective;

(c) Explain the responsibilities of management and auditors with regard to Internal Controls, as mandated by law and regulations; and

(d) Specify certain requirements which need to be met to be able to provide an independent assurance on Internal Controls in the organisation under review.
Internal Controls

2.2 The overall objective of this Standard is to clarify the responsibilities of management and auditors over Internal Controls and how certain requirements need to be met to assess, evaluate, report and provide an independent assurance over Internal Controls.

3 Definition of Internal Controls

3.1 Internal Controls (ICs) are essentially risk mitigation steps taken to strengthen the organisation’s systems and processes, as well as help to prevent and detect errors and irregularities. The actual steps of mitigation (e.g., review, approval, physical count, segregation of duty, etc.) are referred to as “Control Activities”. When ICs mitigate the risk of financial exposure, they are also referred to as Internal Financial Controls (IFCs) and when they mitigate operational risks, they are also referred to as Operational Controls (OCs). ICs generally operate with human intervention (Manual Controls), but in an automated environment, computer controls are deployed to secure the systems and called IT General Controls (e.g., access controls) or check transaction processing at an application level and called Application Controls (e.g., sequential numbering of invoices, etc).

3.2 Internal Controls can be broad-based covering the whole entity (e.g., Code of Conduct), or focused to a specific process or area (e.g., Order processing or Payroll, etc.). In the former case they are generally referred to as “Entity Level Controls (ELCs)” as part of the “Control Environment”. In the case of latter, they are also referred to as “Process Level Controls (PLCs)”.

3.3 In the Standard on Auditing (SA) 315, “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment” issued by the ICAI, Internal Control is defined as follows:

“The process designed, implemented and maintained by those charged with governance, management and other personnel to provide reasonable assurance about the achievement of an entity’s objectives with regard to reliability of financial reporting, effectiveness and efficiency of operations, safeguarding of assets and compliance with applicable laws and regulations. The term “controls” refers to any aspects of one or more of the components of internal control”.

IV-15
ICAI has issued a “Guidance Note on Audit of Internal Financial Controls over Financial Reporting” which defines internal financial controls over Financial Reporting quite narrowly as follows:

“A process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with Generally Accepted Accounting Principles. A company’s internal financial control over financial reporting includes those policies and procedures that

(i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company;

(ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with Generally Accepted Accounting Principles, and that receipts and expenditures of the company are being made only in accordance with authorisations of management and directors of the company; and

(iii) provide reasonable assurance regarding prevention or timely detection of unauthorised acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.”

Section 134 (5) of Companies Act, 2013, (applicable to listed companies) concerning Directors’ Responsibility Statement vide clause (e) thereof, defines the term “Internal Financial Controls” as follows:

“the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information”.

Internal Controls is a broader term of the legal definition of Internal Financial Controls (refer para 3.4 and 3.5) and goes beyond the financial areas and also covers a wide range of operational areas of an entity. It includes all the policies and procedures, systems and processes adopted by the company to assist in achieving its objective
of ensuring an orderly and efficient conduct of its business and operations, the safeguarding of assets, the prevention and detection of frauds and errors, but also covers the accuracy and completeness of the company records and the timely preparation of reliable financial and management information.

3.7 The term “Internal Controls System” is an all-encompassing term generally used to refer all types of controls put together, covering ELCs, IFCs and OCs. The Control Environment (ELCs) includes the overall culture, attitude, awareness and actions of Board of Directors and management regarding the internal controls and their importance to the organisation. The control environment has an influence on the effectiveness of the overall Internal Control System since it provides the basis for establishing and operating process level controls (such as IFC and OCs) in the organisation.

3.8 A pictorial depiction of the various controls, defined above, is as follows:

3.9 “Internal Controls Framework”, is a pre-defined benchmark Internal Control System, based on suitable criteria, which can be used by management or auditors to assess the design, adequacy and operating effectiveness of the overall internal control system. In the Indian context, for example, Appendix 1 to Standard on Auditing (SA) 315, “Identifying and Assessing the Risks of Material Misstatement Through Understanding the Entity and Its Environment” issued by the ICAI, provides the necessary criteria for Internal Financial Controls over Financial Reporting as per Companies Act, 2013. Globally, there are similar frameworks, such as the COSO (Committee of Sponsoring Organisations) Internal Control – Integrated Framework which help to serve the same purpose.
Responsibility of the Board and Management

4.1 The Companies Act, 2013 imposes overall responsibility on the Board of Directors with regard to Internal Financial Controls. Clause (e) of Section 134 (5) requires the Directors’ Responsibility Statement to state that “the directors, in the case of a listed company, had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and were operating effectively.”

4.2 In addition, Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 (applicable to all companies) requires the Board of Directors’ Report to include “the details in respect of adequacy of internal financial controls with reference to the Financial Statements”.

4.3 For listed companies, as per The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (“LODR”), the Management of the company has additional responsibilities on Internal Controls for Financial Reporting. Regulation 17(8) of LODR mandates a Compliance Certificate, signed by the CEO and CFO to indicate that “They accept responsibility for establishing and maintaining internal controls for financial reporting and that they have evaluated the effectiveness of internal control systems of the listed entity pertaining to financial reporting and they have disclosed to the auditors and the audit committee, deficiencies in the design or operation of such internal controls, if any, of which they are aware and the steps they have taken or propose to take to rectify these deficiencies”.

4.4 Also, Section 143(3)(i) of the Companies Act, 2013 (applicable to all companies) requires the statutory auditor to report on “whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls”.

4.5 Hence, the overall responsibility for designing, assessing the adequacy, implementing and maintaining the operating effectiveness of Internal Controls rests with the Board of Directors and the Management.
5 Responsibility of the Internal Auditor

5.1 As indicated in SIA 230, “Objectives of Internal Audit”, the Internal Auditor derives the audit mandate from those charged with governance, which in the case of listed entities, is generally the Audit Committee. In line with the definition of internal audit and as per the objectives defined for internal audit, the Internal Auditor is expected to include Internal Controls as a key part of the scope and approach.

5.2 The Internal Auditor shall ensure that the entity has designed, implemented and maintains effective and efficient Internal Controls. The audit procedures shall be sufficient to allow the Internal Auditor to check the design, proper implementation and operating effectiveness of the Internal Controls. Any shortcoming shall result in recommendations for improvement and suggestions on how to make the Internal Controls more efficient and effective in line with the objectives.

5.3 The Internal Auditor shall review the risk assessment exercise undertaken at the time of planning the audit assignment to establish a basis of evaluating whether adequate and appropriate Internal Controls are in place to address the risks identified. Audit procedures to be conducted would primarily be directed over high and medium risk Internal Controls and adequate documentation (e.g., a Risk Control Matrix) should be in place to confirm the linkage of the audit procedure with the respective risks.

5.4 Where the Internal Auditor is required to provide an independent opinion over the presence, design, implementation and/or operating effectiveness over Internal Controls, this shall be consistent with the requirements of SIA 110, “Nature of Assurance”, especially with regard to the need to have a clear understanding of the Internal Controls Framework which shall form the basis of the assurance. Also, in such situations where a written assurance report is being issued, the Internal Auditor shall consider the following (as a basis for the opinion):

(a) An evaluation of the system of Control Self-Assessment by owners of Internal Controls to support the CEO/CFO certification process.
Compendium of Standards on Internal Audit

(b) Availability of Compliance Certificates from owners of Key Controls to support a continuous system of compliance.

5.5 In situations where the Statutory Auditor is expected to rely on the work of the Internal Auditor as per Standard on Auditing (SA) 610, “Using the Work of Internal Auditors”, issued by ICAI, regarding their audit of Internal Financial Controls over Financial Reporting, the Internal Auditor shall document the objectives and agreed scope and approach of the internal audit, over which the reliance is to be placed by the Statutory Auditor.

6 Effective Date

6.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
Standards on Internal Audit Management (200 Series)
STANDARD ON INTERNAL AUDIT (SIA) 210*
MANAGING THE INTERNAL AUDIT FUNCTION

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This Standard on Internal Audit (SIA) 210, “Managing the Internal Audit Function”, issued by the Council of the Institute of Chartered Accountants of India (ICAI) should be read in conjunction with the “Preface to the Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

* Issued in November 2018.
1 Introduction

1.1 The Internal Audit Function, generally, comprises of the Chief Internal Auditor and a team of individuals performing internal audits in an organisation.

1.2 The Internal Audit Function performs a number of activities to achieve its objectives as outlined in its Charter (or Terms of Engagement). A few of the critical activities are as follows:

(a) Define the overall plan, scope and methodology of the Internal Audit Function on a periodic basis.

(b) Oversee and monitor various audit assignments, their proper planning, execution, reporting of findings and subsequent closure of reported observations.

(c) Plan, acquire, engage and review the performance, training and development of professional staff, talent and other resources to achieve its objectives.

(d) Identify, source, engage and manage external experts and technical solutions, if required.

(e) Communicate and engage with all key stakeholders regarding progress and achievement of objectives.

(f) Develop and maintain a quality evaluation and improvement program.

1.3 Completion of the above activities are part of the responsibility of the Chief Internal Auditor or the person who has been designated to coordinate and manage the overall performance of above-mentioned activities.

1.4 Scope: For companies’ subject to internal audit under Companies Act, 2013, the individual (or firm) notified by the Company to the Government as the officially appointed internal auditor as per Section 138 of the Companies Act, 2013, is expected to act as the Chief Internal Auditor. In other cases, it is the person appointed by the Company to perform a similar role. Where the internal audit activity is partly outsourced, the external engagement partner may not be able to assume the overall responsibility of managing the internal audit activity for the whole Company. This limitation, if applicable, shall be
Managing the Internal Audit Function

documented in the terms of engagement with the Company. In such situations, this SIA will apply to members only to the extent of the outsourced part of the internal audit activity.

2 Objectives

2.1 The objectives of this Standard on Managing the Internal Audit Function are to ensure the following:

(a) The achievement of overall objectives of internal audit (as outlined in the Internal Audit Charter or Engagement Letter).

(b) Adequate skilled resources and expertise are in place and deployed well, to provide the required level of assurance.

(c) Internal audit assignments are undertaken in a systematic, disciplined and professional manner.

(d) Quality of the work performed forms a sound basis for reporting and is supported by evidence and documentation.

(e) Work is conducted in conformance with the Standards on Internal Audit and other related pronouncements issued by the ICAI.

3 Requirements

3.1 The Chief Internal Auditor has the overall responsibility to ensure the achievement of the objectives of the internal audit function through a well-documented internal audit process (refer Para. 4.1).

3.2 A resourcing plan shall be prepared to ensure that the internal audit function has the required professional skills either internally or acquired externally and assigned to conduct all internal audit assignments effectively (refer Para. 4.2).

3.3 Internal audit assignments shall be executed as per the documented internal audit process. The internal audit process shall be adequately reviewed, monitored and supervised to achieve the planned objectives (refer Para. 4.3).

3.4 The internal audit function shall have in place a formal quality evaluation and improvement program designed to ensure that all the internal audit activities undertaken by the function are conducted in
Conformance with the pronouncements and Standards on Internal Audit (refer Para. 4.4).

4 Explanatory Comments

4.1 Internal Audit Process (refer Para 3.1): An internal audit process helps to execute internal audit activities and assignments in an effective and efficient manner. It documents the policies and procedures for conducting internal audit in a disciplined, time-bound and professional manner. It provides guidance on how each audit assignment is to be undertaken: the key inputs required, significant steps to be completed, milestones to be achieved, and essential output to be generated for desired quality of outcome. Various elements of an internal audit process shall be collated in a comprehensive internal audit manual used as reference material by the internal audit staff performing the assignments.

4.2 Resourcing Plan (refer Para 3.2): The resourcing plan shall map the skill requirements of the planned internal audits with the capabilities of the available resources of the internal audit function. These resources shall be organised and structured into audit teams such that they have the necessary knowledge, experience, expertise and skills required to conduct the planned audit assignments. If such expertise or skills are not available in-house, it shall be outsourced.

The resourcing plan shall ensure proper deployment of the talent as well as the manner in which they are periodically evaluated for performance and skill development through education and training programs.

4.3 Monitoring Progress and Achievement of Objectives (refer Para 3.3): The Internal Auditor shall deploy a set process for monitoring and reviewing the progress by continuously tracking the assignments underway. Using time budgets and deadlines, and monitoring them constantly, helps to ensure that the progress is on track. A continuous review of the nature of findings and emerging issues helps to ensure that the audit work remains focused on the objectives.

Monitoring includes conducting periodic meetings for sharing of progress dash-boards. The Chief Internal Auditor shall engage in periodic meetings with the staff, the outsourced internal audit firm,
Managing the Internal Audit Function

executive management and key stakeholders to ensure progress is on track and concerns, if any, in this regard, are addressed immediately.

4.4 **Quality Evaluation and Improvement Program (refer Para 3.4):** A documented quality evaluation and improvement program shall be designed and implemented to confirm the reliability of the audit work performed by internal audit staff. This program shall be drafted in line with the pronouncements and Standards on Internal Audit issued by the ICAI.

The quality evaluation and improvement program shall be implemented and monitored by a person having the requisite knowledge and skills as well as the authority to intervene in areas of non-compliance. It shall be supported with a system of identifying and reporting key quality parameters periodically, and corrective actions taken in case of deviations from Standards.

4.5 **Documentation:** To confirm compliance with the Standard, all key activities which form part of the internal audit process shall be documented to confirm their timely completion.

Key elements of documentation are as follows:

(a) The Internal Audit Process, in the form of an Internal Audit Manual.

(b) Resourcing Plan, showing staff competencies, assignments conducted, performance evaluation and skill development.

(c) Progress Monitoring Reports showing the various assignments underway, their progress against budgets and anticipated time for completion.

(d) Quality Evaluation and Improvement Program appropriately cross referenced to the SIAs, where applicable.

5 **Effective Date**

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
### STANDARD ON INTERNAL AUDIT (SIA) 220*
**CONDUCTING OVERALL INTERNAL AUDIT PLANNING**

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This Standard on Internal Audit (SIA) 220, “Conducting Overall Internal Audit Planning,” issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

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* Issued in November 2018.

** Note: This Standard on Internal Audit (SIA) supersedes some part or all of the following current SIAs (recommendatory in nature):
1. Standard on Internal Audit (SIA) 1, Planning an Internal Audit, issued in August 2006.
Conducting Overall Internal Audit Planning

1 Introduction

1.1 Internal audit planning is conducted at two levels:
(a) An overall internal audit plan for the entire entity is prepared for a given period of time (usually a year) and presented to the highest governing body responsible for internal audits, normally, the Board of Directors, or the Audit Committee.
(b) A number of specific internal audit plans are prepared for individual assignments to be undertaken covering some part of the entity and presented to the Chief Internal Auditor.

1.2 This Standard on Internal Audit (SIA) covers the first level of planning, “Conducting Overall Internal Audit Planning” for the entity as a whole. Standard on Internal Audit (SIA) 310, deals with “Planning of Internal Audit Assignments” for a particular part of the entity.

1.3 In the case of Companies under Companies Act, 2013, it is a legal requirement for the Audit Committee or its Board of Directors to formulate the overall internal audit plan of the company. Companies (Accounts) Rule 13(2) of Companies Act, 2013 provides as under:

“The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity, and methodology for conducting the internal audit.”

The Audit Committee or the Board takes the active support of the Chief Internal Auditor, to develop the Overall Internal Audit Plan, in consultation with the Executive Management.

1.4 Conducting the Overall Internal Audit Planning involves the following key elements:
(a) It is undertaken prior to the beginning of the plan period (generally, the financial year).
(b) It is comprehensive in nature covering the entire entity.
(c) It is directional in nature and considers all the Auditable Units (i.e., locations, functions, business units and legal entities including third parties, where relevant), along with the...
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periodicity of the assignments to be undertaken during the plan period.

(d) It is normally prepared by the Chief Internal Auditor (or the Engagement Partner, where an external service provider is appointed to conduct internal audits).

(e) The outcome of this exercise is an “Overall Internal Audit Plan” (or the “Audit Engagement Plan,” if outsourced).

1.5 Scope: This SIA deals with the Internal Auditor’s responsibility to prepare the Overall Internal Audit Plan, also referred to as the Annual Internal Audit (Engagement) Plan. Where only part of the internal audit activity is outsourced, this SIA shall apply to the extent the Internal Auditor needs to plan the activities of the outsourced part of the engagement only, as defined in their terms of engagement, which shall also clarify the extent of the planning responsibilities.

2 Objectives

2.1 The objectives of an Overall Internal Audit (Engagement) Plan are to:

(a) ensure that the planned internal audits are in line with the objectives of the internal audit function, as per the internal audit charter of the entity (and terms of engagement, where it is an outsourced engagement) and also in line with the overall objectives of the organisation.

(b) align the organisation’s risk assessment with the effectiveness of the risk mitigation implemented through internal controls.

(c) confirm and agree with those charged with governance the broad scope, methodology and depth of coverage of the internal audit work to be undertaken in the defined time-period.

(d) ensure that overall resources are adequate, skilled and deployed with focus in areas of importance, complexity and sensitivity.

(e) ensure that the audits undertaken conform at all times with the applicable pronouncements of the Institute of Chartered Accountants of India.
Conducting Overall Internal Audit Planning

3 Requirements

3.1 The planning exercise shall follow a laid down process (refer Para 4.1), the outcome of which shall be a written document (Para 4.8) containing all the essential elements required to help achieve the objectives of the plan as outlined under Paragraph 2 above. Technology deployment refer (Para 4.6) and resource allocation (refer Para 4.7) shall form essential elements of the overall internal audit plan.

3.2 The overall internal audit plan shall be reviewed and approved by the highest governing body responsible for internal audits, normally, the Board of Directors, or the Audit Committee.

3.3 Knowledge of the entity, its business and operating environment shall be undertaken to determine the types of audit assignment which could be conducted (refer Para 4.2). As part of the planning process, a discussion with management and other stakeholders shall be undertaken to understand the intricacies of each auditable unit subject to audit (refer Para 4.3).

3.4 An Audit Universe shall be prepared prior to establishing the scope of the overall internal audit plan (refer Para 4.4). The scope shall be consistent with the goals and objectives of the internal audit function (and terms of engagement, where it is an outsourced engagement) as listed in the internal audit charter. The scope shall also be in line with the nature and extent of the assurance to be provided.

3.5 A risk-based planning exercise shall form the basis of the overall internal audit plan. The Internal Auditor shall undertake an independent risk assessment exercise to prioritise and focus the audit work on high risk areas, with due attention to matters of importance, complexity and sensitivity (refer Para 4.5).

3.6 The Audit Universe and the overall internal audit plan shall be continuously monitored during the execution phase for achievement of the objective and to identify any deviations. Certain deviations may require to be notified to the stakeholders or even require a formal modification to the plan. However, any significant modification to the plan shall be done only after consultation with those who approved the original plan. Such changes shall be formally documented, including
reasons for the change, and communicated to all impacted stakeholders.

4 Explanatory Comments

4.1 The Planning Process (refer Para 3.1): The Internal Auditor conducting the overall internal audit planning shall use professional judgement for the process to be followed in completing all essential planning activities. A documented planning process shall be in place which stipulates the essential inputs, steps to complete the planning and the nature of output required to conduct a comprehensive planning exercise.

4.2 Knowledge of the Business and its Environment (refer Para 3.3): The Internal Auditor shall gather all the information required to fully understand the entity’s business environment, the risks it faces and its operational challenges.

The extent of information required shall be sufficient to enable the Internal Auditor to identify matters which have a significant effect on the organisation’s financials. Hence, there is a need to connect the financial aspects of the business with other business elements, such as industry dynamics, company’s business model, operational intricacies, legal and regulatory environment, and the system and processes in place to run its operations.

4.3 Discussion with Management and Stakeholders (refer Para 3.3): A key element of planning involves extensive discussion and deliberation with all stakeholders, including executive management, risk owners, process owners, statutory auditors etc. Their inputs are critical in understanding the intricacies of each assignment under consideration, in identification of important matters of relevance and to align stakeholder expectations with audit objectives.

4.4 Audit Universe and Scope of Coverage (refer Para 3.4): Prior to defining the scope of internal audit, a complete identification of all the Auditable Units (locations, functions, business units, legal entities, including third parties where relevant) of the organisation shall be made. This list of all the Auditable Units is, generally, referred to as the “Audit Universe”. It covers every conceivable audit assignment which could be taken up for review during the plan period. The audit
Conducting Overall Internal Audit Planning

universe helps to ensure that the audit scope does not overlook any Auditable Unit. It forms the basis from which the overall internal audit plan is derived by consciously excluding certain units or areas from the scope, for justifiable reasons, such as low risk.

The internal audit objectives and the nature of assurance to be provided will also help to establish the scope of internal audit. On certain occasions, especially in the case of outsourced engagements, the management may define or mandate the scope and may even restrict the coverage of certain areas or transactions. When finalising the scope, it is important to clearly highlight any scope limitations in the internal audit plan as part of the communication to approving body, such as, the Audit Committee.

4.5 **Risk Assessment (refer Para 3.5):** The internal auditor shall undertake an independent risk assessment of all the Auditable Units identified in the Audit Universe and align this with the risk assessment conducted by the management and the statutory auditor. This is required to prioritise and focus audit work on high risk areas, with due attention to matters of importance, complexity and sensitivity.

The internal auditor may also plan to undertake a dedicated audit of the company's Risk Management Framework and processes, as a separate review or assignment.

4.6 **Technology Deployment (refer Para 3.1):** A key element of the overall internal audit planning exercise involves understanding the extent to which:

(a) the entity has deployed information technology (IT) in its business, operations and transaction processing, and

(b) the auditor needs to deploy IT tools, data mining and analytic procedures, and the expertise required for conducting the audit activities and testing procedures.

This helps to design and plan the audit more efficiently and effectively.

4.7 **Resource Allocation (refer Para 3.1):** The Internal Auditor shall prepare a detailed work schedule to estimate the time required for each audit assignment depending on the audit attention it deserves (on the basis of risk assessment) and maps this with the competencies (knowledge, experience, expertise, etc.) of the
resources available. The requirements are then matched with the limited resources available to:

(a) finalise the scope and depth of coverage of audit assignments;
(b) identify any critical skills/expertise gaps in audit team; and/or
(c) seek other means of acquiring additional resources required (internal or external sourcing).

4.8 **Documentation:** To confirm compliance of audit procedures with the SIA, all key steps undertaken in the planning process shall be adequately documented to confirm their proper completion.

Essential documentation shall be as follows:

(a) Information gathered about the business and its operations, systems and processes and past or known issues.
(b) Audit Universe and summary of Auditable Units.
(c) Summary of meetings and communication with key stakeholders, with a summary of their inputs.
(d) Risk assessment documentation.
(e) Summary of available resources, their competencies and the proper matching of their skills with the audit requirements.
(f) Final overall internal audit plan duly approved by the competent authorities.

5 **Effective Date**

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
STANDARD ON INTERNAL AUDIT (SIA) 230*
OBJECTIVES OF INTERNAL AUDIT**

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This Standard on Internal Audit (SIA) 230, “Objectives of Internal Audit” issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

* Issued in May 2019.
** Note: This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 8, Terms of Internal Audit Engagement, issued in December 2008.
1 Introduction

1.1 The objectives of internal audit vary widely and depend on the size, structure, and complexity of the entity subject to internal audit. These objectives are also influenced by laws and regulations and specific requirements of management and, in most cases, defined by those charged with governance.

1.2 In the case of Companies required to appoint an Internal Auditor as per Section 138 of the Companies Act, 2013, Rule 13(2) of Companies (Accounts) Rules 2014, states:

“The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity, and methodology for conducting the internal audit.”

Hence, in these class of companies, the Audit Committee or the Board, in conjunction with management and the Chief of Internal Audit, is expected to exercise the responsibility to formulate the objectives of internal audit.

1.3 In the case of other organisations not covered under Rule 13, those who appoint the Internal Auditor (e.g., the owners, the promoters, the Board of Trustees, etc.) would generally define the objectives of internal audit.

1.4 While the specific objectives of any internal audit may vary from company to company, these objectives are generally consistent with the overall definition of “Internal Audit”, which as defined under Para 3 of “Framework governing Internal Audit”, issued by the ICAI, states as follows:

“Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives.”

Para 3.2 of the Framework also indicates how the nature of internal audit services may go beyond assurance to include an advisory (consulting) role.

Annexure 1 to this Standard provides an indicative list of the Objectives of Internal Audit mentioned in Standard on Auditing (SA)
Objectives of Internal Audit

610, “Using the Work of an Internal Auditor”, issued by Auditing & Assurance Standards Board, ICAI. Companies may choose some or all of these objectives, or even add something new as per their requirements or legal/regulatory mandates.

1.5 Scope: The current law in India permits internal audit to be performed either by an entity’s own employee (i.e., personnel on the payroll of the organization or its group company) or by a professional who is part of an external agency (e.g., a firm of practicing Chartered Accountants undertaking internal audit engagements). Hence, the manner in which the objective of internal audit is defined in each situation may vary. This Standard applies to all ICAI members in both situations, irrespective of whether the internal audit is conducted by them in the capacity of an employee or as a representative of an external audit firm.

2 Objectives

2.1 The purpose of defining the Objectives of Internal Audit are to:

(a) Document the formation and functioning of the Internal Audit activity and the terms of the out-sourced internal audit arrangement;

(b) Provide clarity to the Internal Auditor and its stakeholders regarding the nature of the internal audit set-up and its working;

(c) Ensure linkage between what is expected of the Internal Auditor and how those expectation can be met within the Framework governing Internal Audits; and

(d) Promote better understanding on key operational areas, such as, accountability and authority, roles and responsibility, and such other functional matters.

2.2 Once the objectives of internal audit are defined, they help to establish the operating parameters within the overall internal audit agenda. These objectives and operating parameters are formally recorded in one of these two documents:

(a) An Internal Audit Charter, primarily designed for the in-house team of internal auditors and its stakeholders; and

(b) An Engagement Letter is a formal agreement signed with the out-sourced internal audit service provider.
3 Requirements

3.1 Every Internal Auditor shall be guided by a document that defines the Objectives of Internal Audit. It is the duty of the Chief of Internal Audit to have in place a written Internal Audit Charter (refer Annexure 2) documenting the formation and functioning of the internal audit activity. (refer Para 4.1).

3.2 Where part of the internal audit activity is out-sourced, the Chief of Internal Audit shall have a formal Engagement Letter defining the terms of engagement and documenting the nature of the arrangement with the external internal audit service provider. If the internal audit activity is completely out-sourced, the Engagement Partner will be acting in the capacity of the Chief of Internal Audit, who shall ensure a formal Engagement Letter documenting the terms of engagement. (refer Para 4.2).

3.3 The Chief of Internal Audit shall ensure that the Internal Audit Charter is reviewed and approved by those charged with governance (the Board of Directors, or the Audit Committee of the Board). In the case of the Engagement Letter, the Engagement Partner shall ensure that the formal agreement with the terms of engagement shall have the approval of the competent authority, as per the company’s Delegation of Powers. Where the complete internal audit activity is out-sourced, then this approval shall come from those charged with governance (the Board of Directors, or the Audit Committee of the Board).

3.4 It is important that the governing body members and other stakeholders are aware of, and in agreement with, the Objectives of Internal Audit and other relevant portions of the Internal Audit Charter and Engagement Letter. This information shall be communicated to all stakeholders through formal channels of communication.

3.5 The Internal Audit Charter and the Engagement Letter shall be reviewed periodically by the Chief of Internal Audit and the Engagement Partner to ensure its relevance to the changing times or circumstances (e.g. change in scope). If found necessary, the proposed amendments to these documents shall be put up to the
4 Explanatory Comments

4.1 Internal Audit Charter (refer Para 3.1): The formation and functioning of the internal audit activity within the organization is noted in a formal document called the Internal Audit Charter. It defines the objectives of internal audit (in line with the definition of Internal Audit) and other important aspects of the functioning of the Internal Audit activity. It also provides clarity to the Internal Auditor regarding the manner in which the internal audit work is undertaken and how the auditor’s responsibility is to be discharged.

An indicative list of areas covered in the Internal Audit Charter is as follows:

(a) Mission and Vision of the Internal Audit function
(b) Purpose and Objectives of Internal Audit
(c) Reporting Structure and Independence
(d) Scope and Approach
(e) Accountability and Authority
(f) Roles and Responsibility
(g) Quality Assurance and Conformance with SIAs.

Further explanation of each of the above-mentioned areas is given as Annexure 2.

4.2 Engagement Letter (refer Para 3.2): The Objectives of Internal Audit and other terms of engagement of the external service provider are documented in a formal agreement referred to as the Engagement Letter. The Engagement Letter is signed by the Engagement Partner along with the appointing authority of the Company.

An indicative list of terms of engagement, covered in an Engagement Letter, is as follows:

(a) Purpose and Objectives of Internal Audit
(b) Independence and Objectivity
(c) Scope and Approach
(d) Accountability and Authority
(e) Roles and Responsibility

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(f) Limitations and Confidentiality
(g) Quality Assurance and Conformance with SIAs
(h) Reporting and Compensation
(i) Ownership of Working Papers
(j) Termination of Arrangement

Further explanation of above-mentioned areas is given as Annexure 3.

4.3 A signed Engagement Letter shall be obtained prior to commencement of any audit work.

5 Effective Date

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
Objectives of Internal Audit

Annexure 1

Indicative List of Objectives of Internal Audit (as per Standard on Auditing (SA) 610, “Using the Work of an Internal Auditor” issued by Auditing & Assurance Standards Board, ICAI).

Scope and Objectives of the Internal Audit Function (refer Para 3)

A3. The objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance. The activities of the internal audit function may include one or more of the following:

- **Monitoring of internal control.** The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation and recommending improvements thereto.

- **Examination of financial and operating information.** The internal audit function may be assigned to review the means used to identify, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.

- **Review of operating activities.** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non-financial activities of an entity.

- **Review of compliance with laws and regulations.** The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.

- **Risk management.** The internal audit function may assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.

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4 The above is not a complete and exhaustive list and is presented only as an example of the nature of Objectives of Internal Audit.
Governance. The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.
Components of a Typical Internal Audit Charter

- **Mission and Vision of the Internal Audit (IA) Function**
  This indicates the long-term view of the Internal Audit function, in line with its reason for existence.

- **Purpose and Objectives of Internal Audit**
  Explains what the Internal Audit function hopes to achieve in a certain period of time. These objectives cover the internal audit definition and are usually in line with the Objectives of the Organisation in a similar period of time. (refer Annexure 1).

- **Reporting Structure and Independence**
  This section explains where the Internal Audit function is placed within the overall Organisation Structure of the Company and whom it reports to (both functionally as well as administratively). It also clarifies how the independence of the function is assured through limitations on responsibilities which may be assigned (such as that seeking active business support) but might compromise on independence. (refer Para 3.1. of “Basic Principles of Internal Audit”).

- **Scope and Approach**
  The scope of the internal audits shall be consistent with the goals and objectives of the internal audit function and also in line with the nature and extent of assurance to be provided by the Internal Auditor. Any entities/units excluded from the scope shall be clearly noted. The approach is generally a risk-based audit approach, with a system and process focus. (refer Para 3.6 and 3.7 of “Basic Principles of Internal Audit”)

- **Accountability and Authority**
  The Internal Auditor may be held accountable for certain deliverables beyond providing basic assurance, such as, improving the control environment, reducing risk ratings or improving compliances level, etc. These should be clearly spelt out. Along with accountability, comes the authority and the powers required to conduct audits without any undue hindrances, engaging external experts and receiving all information and system access on time.
Compendium of Standards on Internal Audit

- **Roles and Responsibility**
  All the key job functions and activities are spelt out in this section, which are usually in line with the objectives of the Internal Audit function.

- **Quality Assurance and Conformance with SIAs**
  This section indicates the importance of ensuring high quality audit work and procedures, including how the audit procedures will be conducted in conformance with ICAI pronouncements applicable at the time. It also notes the checks put in place to ensure reliability and credibility of the output.
Objectives of Internal Audit

Annexure 3

Components of A Typical Engagement Letter

- **Purpose and Objectives of Internal Audit**
  This section indicates what the Internal Audit engagement hopes to achieve in the set period of time. These objectives are mostly defined by those charged with governance and appointing the Internal Auditor. (refer Annexure 1).

- **Independence and Objectivity**
  This section defines the reporting structure and reporting protocol of the Internal Auditor. It also clarifies how the independence of the Internal Auditor is assured through assignments which don’t compromise on his independence. (refer Para 3.1 of “Basic Principles of Internal Audit”)

- **Scope and Approach**
  The scope of the internal audits shall be consistent with the goals and objectives of the internal audit and in line with the nature and extent of assurance to be provided. Any entities/units excluded from the scope shall be clearly noted. The approach is generally a risk-based audit approach, with a system and process focus. (refer Para 3.6 and 3.7 in “Basic Principles of Internal Audit”)

- **Accountability and Authority**
  The Internal Auditor is accountable to deliver the outcome of his work to the appointing authority or those changed with governance. Where the laws and regulations require, the internal auditor may also be required to report directly to external authorities. Along with accountability, comes the authority and the powers required to conduct audits without any undue hindrances and to receive all information and system access on time.

- **Roles and Responsibility**
  All key job functions and activities get clearly spelt out in this section, which are usually in line with the objectives of the Internal Audit function.

- **Limitations and Confidentiality**
  Limitations on liabilities which the auditor is exposed to and the
manner of determination of the same should be included in this section. Obligations on part of the Internal Auditor to maintain confidentiality of information collected and on part of the Company to keep the audit report confidential is also covered here.

- **Quality Assurance and Conformance with SIAs**
  This section indicates the importance of ensuring high quality audit work and procedures, including how the audit procedures will be conducted in conformance with ICAI pronouncements applicable at the time. It also notes the checks put in place to ensure reliability and credibility of the output.

- **Reporting and Compensation**
  All requirements with regards to the nature of reports to be issued, the type of assurance to be provided, the timing, or periodicity of reports and the recipients is clearly noted here.

  The basis upon which the compensation is established, the manner of its review, the ancillary charges (cost reimbursements, taxes, etc.) and how these are to be determined are all covered here.

- **Ownership of Working Papers**
  This section clarifies the understanding regarding the ownership of working papers. Where a formal internal audit report is issued (with or without assurance), the ownership of the working papers should be retained by the Internal Auditor. (refer SIA 330, “Internal Audit Documentation”)

- **Termination of Arrangement**
  The time period of appointment, the timelines for completion of all assignments and the cessation of the arrangements should be covered in this section.
STANDARD ON INTERNAL AUDIT (SIA) 240*
USING THE WORK OF AN EXPERT**

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This Standard on Internal Audit (SIA) 240, “Using the Work of an Expert”, issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

* Issued in May 2019.
** Note: This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 16, Using the Work of an Expert, issued in March 2009.
1 Introduction

1.1 An Expert is a person or an entity (such as an association of persons, a firm or a company), which possesses certain special skills or unique knowledge, along with some years of experience and expertise in a particular area, field or discipline.

1.2 In conducting internal audit assignments, the Chief of Internal Audit may seek the assistance and place reliance on the work of an Expert. This may be in the form of specific audit procedures covering a complex area or field (such as, Information Technology, Civil/Electrical/Mechanical Engineering, Banking, Oil and Gas Industry, etc.) or a unique and specialised discipline (such as, Actuarial Services, Forensic Audit, Taxation, Treasury operations, Financial products, Risk Modelling, Intellectual Property or business valuations, etc.).

1.3 An Expert is generally appointed to help complete part of an internal audit assignment in situations where the required skills are not available within the internal audit team or function. The Expert can be an employee of the company, much like an Internal Auditor, provided all criteria concerning his independence and objectivity with respect the internal audit assignment is fulfilled.

1.4 Scope: This Standard applies to all internal audit assignments where part of the internal audit work is completed by an Expert and relied upon by the Internal Auditor to provide an independent assurance.

However, an external service provider with expertise in accounting and auditing, and engaged to provide regular internal audit services, is not treated as an Expert for this Standard. For such appointments, the Internal Auditor shall refer to another SIA 230 “Objectives of Internal Audit” to fulfil the requirements of engaging External Service Providers, such as ensuring an Engagement Letter to cover the terms and conditions of appointment.

2 Objectives

2.1 The objectives of using the work of an Expert is to ensure that:

(a) Technical assistance and support from competent experts is obtained where the internal audit team does not possess the necessary knowledge and expertise;

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Using the Work of an Expert

(b) Internal audit procedures conducted in complex and specialised areas meet expected quality standards;

(c) Outcome of the internal audit work is credible and reliable; and

(d) Work performed is in conformance with the applicable pronouncements of the Institute of Chartered Accountants of India.

2.2 The overall objective of using the work of an Expert is to allow the Internal Auditor to place reliance on the technical work completed in the most informed manner so as to form an opinion on the outcome of the audit procedures and to add further credibility and reliability to the findings of the internal audit.

3 Requirements

3.1 The Internal Auditor shall make an independent determination of using the work of an Expert based on:

(a) The technicality and complexity of the subject matter of internal audit;

(b) The risk assessment, materiality and importance of the subject matter; and

(c) A comparison of the expertise available within the internal audit team to conduct a quality audit with the expertise required to execute the technical procedures.

3.2 The Internal Auditor shall have the authority to select, appoint and engage the Expert. Where this authority rests with management, then the Internal Auditor shall conduct procedures to validate the independence and objectivity of the Expert and share any concerns highlighted with management and those charged with governance. (refer Para 4.1)

3.3 The Internal Auditor shall conduct an independent evaluation of the qualifications and credentials of the expert. (refer Para 4.2)

3.4 Where the findings of the Expert will form part of the assurance report to be issued by the Internal Auditor, the Internal Auditor shall participate in defining the scope, approach and work to be conducted by the Expert. (refer Para 4.3). Otherwise, the Internal Auditor shall
3.5 The Internal Auditor shall perform an evaluation of the work completed by the Expert to ensure that the work completed constitutes appropriate and reliable evidence to support the overall conclusions to be reported. (refer Para 4.4).

3.6 The Internal Auditor shall retain ultimate responsibility for internal audit conclusions and opinions which are incorporated in his internal audit report, unless specifically mandated otherwise by the Assurance User (the recipient of the Internal Audit Report). Hence, the Internal Auditor shall not refer to the work of an Expert in his Internal Audit Report.

4 Explanatory Comments

4.1 Independence and Objectivity of the Expert (refer Para 3.2)

The Internal Auditor should conduct procedures to assess the ability of the Expert to function in an independent and objective manner, such as the following:

(a) The Appointing and Supervisory Authority: Where the authority to appoint and supervise the Expert rests with someone other than the Internal Auditor, the outcome of the Expert’s work may be influenced by such authority.

(b) Employee of the Company or External Service provider: An external professional would not be influenced by company management in comparison to an Expert who is an employee of the company and reporting to management.

(c) Relationship of Expert: Where there is any relationship of the Expert with Company Management, especially with those who have some role in the internal audit assignment, the objectivity of the Expert may get compromised.

(d) Personal Interests: Where the Expert has any personal, financial or organisational interests (such as significant portion of his income is derived from the company), it may prevent the rendering of an unbiased and impartial report.
Using the Work of an Expert

4.2 Qualifications and Credentials of the Expert (refer Para 3.3)

The Internal Auditor shall independently validate the qualification and credentials of the Expert, with procedures, such as the following:

(a) Confirmation of educational and professional qualifications and membership of professional bodies;

(b) Background and reference checks of the experience and/or reputation of the Expert;

(c) Details of instances and nature of similar past assignments undertaken; and

(d) Self-Certification by the Expert regarding his qualifications, expertise, any conflict of interest or any pending disciplinary actions.

4.3 Defining the Scope, Approach and Work of the Expert (refer Para 3.4)

Where the Internal Auditor plans to incorporate the findings of the work of the Expert as part of his Internal Audit Report, the Internal Auditor shall participate in defining the Plan and Procedures of the Expert, as follows (indicative list):

(a) Define the audit objective of the technical procedures planned;

(b) Identify the Subject matter to be reviewed and evaluated, especially what is included or excluded;

(c) Define any specific requirements or limitations of the work to be undertaken;

(d) The information required by the Expert and the source of that information, the nature and reliability of the original data to be used;

(e) Define any assumptions which need to be incorporated as part of the exercise;

(f) Extent of access to required systems, locations, records and company personnel; and

(g) Clarify the confidentiality of information requirements and ownership of work papers.
4.4 Evaluating the Work of an Expert (refer Para 3.5)

During and after completion of the work by the Expert, the Internal Auditor shall conduct an evaluation of the outcome of the findings of the Expert to make a determination of the quality of the work performed and to validate the reliability of the findings, as follows:

(a) A detailed review of the report and findings;
(b) Extent and thoroughness of the procedures completed;
(c) Any scope limitations or other hurdles faced in completing the assignment, such as missing information or access limitations;
(d) If appropriate, a review of certain work papers to understand the basis of significant observations; and
(e) The harmony and congruence of the Expert’s findings with the rest of the Internal Audit report.

In exceptional cases, where the findings of the Expert are not consistent with other aspects of the entity, the Internal Auditor should attempt to resolve the inconsistency through discussions with the Auditee and the Expert. In extreme situations, conducting additional procedures or engaging another Expert may be required to resolve the inconsistency.

4.5 Documentation: To confirm compliance of audit procedures with this SIA, a list of the documents required is as follows:

(a) Details of procedures conducted to validate the requirements of an Expert (refer Para 3.1).
(b) Details of procedures conducted to validate the Independence and Objectivity of the Expert (refer Para 4.1).
(c) Details of procedures conducted to verify the Qualifications and Credentials of the Expert (refer Para 4.2).
(d) Details of procedures conducted to define the Scope, approach and work plan of the Expert (refer Para 4.3).
(e) A summary of the review completed to evaluate the quality and reliability of the work completed (refer Para 4.4).

5 Effective Date

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
Standards on the Conduct of Audit Assignments
(300 - 400 Series)
STANDARD ON INTERNAL AUDIT (SIA) 310*
PLANNING THE INTERNAL AUDIT ASSIGNMENT**

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This Standard on Internal Audit (SIA) 310, “Planning the Internal Audit Assignment”, issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

* Issued in November 2018.
** Note: This Standard on Internal Audit (SIA) supersedes some part or all of the following current SIAs (recommendatory in nature):
1. Standard on Internal Audit (SIA) 1, Planning an Internal Audit, issued in August 2006.
1 Introduction

1.1 Internal Audit Planning is conducted at two levels:

(a) An overall internal audit plan for the entire entity is prepared for a given period of time (usually a year) and presented to the highest governing body responsible for internal audits, normally, the Board of Directors, or the Audit Committee.

(b) A number of specific internal audit plans are prepared for individual assignments to be undertaken covering some part of the entity and presented to the Chief Internal Auditor.

1.2 This Standard on Internal Audit (SIA) covers the second level, the “Planning the Internal Audit Assignment” for a particular part of the entity. Standard on Internal Audit (SIA) 220 covers the first level, “Conducting Overall Internal Audit Planning” of the entity as a whole.

Planning the Internal Audit Assignment involves the following key elements:

(a) It is a sub-set of the Overall Internal Audit Plan.

(b) It is undertaken prior to the beginning of a particular assignment during the plan period.

(c) Assignments are specific to a part of the entity, covering a particular Auditable Unit\(^1\) (location, function, business unit or a legal entity, including third parties, where relevant).

(d) It is specific in nature, covers the manner in which a particular audit assignment will be conducted with details of the Auditable Unit, such as, the business activities or processes to be audited.

(e) Assignments are, generally, completed during a short period of time;

(f) It is prepared by the Internal Auditor responsible for the assignment (or the Engagement Staff where an external service provider is appointed to conduct internal audits).

\(^1\) The subject matter of an audit assignment is referred to as an Auditable Unit.
Planning the Internal Audit Assignment

(g) The outcome of this exercise is, generally, in the form of an "Internal Audit Assignment Plan".

2 Objectives

2.1 The objectives of an Internal Audit Assignment Plan are as follows:

(a) Ensure its alignment with the objectives of the Overall Internal Audit (Engagement) Plan and also in line with stakeholder expectations.

(b) Ensure that the scope, coverage and methodology of the audit procedures will form a sound basis for providing reasonable assurance.

(c) Allocate adequate time and resources to important aspects of the assignment and assign appropriate skills to complex areas and issues.

(d) Ensure audit procedures are conducted in an efficient and effective manner.

(e) Ensure the audit assignment will conform with the applicable pronouncements of the Institute of Chartered Accountants of India (ICAI).

3 Requirements

3.1 The assignment planning exercise shall follow a laid down process (refer Para 4.1), the outcome of which shall be a comprehensive written document (refer Para 4.8) containing all the essential elements required to help achieve the objectives of assignment planning as outlined under Section 2 above. Technology deployment (refer Para 4.6) and resource allocation (refer Para 4.7) shall form essential features of the Internal Audit Assignment Plan.

3.2 The Internal Audit Assignment Plan shall be reviewed and approved by the Chief Internal Auditor (or Engagement Partner, in case of external service provider).

3.3 A comprehensive knowledge of the Auditable Unit under review, its business and operating environment, shall be undertaken to determine the nature of audit procedures and tests to be conducted (refer Para 4.2). As part of the planning process, a discussion with
Compendium of Standards on Internal Audit

management and process owners shall be undertaken to understand the intricacies of each process considered for review (refer Para 4.3). In addition, the Internal Auditor shall exchange relevant information (such as outcome of risk assessment) with the Statutory Auditor to coordinate the audit work and procedures, as per Standard on Auditing (SA) 610, “Using the Work of Internal Auditors”.

3.4 A risk-based planning exercise shall form the basis of the Internal Audit Assignment Plan. The Internal Auditor shall undertake an independent risk assessment exercise to prioritise and focus audit work on high risk areas and processes, with due attention given to matters of importance, complexity and sensitivity (refer Para 4.4).

3.5 An audit methodology shall be established (refer Para 4.5), together with the depth and nature of audit procedures to be conducted, both of which shall be documented in an Internal Audit Programme (IAP).

3.6 Certain elements of the Internal Audit Assignment Plan (especially, those relevant to its effective execution) shall be communicated to the Auditee and other stakeholders prior to the commencement of the audit procedures to ensure smooth conduct of the audit.

3.7 The Internal Audit Assignment Plan shall be continuously monitored during the execution phase for achievement of the objectives and to identify deviations, if any. Certain deviations may require to be notified to the stakeholders or even require a formal modification to the plan. However, any major modification to the plan shall be done only after consultation with those who approved the original plan. Such changes shall be formally documented and communicated to all impacted stakeholders.

4 Explanatory Comments

4.1 The Planning Process (refer Para 3.1): The Internal Auditor conducting the Internal Audit Assignment Planning shall use professional judgement for the process to be followed in completing all essential planning activities. A documented assignment planning process shall be in place which stipulates the essential inputs, steps to complete the planning and the nature of output required to conduct a comprehensive planning exercise.
Planning the Internal Audit Assignment

4.2 **Knowledge of the Business and its Environment (refer Para 3.3):**
The Internal Auditor shall gather all the information required to fully understand the Auditable Unit’s business environment, the risks it faces, the legal and regulatory requirements, the activities conducted and its day to day operational challenges.

The extent of information required should be sufficient to enable the internal auditor to identify matters which have a significant effect on the Auditable Unit’s financials and operations. Hence, there is a need to connect the financial aspects of the Auditable Unit’s business with the entity’s business elements, as well as external elements such as industry dynamics, business model, operational intricacies, legal and regulatory framework and the system and processes in place to run its operations.

4.3 **Discussion with Management (refer Para 3.3):** A key element of planning involves extensive discussion and deliberation with all stakeholders, including Auditable Unit’s executive management, risk owners, process owners, department heads etc. Their inputs are critical in understanding the intricacies of the assignment, in identification of matters of relevance and to align stakeholder expectations with audit objectives.

4.4 **Risk Assessment (refer Para 3.4):** An Internal Auditor shall undertake an independent risk assessment of all aspects of the Auditable Unit under review and align this with the risk assessment conducted by management. This is required to prioritise and focus audit work on high risk parts of the Auditable Unit, with due attention given to matters of importance, complexity and sensitivity. This exercise may involve site visits and preliminary surveys of the Auditable Unit. Based on this exercise, key risk mitigations (or internal controls) are identified for testing the effectiveness of operation. Absence of any risk mitigations (or missing controls) could point towards process design gaps which shall also be validated and reported.

4.5 **Audit Methodology and Depth of Coverage (refer Para 3.5):** The basic internal audit methodology, generally, undertaken involves the performance of compliance procedures over transactions and
balances so as to identify deviations from the laid down policies and procedures.

However, the Framework governing Internal Audits, issued by the ICAI, requires the conduct of risk-based audits with a system and process focus. Therefore, the depth of coverage shall go beyond basic compliance and could be expanded (for example) as follows:

(a) Application of a basic process review methodology which tests the design and operating efficiency of internal controls, questions the process design and explores better and more efficient ways of transaction processing.

(b) Deploying a risk-based process review methodology which helps to link the internal controls to particular vulnerabilities, evaluate the effectiveness of internal controls, even question the process in place and help identify alternative mitigations.

(c) Entity level control review methodology can be deployed to provide a more holistic evaluation of governance processes such as organisation culture, organisation structure, oversight mechanisms and performance measurement.

The Internal Audit Assignment Plan shall align the audit methodology and depth of coverage (as indicated above) with the assurance to be provided. A detailed Internal Audit Programme (IAP) is required to document all the audit procedures to be conducted for each audit objective in line with the audit methodology adopted.

4.6 Technology Deployment (refer Para 3.1): A key element of the internal audit assignment planning exercise involves understanding the extent to which:

(a) the Auditable Unit has deployed Information Technology (IT) in its business, operations and transaction processing, especially if it is unique and different to the overall entity; and

(b) the auditor needs to deploy IT tools, data mining & analytic procedures, and the expertise required for conducting the audit activities and testing procedures.

This helps to design and plan the audit and testing procedures more efficiently and effectively.
Planning the Internal Audit Assignment

4.7 **Resource Allocation (refer Para 3.1):** The Internal Auditor shall prepare a detailed work schedule to estimate the time required for each audit procedure depending on the audit attention it deserves (on the basis of risk assessment) and map this with the competencies (knowledge, experience, expertise etc.) of the resources available to ensure proper resource availability and allocation.

4.8 **Documentation:** To confirm compliance of audit procedures with the SIA, all key steps undertaken in the planning process shall be adequately documented to confirm their proper completion.

Essential documentation shall be as follows:

(a) Planning Process documentation (or Checklists) and any tools used in the planning process.

(b) Documentation supporting the information gathered about the Auditable Unit’s business and operations, systems and processes and past or known issues.

(c) Summary of meetings and communication with key stakeholders, with a summary of their inputs.

(d) Risk Assessment documentation and a Summary of risk mitigating controls deployed.

(e) Summary of available resources, their competencies and the proper matching of their skills with the audit requirements.

(f) Detailed Internal Audit Programme (IAP) which lists the specific testing procedures to be conducted for each audit objective.

(g) The final Internal Audit Assignment Plan duly approved by the Chief Internal Auditor.

5 **Effective Date**

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
STANDARD ON INTERNAL AUDIT (SIA) 320*
INTERNAL AUDIT EVIDENCE**

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This Standard on Internal Audit (SIA) 320, “Internal Audit Evidence,” issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

** Issued in November 2018.
** Note: This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 10, Internal Audit Evidence, issued in January 2009.
1 Introduction

1.1 “Internal Audit Evidence” refers to all the information used by the Internal Auditor in arriving at the conclusions on which the auditor’s opinion is based. It includes both information collected from underlying entity records and processes, as well as information from the performance of various audit activities and testing procedures.

1.2 Gathering appropriate and reliable audit evidence is a critical part of the internal audit process. This Standard explains certain key requirements in the process of collection, retention and subsequent review of internal audit evidence.

1.3 Scope: This Standard applies to all internal audit assignments. However, the manner in which the audit evidence is to be gathered from the performance of audit activities and testing procedures (e.g., sampling techniques, data analytics, etc.) are not subject matter of this Standard and the Internal Auditor should refer to specific Standard on Internal Audit for that subject. Types of audit evidence and its possible sources are therefore not covered in this Standard.

2 Objectives

2.1 The objectives of gathering appropriate and reliable audit evidence are to:

(a) confirm the nature, timing and sufficiency of the audit procedures undertaken as per the internal audit plan and terms of engagement;

(b) aid in the supervision and review of the internal audit work; and

(c) establish that the work performed is in conformance with the applicable pronouncements of the Institute of Chartered Accountants of India.

2.2 The overall objective of obtaining appropriate and reliable evidence is to allow the Internal Auditor to form an opinion on the outcome of the audit procedures completed. The evidence collected must stand on its own and not require any follow-up clarification or additional information to arrive at the same conclusion.
3 Requirements

3.1 The Internal Auditor shall obtain sufficient and appropriate audit evidence which can form the basis of audit findings and allow reliable conclusions to be drawn from those findings. Evidence collected through various audit procedures shall be complementary and relevant to the objectives of the audit procedure conducted. (refer Para 4.1).

3.2 The evidence shall be obtained from reliable sources with consistency between various evidences collected. (refer Para 4.2).

3.3 All audit evidence collected shall be recorded and the internal audit function shall maintain a written process explaining the manner in which audit evidence is to be gathered, reviewed, documented and stored as per Standards of quality and in conformance to the Standards on Internal Audit. (refer Para 4.3).

4 Explanatory Comments

4.1 Nature of Evidence (refer Para 3.1): Evidence is collected either from the underlying company’s books, records, systems and processes or through the performance of audit activities and testing procedures. Documents supporting transactions (e.g., bills/invoices) or business arrangements (e.g., contracts/agreements) are evidences in the nature of the former. Evidences for the latter are collected by performing one or more of the following audit procedures, i.e., checking, inspection, observation, inquiry, confirmation, computation, re-performance, analytical review and using the help of experts.

Sufficiency and appropriateness are inter-related and apply to evidence obtained. Sufficiency refers to the quantity or quantum of evidence gathered while appropriateness relates to its quality or relevance and reliability. Normally, the internal audit evidence is persuasive on its own and a number of evidential matters in aggregate, help make it conclusive in nature.

4.2 Reliability and Consistency of Evidence (refer Para 3.2): The reliability of the audit evidence depends on its source - internal or external, its type and thoroughness and, may also depend on the timing of the audit procedures conducted. When the Internal Auditor has doubts over the reliability of information collected, or the internal audit evidence obtained from one source is inconsistent with that
Internal Audit Evidence

obtained from another, the Internal Auditor shall evaluate how the audit procedures need to be modified or expanded to resolve the doubt or conflict.

4.3 Evidence Collection and Recording Process (refer Para 3.3): All audit evidence shall be recorded in such a manner that it can be reproduced (if in digital form) and reviewed independently of the Internal Auditor. It shall meet certain basic standards of quality to achieve internal audit objectives. Details of these quality standards, the manner in which audit evidence shall be gathered, reviewed for sufficiency and appropriateness, validated for authenticity and reliability and stored as part of internal audit documentation, shall be written in the form of an internal audit process (as part of the Internal Audit Manual).

4.4 Documentation: To confirm compliance of audit procedures with this SIA, the list of the documents required is as follows:

(a) Written policy and process on audit evidence, as part of the Internal Audit Manual.

(b) Details of the evidence collected, relevance to the audit findings and opinion being formed, cross referenced to the Internal Audit Program, where appropriate.

5 Effective Date

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
STANDARD ON INTERNAL AUDIT (SIA) 330*
INTERNAL AUDIT DOCUMENTATION**

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This Standard on Internal Audit (SIA) 330, “Internal Audit Documentation,” issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

* Issued in November 2018.
** Note: This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 3, Documentation, issued in August 2007.
1 Introduction

1.1 “Internal Audit Documentation” refers to the written record (electronic or otherwise) of the internal audit procedures performed, the relevant audit evidence obtained, and conclusions reached by the Internal Auditor on the basis of such procedures and evidence (Terms such as “work papers” or “working papers” are also used to refer documentation).

1.2 The Internal Auditor is expected to record and collate all the evidence obtained in the form of complete and sufficient audit documentation. This Standard explains certain key requirements in the process of collection, preparation, retention and subsequent review of internal audit documentation.

1.3 Scope: This Standard applies to all internal audit assignments. The nature and content of documentation is covered in a separate implementation guide on the subject.

2 Objectives

2.1 The objectives of preparing complete and sufficient audit documentation is to:

(a) validate the audit findings and support the basis on which audit observations are made and conclusions reached from those findings;

(b) aid in the supervision and review of the internal audit work; and

(c) establish that work performed is in conformance with the applicable pronouncements of the Institute of Chartered Accountants of India.

2.2 The overall objective of preparing audit documentation is to allow the internal auditor to form an opinion on the outcome of the assignment. The internal audit documentation must stand on its own and not require any follow-up clarifications or additional information to arrive at the same conclusions.
Compendium of Standards on Internal Audit

3 Requirements

3.1 The internal auditor shall record the nature, timing and extent of completion of all internal audit activities and testing procedures in the form of reproducible documents. (refer Para 4.1).

3.2 Documentation shall be complete and sufficient to support the analysis conducted on the audit evidence, the identification of findings, the formulation of audit observations and the drafting of the internal audit reports based on the findings. Documentation shall clearly state the purpose of the procedure, the source of evidence, the outcome of the audit work and also identify the performer and reviewer. (refer Para 4.2).

3.3 The internal audit function shall maintain a written process explaining the manner in which documentation will be prepared, reviewed, stored and finally discarded, to ensure quality and conformance to Standards on Internal Audit. (refer Para 4.3).

3.4 The internal audit work paper files shall be completed prior to the issuance of the final internal audit report. Any pending administrative matters shall also be completed within sixty days of the release of the final report. (refer Para 4.4).

3.5 The ownership and custody of the internal audit work papers shall remain with the Internal Auditor. Where part of the audit work is outsourced to an external audit service provider or an expert, and reliance is placed on the work papers to issue the internal audit report, the ownership of the work papers shall be assumed by the Internal Auditor from the third party. However, where reliance is placed only on the report of the third party who insists on retaining ownership to their work papers, adequate provisions shall be in place to have access to the work papers, if and when required (e.g., for quality review purposes).

4 Explanatory Comments

4.1 Nature of Documentation (refer Para 3.1): Documentation includes written records (electronic or otherwise) of various audit activities and procedures conducted, including evidence gathered, information collected, notes taken, and meetings held. It includes, for example, internal memoranda, letters of confirmation and representation,
checklists, external reports and correspondence (including e-mail) concerning significant matters. Abstracts or copies of the entity’s records, significant and specific contracts and agreements may be included as part of internal audit documentation, if and when appropriate.

These documents need not necessarily be printed on paper and soft/electronic/digital version may be used and filed. However, where alternate method of recording and storage is used, it must be reproducible in print form if required, similar in nature to the original documents.

4.2 Content and sufficiency of Documentation (refer Para 3.2): The content and extent of documentation is a matter of professional judgment since it is neither practical nor necessary to document every matter or observation. However, all significant matters which require exercise of judgment, together with the Internal Auditor's conclusion thereon, shall be included in the internal audit documentation. Professional judgement is applied well if documentation helps achieve the objectives listed under Section 2, above.

Nevertheless, documents shall be:

(a) sufficient and complete to avoid the need for follow-up inquiry;
(b) useful and relevant to the objectives of the audit procedure;
(c) undergo at least one level of review or approval; and
(d) dependable and reliable to allow a peer reviewer to reach the same conclusion.

4.3 Documentation Process (refer Para 3.3): Internal audit documentation shall be collated and arranged logically in files as audit work papers and retained to support the performance of the internal audits as per a written process. It shall include various quality checks, e.g., check of completeness (list of contents of all work papers), check of relevance (cross reference to findings and reports), check of conformance to Standards of Internal Audit (reference to relevant SIAs).

All audit work papers shall be retained in accordance with the legal and company’s retention policy and only shared with those who are
Compendium of Standards on Internal Audit

authorised to access them. Advice of legal counsel and/or approval of senior management or engaging authority (for outsourced engagements) shall be obtained (if required) prior to releasing any audit documentation to external parties.

4.4 **Timely Completion of Documentation (refer Para 3.4):** Audit working papers shall be compiled into internal audit files soon after the completion of all audit procedures, while pending matters may be closed during the draft stage of audit reporting. However, the final internal audit report shall not be released unless all significant audit evidence has been collected and documented.

The administrative process of arranging the final audit files shall be completed within sixty days of the release of the final report.

4.5 **Confirmation of Compliance:** To confirm compliance of audit procedures with this SIA, a list of the documents required is as follows:

(a) Written documentation policy and process on audit work papers, as part of the Internal Audit Manual;

(b) Work paper files for each audit assignment, reviewed and approved with cross reference to the Internal Audit Program, where appropriate.

5 **Effective Date**

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
STANDARD ON INTERNAL AUDIT (SIA) 350*
REVIEW AND SUPERVISION OF AUDIT ASSIGNMENTS

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This Standard on Internal Audit (SIA) 350, “Review and Supervision of Audit Assignments,” issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

* Issued in January 2020.
1 Introduction

1.1 This Standard deals with the responsibility of the Internal Auditor to conduct due review and supervision of the internal audit assignment to ensure its effective performance and completion.

1.2 In this Standard, the term “Review” refers to the examination of audit plan and procedures, collection of audit evidence, conclusions drawn therefrom and documenting the working papers. The term “Supervision” refers to the oversight of the audit activities and the provision of overall guidance for the achievement of audit objectives. Review is an exercise generally undertaken post completion of the work to be reviewed, whereas supervision is an on-going exercise.

1.3 Scope: This Standard applies to all internal audit assignments, conducted either by an in-house auditor and/ or an out-sourced auditor and also to any advisory assignments undertaken by the Internal Auditor.

2 Objectives

2.1 The objectives of review and supervision of audit assignments are to:

(a) Confirm and update the audit assignment plan, including the planned audit procedures and the adequacy of the resources allocated;

(b) Evaluate the audit procedures undertaken, evidence collected, proper documentation and conclusions drawn by the audit staff;

(c) Help formulate the audit observations and draft the internal audit report; and

(d) Establish that work performed is in conformance with the applicable pronouncements of the Institute of Chartered Accountants of India (ICAI).

2.2 The overall objective of review and supervision of an audit assignment is to ensure the effective and efficient performance of the audit procedures in line with quality standards and to accomplish the objectives of the audit.
3 Requirements

3.1 The Chief Internal Auditor (or the Engagement Partner) has the overall responsibility of review and supervision of the nature, timing and extent of all internal audit activities and testing procedures, and to ensure that evidence collected is sufficient and reliable. As indicated in para 4.2 (c), SIA 330, “Internal Audit Documentation” all documentation shall undergo at least one level of review (refer Para 4.1).

3.2 The periodicity and extent of the review shall be planned and documented at the audit planning stage taking into account the overall audit objectives, proficiency of staff, time and budget constraints, as per the professional judgement of the Chief Internal Auditor or Engagement Partner (refer Para 4.2).

3.3 A review of the audit workpapers shall be carried out to ensure that these are sufficient and appropriate to allow the reviewer to arrive at the same conclusions and formulate similar observations, as done by the audit staff. The documentation shall record the evidence of the supervision and review conducted, including the performance of any audit procedures subsequent to the review (refer Para 4.3).

3.4 The Internal Audit function (or out-sourced Firm) shall maintain a written process explaining the manner in which review and supervision shall be performed to ensure conformance to the quality as per Standards on Internal Audit (refer Para 4.4).

4 Explanatory Comments

4.1 Nature of Review and Supervision (refer Para 3.1): The extent of review and supervision varies for each assignment depending upon various factors such as the nature, objectives and scope of the assignment, its complexity, extent of automation, and the competency of the staff performing the audit. Nevertheless, it covers all audit activities such as, audit planning, sampling, audit testing procedures, collecting evidence, documentation, using the work of an expert and concluding audit observations in accordance with the pronouncements of the ICAI. Working papers prepared by the internal audit staff shall be reviewed at least one level up to ensure the completion of audit procedures in accordance with the audit plan and objectives.
The review and supervision duties may be delegated by the Chief Internal Auditor (or the Engagement Partner) to a subordinate who is a person with requisite experience and proficiency in conducting internal audits or preferably a Chartered Accountant. However, as indicated in Para 3.1 above, the overall responsibility remains with the Chief Internal Auditor (or the Engagement Partner).

4.2 Reviewing and Supervising the Audit Procedures (refer Para 3.2): The reviewer and supervisor shall ensure that the audit work is executed in accordance with the Internal Audit Programme and Audit Procedures are completed effectively and timely to help achieve overall objectives of the audit assignment. A review may indicate the need for additional or alternate audit procedures, which shall be performed, duly documented and communicated to the appropriate authority.

4.3 Review and Supervision of Documentation (refer Para 3.3): The extent of the documentation reviewed is based on the professional judgement of the reviewer, and can include checking the name of preparer, date of preparation, relevance and reliability of audit evidence, conclusions formed, audit observations drafted, the sufficiency of documents, etc. The adequacy of the documentation is tested on the basis of the requirements of the applicable Standards on Internal Audit.

An indicative list of review and supervision activities is set out as Annexure 1.

4.4 Documentation (refer Para 3.3 and Para 3.4): To conform to the requirements of this Standard, the following documentation shall be maintained:

(a) Process documentation on Review and Supervision, as part of the Internal Audit Manual.

(b) Documentation indicating the signature and date of review undertaken on the working papers, follow-up points raised, and minutes of any review meetings held with the audit team.

5 Effective Date

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.

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# Indicative List of Review and Supervision Activities

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• Audit Plan (SIA 310)  
• Audit Programme  
• Work allocation | • Audit Objectives (SIA 230)  
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This Standard on Internal Audit (SIA) 360, “Communication with Management,” issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

* Issued in May 2019.
** Note: This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 9, Communication with Management, issued in January 2009.
Communication with Management

1 Introduction

1.1 The Internal Auditor is required to have an effective two-way communication with the management, both while managing the internal audit function, and also while conducting an internal audit assignment. A continuous dialogue with management, at various stages of the internal audit process, is essential to the achievement of internal audit objectives.

1.2 “Communication” refers to any information exchange between the Internal Auditor and management, either through written or verbal means. “Management” refers to persons(s) with executive responsibility to run the company’s operations. The focus of this Standard is on the need for important communication to execute effective internal audits.

1.3 Scope: This Standard applies to all internal audit activities and audit assignments. The communication required for the Internal Auditor to report his findings in the form of a formal presentation or written report is the subject matter of another Standard (SIA) 370, “Reporting Results”.

2 Objectives

2.1 The objectives of this Standard to ensure the following:

(a) There is clarity and consensus between the Internal Auditor and the management with regard to the scope, approach, objectives and timing of an internal audit.

(b) To help inform, persuade and act on matters important to the conduct of an internal audit by promoting a continuous dialogue and free flow of information between the Internal Auditor and management.

(c) To help resolve any conflicts in a timely manner.

3 Requirements

3.1 The Internal Auditor shall establish a written communication process and protocol with management, which is shared and agreed with them. All communication shall be clear, appropriate and in line with the agreed process and timelines. (refer Para 4.1)
Compendium of Standards on Internal Audit

3.2 The process documentation shall outline the various modes and channels of communication (refer Para 4.2), the periodicity and timelines for communication (refer Para 4.3), and also cover certain essential information required to be communicated (refer Para 4.4). Where essential matters (refer Para 4.4) are concerned, any verbal communication should subsequently be confirmed in writing and maintained as audit documentation.

3.3 The Chief Internal Auditor (or the Engagement Partner, in case of external service provider) or their designate, shall play an active role in resolving conflicts through timely communication with management.

4 Explanatory Comments

4.1 Communication Process and Protocol (refer Para 3.1): A process-based communication will stipulate all the key elements (e.g. protocol, mode, channel, timelines, content, etc.) required for accurate, complete and timely communication. A communication protocol will clarify who will communicate with whom during the duration of the assignment, including escalations required for timely intervention.

4.2 Modes and Channels of Communication (refer Para 3.2): The manner in which information is exchanged (e.g., verbal, written, picture, video, etc.) is the mode of communication. The medium used to exchange information (e.g., through phone, hard-copy (paper), email, file exchange, etc..) is the channel of communication.

4.3 Periodicity and Time-line of Communication (refer Para 3.2): The Internal Auditor, jointly in consultation with management, shall determine the nature and timing of communication. It is necessary that certain matters are conveyed during, or by a certain point in time, of the internal audit.

4.4 Essential Information for Communication (refer Para 3.2): Various Standards on Internal Audit (SIA) includes reference to information which is considered essential for conduct of the internal audit. Such communication requirements shall be noted for compliance in written form.

For example, para 4.1 of SIA 110, "Nature of Assurance", requires the Internal Auditor to consult with the Auditee and Assurance User regarding the type of assurance to be provided. This would have to be communicated in writing prior to the commencement of the audit work.
Communication with Management

Similarly, para 4.3 of SIA 210, “Managing the Internal Audit Function” mentions that “the Internal Auditor shall engage in periodic meetings with (management) to ensure progress is on track and concerns, if any in this regard, are addressed immediately”. Also, in para 4.3 of SIA 310, “Planning the Internal Audit Assignment” requires a “Discussion with Management” as part of the planning process. This exchange of information is considered important and essential for conduct of internal audits.

4.5 **Documentation:** To confirm compliance of audit procedures with this SIA, the list of documents required is as follows:

(a) Written Communication process and protocol, as part of the Internal Audit Manual.

(b) Written details of essential exchange of information, as required by other SIAs, cross reference to the Internal Audit Program, where appropriate.

5 **Effective Date**

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
STANDARD ON INTERNAL AUDIT (SIA) 370*
REPORTING RESULTS**

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This Standard on Internal Audit (SIA) 370, “Reporting Results”, issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

* Issued in May 2019.
** Note: This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 4, Reporting, issued in October 2008.
1 Introduction

1.1 Dissemination of the results of internal audit and reporting the findings to management, and those charged with governance, is an essential part of any internal audit. Reporting of results needs to be done with a certain level of uniformity and, both the Internal Auditor and the recipient of the reports, should have clarity and agreement with regard to the nature of assurance being provided through these reports.

1.2 Reporting of internal audit results is generally undertaken in two stages:

(a) At the end of a particular audit assignment, an “Internal Audit Report” covering a specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from those assignments. This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.

(b) On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.

1.3 Scope: This Standard on Internal Audit (SIA) deals with the internal auditor’s responsibility to issue only the first type of reports, the Internal Audit Report pertaining to specific audit assignments (refer Para 1.2 (a) above) and not to the periodic (e.g. Quarterly) reporting for the whole entity as per the Annual/Quarterly audit plan. Also, this SIA does not cover the form or content of the Internal Audit Report where an assurance (i.e. a written opinion as per SIA 110) is being provided, for which a separate Standard on Internal Audit (SIA) 380, “Issuing Assurance Reports” should be referred to.
2 Objectives

2.2 The objectives of issuing Internal Audit Reports on significant internal audit assignments is to:

(a) Share with the auditee, details of all significant findings based on audit procedures undertaken;

(b) Allow management to understand the issues and take corrective actions in a methodical and comprehensive manner; and

(c) Provide a sound basis for any assurance being provided by the Internal Auditor.

2.3 The overall objective of Reporting Results is to highlight the effectiveness of internal controls and risk management processes to enhance governance in line with the Internal Audit Charter (or Terms of Reference, in case of external service provider).

3 Requirements

3.1 On the basis of the internal audit work completed, (refer Para 4.1) the Internal Auditor shall issue a clear, well documented Internal Audit Report which includes the following key elements:

(a) An overview of the objectives, scope and approach of the audit assignments;

(b) The fact that an internal audit has been conducted in accordance the Standards of Internal Audit (refer Para 4.2);

(c) An executive summary of key observations covering all important aspects, and specific to the scope of the assignment;

(d) A summary of the corrective actions required (or agreed by management) for each observation; and

(e) Nature of assurance, if any, which can be derived from the observations.

3.2 The nature of assurance, if any, to be provided shall be in line with Standard on Internal Audit (SIA) 110 “Nature of Assurance” as pre-agreed with the auditee at the planning stage.

3.3 The content and form of the Internal Audit Report is to be established by the Internal Auditor based on his best professional judgement, in consultation with the auditee and, if necessary, with inputs from other
key stakeholders. No internal audit report shall be issued in final form unless a written draft of the report has previously been shared with the auditee. (refer Para 4.3).

3.4 The internal audit report shall be issued within a reasonable time frame from the completion of the internal audit work.

4 Explanatory Comments

4.1 Basis of Internal Audit Report (refer Para 3.1): Each internal audit report is prepared on the basis of the audit procedures conducted and the analysis of the audit evidence gathered. Conclusions reached shall be based on all the findings rather than on a few deviations or issues noted. Controls operating effectively have their own importance and should be acknowledged, while the risk and significance of observations noted have a role to play in prioritising the matters to be reported.

4.2 Conducted in Accordance with SIAs (refer Para 3.1): Where the internal audit is conducted in compliance with the Standards of Internal Audit, (within the Framework governing Internal Audits), and the internal auditor can substantiate the same with supporting evidence and documentation, the internal audit report shall include a statement confirming that “the internal audit was conducted in accordance with the Standards of Internal Audit issued by the Institute of Chartered Accountants of India”.

4.3 Content and Format of Internal Audit Report (refer Para 3.3): The manner in which the internal audit report is drafted and presented is a matter of professional judgment and choice and could be influenced with preferences of the recipients. The SIA does not mandate any particular format or list of contents since the Internal Auditor is expected to exercise his best professional judgement on matters regarding how and what to report. Where some level of assurance is being provided, the form and content of the report shall be as per SIA 380, “Issuing Assurance Reports”.

4.4 Documentation: To confirm compliance of audit procedures with this SIA, the list of documents required is as follows:

(a) Copies of draft and final internal audit reports to be maintained, appropriately cross referenced to specific observations.
Compendium of Standards on Internal Audit

(b) If appropriate, management action plans may be counter signed by respective management personnel.

5 Effective Date

5.1 This Standard is applicable for internal audits beginning on or after date to be notified by the Council of the Institute.
# Standard on Internal Audit (SIA) 390*

**Monitoring and Reporting of Prior Audit Issues**

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This Standard on Internal Audit (SIA) 390, “Monitoring and Reporting of Prior Audit Issues,” issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.

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* Issued in January 2020.
Compendium of Standards on Internal Audit

1 Introduction

1.1 This Standard deals with the responsibility of the Internal Auditor in monitoring and reporting of prior audit issues, usually in the form of an “Action Taken Report (ATR) of previous audits”.

1.2 The term “Monitoring and Reporting” used in this Standard refers to the periodic tracking of issues raised during prior audits and evaluation of the corrective actions undertaken by the auditee to resolve them and to report any open and pending matters to the management and those charged with governance (e.g. the Audit Committee).

1.3 Scope: This Standard applies to all prior internal audits where audit issues remain open, pending the implementation of audit recommendations within pre-agreed timelines.

2 Objectives

2.1 The specific objectives of this Standard are to ensure:

(a) Proper monitoring and closure of open issues from prior audits;

(b) Independent validation of corrective actions taken by the auditee;

(c) Escalation of any concerns in case of delays in closure of issues; and

(d) Timely reporting of status to those charged with governance.

2.2 The overall objective of this Standard is to ensure that the auditee mitigates the risks highlighted in the audit observations through timely corrective actions or that a conscious decision is taken to accept the risks, in case recommendations are delayed or not implemented.

3 Requirements

3.1 The Chief Internal Auditor is responsible for continuously monitoring the closure of prior audit issues through a timely implementation of action plans included in past audits. This shall be done with a formal monitoring process, elements of which are pre-agreed with management and those charged with governance (refer Para 4.1). The responsibility to implement the action plans remains with the management.
Monitoring and Reporting of Prior Audit Issues

3.2 After receiving confirmation from the auditee regarding the implementation of corrective actions, additional audit procedures shall be performed by the Internal Auditor to confirm that the issues have been adequately addressed. Sufficient and appropriate audit evidences shall be obtained, and documentation shall be maintained (or updated) to confirm either effective closure of the issue, or reasons for its delay or deferral (refer Para 4.2).

3.3 In case of delays or ineffective implementation of the agreed corrective actions, the Internal Auditor shall escalate such delays and concerns to the appropriate levels of management. However, if new facts come to light justifying the ineffective or delayed implementation, the Internal Auditor may agree upon a new time-bound action plan. In such a situation, the follow-up timelines may be reset, or the issue may be deferred to the next audit and a plan to carry-forward such audit recommendation(s) may be agreed upon with management (refer Para 4.3).

3.4 The internal auditor shall periodically report to the management, and the Audit Committee, the status of prior issues (generally in the form of an "Action Taken Report"), including providing a confirmation of closure based on additional procedures, ageing of issues pending closure and reasons for any delays.

4 Explanatory Comments

4.1 Monitoring of Prior Issues (refer Para 3.1): The management is responsible for timely implementation of corrective action plans to address prior audit issues as per the agreed time-lines. The Chief Internal Auditor, or designate, will undertake a follow-up with the auditee, after the lapse of agreed time schedule for implementing the agreed actions, so as to evaluate the status of resolution. An automated process, which continuously alerts all parties, may be implemented by the management to ensure an effective follow-up. In situations where the prior audit issues were raised by an external service provider (internal audit firm), the succeeding audit firm will seek the help of the Chief Internal Auditor or the management to obtain any details required to assume the responsibility of monitoring and tracking the Action Taken Report.
4.2 **Closure of Prior Issues (refer Para 3.2):** For critical or sensitive issues (e.g., those rated high risk or with fraud risk), follow-up audit procedures shall be performed to ensure that the risk has been mitigated to an acceptable level. For medium risk issues, documentation proof of the implementation of the audit recommendations may be acceptable. For low risk issues, a written note confirmation from management may be sufficient. However, the documentation for all the three categories of risks shall be maintained as per the Standard on Internal Audit (SIA) 330, “Internal Audit Documentation”.

Note: If on the basis of additional audit procedures and evidence collected, the corrective actions appear to be sufficient to address the issues, the Internal Auditor may close the observation and issue a closure report. However, in case of ineffective or non-implementation of the recommendations, the Internal Auditor shall communicate the same as per the escalation procedures (refer Para 4.3). If despite such escalation, the recommendation remains pending, the Internal Auditor shall either obtain a written confirmation that the management accepts the risks, or issue a note of unaddressed risks, consequent to non-implementation of the audit recommendations.

4.3 **Escalation Procedure (refer Para 3.3):** When the Internal Auditor observes delay in the agreed time schedule for implementation, the Internal Auditor shall intimate the auditee and agree to a new time schedule. On further delays in timelines of implementation, the Internal Auditor shall escalate details of delays to management as per a pre-agreed escalation protocol. Status updates, including ageing of pending issues and delays in issue resolutions, should be shared periodically with management and the Audit Committee.

4.4 **Documentation:** The Internal Auditor shall document the working papers according to the Standard on Internal Audit (SIA) 330, “Internal Audit Documentation”, which shall include:

(a) The monitoring plan as agreed with management, including escalation procedures and protocol to be followed in case of delays.
Monitoring and Reporting of Prior Audit Issues

(b) Auditee’s confirmation of either complete implementation of agreed actions, or reasons for part/non-implementation and thereby, acceptance of risks.

(c) The documentary evidence and working papers to support additional audit procedures performed to confirm effective closure of prior issues.

(d) Escalation communication with corresponding management responses.

(e) Periodic status reports (ATR) issued to the management and those charged with governance.

5 Effective Date

5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.
Standards on Internal Audit
(As on July 1, 2013)
The following is the text of the Standard on Internal Audit (SIA) 5, *Sampling*, issued by the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the “*Preface to the Standards on Internal Audit*”, issued by the Institute of Chartered Accountants of India.

In terms of the decision taken by the Council of the Institute at its 260th meeting held in June 2006, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standard shall become mandatory from such date as notified by the Council.

* Published in the October 2008 issue of *The Chartered Accountant*. 
Introduction

1. The purpose of this Standard on Internal Audit (SIA) is to establish standards on the design and selection of an audit sample and provide guidance on the use of audit sampling in internal audit engagements. The SIA also deals with the evaluation of the sample results. This SIA applies equally to both statistical and non-statistical sampling methods. Either method, when properly applied, can provide sufficient appropriate audit evidence.

2. When using either statistical or non-statistical sampling methods, the internal auditor should design and select an audit sample, perform audit procedures thereon, and evaluate sample results so as to provide sufficient appropriate audit evidence to meet the objectives of the internal audit engagement unless otherwise specified by the client.

Definitions

3. "Audit sampling" means the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the internal auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form a conclusion concerning the population. Certain testing procedures, however, do not come within the definition of sampling. Tests performed on 100% of the items within a population do not involve sampling. Likewise, applying internal audit procedures to all items within a population which have a particular characteristic (for example, all items over a certain amount) does not qualify as audit sampling with respect to the portion of the population examined, nor with regard to the population as a whole, since the items were not selected from the total population on a basis that was expected to be representative. Such items might imply some characteristic of the remaining portion of the population but would not necessarily be the basis for a valid conclusion about the remaining portion of the population.
Sampling

4. “Error” means either control deviations when performing tests of controls, or misstatements, when performing tests of details.

5. “Population” means the entire set of data from which the sample is selected and about which the internal auditor wishes to draw conclusions. A population may be divided into various strata, or sub-populations, with each stratum being examined separately.

6. “Sampling risk” means the risk that from the possibility that the internal auditor’s conclusions, based on examination of a sample may be different from the conclusion reached if the entire population was subjected to the same types of internal audit procedure. The two types of sampling risk are –

   (a) The risk that the internal auditor concludes, in the case of tests of controls (TOC), that controls are more effective than they actually are, or in the case of tests of details (TOD), that a material error or misstatement does not exist when in fact it does.

   (b) The risk that the internal auditor concludes, in the case of tests of controls (TOC), that controls are less effective than they actually are, or in the case of tests of details (TOD), that a material error or misstatement exists when in fact it does not.

The mathematical complements of these risks are termed confidence levels.

7. “Sampling unit” means the individual items or units constituting a population, for example, credit entries in bank statements, sales invoices or debtors’ balances.

8. “Statistical sampling” means any approach to sampling procedure which has the following characteristics –

   (a) Random selection of a sample; and

   (b) Use of theory of probability to evaluate sample results, including measurement of sampling risk.

9. “Tolerable error” means the maximum error in a population that the internal auditor is willing to accept.
Use of Sampling in Risk Assessment Procedures and Tests of Controls

10. The internal auditor performs risk assessment procedures to obtain an understanding of the entity, business and its environment, including the mechanism of its internal control. Ordinarily, risk assessment procedures do not involve the use of sampling. However, there are cases, where the internal auditor often plans and performs tests of controls concurrently with obtaining an understanding of the design of controls and examining whether they have been implemented.

11. Tests of controls are performed when the internal auditor's risk assessment includes an expectation of the operating effectiveness of controls. Sampling of tests of controls is appropriate when application of the control leaves audit evidence of performance (for example, initials of the credit manager on a sales invoice indicating formal credit approval).

12. Sampling risk can be reduced by increasing sample size for both tests of controls and tests of details. Non-sampling risk can be reduced by proper engagement planning, supervision, monitoring and review.

Design of the Sample

13. When designing an audit sample, the internal auditor should consider the specific audit objectives, the population from which the internal auditor wishes to sample, and the sample size.

Internal Audit Objectives

14. The internal auditor would first consider the specific audit objectives to be achieved and the internal audit procedures which are likely to best achieve those objectives. In addition, when internal audit sampling is appropriate, consideration of the nature of the audit evidence sought and possible error conditions or other characteristics relating to that audit evidence will assist the internal auditor in defining what constitutes an error and what population to use for sampling. For example, when performing tests of controls over an entity's purchasing procedures, the internal auditor will be concerned with
Sampling

matters such as whether an invoice was clerically checked and properly approved. On the other hand, when performing substantive procedures on invoices processed during the period, the internal auditor will be concerned with matters such as the proper reflection of the monetary amounts of such invoices in the periodic financial statements. When performing tests of controls, the internal auditor makes an assessment of the rate of error the internal auditor expects to find in the population to be tested. This assessment is on the basis of the internal auditor’s understanding of the design of the relevant controls, and whether they have actually been implemented or the examination of a small number of items from the population.

Population

15. The population is the entire set of data from which the internal auditor wishes to sample in order to reach a conclusion. The internal auditor will need to determine that the population from which the sample is drawn is appropriate for the specific audit objective. For example, if the internal auditor’s objective were to test for overstatement of accounts receivable, the population could be defined as the accounts receivable listing. On the other hand, when testing for understatement of accounts payable, the population would not be the accounts payable listing, but rather subsequent disbursements, unpaid invoices, suppliers’ statements, unmatched receiving reports, or other populations that would provide audit evidence of understatement of accounts payable.

16. The individual items that make up the population are known as sampling units. The population can be divided into sampling units in a variety of ways. For example, if the internal auditor’s objective were to test the validity of accounts receivables, the sampling unit could be defined as customer balances or individual customer invoices. The internal auditor defines the sampling unit in order to obtain an efficient and effective sample to achieve the particular audit objectives.

17. It is important for the internal auditor to ensure that the population is appropriate to the objective of the internal audit procedure, which will include consideration of the direction of testing. The population also needs to be complete, which means that if the internal auditor intends
to use the sample to draw conclusions about whether a control activity operated effectively during the financial reporting period, the population needs to include all relevant items from throughout the entire period.

18. When performing the audit sampling, the internal auditor performs internal audit procedures to ensure that the information upon which the audit sampling is performed is sufficiently complete and accurate.

**Stratification**

19. To assist in the efficient and effective design of the sample, stratification may be appropriate. Stratification is the process of dividing a population into sub-populations, each of which is a group of sampling units, which have similar characteristics (often monetary value). The strata need to be explicitly defined so that each sampling unit can belong to only one stratum. This process reduces the variability of the items within each stratum. Stratification, therefore, enables the internal auditor to direct audit efforts towards the items which, for example, contain the greatest potential monetary error. For example, the internal auditor may direct attention to larger value items for accounts receivable to detect overstated material misstatements. In addition, stratification may result in a smaller sample size.

**Sample Size**

20. **When determining the sample size, the internal auditor should consider sampling risk, the tolerable error, and the expected error.** The lower the risk that the internal auditor is willing to accept, the greater the sample size needs to be. Examples of some factors affecting sample size are contained in Appendix 1 and Appendix 2 to the Standard.

21. The sample size can be determined by the application of a statistically based formula or through exercise of professional judgment applied objectively to the circumstances of the particular internal audit engagement.
Statistical and Non-Statistical Approaches

22. The decision of using either statistical or non-statistical sampling approach is a matter for the internal auditor's professional judgment. In the case of tests of controls, the internal auditor's analysis of the nature and cause of errors will often be of more importance than the statistical analysis of the mere presence or absence of errors. In such case, non-statistical sampling approach may be preferred.

23. When applying statistical sampling, sample size may be ascertained using either probability theory or professional judgment. Sample size is a function of several factors. Appendices 1 and 2 discuss some of these factors.

Tolerable Error

24. Tolerable error is the maximum error in the population that the internal auditor would be willing to accept and still conclude that the result from the sample has achieved the objective(s) of the internal audit. Tolerable error is considered during the planning stage and, for substantive procedures, is related to the internal auditor's judgment about materiality. The smaller the tolerable error, the greater the sample size will need to be.

25. In tests of controls, the tolerable error is the maximum rate of deviation from a prescribed control procedure that the internal auditor would be willing to accept, based on the preliminary assessment of control risk. In substantive procedures, the tolerable error is the maximum monetary error in an account balance or class of transactions that the internal auditor would be willing to accept so that when the results of all audit procedures are considered, the internal auditor is able to conclude, with reasonable assurance, that the financial statements are not materially misstated.

Expected Error

26. If the internal auditor expects error to be present in the population, a larger sample than when no error is expected ordinarily needs to be examined to conclude that the actual error in the population is not
greater than the planned tolerable error. Smaller sample sizes are justified when the population is expected to be error free. In determining the expected error in a population, the internal auditor would consider such matters as error levels identified in previous internal audits, changes in the entity’s procedures, and evidence available from other procedures.

**Selection of the Sample**

27. The internal auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items or sampling units in the population have an opportunity of being selected.

28. While there are a number of selection methods, three methods commonly used are:

- Random selection and use of CAATs
- Systematic selection
- Haphazard selection

Appendix 3 to the Standard discusses these methods.

**Evaluation of Sample Results**

29. Having carried out, on each sample item, those audit procedures that are appropriate to the particular audit objective, the internal auditor should:

(a) analyse the nature and cause of any errors detected in the sample;
(b) project the errors found in the sample to the population;
(c) reassess the sampling risk; and
(d) consider their possible effect on the particular internal audit objective and on other areas of the internal audit engagement.
Sampling

30. The internal auditor should evaluate the sample results to determine whether the assessment of the relevant characteristics of the population is confirmed or whether it needs to be revised.

Analysis of Errors in the Sample

31. In analysing the errors detected in the sample, the internal auditor will first need to determine that an item in question is in fact an error. In designing the sample, the internal auditor will have defined those conditions that constitute an error by reference to the audit objectives. For example, in a substantive procedure relating to the recording of accounts receivable, a mis-posting between customer accounts does not affect the total accounts receivable. Therefore, it may be inappropriate to consider this an error in evaluating the sample results of this particular procedure, even though it may have an effect on other areas of the audit such as the assessment of doubtful accounts.

32. When the expected audit evidence regarding a specific sample item cannot be obtained, the internal auditor may be able to obtain sufficient appropriate audit evidence through performing alternative procedures. For example, if a positive account receivable confirmation has been requested and no reply was received, the internal auditor may be able to obtain sufficient appropriate audit evidence that the receivable is valid by reviewing subsequent payments from the customer. If the internal auditor does not, or is unable to, perform satisfactory alternative procedures, or if the procedures performed do not enable the internal auditor to obtain sufficient appropriate audit evidence, the item would be treated as an error.

33. The internal auditor would also consider the qualitative aspects of the errors. These include the nature and cause of the error and the possible effect of the error on other phases of the audit.

34. In analysing the errors discovered, the internal auditor may observe that many have a common feature, for example, type of transaction, location, product line, or period of time. In such circumstances, the internal auditor may decide to identify all items in the population which possess the common feature, thereby producing a sub-population, and extend audit procedures in this area. The internal auditor would
then perform a separate analysis based on the items examined for each sub-population.

**Projection of Errors**

35. The internal auditor projects the error results of the sample to the population from which the sample was selected. There are several acceptable methods of projecting error results. However, in all the cases, the method of projection will need to be consistent with the method used to select the sampling unit. When projecting error results, the internal auditor needs to keep in mind the qualitative aspects of the errors found. When the population has been divided into sub-population, the projection of errors is done separately for each sub-population and the results are combined.

36. For tests of controls, no explicit projection of errors is necessary since the sample error rate is also the projected rate of error for the population as a whole.

**Reassessing Sampling Risk**

37. The internal auditor needs to consider whether errors in the population might exceed the tolerable error. To accomplish this, the internal auditor compares the projected population error to the tolerable error taking into account the results of other audit procedures relevant to the specific control or financial statement assertion. The projected population error used for this comparison in the case of substantive procedures is net of adjustments made by the entity. When the projected error exceeds tolerable error, the internal auditor reassesses the sampling risk and if that risk is unacceptable, would consider extending the audit procedure or performing alternative internal audit procedures.

38. If the evaluation of sample results indicates that the assessment of the relevant characteristic of the population needs to be revised, the internal auditor, may:

(a) Request management to investigate the identified errors and the potential for any further errors, and to make necessary
Sampling

adjustments, in cases where management prescribes the sample size; and / or

(b) Modify the nature, timing and extent of internal audit procedures.
   In case of tests of controls, the internal auditor might extend the sample size, test an alternative control or modify related substantive procedures; and / or

(c) Consider the effect on the Internal Audit Report.

Documentation

39. Documentation provides the essential support to the opinion and/ or findings of the internal auditor. In the context of sampling, the internal auditor’s documentation may include aspects such as:
   i. Relationship between the design of the sample vis a vis specific audit objective, population from which sample is drawn and the sample size.
   ii. Assessment of the expected rate of error in the population to be tested vis a vis 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 a 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, where appropriate.
   ix. Effect of the sample results on the internal audit’s objective(s).
   x. Projection of sample results to the characteristics of the population.
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Effective Date

40. This Standard on Internal Audit is applicable to all internal audits commencing on or after______. Earlier application of the SIA is encouraged.
Appendix 1

Examples of Factors Influencing Sample Size for Tests of Controls

The following are some factors which the internal auditor considers when determining the sample size required for tests of controls (TOC). These factors need to be considered together assuming the internal auditor does not modify the nature or timing of TOC or otherwise modify the approach to substantive procedures in response to assessed risks.

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

Notes –

1. Other things being equal, the more the internal auditor relies on the operating effectiveness of controls in risk assessment, the greater is the extent of the internal auditor’s tests of controls, and hence the sample size is increased.

2. The lower the rate of deviation that the internal auditor is willing to accept, the larger the sample size needs to be.
3. The higher the rate of deviation that the internal auditor expects, the larger the sample size needs to be so as to make a reasonable estimate of the actual rate of deviation.

4. The higher the degree of confidence that the internal auditor requires that the results of the sample are indicative of the actual incidence of errors in the population, the larger the sample size needs to be.

5. For large populations, the actual population size has little effect on sample size. For small populations, sampling is often not as efficient as alternative means of obtaining sufficient appropriate audit evidence.
Appendix 2

Examples of Factors Influencing Sample Size for Tests of Details (TOD)

The following are some factors which the internal auditor considers when determining the sample size required for tests of details (TOD). These factors need to be considered together assuming the internal auditor does not modify the nature or timing of TOD or otherwise modify the approach to substantive procedures in response to assessed risks.

<table>
<thead>
<tr>
<th>Factor to be considered by Internal Auditor</th>
<th>Effect on sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td>An increase in the internal auditor’s assessment of the risk of material misstatement</td>
<td>Increase</td>
</tr>
<tr>
<td>An increase in the use of other substantive procedures by the internal auditor, directed at the same assertion</td>
<td>Decrease</td>
</tr>
<tr>
<td>An increase in the total error that the internal auditor is willing to accept (Tolerable Error)</td>
<td>Decrease</td>
</tr>
<tr>
<td>Stratification of the population when appropriate</td>
<td>Decrease</td>
</tr>
<tr>
<td>An increase in the amount of error which the internal auditor expects to find in the population</td>
<td>Increase</td>
</tr>
<tr>
<td>An increase in the internal auditor’s required confidence level</td>
<td>Increase</td>
</tr>
<tr>
<td>The number of sampling units in the population</td>
<td>Negligible effect</td>
</tr>
</tbody>
</table>
Appendix 3

Methods of Sample Selection

The principal methods of sample selection are as –

1. **Using a computerized random number generator** or through random number tables.

2. **Systematic selection** – In this method, the number of sampling units in the population is divided by the sample size to give a sampling interval, for example 20, and having thus determined a starting point within the first 20, each 20th sampling unit thereafter is selected. Although the starting point may be haphazardly determined, the sample is likely to be truly random if the same is determined by using a computerized random number generator or random number tables. In this method, the internal auditor would need to determine that sampling units within the population are not structured in such a way that the sampling interval corresponds with any particular pattern within the population.

3. **Haphazard selection** – In this method, the internal auditor selects the sample without following any structured technique. The internal auditor should attempt to ensure that all items within the population have a chance of selection, without having any conscious bias or predictability. This method is not appropriate when using statistical sampling technique.

4. **Block selection** – This method involves selection of a block(s) of adjacent or contiguous items from within the population. Block selection normally cannot be used in internal audit sampling because most populations are structured in such a manner that items forming a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population. This method would not be an appropriate sample selection technique when the internal auditor intends to draw valid inferences about the entire population, based on the sample.
Frequency of Control Activity and Sample Size

The following guidance related to the frequency of the performance of control may be considered when planning the extent of tests of operating effectiveness of manual controls for which control deviations are not expected to be found. The internal auditor may determine the appropriate number of control occurrences to test based on the following minimum sample size for the frequency of the control activity dependent on whether assessment has been made on a lower or higher risk of failure of the control.

<table>
<thead>
<tr>
<th>Frequency of control activity</th>
<th>Minimum sample size</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Risk of failure</td>
</tr>
<tr>
<td></td>
<td>Lower</td>
</tr>
<tr>
<td>Annual</td>
<td>1</td>
</tr>
<tr>
<td>Quarterly (including period-end, i.e., +1)</td>
<td>1+1</td>
</tr>
<tr>
<td>Monthly</td>
<td>2</td>
</tr>
<tr>
<td>Weekly</td>
<td>5</td>
</tr>
<tr>
<td>Daily</td>
<td>15</td>
</tr>
<tr>
<td>Recurring manual control (multiple times per day)</td>
<td>25</td>
</tr>
</tbody>
</table>

**Note:** Although +1 is used to indicate that the period-end control is tested, this does not mean that for more frequent control operations the year-end operation cannot be tested.
The following is the text of the Standard on Internal Audit (SIA) 6, *Analytical Procedures*, issued by the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the "Preface to the Standards on Internal Audit", issued by the Institute of Chartered Accountants of India.

In terms of the decision taken by the Council of the Institute at its 260th meeting held in June 2006, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standard shall become mandatory from such date as notified by the Council.

* Published in the October 2008 issue of The Chartered Accountant.
Analytical Procedures

Introduction

1. The purpose of this Standard on Internal Audit (SIA) is to establish standards on the application of analytical procedures during an internal audit.

2. The internal auditor should apply analytical procedures as the risk assessment procedures at the planning and overall review stages of the internal audit. Risk assessment procedures refer to the internal audit procedures performed to obtain an understanding of the entity and its environment, including the entity's internal control, to identify and assess the risks of material misstatement, whether due to fraud or error, in the information subjected to internal audit. Analytical procedures may also be applied at other stages.

3. "Analytical procedures" means the analysis of significant ratios and trends, including the resulting investigation of fluctuations and relationships in both financial and non-financial data that are inconsistent with other relevant information or which deviate significantly from predicted amounts. Analytical procedures provide the internal auditor with an efficient and effective means of making an assessment of information collected in an audit. The assessment results from comparing such information with expectations identified or developed by the internal auditor.

Nature and Purpose of Analytical Procedures

4. Analytical procedures include the consideration of comparisons of the entity's financial and non-financial information with, for example:

   - Comparable information for prior periods.
   - Anticipated results of the entity, such as budgets or forecasts or expectations of the internal auditor.
   - Predictive estimates prepared by the internal auditor, such as an estimation of depreciation charge for the year.
   - Similar industry information, such as a comparison of the entity's ratio of sales to trade debtors with industry averages, or with other entities of comparable size in the same industry.
Compendium of Standards on Internal Audit

5. Analytical procedures also include consideration of relationships:
   - Among elements of financial information that would be expected to conform to a predictable pattern based on the entity's experience, such as gross margin percentages.
   - Between financial information and relevant non-financial information, such as payroll costs to number of employees or total production costs to quantity produced.

6. Various methods may be used in performing the above procedures. These range from simple comparisons to complex analyses using advanced statistical techniques. Analytical procedures may be applied to consolidated financial statements, financial statements of components (such as subsidiaries, divisions or segments) and individual elements of financial information and relevant non-financial information. The internal auditor's choice of procedures, methods and level of application is a matter of professional judgement. Specific analytical procedures include, but are not limited to ratio, trend, and regression analysis, reasonableness tests, period-to-period comparisons, comparisons with budgets, forecasts, and external economic information.

7. In determining the extent to which the analytical procedures should be used, the internal auditor should consider the following factors, including:
   - The significance of the area being examined.
   - The adequacy of the system of internal control.
   - The availability and reliability of financial and non-financial information.
   - The precision with which the results of analytical procedures can be predicted.
   - The availability and comparability of information regarding the industry in which the organization operates.
   - The extent to which other auditing procedures provide support for audit results.

After evaluating the aforementioned factors, the internal auditor should consider and use additional auditing procedures, as necessary, to achieve the audit objective.
Analytical Procedures

8. Analytical procedures are used for the following purposes:
   - to assist the internal auditor as risk assessment procedures to obtain initial understanding of the entity and its environment and thereafter in planning the nature, timing and extent of other internal audit procedures;
   - as substantive procedures when their use can be more effective or efficient than tests of details in reducing detection risk for specific financial statement assertions;
   - as an overall review of the systems and processes in the final review stage of the internal audit; and
   - to evaluate the efficiency of various business/management systems.

9. Analytical procedures may identify, among other things, differences that are not expected or absence of differences when they are expected, which may have arisen on account of factors such as errors, frauds, unusual or non-recurring transaction or events, etc.

Analytical Procedures as Risk Assessment Procedures and in Planning the Internal Audit

10. The internal auditor should apply analytical procedures as risk assessment procedures to obtain an understanding of the business, the entity and its environment and in identifying areas of potential risk. Application of analytical procedures may indicate aspects of the business of which the internal auditor was unaware and will assist in determining the nature, timing and extent of other internal audit procedures.

11. Analytical procedures in planning the internal audit use both financial and non-financial information, for example, in retail business, the relationship between sales and square footage of selling space or volume of goods sold.

Analytical Procedures as Substantive Procedures

12. The internal auditor’s reliance on substantive procedures to reduce detection risk relating to specific financial statement assertions and assertions relating to process, systems and controls may be derived
from tests of details, from analytical procedures, or from a combination of both. The decision about which procedures to use to achieve a particular internal audit objective is based on the internal auditor's judgement about the expected effectiveness and efficiency of the available procedures in reducing detection risk for specific financial statement assertions or assertions relating to process, systems and controls.

13. The internal auditor will ordinarily inquire of management as to the availability and reliability of information needed to apply analytical procedures and the results of any such procedures performed by the entity. It may be efficient to use analytical data prepared by the entity, provided the internal auditor is satisfied that such data is properly prepared.

14. When intending to perform analytical procedures as substantive procedures, the internal auditor will need to consider a number of factors such as the:

- Objectives of the analytical procedures and the extent to which their results can be relied upon.
- Nature of the business, entity and the degree to which information can be disaggregated.
- Availability of information, both financial, such as budgets or forecasts, and non-financial, such as the number of units produced or sold.
- Reliability of the information available, for example, whether budgets is prepared with sufficient professional care.
- Relevance of the information available, for example, whether budgets have been established as results to be expected rather than as goals to be achieved.
- Source of the information available, for example, sources independent of the entity are ordinarily more reliable than internal sources.
- Comparability of the information available, for example, broad industry data may need to be supplemented to be comparable to that of an entity that produces and sells specialised products.
Analytical Procedures

- Knowledge gained during previous internal audits, together with the internal auditor's understanding of the effectiveness of the accounting and internal control systems and the types of problems that in prior periods have given rise to accounting adjustments.

- Controls over the preparation of the information, for example, controls over the preparation, review and maintenance of MIS reports, budgets, etc.

Analytical Procedures in the Overall Review at the End of the Internal Audit

15. The internal auditor should apply analytical procedures 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 the business. The conclusions drawn from the results of such procedures are intended to corroborate conclusions formed during the internal audit of individual components or elements of the financial statements, e.g., purchases, and assist in arriving at the overall conclusion. However, in some cases, as a result of application of analytical procedures, the internal auditor may identify areas where further procedures need to be applied before the internal auditor can form an overall conclusion about the systems, processes and associated controls.

Extent of Reliance on Analytical Procedures

16. The application of analytical procedures is based on the expectation that relationships among data exist and continue in the absence of known conditions to the contrary. The presence of these relationships provides the internal auditor evidence as to the completeness, efficiency and effectiveness of systems, processes and controls. However, reliance on the results of analytical procedures will depend on the internal auditor's assessment of the risk that the analytical procedures may identify relationships as expected when, in fact, a material misstatement exists.

17. The extent of reliance that the internal auditor places on the results of analytical procedures depends on the following factors:
Compendium of Standards on Internal Audit

- materiality of the items involved, for example, when inventory balances are material, the internal auditor does not rely only on analytical procedures in forming conclusions. However, the internal auditor may rely solely on analytical procedures for certain income and expense items when they are not individually material;

- other internal audit procedures directed toward the same internal audit objectives, for example, other procedures performed by the internal auditor while reviewing the credit management process, in the collectability of accounts receivable, such as the review of subsequent cash receipts, might confirm or disprove questions raised from the application of analytical procedures to an ageing schedule of customers’ accounts;

- accuracy with which the expected results of analytical procedures can be predicted. For example, the internal auditor will ordinarily expect greater consistency in comparing gross profit margins from one period to another than in comparing discretionary expenses, such as research or advertising; and

- assessments of inherent and control risks, for example, if internal control over sales order processing is weak and, therefore, control risk is high, more reliance on tests of details of transactions and balances than on analytical procedures in drawing conclusions on receivables may be required.

18. The internal auditor will need to consider testing the controls, if any, over the preparation of information used in applying analytical procedures. When such controls are effective, the internal auditor will have greater confidence in the reliability of the information and, therefore, in the results of analytical procedures. The controls over non-financial information can often be tested in conjunction with tests of accounting-related controls. For example, an entity in establishing controls over the processing of sales invoices may include controls over the recording of unit sales. In these circumstances, the internal auditor could test the controls over the recording of unit sales in conjunction with tests of the controls over the processing of sales invoices.
Investigating Unusual Items or Trends

19. When analytical procedures identify significant fluctuations or relationships that are inconsistent with other relevant information or that deviate from predicted amounts, the internal auditor should investigate and obtain adequate explanations and appropriate corroborative evidence. The examination and evaluation should include inquiries of management and the application of other auditing procedures until the internal auditor is satisfied that the results or relationships are sufficiently explained. Unexplained results or relationships may be indicative of a significant condition such as a potential error, irregularity, or illegal act. Results or relationships that are not sufficiently explained should be communicated to the appropriate levels of management. The internal auditor may recommend appropriate courses of action, depending on the circumstances.

20. The investigation of unusual fluctuations and relationships ordinarily begins with inquiries of management, followed by:
   - corroboration of management's responses, for example, by comparing them with the internal auditor's knowledge of the business and other evidence obtained during the course of the internal audit; and
   - consideration of the need to apply other internal audit procedures based on the results of such inquiries, if management is unable to provide an explanation or if the explanation is not considered adequate.

Effective Date

21. This Standard on Internal Audit is applicable to all internal audits commencing on or after ______. Earlier application of the SIA is encouraged.
STANDARD ON INTERNAL AUDIT (SIA) 7
QUALITY ASSURANCE IN INTERNAL
AUDIT*

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The following is the text of the Standard on Internal Audit (SIA) 7, Quality Assurance in Internal Audit, issued by the Institute of Chartered Accountants of India. This Standard should be read in conjunction with the "Preface to the Standards on Internal Audit", issued by the Institute of Chartered Accountants of India.

In terms of the decision taken by the Council of the Institute taken at its 260th meeting held in June 2006, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standard shall become mandatory from such date as notified by the Council.

* Published in the October 2008 issue of The Chartered Accountant.
Quality Assurance in Internal Audit

Introduction

1. Paragraph 3.1 of the Preface to the Standards on Internal Audit, describes the internal audit as follows:

“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.”

2. Paragraphs 7 and 8 of the Standard on Internal Audit (SIA) 2, Basic Principles Governing Internal Audit, state as follows:

“7. The internal auditor should either have or obtain such skills and competence, acquired through general education, technical knowledge obtained through study and formal courses, as are necessary for the purpose of discharging his responsibilities.

8. The internal auditor also has a continuing responsibility to maintain professional knowledge and skills at a level required to ensure that the client or the employer receives the advantage of competent professional service based on the latest developments in the profession, the economy, the relevant industry and legislation.”

Scope

3. This Standard on Internal Audit shall apply whenever an internal audit is carried out, whether carried out by an in house internal audit department or by an external firm of professional accountants. For the purpose of this Standard, the term “firm” means a sole practitioner/ proprietor, partnership or any such entity of professional accountants as may be permitted by law.

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1 The Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements issued by the Council of the Institute of Chartered Accountants of India applies to the firms carrying out internal audit to the extent such internal audit activities fall under the scope of audits and reviews of the historical financial information and other assurance and related services.
Objective

4. The purpose of this Standard on Internal Audit (SIA) is to establish standards and provide guidance regarding quality assurance in internal audit.

5. A system for assuring quality in internal audit should provide reasonable assurance that the internal auditors comply with professional Standards, regulatory and legal requirements, so that the reports issued by them are appropriate in the circumstances.

6. In order to ensure compliance with the professional Standards, regulatory and legal requirements, and to achieve the desired objective of the internal audit, a person within the organization should be entrusted with the responsibility for the quality in the internal audit, whether done in-house or by an external agency.

7. In the case of the in-house internal audit or a firm carrying out internal audit, the person entrusted with the responsibility for the quality in internal audit should ensure that the system of quality assurance include policies and procedures addressing each of the following elements:

   a) **Leadership responsibilities for quality in internal audit** - The person entrusted with the responsibility for the quality in internal audit should take responsibility for the overall quality in internal audit.

   b) **Ethical requirements** - The person entrusted with the responsibility for the quality in internal audit should establish policies and procedures designed to provide it with reasonable assurance that the personnel comply with relevant ethical requirements. If matters come to his attention that indicate that the members of the internal audit engagement team have not complied with relevant ethical requirements, he should, in consultation with the appropriate authority in the entity, determine the appropriate course of action.

   c) **Acceptance and continuance of client relationship and specific engagement, as may be applicable** - The person entrusted with the responsibility for the quality in internal audit should
establish policies and procedures for the acceptances and continuance of client relationships and specific engagements, designed to provide reasonable assurance that it will undertake or continue relationships and engagements.

d) **Human resources** - The person entrusted with the responsibility for the quality in internal audit should establish policies and procedures regarding assessment of the staff's capabilities and competence designed to provide it with reasonable assurance that there are sufficient personnel with the capabilities, competence, and commitment to ethical principles necessary to:

- Perform engagements in accordance with professional standards and regulatory and legal requirements; and
- Enable the firm or engagement partner to issue reports that are appropriate in the circumstances.

e) **Engagement performance** - The person entrusted with the responsibility for the quality in internal audit should establish policies and procedures designed to provide it with reasonable assurance that engagements are performed in accordance with the applicable professional Standards and regulatory and legal requirements and that the reports issued by the internal auditors are appropriate in the circumstances.

f) **Monitoring** - The person entrusted with the responsibility for the quality in internal audit should establish policies and procedures designed to provide reasonable assurance that the policies and procedures relating to the system of quality assurance are relevant, adequate, operating effectively and complied with in practice.

8. In order to improve the functionalities of the organization, transparency in reporting and good governance, the person entrusted with responsibility for the quality in internal audit, while establishing the quality assurance framework, should consider the following parameters of the internal audit activity:

- Terms of engagement and their adequacy.
- Professional standards and compliance therewith.
Compendium of Standards on Internal Audit

- Internal audit goals and the extent to which they are being achieved.
- Recommendations for improving the quality of internal audit and the extent to which they are being implemented and their effectiveness.
- Skills and technology used in carrying out internal audit.

9. The person entrusted with the responsibility for the quality in internal audit needs to ensure that the quality assurance framework is embedded in the internal audit. This can, for example, be achieved in the following manner:

- Developing an internal audit manual clearly defining the specific role and responsibilities, policies and procedures, documentation requirements, reporting lines and protocols, targets and training requirements for the staff, internal audit performance measures and the indicators.
- Ensuring that the internal audit staff at all levels is appropriately trained and adequately supervised and directed on all assignments.
- Identifying the customers of the internal audit activity.
- Establishing a formal process of feedback from the users of the internal audit services, such as the senior management executives, etc. Some of the attributes on which the feedback may be sought include quality, timeliness, value addition, efficiency, innovation, effective communication, audit team, time management. The responses received from the users of the internal audit services should also be shared with the appropriate levels of management and those charged with governance.
- Establishing appropriate performance criteria for measuring the performance of the internal audit function. In case the internal audit activity is performed by an external agency, the contract of the engagement should contain a clause for establishment of performance measurement criteria and periodic performance review. These performance
measurement criteria should be approved by the management.

- Identify and benchmark with industry/peer group performance.

10. The quality assurance framework established by the person entrusted with the responsibility for the quality in internal audit should, therefore, cover all the elements of the internal audit activity. For example,

- Development and implementation of the internal audit policies and procedures.
- Maintenance and monitoring of the budget for the internal audit activity.
- Maintenance and updation of the overall internal audit plan.
- Identification of the risk areas and the internal audit plan to address these risks.
- Acquisition and deployment of audit tools and use of technology to enhance the efficiency and effectiveness of the internal audit activity.
- Co-ordination with the external auditors.
- Staffing related aspects of internal audit – recruitment, training, etc.
- Planning and implementation of the training and professional development of the internal audit staff.
- Implementation of the performance metrics for the internal audit activity and periodic monitoring of the same.
- Review of the follow up actions taken on the findings of the internal audit activity.

Internal Quality Reviews

11. The internal quality review framework should be designed with a view to provide reasonable assurance to that the internal audit is able to efficiently and effectively achieve its objectives of adding value and strengthening the overall governance mechanism of the
Compendium of Standards on Internal Audit

entity, including the entity's strategic risk management and internal control system.

Internal Quality Reviewer

12. The internal quality review should be done by the person entrusted with the responsibility for the quality in internal audit and/or other experienced member(s) of the internal audit function.

13. The internal quality reviews should be undertaken on an ongoing basis. The person entrusted with the responsibility for the quality in internal audit should ensure that recommendations resulting from the quality reviews for the improvements in the internal audit activity are promptly implemented.

Communicating the Results of the Internal Quality Review

14. The person entrusted with the responsibility for the quality in internal audit should also ensure that the results of the internal quality reviews are also communicated to the appropriate levels of management and those charged with governance on a timely basis along with the proposed plan of action to address issues and concerns raised in the review report.

External Quality Review

15. External quality review is a critical factor in ensuring and enhancing the quality of internal audit. The frequency of the external quality review should be based on a consideration of the factors such as the maturity level of the internal audit activity in the entity, results of the earlier internal audit quality reviews, feedbacks as to the usefulness of the internal audit activity from the customers of the internal audit, costs vis a vis perceived benefits of the frequent external reviews. The frequency should not in any case be less than once in three years.

External Quality Reviewer

16. The external quality review should be done by a professionally qualified person having an in depth knowledge and experience of, inter alia, the professional Standards applicable to the internal
auditors, the processes and procedures involved in the internal audit generally and those peculiar to the industry in which the entity is operating, etc. The external quality reviewer should be appointed in consultation with the person entrusted with the responsibility for the quality in internal audit, senior management and those charged with governance.

**Communicating Results of the External Quality Review**

17. The external quality reviewer should discuss his findings with the person entrusted with the responsibility for the quality in internal audit. His final report should contain his opinion on all the parameters of the internal audit activity, as discussed in paragraph 10, and should be submitted to the person entrusted with the responsibility for the quality in internal audit and copies thereof be also sent to those charged with governance. The person entrusted with the responsibility for the quality in internal audit should, also submit to those charged with governance, a plan of action to address the issues and concerns raised by the external quality reviewers in his report.

**Effective Date**

18. This SIA is effective for all quality assessments/ reviews of internal audit undertaken on or after ............................. Earlier application of the SIA is encouraged.
# Standard on Internal Audit (SIA) 11

## Consideration of Fraud in an Internal Audit*

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The following is the text of the Standard on Internal Audit (SIA) 11, *Consideration of Fraud in an Internal Audit*, issued by the Council of the Institute of Chartered Accountants of India. These Standards should be read in conjunction with the Preface to the Standards on Internal Audit, issued by the Institute.

In terms of the decision of the Council of the Institute of Chartered Accountants of India taken at its 260th meeting held in June 2006, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standards shall become mandatory from such date as notified by the Council.

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*Published in the January 2009 issue of *The Chartered Accountant*. *
Consideration of Fraud in an Internal Audit

Introduction

1. Fraud is defined as an intentional act by one or more individuals among management, those charged with governance, or third parties, involving the use of deception to obtain unjust or illegal advantage. A fraud could take form of misstatement of an information (financial or otherwise) or misappropriation of the assets of the entity.

2. The primary responsibility for prevention and detection of frauds rests with management and those charged with governance. They achieve this by designing, establishing and ensuring continuous operation of an effective system of internal controls.

3. Paragraph 6 of the Standard on Internal Audit (SIA) 2, Basic Principles Governing Internal Audit, states as follows:

“The internal auditor should exercise due professional care, competence and diligence expected of him while carrying out the internal audit. Due professional care signifies that the internal auditor exercises due professional care in carrying out the work entrusted to him in terms of deciding on aspects such as the extent of work required to achieve the objectives of the engagement, relative complexity and materiality of the matters subjected to internal audit, assessment of risk management, control and governance processes and cost benefit analysis. Due professional care, however, neither implies nor guarantees infallibility, nor does it require the internal auditor to travel beyond the scope of his engagement.”

An internal auditor should, therefore, use his knowledge and skills to reasonably enable him to identify indicators of frauds. However, the internal auditor cannot be expected to possess the expertise of a person with specialized knowledge and skills in detecting and investigating frauds.

Common Fraud Situations

4. A fraud normally occurs in situations where there is an incentive or a
pressure to commit fraud, an opportunity to commit fraud or a rationalisation for committing fraud. Although, normally, an internal auditor is not expected to possess skills and knowledge of a person expert in detecting and investigating frauds, he should, however, have reasonable knowledge of factors that might increase the risk of opportunities for frauds in an entity and exercise reasonable care and professional scepticism while carrying out internal audit. In addition, the understanding of the design and implementation of the internal controls in an entity would also help the internal auditor to assess the risk of frauds.

Internal Control System

5. Internal control refers to the process designed, implemented and maintained by the management of the entity to ensure accomplishment of its following objectives:

- Reliability of financial reporting;
- Efficiency and effectiveness in operations;
- Compliance with applicable laws and regulations; and
- Safeguarding of assets.

The design and the manner of implementation and maintenance of internal controls varies with the size and complexity of the entity.

6. Internal controls can, however, provide only reasonable assurance to the entity with regard to accomplishments of its objectives stated in paragraph 5 above since any system of internal control is subject to inherent limitations such as faulty human judgment, ineffective use of the information generated for the purpose of internal controls, collusion among two or more persons, management override of controls, faulty design of controls, management judgments as to nature and extent of risks it wants to assume, etc.
Elements of Internal Control System

7. A system of internal control comprises of following five elements:
   - the control environment;
   - entity’s risk assessment process;
   - information system and communication;
   - control activities; and
   - monitoring of controls.

It is essential for the internal auditor to gain an understanding of the components of the system of internal control. These components have been discussed in the following paragraphs.

8. The control environment sets the tone at the top in an entity and greatly impacts the effectiveness of internal controls. It includes the following:
   - the policies and procedures established by the management to communicate and enforce the culture of integrity and ethical values in the entity.
   - management’s commitment to competence.
   - management’s philosophy and operating style.
   - organizational structure.
   - assignment of authority and responsibility.
   - human resources policies and practices.

9. The entity’s risk assessment process includes the policies and procedures adopted by the management to identify risks that can
affect the achievement of the objectives of the entity and to distinguish risks from opportunities. In the context of prevention of frauds, the entity’s risk assessment process would include the policies and procedures of the management to identify and assess the risk of frauds, including the possibility of fraudulent financial reporting and misappropriation of assets.

10. The information system and communication refer to the policies and procedures established by the management to identify, capture and communicate relevant information to the concerned persons in the entity to enable them to make timely and effective decisions and discharge their responsibilities efficiently. In the context of frauds, such policies and procedures could take form of whistle-blower policies and mechanisms, ethics helplines and counseling, training of employees, etc.

11. The control activities refer to the policies and procedures established by the management to ensure that the risks identified are responded to as per the policy or the specific decision of the management, as the case may be. In the context of frauds, the control activities include actions taken by management to prevent or detect and correct the frauds or breach of internal controls.

12. Monitoring refers to continuous supervision and assessment of the internal controls to identify instances of any actual or possible breaches therein and to take corrective action on a timely basis.

Responsibilities of the Internal Auditor

13. As discussed in paragraph 2, the primary responsibility for prevention and detection of frauds is that of the management of the entity. The internal auditor should, however, help the management fulfil its responsibilities relating to fraud prevention and detection. The following paragraphs discuss the approach of the internal auditor regarding this.
Consideration of Fraud in an Internal Audit

Control Environment

14. The internal auditor should obtain an understanding of the various aspects of the control environment and evaluate the same as to the operating effectiveness.

Risk Assessment

15. The internal auditor should obtain an understanding of the policies and procedures adopted by the management to identify risks that can affect the achievement of the objectives of the entity and to distinguish risks from opportunities and evaluate the effectiveness of these policies and procedures. In the context of prevention of frauds, the internal auditor should specifically evaluate the policies and procedures established by the management to identify and assess the risk of frauds, including the possibility of fraudulent financial reporting and misappropriation of assets.

Information System and Communication

16. The internal auditor should assess the operating effectiveness of the policies and procedures established by the management to identify, capture and communicate relevant information to the concerned persons in the entity to enable them to make timely and effective decisions and discharge their responsibilities efficiently.

Control Activities

17. The internal auditor should assess whether the controls implemented by the management to ensure that the risks identified are responded to as per the policy or the specific decision of the management, as the case may be, are in fact working effectively and whether they are effective in prevention or timely detection and correction of the frauds or breach of internal controls.
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Monitoring

18. The internal auditor should evaluate the mechanism in place for supervision and assessment of the internal controls to identify instances of any actual or possible breaches therein and to take corrective action on a timely basis.

Communication of Fraud

19. The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action. However, in case the internal auditor comes across any actual or suspected fraud or any other misappropriation of assets, he should immediately bring the same to the attention of the management.

Documentation

20. The internal auditor should document fraud risk factors identified as being present during the internal auditor’s assessment process and document the internal auditor’s response to any other factors. If during the performance of the internal audit fraud risk factors are identified that cause the internal auditor to believe that additional internal audit procedures are necessary, the internal auditor should document the same.

Effective Date

21. This Standard on Internal Audit is effective for all internal audits beginning on or after ______________. Earlier application of the Standard is encouraged.
STANDARD ON INTERNAL AUDIT (SIA) 13
ENTERPRISE RISK MANAGEMENT*

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The following is the text of the Standard on Internal Audit (SIA) 13, Enterprise Risk Management, issued by the Institute of Chartered Accountants of India. The Standard should be read in the conjunction with the “Preface to the Standards on Internal Audit”, issued by the Institute.

In terms of the decision taken by the Council of the Institute at its 260th meeting held in June 2006, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standard shall become mandatory from such date as may be notified by the Council in this regard.

* Published in the February 2009 issue of The Chartered Accountant.
Compendium of Standards on Internal Audit

Introduction

1. The purpose of this Standard on Internal Audit is to establish standards and provide guidance on review of an entity’s risk management system during an internal audit or such other review exercise with the objective of providing an assurance thereon. This Standard applies where the internal auditor has been requested by the management to provide such an assurance on the effectiveness of its enterprise risk management system.

2. Enterprise risk management enables management to effectively deal with risk, associated uncertainty and enhancing the capacity to build value to the entity or enterprise and its stakeholders. Internal auditor may review each of these activities and focus on the processes used by management to report and monitor the risks identified.

Risk and Enterprise Risk Management

3. Risk is an event which can prevent, hinder, fail to further or otherwise obstruct the enterprise in achieving its objectives. A business risk is the threat that an event or action will adversely affect an enterprise’s ability to maximize stakeholder value and to achieve its business objectives. Risk can cause financial disadvantage, for example, additional costs or loss of funds or assets. It can result in damage, loss of value and /or loss of an opportunity to enhance the enterprise operations or activities. Risk is the product of probability of occurrence of an event and the financial impact of such occurrence to an enterprise.

4. Risk may be broadly classified into Strategic, Operational, Financial and Knowledge. Strategic Risks are associated with the primary long-term purpose, objectives and direction of the business. Operational risks are associated with the on-going, day-to-day operations of the enterprise. Financial Risks are related specifically to the processes, techniques and instruments utilised to manage the finances of the enterprise, as well as those processes involved in sustaining effective financial
relationships with customers and third parties. Knowledge Risks are associated with the management and protection of knowledge and information within the enterprise.

Process of Enterprise Risk Management and Internal audit

5. Enterprise Risk Management is a structured, consistent and continuous process of measuring or assessing risk and developing strategies to manage risk within the risk appetite. It involves identification, assessment, mitigation, planning and implementation of risk and developing an appropriate Risk Response policy. Management is responsible for establishing and operating the risk management framework.

6. The Enterprise Risk Management process consists of Risk identification, prioritization and reporting, Risk mitigation, Risk monitoring and assurance. Internal audit is a key part of the lifecycle of risk management. The corporate risk function establishes the policies and procedures, and the assurance phase is accomplished by internal audit.

Role of the Internal Auditor in Relation to Enterprise Risk Management

7. The role of the internal auditor in relation to Enterprise Risk Management is to provide assurance to management on the effectiveness of risk management. Due consideration should be given to ensure that the internal auditor protects his independence and objectivity of the assurance provided. The role of the internal auditor is to ascertain that risks are appropriately defined and managed.

8. The scope of the internal auditor's work in assessing the effectiveness of the enterprise risk management would, normally, include:

(a) assessing the risk maturity level both at the entity level as well as the auditable unit level;
(b) assessing the adequacy of and compliance with the risk management policy and framework; and

(c) for the risks covered by the internal audit plan:

(i) Assessing the efficiency and effectiveness of the risk response; and

(ii) Assessing whether the score of the residual risk is within the risk appetite.

9. The extent of internal auditor’s role in enterprise risk management will depend on other resources, internal and external, available to the board and on the risk maturity of the organisation. The nature of internal auditor’s responsibilities should be adequately documented and approved by those charged with governance. The internal auditor should not manage any of the risks on behalf of the management or take risk management decisions. The internal auditor should not assume any accountability for risk management decisions taken by the management. Internal auditor has a role only in commenting and advising on risk management and assisting in the effective mitigation of risk.

10. The internal auditor has to review the structure, effectiveness and maturity of an enterprise risk management system. In doing so, he should consider whether the enterprise has developed a risk management policy setting out roles and responsibilities and framing a risk management activity calendar. The internal auditor should review the maturity of an enterprise risk management structure by considering whether the framework so developed, inter alia:

a) protects the enterprise against surprises;

b) stabilizes overall performance with less volatile earnings;

c) operates within established risk appetite;
d) protects ability of the enterprise to attend to its core business and;

e) creates a system to proactively manage risks.

11. The internal auditor should review whether the enterprise risk management coordinators in the entity report on the results of the assessment of key risks at the appropriate levels, which are, *inter alia*:

- Risk management committee
- Enterprise Business and Unit heads
- Audit Committee

**Internal Audit Plan and Risk Assessment**

12. The internal auditor will normally perform an annual risk assessment of the enterprise, to develop a plan of audit engagements for the subsequent period. This plan will be reviewed at various frequencies in practice. This typically involves review of the various risk assessments performed by the enterprise (e.g., strategic plans, competitive benchmarking, etc.), consideration of prior audits, and interviews with a variety of senior management. It is designed for identifying internal audit key areas and, not for identifying, prioritizing, and managing risks directly for the enterprise. The internal audit plan, which should be approved by the audit committee, should be based on risk assessment as well as on issues highlighted by the audit committee and senior management. The risk assessment process should be of a continuous nature so as to identify not only residual or existing risks, but also emerging risks. The risk assessment should be conducted formally at least annually, but more often in complex enterprises. To serve this objective, the internal auditor should design the audit work plan by aligning it with the objectives and risks of the enterprise and concentrate on
those issues where assurance is sought by those charged with governance.

13. The risk review process to be carried out by the internal auditor provides the assurance that there are appropriate controls in place for the risk management activities and that the procedures are understood and followed. Effective enterprise risk management requires a monitoring structure to ensure that the risks are effectively identified and assessed and that the appropriate mitigation plans are in place.

14. The review process conducted by internal auditors will help to determine, inter alia:

   a) whether the adopted measures result in what was intended;
   b) whether the procedures adopted, and information gathered for undertaking the assessment were appropriate; and

Further, improved knowledge would help in reaching better decisions and identifying the lessons to improve future assessment and management of risks.

15. The internal auditor should submit his report to the Board or its relevant Committee, delineating the following information:

   • Assurance rating (segregated into High, Medium or Low) as a result of the review;
   • Tests conducted;
   • Samples covered; and
   • Observations and recommendations.

Effective Date

16. This Standard on Internal Audit is applicable to all internal audits commencing on or after ______. Earlier application of the SIA is encouraged.
The following is the text of the Standard on Internal Audit (SIA) 14, *Internal Audit in An Information Technology Environment*, issued by the Council of the Institute of Chartered Accountants of India. These Standards should be read in conjunction with the Preface to the Standards on Internal Audit, issued by the Institute.

In terms of the decision of the Council of the Institute of Chartered Accountants of India taken at its 260th meeting held in June 2006, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standards shall become mandatory from such date as notified by the Council.

* Published in the March 2009 issue of *The Chartered Accountant*. 
Introduction

1. The purpose of this Standard on Internal Audit (SIA) is to establish standards on procedures to be followed when an internal audit is conducted in an information technology (IT) environment. An information technology environment exists when one or more computer(s) of any type or size is (are) involved in the processing of financial information, including quantitative data, and other types of information processing whether those computers are operated by the entity or by a third party. An IT system is a system that uses technology to capture, classify, summarize and report data in a meaningful manner to interested users, including an enterprise resource planning (ERP) system.

2. The overall objective and scope of an internal audit does not change in an IT environment. However, the use of a computer changes the processing, storage, retrieval and communication of financial information and the interplay of processes, systems and control procedures. This may affect the internal control systems employed by the entity. Accordingly, an IT environment may affect:

   (a) the procedures followed by the internal auditor in obtaining a sufficient understanding of the processes, systems and internal control system; and
   (b) the auditor’s review of the entity’s risk management and continuity systems.

IT Environment – Matters to Consider

3. The internal auditor should consider the effect of an IT environment on the internal audit engagement, inter alia:

   a. the extent to which the IT environment is used to record, compile, process and analyze information; and
   b. the system of internal control in existence in the entity with regard to:
      • the flow of authorized, correct and complete data to the processing center;
      • the processing, analysis and reporting tasks undertaken in the installation; and
Internal Audit in an Information Technology Environment

- the impact of computer-based accounting system on the audit trail that could otherwise be expected to exist in an entirely manual system.

Skills and Competence

4. The internal auditor should have sufficient knowledge of the information technology systems to plan, direct, supervise, control and review the work performed. The sufficiency of knowledge would depend on the nature and extent of the IT environment. The internal auditor should consider whether any specialized IT skills are needed in the conduct of the audit, for example, the operating knowledge of a specialized ERP system.

Specialized skills may be needed, for example, to:

a) obtain sufficient understanding of the effect of the IT environment on systems, processes, internal control and risk management systems;

b) design and perform appropriate tests of control and substantive procedures; and

c) determine the effect of the IT environment on assessment of overall audit risk.

5. If specialized skills are needed, the internal auditor should seek the assistance of a technical expert possessing such skills, who may either be the internal auditor's staff or an outside professional. If the use of such a professional is planned, the internal auditor should, in accordance with SIA16*, "Using the Work of an Expert", obtain sufficient appropriate evidence that the work performed by the expert is adequate for the purposes of the internal audit.

Planning

6. The internal auditor should obtain an understanding of the systems, processes, control environment, risk-response activities and internal control systems sufficient to plan the internal audit and to determine the nature, timing and extent of the audit

* Being Published in the March 2009 issue of The Chartered Accountant.
Compendium of Standards on Internal Audit

procedures, in accordance with SIA 1, “Planning an Internal Audit”. Such an understanding would help the internal auditor to develop an effective audit approach.

7. In planning the portions of the internal audit which may be affected by the IT environment, the internal auditor should obtain an understanding of the significance and complexity of the IT activities and the availability of the data for use in the internal audit. This understanding would include such matters as:

i) the information technology infrastructure [hardware, operating system(s), etc., and application software(s)] used by the entity including changes, if any, therein since last audit.

ii) the significance and complexity of computerized processing in each significant application. An application may be considered to be complex when, for example:

a) the volume and materiality of transactions is such that users would find it difficult to identify and correct errors in processing.

b) the computer automatically generates material transactions or entries directly to another application.

c) the computer performs complicated computations of financial information and/or automatically generates material transactions or entries that cannot be (or are not) validated independently.

d) transactions are exchanged electronically with other organizations [as in electronic data interchange (EDI) systems] without manual review for propriety or reasonableness.

iii) determination of the organizational structure of the client's IT activities and the extent of concentration or distribution of computer processing throughout the entity, particularly, as they may affect segregation of duties.

iv) determination of the availability of data. Source documents, computer files, and other evidential matter that may be required by the internal auditor may exist for only a short period or only in
Internal Audit in an Information Technology Environment

machine-readable form. Information Technology systems may generate reports that might be useful in performing substantive tests (particularly analytical procedures). The potential for use of computer-assisted audit techniques may permit increased efficiency in the performance of internal audit procedures or may enable the auditor to economically apply certain procedures to the entire population of transactions.

8. **When the information technology systems are significant, the internal auditor should also obtain an understanding of the IT environment and whether it influences the assessment of inherent and control risks.** The nature of the risks and the internal control characteristics in IT environments include the following:

   a. *Lack of transaction trails:* Some IT systems are designed so that a complete transaction trail that is useful for audit purposes might exist for only a short period of time or only in computer readable form. Where a complex application system performs a large number of processing steps, there may not be a complete trail. Accordingly, errors embedded in an application's program logic may be difficult to detect on a timely basis by manual (user) procedures.

   b. *Uniform processing of transactions:* Computer processing uniformly processes like transactions with the same processing instructions. Thus, the clerical errors ordinarily associated with manual processing are virtually eliminated. Conversely, programming errors (or other systemic errors in hardware or software) will ordinarily result in all transactions being processed incorrectly.

   c. *Lack of segregation of functions:* Many control procedures that would ordinarily be performed by separate individuals in manual systems may become concentrated in a IT environment. Thus, an individual who has access to computer programs, processing or data may be in a position to perform incompatible functions.

   d. *Potential for errors and irregularities:* The potential for human error in the development, maintenance and execution of computer information systems may be greater than in manual systems, partially because of the level of detail inherent in these
activities. Also, the potential for individuals to gain unauthorized access to data or to alter data without visible evidence may be greater in IT than in manual systems. In addition, decreased human involvement in handling transactions processed by computer information systems can reduce the potential for observing errors and irregularities. Errors or irregularities occurring during the design or modification of application programs or systems software can remain undetected for long periods of time.

e. *Initiation or execution of transactions:* Information Technology systems may include the capability to initiate or cause the execution of certain types of transactions, automatically. The authorization of these transactions or procedures may not be documented in the same way as that in a manual system, and management's authorization of these transactions may be implicit in its acceptance of the design of the information technology systems and subsequent modification.

f. *Dependence of other controls over computer processing:* Computer processing may produce reports and other output that are used in performing manual control procedures. The effectiveness of these manual control procedures can be dependent on the effectiveness of controls over the completeness and accuracy of computer processing. In turn, the effectiveness and consistent operation of transaction processing controls in computer applications is often dependent on the effectiveness of general computer information systems controls.

g. *Potential for increased management supervision:* IT systems can offer management a variety of analytical tools that may be used to review and supervise the operations of the entity. The availability of these analytical tools, if used, may serve to enhance the entire internal control structure.

h. *Potential for the use of computer-assisted audit techniques:* The case of processing and analyzing large quantities of data using computers may require the auditor to apply general or specialized computer audit techniques and tools in the execution of audit tests.
Internal Audit in an Information Technology Environment

Both the risks and the controls introduced as a result of these characteristics of information technology systems have a potential impact on the internal auditor's assessment of risk, and the nature, timing and extent of audit procedures.

9. While evaluating the reliability of the internal control systems, the internal auditor should consider whether these systems, *inter alia*:

a. ensure that authorized, correct and complete data is made available for processing;

b. provide for timely detection and correction of errors;

c. ensure that in case of interruption in the working of the IT environment due to power, mechanical or processing failures, the system restarts without distorting the completion of the entries and records;

d. ensure the accuracy and completeness of output;

e. provide adequate data security against fire and other calamities, wrong processing, frauds etc.;

f. prevent unauthorized amendments to the programs; and

g. provide for safe custody of source code of application software and data files.

Risk Assessment

10. The internal auditor should make an assessment of inherent and control risks for material assertions related to significant processes and systems. These assertions apply to significant processes and systems for example - sales, procurement, inventory management, production, marketing, human resources and logistics.

11. The internal auditor should review whether the information technology system in the entity considers the confidentiality, effectiveness, integrity, availability, compliance and validity of data and information processed. The internal auditor should also review the effectiveness and safeguarding of IT resources, including – people, applications, facilities and data.
The inherent risks and control risks in an IT environment may have both a pervasive effect and an account-specific effect on the likelihood of material misstatements, as follows:

a. The risks may result from deficiencies in pervasive IT activities such as program development and maintenance, system software support, operations, physical IT security and control over access to special privilege utility programs. These deficiencies would tend to have a pervasive impact on all application systems that are processed on the IT system.

b. The risks may increase the potential for errors or fraudulent activities in specific applications, in specific databases or master files, or in specific processing activities. For example, errors are not uncommon in systems that perform complex logic or calculations, or that must deal with many different exception conditions. Systems that control cash disbursements or other liquid assets are susceptible to fraudulent actions by users or by IT personnel.

Audit Procedures

The internal auditor should consider the IT environment in designing audit procedures to review the systems, processes, controls and risk management framework of the entity.

Review of Information Technology Environment

The internal auditor should review the robustness of the IT environment and consider any weakness or deficiency in the design and operation of any IT control within the entity, by reviewing:

a) System Audit reports of the entity, conducted by independent Information System auditors;
b) Reports of system breaches, unsuccessful login attempts, passwords compromised and other exception reports;
c) Reports of network failures, virus attacks and threats to perimeter security, if any;
Internal Audit in an Information Technology Environment

d) General controls like segregation of duties, physical access records, logical access controls;

e) Application controls like input, output, processing and run-to-run controls; and

f) Excerpts from the IT policy of the entity relating to business continuity planning, crisis management and disaster recovery procedures.

An illustrative checklist of IT controls to be reviewed by the internal auditor is given in the Appendix to this Standard.

15. If the internal auditor is not able to rely on the effectiveness of the IT environment as a result of the review, he may perform such substantive testing or test of IT controls, as deemed fit in the circumstances. The internal auditor should apply his professional judgment and skill in reviewing the IT environment and assessing the interfaces of such IT infrastructure with other business processes.

Outsourced Information Processing

16. The internal auditor should assess and review the reliance which the management of the entity places on the outsourced agency, in case where such information processing has been outsourced to the outside party. The risks associated with such outsourced services should be considered by the internal auditor in light of the review of IT controls prevalent in such outside entity. The internal auditor should also review the extent to which the entity’s controls provide reasonable assurance regarding the completeness, validity, reliability and availability of the data and information processed by such outsourced agency.

Documentation

17. The internal auditor should document the internal audit plan, nature, timing and extent of audit procedures performed and the conclusions drawn from the evidence obtained. In an internal audit in IT environment, some or all of the audit evidence may be in the electronic form. The internal auditor should satisfy himself that
such evidence is adequately and safely stored and is retrievable in its entirety as and when required.

Effective Date

18. This Standard on Internal Audit is applicable to all internal audits commencing on or after ___. Earlier application of the SIA is encouraged.
Appendix

Illustrative Information Technology Controls to be Reviewed During Internal Audit in An IT Environment

(Refer paragraph 14)

(The Appendix is only illustrative in nature and does not form part of the Standard)

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>CONTROL PARAMETERS</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>IT Access Control</td>
</tr>
<tr>
<td>1</td>
<td>There is structured IT Policy and facility personnel are aware of the applicable policies.</td>
</tr>
<tr>
<td></td>
<td>IT Back-up and Recovery</td>
</tr>
<tr>
<td>2</td>
<td>The network has adequately documented backup and recovery procedures/plans/schedules for critical sites.</td>
</tr>
<tr>
<td>3</td>
<td>LAN is supported by an uninterruptible power supply (UPS).</td>
</tr>
<tr>
<td>4</td>
<td>UPS tested in the last year (to test the batteries)?</td>
</tr>
<tr>
<td>5</td>
<td>For disaster-recovery purposes, LAN applications have been prioritized and scheduled for recovery based on importance to the operation.</td>
</tr>
<tr>
<td></td>
<td>IT Environmental Controls</td>
</tr>
<tr>
<td>6</td>
<td>Smoke detection and automatic fire-extinguishing equipments installed for adequate functioning and protection against fire hazards.</td>
</tr>
<tr>
<td></td>
<td>IT Inventory</td>
</tr>
<tr>
<td>7</td>
<td>There is a complete inventory of the following: Hardware: Computers, File Servers, Printers, Modems, Switches, Routers, Hubs, etc. Software: all software for each Computer is logged with licenses and serial numbers.</td>
</tr>
<tr>
<td>8</td>
<td>There are written procedures for keeping LAN inventory and they identify who (title) is responsible for maintaining the inventory report.</td>
</tr>
<tr>
<td>9</td>
<td>Unused equipment is properly and securely stored.</td>
</tr>
<tr>
<td></td>
<td>IT Operations</td>
</tr>
<tr>
<td>---</td>
<td>-------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>10</td>
<td>LAN administrator has a backup person.</td>
</tr>
<tr>
<td>11</td>
<td>LAN administrator monitors the LAN response time, disk storage space, and LAN utilization.</td>
</tr>
<tr>
<td>12</td>
<td>LAN administrator is experienced and familiar with operation of the LAN facility.</td>
</tr>
<tr>
<td></td>
<td>IT Physical Security</td>
</tr>
<tr>
<td>13</td>
<td>Alarms installed at all potential entry and exist points of sensitive areas.</td>
</tr>
<tr>
<td></td>
<td>IT Service Agreements</td>
</tr>
<tr>
<td>14</td>
<td>Vendor reliability considered before purchasing LAN hardware and software.</td>
</tr>
<tr>
<td>15</td>
<td>Service log maintained to document vendor support servicing.</td>
</tr>
<tr>
<td>16</td>
<td>LAN hardware and software purchase contracts include statements regarding vendor support and licensing.</td>
</tr>
<tr>
<td></td>
<td>IT Virus Protection Policy</td>
</tr>
<tr>
<td>17</td>
<td>The level of virus protection established on servers and workstations is determined and the monitoring of infection are being done by IT administration. Virus Application should be updated on a monthly basis. Laptops if issued should be ensured to have secured internet access.</td>
</tr>
</tbody>
</table>
STANDARD ON INTERNAL AUDIT (SIA) 17
CONSIDERATION OF LAWS AND
REGULATIONS IN AN INTERNAL AUDIT*

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The following is the text of the Standard on Internal Audit (SIA) 17,
Consideration of Laws and Regulations in an Internal Audit, issued by the
Institute of Chartered Accountants of India. The Standard should be read in
the conjunction with the “Preface to the Standards on Internal Audit”, issued
by the Institute.

In terms of the decision taken by the Council of the Institute at its 260th
meeting held in June 2006, the following Standard on Internal Audit shall be
recommendatory in nature in the initial period. The Standard shall become
mandatory from such date as may be notified by the Council in this regard.

* Published in the February 2010 issue of The Chartered Accountant.
Compendium of Standards on Internal Audit

Scope
1. This Standard on Internal Audit (SIA) deals with the internal auditor’s responsibility to consider laws and regulations when performing an internal audit. This SIA also applies to other engagements in which the internal auditor is specifically engaged to test and report separately on compliance with specific laws or regulations.

Definition
2. For the purposes of this SIA, the following term has the meaning attributed below:

   Non-compliance – Acts of omission or commission by the entity, either intentional or unintentional, which are contrary to the prevailing laws or regulations. Such acts include transactions entered into by, or in the name of, the entity, or on its behalf, by those charged with governance, management or employees. Non-compliance does not include personal misconduct (unrelated to the business activities of the entity) by those charged with governance, management or employees of the entity.

Effect of Laws and Regulations
3. The effect on the functioning of an entity of laws and regulations varies considerably. Those laws and regulations to which an entity is subject to constitute the legal and regulatory framework. The provisions of some laws or regulations have a direct effect on the financial statements in that they determine the reported amounts and disclosures in an entity’s financial statements. Other laws or regulations are to be complied with by management or set the provisions under which the entity is allowed to conduct its business but do not have a direct effect on an entity’s financial statements. Some entities operate in heavily regulated sectors (such as banking, non-banking finance, insurance, telecom, etc.). Others are subject only to the many laws and regulations that relate generally to the operating aspects of the business (such as those related to environment, occupational safety and health).

4. Non-compliance with laws and regulations may result in fines, litigation or other consequences for the entity that may have a material effect on not only the reporting framework of the financial statements but also
Consideration of Laws and Regulations in an Internal Audit

on the functioning of the entity and which in extreme cases may impair their ability to continue as a going concern itself.

Responsibility of Management for Compliance with Laws and Regulations

5. It is the primary responsibility of management, with the oversight of those charged with governance, to ensure that the entity’s operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity’s financial statements.

6. The following are examples of the types of policies and procedures an entity may implement to assist in the prevention and detection of non-compliance with laws and regulations:

- Monitoring legal requirements and ensuring that operating procedures are designed to meet these requirements.

- Instituting and operating appropriate systems of internal control.

- Developing, publicizing and following a code of conduct. Ensuring employees are properly trained and understand the code of conduct. Monitoring compliance with the code of conduct and acting appropriately to discipline employees who fail to comply with it.

- Targeting information for compliance to those employees or departments who are in the best position to verify possibilities of non-compliance.

- Engaging legal advisors to assist in monitoring legal requirements.

- Maintaining a register of significant laws and regulations with which the entity has to comply within its particular industry and a record of complaints.

These policies and procedures may be supplemented by assigning appropriate responsibilities to the following:

- A compliance function.

- An audit committee.
Compendium of Standards on Internal Audit

Objectives

7. The objectives of the internal auditor are:

(a) To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements;

(b) To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a significant impact on the functioning of the entity; and

(c) To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the internal audit.

Responsibility of the Internal Auditor

8. Paragraph 3.1 of the “Preface to the Standards on Internal Audit”, issued by the Council of the Institute of Chartered Accountants of India in 2007, describes internal audit as follows:

“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.”

9. Compliance with laws and regulations is an inherent part of the functioning of an entity. Since the role of an internal auditor is to carry out a continuous and critical appraisal of the functioning of an entity and suggest improvements thereto, the identification of non-compliance with laws and regulations is also an inherent part of his responsibilities. It will be pertinent to add here that the scope of an internal audit as described in paragraph 9 of the Standard on Internal Audit (SIA) 1, “Planning an Internal Audit”, is also affected by the statutory or regulatory framework in which the entity operates.

10. Unlike the statutory audit function, in which the auditor is responsible for identification of non-compliance with the laws and regulations with a view to obtain reasonable assurance that the financial statements, taken as a whole, are free from material misstatements, whether
Consideration of Laws and Regulations in an Internal Audit

causd by fraud or error, the responsibilities of an internal auditor are much wider. As discussed in Para 3 (v) of the Standard on Internal Audit (SIA) 1, “Planning an Internal Audit”, internal audit helps, inter alia, amongst other things, in ensuring compliance with the applicable statutory and regulatory requirements.

11. The scope of internal audit is determined by the terms of engagement of the internal audit activity whether carried out in house or by an external agency. Hence, in the case of an internal audit, the terms of engagement are variable and have an impact on the responsibility of the management vis a vis the internal auditor. The terms of engagement amongst other things, generally, require the internal auditor to examine the status of compliance with various statutes governing the entity. Even in the absence of an explicit mention in the terms of the engagement, the internal auditor has to verify compliance with laws and regulations within the overall objectives of an internal audit, as discussed in paragraph 2 of the Standard on Internal Audit (SIA) 1, “Planning an Internal Audit” which are as follows:

- to suggest improvements to the functioning of the entity; and
- to strengthen the overall governance mechanism of the entity, including its strategic risk management as well as internal control system.

12. Paragraph 8 of the Standard on Internal Audit (SIA) 12, “Internal Control Evaluation”, describes that the internal audit function adds value to an organization’s internal control system by bringing a systematic, disciplined approach to the evaluation of risks and by making recommendations to strengthen the effectiveness of risk management efforts. Further, as discussed in paragraph 10 of the Standard on Internal Audit (SIA) 12, one of the broad areas of review by the internal auditor in evaluating the internal control system, inter alia, includes accounting and financial reporting policies and compliance with applicable legal and regulatory standards.

13. At the same time, as discussed in paragraphs 8 and 9 of the Standard on Internal Audit (SIA) 12, it may be noted that though the internal auditor’s evaluation of internal control involves assessing non-compliance with laws and regulations, the internal auditor is not vested with the management’s primary responsibility for designing,
implementing, maintaining and documenting internal control.

14. Paragraph 9 of the Standard on Internal Audit (SIA) 13, “Enterprise Risk Management”, describes that “the internal auditor should not manage any of the risks on behalf of the management or take risk management decisions. The internal auditor should not assume any accountability for risk management decisions taken by the management. Internal auditor has a role only in advising on risk management and assisting in the effective mitigation of risk.”

15. The internal auditor is expected to exercise due professional care while carrying out the internal audit in detecting non-compliance with laws and regulations. As discussed in paragraph 6 of the Standard on Internal Audit (SIA) 2, “Basic Principles Governing Internal Audit”, due professional care, however, neither implies nor guarantees infallibility, nor does it require the internal auditor to travel beyond the scope of his engagement.

16. The requirements in this SIA are designed to assist the internal auditor in identifying the significant impact of non-compliance with laws and regulations on the functioning of the entity. However, in view of the inherent limitations on the role of the internal auditor as discussed above, the internal auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all laws and regulations.

17. In conducting an internal audit of an entity, the internal auditor takes into account the applicable legal and regulatory framework. Owing to the inherent limitations of an internal audit, there is an unavoidable risk that some non-compliances with laws and regulations and consequential material misstatements in the financial statements may not be detected, even though the internal audit is properly planned and performed in accordance with the SIAs. In the context of laws and regulations, the potential effects of inherent limitations on the internal auditor’s ability to detect non-compliance are greater for such reasons as the following:

- There are many laws and regulations, relating principally to the operating aspects of an entity that typically do not affect the financial statements and are not captured by the entity’s information systems relevant to financial reporting.

- Non-compliance may involve conduct designed to conceal it,
Consideration of Laws and Regulations in an Internal Audit

such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations being made to the internal auditor.

- Whether an act constitutes non-compliance is ultimately a matter for legal determination by a court of law.

Ordinarily, the further removed non-compliance is from the events and transactions captured or reflected in the entity’s information systems relevant to financial reporting, the less likely the internal auditor is to become aware of it or to recognize the non-compliance.

18. This SIA distinguishes the internal auditor’s responsibilities in relation to compliance with two different categories of laws and regulations as follows:

(a) The provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements such as tax and laws regulating the reporting framework; and

(b) Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, to an entity’s ability to continue its business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations). Non-compliance with other laws and regulations may result in fines, litigation or other consequences for the entity, the costs of which may need to be provided for in the financial statements or may even have a significant impact on the operations of the entity but are not considered to have a direct effect on the financial statements, as described in paragraph 18(a). Non-compliance with laws and regulations that have a significant impact on the operations of the entity may cause the entity to cease operations or call into question the entity’s continuance as a going concern. For example, non-compliance with the requirements of the entity’s license or other entitlement to perform its operations could have such an impact (for example,
for a bank, non-compliance with capital or investment requirements). To illustrate further, a Non-Banking Financial Company might have to cease to carry on the business of a non-banking financial institution if it fails to obtain a certificate of registration issued under Chapter III B of the Reserve Bank of India Act, 1934 and if its Net Owned Funds are less than the amount specified by the RBI in this regard. There are also many laws and regulations relating principally to the operating aspects of the entity that typically do not affect the financial statements and are not captured by the entity’s information systems relevant to financial reporting. An example here could be an airline failing to meet the safety norms prescribed by the government leading to an uncertainty over continuance of its license to operate. Non-compliance with such laws and regulations may, therefore, have a significant impact on the functioning of an entity.

19. In this SIA, differing requirements are specified for each of the above categories of laws and regulations:

- For the category referred to in paragraph 18(a), the internal auditor’s responsibility is to obtain sufficient appropriate audit evidence, in accordance with the Standard on Internal Audit (SIA) 10, “Internal Audit Evidence”, about compliance with the provisions of those laws and regulations.

- For the category referred to in paragraph 18(b), the internal auditor’s responsibility is limited to undertaking specified audit procedures to help identify non-compliance with those laws and regulations that may have a significant impact on the functioning of the entity.

20. Non-compliance by the entity with laws and regulations may result in a material misstatement of the financial statements and in some cases, may impact significantly the functioning of the entity itself. Whether an act constitutes non-compliance with laws and regulations is a matter for legal determination, which is ordinarily beyond the internal auditor’s professional competence to determine. Paragraph 2 of Standard on Internal Audit (SIA) 16, “Using the Work of an Expert” states as follows:
“The internal auditor should obtain technical advice and assistance from competent experts if the internal audit team does not possess the necessary knowledge, skills, expertise or experience needed to perform all or part of the internal audit engagement.”

Nevertheless, the internal auditor’s training, experience and understanding of the entity and its industry or sector may provide a basis to recognize that some acts, coming to the internal auditor’s attention, may constitute non-compliance with laws and regulations.

21. The internal auditor may have a specific responsibility, one that may arise out of the terms of engagement or a law or a regulation or a standard applicable to the internal auditor, to communicate directly, the above mentioned issues to an appropriate authority within the entity or a regulator. In these circumstances, Standards on Internal Audit, SIA 4, “Reporting” and SIA 8, “Terms of Internal Audit Engagement”, deal with how these audit responsibilities should be addressed in the internal auditor’s report. Furthermore, where there are specific statutory reporting requirements, it may be necessary for the internal audit plan to include appropriate tests for compliance with those provisions of the laws and regulations.

The Internal Auditor’s Consideration of Compliance with Laws and Regulations

Obtaining an Understanding of the Legal and Regulatory Framework

22. As part of obtaining an understanding of the entity and its environment in accordance with Standard on Internal Audit (SIA) 15, “Knowledge of the Entity and its Environment”, the internal auditor shall obtain a general understanding of:

(a) The legal, regulatory and the financial reporting framework applicable to the entity and the industry or sector in which the entity operates; and

(b) How the entity is complying with that framework.

To obtain a general understanding of such a legal and regulatory framework, and how the entity complies with that framework, the internal auditor may, for example:
Compendium of Standards on Internal Audit

- Use the internal auditor’s existing understanding of the entity’s industry, regulatory and other external factors;
- Update the understanding of those laws and regulations that directly determine the reported amounts and disclosures in the financial statements;
- Inquire of management as to other laws or regulations that may be expected to have a significant effect on the operations of the entity;
- Inquire of management concerning the entity’s policies and procedures regarding compliance with laws and regulations as well as ethical issues within the entity; and
- Inquire of management regarding the policies or procedures adopted for identifying, evaluating and accounting for litigation claims.

Laws and Regulations Generally Recognized to have a Direct Effect on the Determination of Material Amounts and Disclosures in the Financial Statements

23. Certain laws and regulations are well-established, known to the entity and within the entity’s industry or sector, and relevant to the entity’s financial statements (as described in paragraph 18(a)). They could include those that relate to, for example:

- The form and content of financial statements;
- Industry-specific financial reporting issues;
- Accounting for transactions under government contracts; or
- The accrual or recognition of expenses for income tax or retirement benefits.

24. Some matters may be relevant to specific assertions (for example, the completeness of income tax provisions), while others may be relevant to the financial statements as a whole (for example, the required statements constituting a complete set of financial statements).

25. The internal auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of
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material amounts and disclosures in the financial statements.

Procedures to Identify Instances of Non-Compliance – Other Laws and Regulations

26. The internal auditor shall perform the following audit procedures to help identify instances of non-compliance with other laws and regulations that may have a significant impact on the entity’s functioning:

(a) Inquiring of management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and

(b) Inspecting correspondence, if any, with the relevant licensing or regulatory authorities.

27. As the financial reporting consequences of other laws and regulations can vary depending on the entity’s operations, the internal audit procedures required by paragraph 26 are directed to bringing to the internal auditor’s attention instances of non-compliance with laws and regulations that may have a significant impact on the functioning of the entity.

Non-Compliance brought to the Internal Auditor’s Attention through Other Audit Procedures

28. During the internal audit, the internal auditor shall remain alert to the possibility that other audit procedures applied may bring instances of non-compliance or suspected non-compliance with laws and regulations to the internal auditor’s attention. For example, such audit procedures may include:

- Reading minutes;
- Inquiring of the entity’s management and in-house legal counsel or external legal counsel concerning litigation, claims and assessments; and
- performing substantive tests of details of classes of transactions, account balances or disclosures.

Written Representations

29. The internal auditor shall request management and, where
appropriate, those charged with governance to provide written representations that all known instances of non-compliance or suspected non-compliance with laws and regulations which impact the functioning of the entity, including the reporting framework, have been disclosed to the internal auditor.

30. Because the effect of non-compliance on the functioning of an entity can vary considerably, written representations provide necessary audit evidence about management’s knowledge of identified or suspected non-compliance with laws and regulations, whose effects may have a significant impact on the functioning of the entity. However, written representations do not provide sufficient appropriate audit evidence on their own and, accordingly, do not affect the nature and extent of another audit evidence that is to be obtained by the internal auditor.

Internal Audit Procedures When Non-Compliance is Not Identified or Suspected

31. In the absence of identified or suspected non-compliance, the internal auditor is not required to perform audit procedures regarding the entity’s compliance with laws and regulations, other than those set out in paragraphs 22-30.

Internal Audit Procedures When Non-Compliance is Identified or Suspected

32. If the internal auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the internal auditor shall obtain:

(a) An understanding of the nature of the act and the circumstances in which it has occurred; and

(b) Further information to evaluate the possible effect on the functioning of the entity.
Consideration of Laws and Regulations in an Internal Audit

Indications of Non-Compliance with Laws and Regulations

33. When the internal auditor becomes aware of the existence of, or information about, the following matters, it may be an indication of non-compliance with laws and regulations:

- Investigations by regulatory organizations and government departments or payment of fines or penalties.
- Payments for unspecified services or loans to consultants, related parties, employees or government employees.
- Sales commissions or agent’s fees that appear excessive in relation to those ordinarily paid by the entity or in its industry or to the services actually received.
- Purchasing at prices significantly above or below market price.
- Unusual payments in cash, purchases in the form of cashiers’ cheques payable to bearer or transfers to numbered bank accounts.
- Unusual payments towards legal and retainership fees.
- Unusual transactions with companies registered in tax havens.
- Payments for goods or services made other than to the country from which the goods or services originated.
- Payments without proper exchange control documentation.
- Existence of an information system which fails, whether by design or by accident, to provide an adequate audit trail or sufficient evidence.
- Unauthorized transactions or improperly recorded transactions.
- Adverse media comment.

Matters Relevant to the Internal Auditor’s Evaluation

34. Matters relevant to the internal auditor’s evaluation of the possible effect on the entity’s functioning include:

- The potential financial consequences of non-compliance with laws and regulations on the functioning of the entity including, for example, the imposition of fines, penalties, damages, threat
of expropriation of assets, enforced discontinuation of operations and litigation.

- Whether the potential financial consequences need to be informed to the management for the limited objective of suitable disclosure.
- Whether the potential financial consequences are so serious as to call into question the ability of the entity to continue as a going concern.

35. The internal auditor may discuss the findings with those charged with governance where they may be able to provide additional audit evidence. For example, the internal auditor may confirm that those charged with governance have the same understanding of the facts and circumstances relevant to transactions or events that have led to the possibility of non-compliance with laws and regulations.

36. If the internal auditor suspects there may be non-compliance, the internal auditor shall discuss the matter with management and, where appropriate, those charged with governance. If management or, as appropriate, those charged with governance do not provide sufficient information to the internal auditor that the entity is in fact in compliance with laws and regulations, the internal auditor may consider it appropriate to consult with the entity’s in-house legal counsel or external legal counsel about the application of the laws and regulations to the circumstances, including the possibility of fraud, and the possible impact on the functioning of the entity. When it is not considered appropriate to consult with the entity’s legal counsel or when the internal auditor is not satisfied with the legal counsel’s opinion, the internal auditor may consider it appropriate to consult the internal auditor’s own legal counsel as to whether a contravention of a law or regulation is involved, the possible legal consequences, including the possibility of fraud in accordance with the Standard on Internal Audit (SIA) 11, “Consideration of Fraud in an Internal Audit”, and what further action, if any, the internal auditor would take.

37. If sufficient information about suspected non-compliance cannot be obtained, the internal auditor shall evaluate the effect of the lack of sufficient appropriate audit evidence on the internal auditor’s observations and findings.
Evaluating the Implications of Non-Compliance

38. The internal auditor shall evaluate the implications of non-compliance in relation to other aspects of the internal audit, including the internal auditor’s risk assessment and the reliability of written representations, and take appropriate action.

39. The implications of particular instances of non-compliance identified by the internal auditor will depend on the relationship of the perpetration and concealment, if any, of the act to specific control activities and the level of management or employees involved, especially implications arising from the involvement of the highest authority within the entity.

40. In exceptional cases, the internal auditor may consider whether, unless prohibited by law or regulation, withdrawal from the engagement is necessary when management or those charged with governance do not take the remedial action that the internal auditor considers appropriate in the circumstances. When deciding whether withdrawal from the engagement is necessary, the internal auditor should consider whether there is an obligation, contractual or otherwise to report the circumstances necessitating the withdrawal to other parties.

Reporting of Identified or Suspected Non-Compliance

Reporting Non-Compliance to Those Charged with Governance

41. Unless all of those charged with governance are involved in management of the entity, and therefore are aware of matters involving identified or suspected non-compliance already communicated in accordance with the Standard on Internal Audit (SIA) 9, “Communication with Management”, by the internal auditor, the internal auditor shall communicate with those charged with governance matters involving non-compliance with laws and regulations that come to the internal auditor’s attention during the course of the internal audit, other than when the matters are clearly inconsequential.

42. If, in the internal auditor’s judgment, the non-compliance referred to in paragraph 41 is believed to be intentional and material, the internal auditor shall communicate the matter to those charged with governance as soon as practicable.
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Reporting Non-Compliance in the Internal Auditor’s Report

43. If the internal auditor concludes that the non-compliance has a significant impact on the functioning of an entity and has not been adequately dealt with by the management, the internal auditor shall report the same in accordance with SIA 4, “Reporting”.

44. If the internal auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be significant to the functioning of the entity has, or is likely to have, occurred, the internal auditor should report the same in accordance with SIA 4, “Reporting”.

45. If the internal auditor is unable to determine whether non-compliance has occurred because of limitations imposed by the circumstances rather than by management or those charged with governance, the internal auditor shall evaluate the effect on the internal auditor’s observations and findings in accordance with SIA 4, “Reporting”.

Documentation

46. The internal auditor shall document identified or suspected non-compliance with laws and regulations and the results of discussion with management and, where applicable, those charged with governance and other parties outside the entity in accordance with the Standard on Internal Audit (SIA) 3, “Documentation”.

47. The internal auditor’s documentation of findings regarding identified or suspected non-compliance with laws and regulations may include, for example:
   - Copies of records or documents.
   - Minutes of discussions held with management, those charged with governance or parties outside the entity.

Effective Date

48. This Standard on Internal Audit (SIA) is applicable for all internal audits commencing on or after ..........

Earlier application of the SIA is encouraged.
The following is the text of the Standard on Internal Audit (SIA) 18, Related Parties, issued by the Institute of Chartered Accountants of India. The Standard should be read in conjunction with the "Preface to the Standards on Internal Audit", issued by the Institute of Chartered Accountants of India.

In terms of the decision taken by the Council of the Institute at its 260th meeting held in June 2006, the following Standard on Internal Audit shall be recommendatory in nature in the initial period. The Standard shall become mandatory from such date as may be notified by the Council in this regard.

* Published in the March 2013 issue of The Chartered Accountant.
Introduction

1. The purpose of this Standard on Internal Audit (SIA) is to establish standard and provide guidance on the procedures to be followed by the internal auditor in ensuring that related party activities of the entity are properly captured through internal controls; and that related party activities are consistent with the entity’s code of conduct and conflict of interest policy, applicable laws and regulations and disclosure requirements.

2. Management is responsible for the identification and disclosure of related parties and accounting for the related party transactions. This responsibility requires management to implement adequate internal control to ensure that transactions with related parties are appropriately identified, recorded and disclosed in the financial statements. The internal auditor is the appropriate resource for assessing what management has implemented with regard to related party information by evaluating relevant internal controls, and informing the management about the deficiencies detected with suggestions for improvement.

Definitions

3. (i) **Related Party**

   Parties are considered to be related, if at any time during the reporting period, one party has the ability to control the other party or exercise significant influence over the other party in making financial and/or operating decisions.

(ii) **Control**

   (a) Ownership, directly or indirectly, of more than one half of the voting power of an enterprise, or

   (b) Control of the composition of the board of directors in the case of a company or of the composition of the corresponding governing body in case of any other enterprise, or
(c) A substantial interest in voting power and the power to direct, by statute or agreement, the financial and/or operating policies of the enterprise.

(iii) Significant Influence

Participation in the financial and/or operating policy decisions of an enterprise, but not control of those policies.

(iv) Relative

In relation to an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her dealings with the reporting enterprise.

For the purpose of this Standard, all other terms used herein would have the same definition/meaning as used in Accounting Standard (AS) 18, “Related Party Disclosures” issued by the Institute of Chartered Accountants of India.

4. An entity is considered to control the composition of:

(i) the board of directors of a company, if it has the power, without the consent or concurrence of any other person, to appoint or remove all or a majority of directors of that company. An enterprise is deemed to have the power to appoint a director if any of the following conditions is satisfied:

(a) a person cannot be appointed as director without the exercise in his favor by that enterprise of such a power as aforesaid; or

(b) a person’s appointment as director follows necessarily from his appointment to a position held by him in that enterprise; or

(c) the director is nominated by that enterprise, in case that enterprise is a company, the director is nominated by that company/subsidiary thereof.

(ii) the governing body of an enterprise that is not a company, if it has the power, without the consent or the concurrence of any
other person, to appoint or remove all or a majority of members of the governing body of that other enterprise. An enterprise is deemed to have the power to appoint a member if any of the following conditions is satisfied:

(a) a person cannot be appointed as member of the governing body without the exercise in his favor by that other enterprise of such a power as aforesaid; or

(b) a person’s appointment as member of the governing body follows necessarily from his appointment to a position held by him in that other enterprise; or

(c) the member of the governing body is nominated by that other enterprise.

Related Party Transactions

5. A related party transaction is a transfer of resources, services or obligations between an entity and a related party, regardless of whether or not a price is charged. Transactions that because of their nature may be indicative of the existence of related parties include:

(a) Borrowing or lending on an interest-free basis or at a rate of interest significantly above or below market rates prevailing at the time of the transaction.

(b) Buying/ selling transactions at a price that differs significantly from its appraised value.

(c) Exchanging property for similar property in a non-monetary transaction.

(d) Making loans with no scheduled terms of repayment.

(e) Granting of a guarantee without adequate compensation.

6. Related party transactions may not be conducted under normal market terms and conditions at all times. There may be possibility that transactions with related party may have been motivated solely, or in large measure, by conditions similar to the following:

(a) Lack of sufficient working capital or credit to continue the business;
Related Parties

(b) An urgent desire for a continued favorable earnings record in the hope of supporting the price of the company’s share;

(c) Overly optimistic earnings forecast;

(d) Depending on a single or relatively few products, services, customers, suppliers or transactions for the continuing success of the venture;

(e) Excess capacity;

(f) Significant litigation, especially, litigation between stakeholders and management;

(g) A declining industry characterized by a large number of business failures;

(h) Significant technology obsolescence.

Internal Audit Procedures

7. The internal auditor shall perform the internal audit procedures and related activities to obtain information relevant to evaluating internal controls associated with related party relationships and transactions. The internal auditor shall gather the following information pertaining to related party relationships and transactions:

(a) The identity of the entity’s related parties including changes from the prior period;

(b) The nature of the relationships between the entity and these related parties; and

(c) Whether the entity has entered into any transaction with these related parties during the period and, if so, the nature and extent, and the purpose of the transaction.

8. The following may be considered by the internal auditor while understanding the entity’s related party relationships and transactions:

(a) The nature and extent of the entity’s relationships and transactions with related parties.

(b) An emphasis on the importance of maintaining due professional care throughout the internal audit regarding the potential for
material misstatement associated with related party relationships and transactions.

(c) The circumstances or conditions of the entity that they indicate the existence of related party relationships or transactions that management has not identified or disclosed to the internal auditor (for example, a complex organizational structure, use of special-purpose entities for off-balance sheet transactions, or an inadequate information system).

(d) The records or documents that may indicate the existence of related party relationships or transactions.

(e) The importance that management and those charged with governance attach to the identification, appropriate accounting for, and disclosure of related party relationships and transactions, and the related risk of management override of relevant controls.

9. The internal auditor shall inspect the following for indications of the existence of related party relationships or transactions that management has not previously identified or disclosed:

(a) Bank and legal confirmations obtained as part of the internal auditor’s procedures;

(b) Minutes of the meetings of the shareholders and of those charged with governance; and

(c) Such other records or documents as the internal auditor considers necessary in the circumstances of the entity, for example:

- Entity income tax returns.
- Information supplied by the entity to statutory and regulatory authorities.
- Shareholder registers to identify the entity’s principal shareholders.
- Statements of conflicts of interest from management and those charged with governance.
Related Parties

- Records of the entity’s investments and those of its pension plans.
- Contracts and agreements with key management or those charged with governance.
- Significant contracts and agreements not in the entity’s ordinary course of business.
- Specific invoices and correspondence from the entity’s professional advisors.
- Life insurance policies acquired by the entity.
- Significant contracts re-negotiated by the entity during the period.
- Documents associated with the entity’s filings with a securities regulator (e.g., prospectuses).

If the internal auditor identifies significant transactions outside the entity’s normal course of business then the internal auditor shall obtain information about the nature of these transactions and whether the related parties are involved.

10. In smaller entities, the identification of related party transactions can often be difficult. If the entity uses a standard software package to record transactions, consider obtaining an electronic copy of the transactions and importing them into an electronic spreadsheet. By using the sort feature and configuring the selection criteria, it may be possible to obtain information about customers/ suppliers with only a few, but large, transactions, or those with significant transactions of a size or nature that is unusual.

11. In responding to the identified risks of material misstatement associated with related party relationships and transactions, the internal auditor would consider the following:

(a) Determine whether underlying circumstances confirm their existence;
(b) Promptly communicate the information to the engagement team;
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(c) Request management to identify all the transactions with the related party;

(d) If related party was not previously identified, consider:
   • failure of any related party identification controls, and
   • fraud (non-disclosure by management appears intentional);

(e) Reconsider the risk that the other undisclosed related parties or significant related party transactions may exist, and perform additional internal audit procedures as necessary; and

(f) Perform appropriate substantive internal audit procedures.

12. With regard to significant related party transactions outside normal course of business, the internal auditor should inspect underlying contracts or agreements, if any, and evaluate whether:

   (a) Rationale suggests possible fraudulent financial reporting or concealment of misappropriated assets;

   (b) Terms are consistent with management’s explanations; and

   (c) Transactions are accounted for and disclosed in accordance with the generally accepted accounting principles;

   (d) Ensure transactions have been appropriately authorized and approved.

13. The internal auditor should obtain sufficient appropriate audit evidence about management’s assertion that a related party transaction was conducted on terms equivalent to those prevailing in an arm’s length transaction. Evaluating management’s support for this assertion may involve one or more of the following:

   (a) Considering the appropriateness of management’s process for supporting the assertion.

   (b) Verifying the source of the internal or external data supporting the assertion, and testing the data to determine their accuracy, completeness and relevance.
Related Parties

(c) Evaluating the reasonableness of any significant assumptions on which the assertion is based.

14. The internal auditor should consider the following matters:

(a) Document the names of the identified related parties and the nature of the related party relationships; and

(b) Communicate with those charged with governance, or relevant committee thereof, such as, audit committee, any significant matters arising during the internal audit in connection with related parties.

15. The internal auditor should consider the impact on the internal audit report if it is not possible to obtain sufficient appropriate audit evidence concerning related parties and transactions and should suitably disclose it in the internal audit report, based on its materiality.

Effective Date

16. This Standard on Internal Audit will apply to all internal audits commencing on or after ______. Earlier application of the SIA is encouraged.