

**Compendium of  
Standards on Internal Audit**  
*(As on October 1, 2022)*



**Internal Audit Standards Board**  
**The Institute of Chartered Accountants of India**  
*(Set up by an Act of Parliament)*  
New Delhi

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# FOREWORD

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The Internal Audit Standards Board (formerly known as the Committee on Internal Audit) was constituted by the Council of the Institute in 2004 with the primary objective of developing Standards on Internal Audit, codifying the best practices in the area of internal audit to help the members provide quality services in the area of internal audit. I am happy to note that the Board is issuing this Compendium that 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.

I wish to place my appreciation to CA. Charanjot Singh Nanda, Chairman, Internal Audit Standards Board, CA. Gyan Chandra Misra, Vice-Chairman, Internal Audit Standards Board and other members of the Board for their commitments in bringing out Compendium with a view to place all the Standards at one place and easy to understand format.

I am sure that the members will make optimum use of the Compendium.

October 19, 2022

**CA. (Dr.) Debashis Mitra**  
President, ICAI



# PREFACE

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Today's increasingly complex and risky business landscape has resulted in both elevating the importance of internal audit as well as subjecting it to significant challenges. Internal audit activities have become more critical for organizations for improving efficiency and effectiveness of operations, increasing reliability of financial reporting and promoting compliance with regulations. Considering these developments, the Internal Audit Standards Board of the Institute of the Chartered Accountants of India provides continuous support to its members through proactive standard setting and guidance in the area of internal audit, including guidance related to risk management and governance and to conduct cutting edge research and education to help members offer innovative and effective solutions and comprehensively serve needs of all stakeholders.

Standards on Internal Audit (SIAs) as issued by the Internal Audit Standards Board, ICAI represent a codification of the best practices for internal auditors. These Standards play a vital role in strengthening and building up the performance benchmarks in internal audit. They provide a framework for internal audit activities, establish the basis for evaluation of internal audit performance, and foster improved organizational processes and operations. The Standards constitute an important tool in helping the internal auditors provide effective and efficient internal audit services to the clients and/ or employers.

These principle-based Standards would support the members in discharging their duties as highly valued, trusted advisors and groom them as stalwarts in the 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 19 principle based Standards on Internal Audit including other Standards on Internal Audit.

I would like to thank to CA. (Dr.) Debashis Mitra, President, ICAI and CA. Aniket S. Talati, Vice President, ICAI and CA. Gyan Chandra Misra, 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. Chandrashekhar V. Chitale, CA. Vishal Doshi, CA. Durgesh Kumar Kabra, CA. Purushottam Khandelwal, CA. Priti Salva, CA. Sridhar Muppala, CA. Prasanna Kumar D., CA. Cotha S. Srinivas, CA. Ranjeet Kumar Agarwal, CA. Rohit Ruwatia, CA. Abhay Chhajer, CA. Anuj Goyal, CA. Prakash Sharma, CA. Sanjay Kumar Agarwal, CA. (Dr.) Raj Chawla, CA. Hans Raj Chugh, CA. Pramod Jain, CA. (Dr.) Sanjeev Kumar Singhal, Ms. Ritika Bhatia and Shri Chandra Wadhwa and co-opted Members, viz., CA. Anil Kumar Jain, CA. Sapna Govindalal, Gandhi, CA. Viswanath K., CA. Vivek Choudhary, CA. Nagesh Pinge, CA. Venugopala Rao P., CA. Satish Patel, CA. Sunil Kumar Mehta, and Special Invitee, CA. Pradeep Tyagi for their vision and support and their invaluable guidance and also their dedication and support to the various initiatives of the Board. I also wish to express my sincere appreciation for CA. Arti Bansal, Secretary, Internal Audit Standards Board, ICAI and her team for their efforts in giving final shape to the publication. I am sure that the readers would find this Compendium really useful.

October 19, 2022  
New Delhi

**CA. Charanjot Singh Nanda**  
Chairman, Internal Audit Standards Board, ICAI

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# TERMS OF REFERENCE

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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**

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### **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.

## **Compendium of Standards on Internal Audit**

### **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<sup>1</sup> 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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<sup>1</sup> 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.

## **Compendium of Standards on Internal Audit**

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.

## **Compendium of Standards on Internal Audit**

### **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,

## **Compendium of Standards on Internal Audit**

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**

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### **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.**

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\* 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

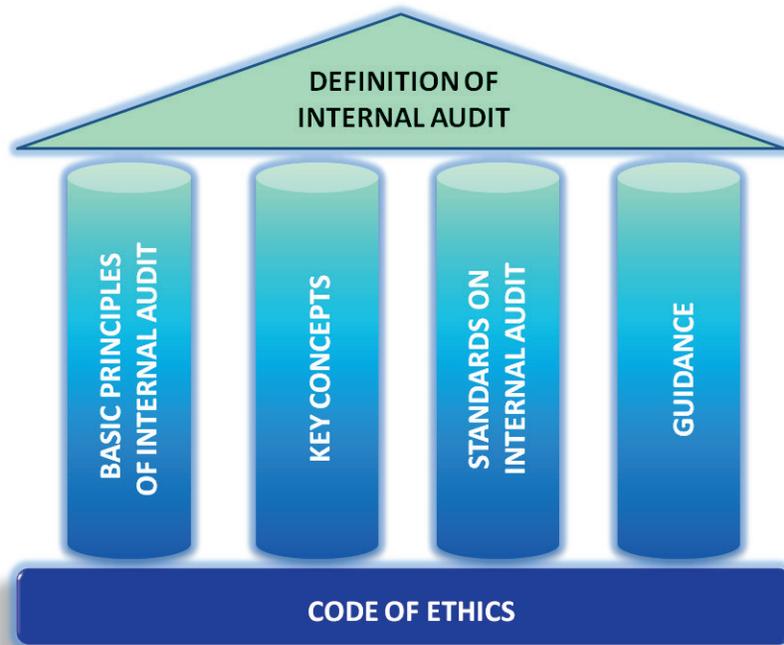
4.1 The Framework Governing Internal Audits comprises of "Definition of Internal Audit" (as covered above), four components and the most important underlying principle "Code of Ethics". Each component is inherent to the whole process of internal audit and implicitly forms part of the Standards on Internal 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.

## Compendium of Standards on Internal Audit

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:
- the requirements of the Chartered Accountants Act, 1949
  - the Code of Ethics issued by the Institute of Chartered Accountants of India
  - other relevant pronouncements of the Institute of Chartered Accountants of India.

## 6 Components of the Framework

### 6.1 Basic Principles of Internal Audit<sup>1</sup>

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<sup>2</sup>

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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<sup>1</sup> Refer Para. 3 of *Basic Principles of Internal Audit* issued by the Board.

<sup>2</sup> 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**

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### **Basic Principles**



# BASIC PRINCIPLES OF INTERNAL AUDIT\*

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**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.**

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\* Issued in November 2018.

## Compendium of Standards on Internal Audit

### 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

## **Basic Principles of Internal Audit**

the Chief Internal Auditor within this structure, along with the powers 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.

## **Compendium of Standards on Internal Audit**

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.

## **Basic Principles of Internal Audit**

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

## **Compendium of Standards on Internal Audit**

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

## **Basic Principles of Internal Audit**

- (c) continuously improve the quality of the internal audit process and the internal audit reports.

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.



## **SECTION IV**

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# **Standards on Key Concepts (100 Series)**



# STANDARD ON INTERNAL AUDIT (SIA) 110

## NATURE OF ASSURANCE\*

### Contents

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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.**

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\* Issued in May 2019.

## Compendium of Standards on Internal Audit

### 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.

## **Compendium of Standards on Internal Audit**

- 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.

## Compendium of Standards on Internal Audit

- 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 Statute, 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

## Compendium of Standards on Internal Audit

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

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

## **Compendium of Standards on Internal Audit**

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\*\*

### Contents

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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.**

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\* Issued in January 2020.

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

## Compendium of Standards on Internal Audit

### 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".*

## Compendium of Standards on Internal Audit

- 3.4 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.”*

- 3.5 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:

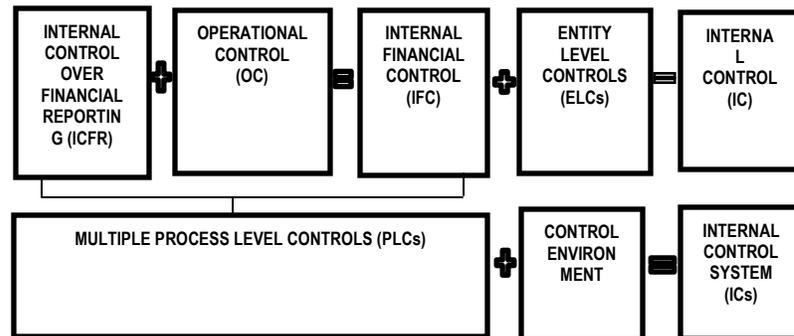
*“the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and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

- 3.6 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

## Internal Controls

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.

## Compendium of Standards on Internal Audit

### 4 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.

# STANDARD ON INTERNAL AUDIT (SIA) 130\*

## RISK MANAGEMENT\*\*

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**This Standard on Internal Audit (SIA) 130, “Risk Management,” issued by the Council of the Institute of Chartered Accountants of India (ICAI) should be read in conjunction with the “Preface to the Framework and Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.**

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\* Issued in September 2022.

\*\* **Note:** This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 13 “*Enterprise Risk Management*” issued in February 2009.

## Compendium of Standards on Internal Audit

### 1 Introduction

- 1.1 Risk Management is a key concept in internal audit. This Standard seeks to clarify the concept and also the responsibility of the Internal Auditor, Management and other Stakeholders with respect to risk management, keeping in mind the legal, regulatory and professional obligations.
- 1.2 Definition of Internal Audit (refer Para 3.1 in the “Framework Governing Internal Audits”) indicates providing independent reasonable assurance on the effectiveness of internal controls and risk management processes as a basic expectation from internal audit. The definition on Internal Audit elaborates on the term “Risk Management” by clarifying how this is an integral part of management function and business operations.
- 1.3 Scope: This Standard applies to all risk based internal audits and also where risk management framework is a subject matter of an audit, and is being assessed, evaluated and reported upon.

### 2 Objectives

- 2.1 The purpose of this Standard on Risk Management is to:
  - (a) Provide a common terminology by defining various risk management terms to prevent ambiguity and provide clarity on the subject matter;
  - (b) Explain the responsibilities of the Board of Directors, risk management department and management with regard to risk management, as mandated by law and regulations; and
  - (c) State the responsibilities of the internal auditor, especially when providing an assurance on the risk management framework.
- 2.2 The overall objective of this Standard is to clarify the responsibilities of management and Internal Auditor over risk management, and to prescribe the essential requirements with regard to assessment, evaluation, reporting and providing an assurance on risk management.

### 3 Definition

- 3.1 Risk can be defined as the probability of a threat exploiting vulnerability of business assets or processes or controls by

## **Risk Management**

occurrence of an event causing significant impact to the business operations and continuity and which could prevent the organization from achieving its goals and objectives. Areas which can be impacted by risk are broadly classified into strategic, reputation, operational, financial, legal, environmental, etc.

- 3.2 Risk Management is a process with a series of steps, taken on a continuous basis to identify the threats and vulnerabilities, assess them for severity and likelihood, monitor risks, prioritize them for action and to minimize their possible negative impact through mitigation actions. The process also encompasses the monitoring and reporting of the status of these risks.
- 3.3 Risk Management Framework is the combination of structure, systems and processes put in place to organise the various risk management activities and to integrate them seamlessly into the organisation. Risk management activities, forming part of the framework, are designed to enhance the organisation's ability to, amongst others:
  - (a) Provide strategy, leadership and direction on risk management;
  - (b) Establish a culture of risk management throughout the organisation;
  - (c) Provide an organisation structure for assigning risk management resources and defining their responsibilities;
  - (d) Capture and maintain a comprehensive database of all risks;
  - (e) Ensure expertise and competence in the area of risk management;
  - (f) Exercise continuous monitoring and oversight on risk management; and
  - (g) Periodic communication of risk management matters and formal reporting of risk status to management and those charged with governance.
- 3.4 Enterprise Risk Management is a term used to refer to various risk management frameworks uniformly applied on an entity-wide basis towards a comprehensive approach to manage organisational risks. It usually involves a separate and dedicated risk management function or department, led by a (Chief) Risk Officer to support those charged

## Compendium of Standards on Internal Audit

with governance in achieving organisation objectives through risk management.

### 4 Responsibility of the Board and Management

4.1 The responsibility of the Board of Directors in the areas of Risk Management is, generally, established by the prevailing laws of the nation. The responsibility of the management is established by both the prevailing laws and the oversight of the Board of Directors.

4.2 Companies Act, 2013 imposes overall responsibility on the Board of Directors with regard to risk management. Clause (n) of Section 134 (3) requires the report of the Board of Directors to include:

*(n) a statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the company;*

Under Section 177 (4) (vii), it is the duty of the Audit Committee to evaluate the internal financial controls and risk management systems.

4.3 In addition, Subsection (1) and (4) of Section II of Schedule IV of Companies Act, 2013 on “Code for Independent Directors”, role and function requires them to:

*(1) help in bringing an independent judgment to bear on the Board’s deliberations especially on issues of strategy, performance, risk management, resources, key appointments and standards of conduct;*

*(4) satisfy themselves on the integrity of financial information and that financial controls and the systems of risk management are robust and defensible;*

4.4 For listed companies, Regulation 17(9) of The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR) mandates one of the responsibilities of the Company and its Board of Directors, as:

*(9) (a) The listed entity shall lay down procedures to inform members of board of directors about risk assessment and minimization procedures.*

## **Risk Management**

- (b) *The board of directors shall be responsible for framing, implementing and monitoring the risk management plan for the listed entity.*
- (c) *Composition of Risk Management Committee may be discussed here in brief.*

In addition, Regulation 21 of the LODR mandates the constitution of a Risk Management Committee for the top 500 listed entities, which shall be charged with monitoring and reviewing the risk management plan.

- 4.5 Hence, the overall responsibility for developing, implementing and monitoring of risk management rests with the Board of Directors, risk management department and Management and should be appropriately covered in the internal audit scope.

## **5 Responsibility of the Internal Auditor**

- 5.1 Unless specially excluded from the audit approach, the Internal Auditor shall plan and conduct risk based internal audits. This requires the application of risk management concepts to ensure that the audits are prioritised in areas of importance, appropriate resources are allocated effectively where needed most, audit procedures are designed to give due attention to important matters and issues identified and reported are significant in nature (refer Para 6.1).
- 5.2 The nature and extent of audit procedures to be conducted in the area of risk management is dependent on the maturity of the risk management processes and the framework in place. Where management has implemented a risk management framework, the Internal Auditor shall plan and perform audit procedures to evaluate the design, implementation and operating effectiveness of the organisation's risk management framework to provide independent assurance to management and those charged with governance (refer Para 6.2 and Para 6.3).
- 5.3 Where no formal risk management framework exists, the Internal Auditor shall design and conduct audit procedures with a view to highlight any exposures arising from weak or absent risk management activities, make recommendations to implement and strengthen related processes and thereby improve risk management (refer Para 6.4).

## Compendium of Standards on Internal Audit

- 5.4 Where the independent assurance requires the issuance of an audit opinion over the design, implementation and operating effectiveness of risk management, this shall be undertaken in line with the requirements of SIA 110, “Nature of Assurance”, especially with regard to the need to have a formal Risk Management Framework in place, which shall form the basis of such an assurance (refer Para 6.5).
- 5.5 The Internal Auditor shall not assume any responsibility to manage the risks or to execute risk management decisions. It is not responsibility of the Internal Auditor to mitigate or resolve the risks.

## 6 Explanatory Comments

- 6.1 **Risk Based Internal Audit (refer Para 5.1):** Para 3.6 of “Basic Principles of Internal Audit” on Risk Based Audits, requires the Internal Auditor to conduct the audits based on a risk assessment exercise. SIA 220, “Conducting Overall Internal Audit Planning” and SIA 310, “Planning the Internal Audit Assignment” mandate the Internal Auditor to conduct risk-based audit planning to ensure that due attention is given to matters of importance, complexity and sensitivity. Similarly, SIA 370, “Reporting Results” expects the auditor to consider the risk of the observations in deciding the matters to be reported.
- 6.2 **Audit Objectives on Risk Management Framework (refer Para 5.2):** The Internal Auditor shall perform audit procedures over the risk management framework with an overall objective to review the organisation’s ability to:
- (a) identify all risks;
  - (b) assess them objectively;
  - (c) respond to them through controls or other mitigations;
  - (d) ensure unmitigated risks are within the tolerance level; and
  - (e) monitor and report their status in a timely manner, to enable achievement of organisational objectives.
- 6.3 **Auditing the Risk Management Framework (refer Para 5.2):** Where there is a formal risk management framework in place, the work of the Internal Auditor shall be directed to ensure that the organisation has, amongst others:

## **Risk Management**

- (a) Designed the framework consistent with best-in-class and globally recognised frameworks, such as, COSO or ISO 31000, etc.;
- (b) Implemented various enabling mechanisms, such as:
  - (i) Issued risk management policies and implemented supporting procedures;
  - (ii) Set the right culture with supporting messages and activities;
  - (iii) Designed risk management structure, established a risk management committee, appointed risk officers and assigned each risk to a specific “risk owner”;
  - (iv) Identified all risks applicable to the entity (created a database), assessed each for importance and priority, and undertaken appropriate mitigation steps or implement controls;
  - (v) Conduct training programs for risk officers and owners, covering knowledge and competency;
  - (vi) Implemented robust risk management systems, deploying technology (where possible), to monitor their progress and track their status, to document timely mitigation steps and to allow timely escalation in case of any slippage;
  - (vii) Continuously tracks performance against risk appetite, along with sufficient reviews and oversight mechanisms;
  - (viii) Established timely communication and periodic reporting systems and protocols.

The Internal Auditor will review the risk management system and processes in place to evaluate whether they are operating in an effective and efficient manner and help to ensure full compliance. Any shortcoming highlighted shall result in recommendations for improvement and suggestions on how to make the risk management framework more efficient and effective in line with stated objectives.

- 6.4 **Auditing Risk Management Activities and Processes (refer Para 5.3):** Where management has not implemented a formal risk

## **Compendium of Standards on Internal Audit**

management framework, the Internal Auditor will conduct audit procedures over various risk management related activities which may be present (similar to those indicated under Para 3.3). These activities may be supported by certain enabling mechanisms (similar to those indicated under Para 6.3 (b)) and which may be recommended as desirable actions to be undertaken to establish a formal framework.

- 6.5 **Independent Assurance over Risk Management (refer Para 5.4):** Where a written assurance report is being issued, the Internal Auditor shall also consider the following as a basis for audit opinion:
- (a) The linkage of the risk management framework with the system of CEO and CFO certification on Internal Controls; and
  - (b) Certificates of self-compliance from owners of key risks to support a system of continuous compliance.

## **7 Effective Date**

- 7.1 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) 140\*

## GOVERNANCE

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**This Standard on Internal Audit (SIA) 140, “Governance,” issued by the Council of the Institute of Chartered Accountants of India (ICAI) should be read in conjunction with the “Preface to the Framework and Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.**

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\* Issued in September 2022

## Compendium of Standards on Internal Audit

### 1 Introduction

- 1.1 Governance is a key concept in Internal Audit and this Standard seeks to clarify both, the concept and the responsibility of the Internal Auditor, Management, Board of Directors, Audit Committee and other Stakeholders, with respect to governance, keeping in mind their legal, regulatory and professional obligations.
- 1.2 The definition of Internal Audit (refer Para 3.1 of the “Framework Governing Internal Audits”) indicates providing independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives as a key expectation from internal audit. This definition on internal audit elaborates on the term “Governance” by clarifying how this is a critical operation of the company and fulfilling expectations of its various stakeholders.
- 1.3 Scope: This Standard applies to all internal audits conducted where governance activities and framework is a subject matter of an audit, and is being assessed, evaluated and reported on by the Internal Auditor.

### 2 Objectives

- 2.1 The purpose of this Standard is to:
  - (a) Provide a common terminology on governance to prevent ambiguity or confusion on the subject matter;
  - (b) Explain the responsibilities of the Board of Directors and Management, Audit Committee with regard to governance, as mandated by law and regulations; and
  - (c) Specify responsibilities of the Internal Auditor, especially, when providing independent assurance on the governance framework.
- 2.2 The overall objective of this Standard is to clarify the responsibilities of Management, Audit Committee, Board of Directors and Internal Auditors towards various stakeholders (both internal and external), and the requirements which need to be met to assess, evaluate, report and provide independent assurance over the governance framework.

### 3 Definition

- 3.1 Governance is defined as a set of relationships between the company and its various stakeholders (both internal and external), and provides the structure through which the company’s objectives are achieved. The relationship and structure help to guide the behaviour of individuals and

## **Governance**

groups in the right direction. The following are well accepted underpinnings of good governance:

- Integrity and Accountability
- Trust and Equity
- Transparency and Justice

3.2 Governance ensures that everyone is aligned to the best interest of the organisation, and does what they are supposed to do, to help achieve organisational objectives. Governance framework refers to the whole structure, systems and processes put in place to organise the various governance activities and to integrate them seamlessly into the organisation.

3.3 Governance activities, forming part of the framework, are designed to enhance the organisation's ability to, amongst others:

- (a) Provide strategy, leadership and direction;
- (b) Nurture a culture of values and ethics;
- (c) Sensitive to multiple stakeholder interests;
- (d) Promote collaborative decision making;
- (e) Provide structure and design to organisation resources and their deployment;
- (f) Prevent undue concentration of power with few;
- (g) Encourage risk-based prioritisation, consistency and efficiency in business processing;
- (h) Support resource development in the area of good governance;
- (i) Exercise judicious monitoring and oversight on business and individual performance; and
- (j) Ensure full and transparent communication and reporting.

All these initiatives, generally, form part of the Entity Level Controls (ELCs) which are essential to the overall internal audit agenda.

## **4 Responsibility of the Board and Management**

4.1 The responsibility of the Board of Directors in the area of governance is generally, established by the prevailing laws of the nation. The responsibility of the management is established by both the prevailing laws and the oversight of the Board of Directors.

## Compendium of Standards on Internal Audit

- 4.2 Companies Act, 2013 imposes overall responsibility on the Board of Directors with regard to governance and specifically towards the Company's stakeholders. Section 166, Duties of Directors states:

*(2) A director of a company shall act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment.*

- 4.3 More specifically, Section I, Guidelines of Professional Conduct of Schedule IV, "Code for Independent Directors" of Companies Act, 2013 requires them to:

*(9) assist the company in implementing the best corporate governance practices.*

- 4.4 For listed companies, as per The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("LODR"), the Board of Directors of the Company have additional responsibilities on governance. Chapter II of Regulation 4(2)(f) of LODR mandates the responsibilities of the Board of Directors, as:

*(ii) Key functions of the board of directors -*

*(2) Monitoring the effectiveness of the listed entity's governance practices and making changes as needed.*

In addition, under the same regulation, it states:

*(iii) Other responsibilities -*

*(2) The board of directors shall set a corporate culture and the values by which executives throughout a group shall behave.*

- 4.5 For listed companies, the LODR has an exhaustive list, as per Schedule II, Corporate Governance, which stipulates various requirements and good governance practices in this area. Without enumerating them here, it is pertinent to note a few provisions, which are most relevant to internal audit:

(a) Part C: Section A. The role of the audit committee shall include the following:

*(12) reviewing, with the management, performance of statutory and internal auditors, adequacy of the internal control systems;*

## **Governance**

*(13) reviewing the adequacy of internal audit function, if any, including the structure of the internal audit department, staffing and seniority of the official heading the department, reporting structure coverage and frequency of internal audit;*

*(14) discussion with internal auditors of any significant findings and follow up there on;*

*(15) reviewing the findings of any internal investigations by the internal auditors into matters where there is suspected fraud or irregularity or a failure of internal control systems of a material nature and reporting the matter to the board;*

(b) Part C: Section B. The audit committee shall mandatorily review the following information:

*(4) internal audit reports relating to internal control weaknesses; and*

*(5) the appointment, removal and terms of remuneration of the chief internal auditor shall be subject to review by the audit committee.*

4.6 Hence, governance is seen as an essential element of business functioning, and internal audit as a key element of governance. Therefore, the overall responsibility for developing, implementing and monitoring the governance framework rests with the Board of Directors and management.

## **5 Responsibility of the Internal Auditor**

5.1 The nature and extent of internal audit procedures to be conducted in the area of governance is dependent on the framework in place and the maturity of the processes. Where management has implemented a formal governance framework, and unless specifically excluded from the audit scope (or technically not feasible), the Internal Auditor shall plan and perform internal audit procedures to evaluate the design, implementation and operating effectiveness of such framework so as to provide independent assurance to management and to those charged with governance (refer Para 6.1).

5.2 Where no formal governance framework exists, the Internal Auditor shall design and conduct audit procedures with a view to highlight any exposures arising from weak or absent governance activities and

## Compendium of Standards on Internal Audit

processes, make recommendations to implement and strengthen those processes and thereby, improve governance (refer Para 6.2).

- 5.3 Where the independent assurance requires the issuance of an audit opinion over the design, implementation and operating effectiveness over governance, this shall be undertaken in line with the requirements of SIA 110, "Nature of Assurance", especially with regard to the need to have a formal governance framework in place, which shall form the basis of such an assurance (refer Para 6.3).
- 5.4 The Internal Auditor shall not assume any responsibility to manage or operate the Governance framework or to take governance related decisions. The focus of the audit procedures is on the process of governance and not the outcome of the process, such as, second guessing or questioning the actions or decisions of the governing bodies. It is not responsibility of the Internal Auditor to execute or resolve governance related risks.

## 6 Explanatory Comments

- 6.1 **Auditing the Governance Framework (refer Para 5.1):** Where there is a formal governance framework in place, the work to be performed by the Internal Auditor shall be directed to ensure that, amongst others:
- (a) The organisation has designed the framework consistent with best-in-class and globally recognised frameworks;
  - (b) The organisation has implemented various enabling mechanisms, such as:
    - (i) Shared organisation vision, mission, objectives, goals and targets;
    - (ii) Established a code of conduct or ethics and a whistle blower mechanism;
    - (iii) Acts to identify and address the concerns, and balance the needs of various stakeholders (internal and external), through open communication and discussion;
    - (iv) Formed active and functioning governing bodies with defined agendas;
    - (v) Shared organisation design and structure with clearly defined roles and responsibilities of each position;

## Governance

- (vi) Delegated power and authority through a formal document, duly approved by the Board;
- (vii) Deployed risk-based systems and processes deploying, where possible, with technology as a foundation;
- (viii) Conducts regular training programs to develop staff awareness and competency in the area of good governance;
- (ix) Continuously tracks business performance against budgets and goals with adequate reviews and oversight mechanisms; and
- (x) Undertakes active communication and periodic reporting of governance matters to those charged with governance and other stakeholders.

The Internal Auditor will review the governance system and processes in place to evaluate whether they are operating in an effective and efficient manner and help to ensure full compliance. Any shortcoming shall result in recommendations for improvement and suggestions on how to make the governance framework more efficient and effective in line with stated objectives.

### 6.2 **Auditing Governance Activities and Processes (refer Para 5.2):**

Where management has not implemented any formal governance framework, the Internal Auditor will conduct audit procedures over the various governance related processes and activities which may be present (similar to those indicated under Para 3.3). These activities may be supported by certain enabling systems and processes (similar to those indicated under Para 6.1) and which may be recommended as desirable actions to be undertaken by management to establish a formal framework.

### 6.3 **Independent Assurance over Governance Framework (refer**

**Para 5.3):** In situations where a written assurance report is being issued, the Internal Auditor shall consider the following (as a basis for his opinion):

- (a) The linkage of the governance framework with other frameworks, such as, Risk, Compliance, Fraud, or Information Technology frameworks which may exist.
- (b) The system of compliance certification on governance matters.
- (c) The process in place for self-assessment and certification from governance owners as part of a continuous system of compliance.

## **Compendium of Standards on Internal Audit**

### **7 Effective Date**

- 7.1 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) 150\*

## COMPLIANCE WITH LAWS AND REGULATIONS\*\*

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**This Standard on Internal Audit (SIA) 150, “Compliance with Laws and Regulations,” issued by the Council of the Institute of Chartered Accountants of India (ICAI) should be read in conjunction with the “Preface to the Framework and Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.**

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\* Issued in September 2022

\*\* This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 17, *Consideration of Laws and Regulations in an Internal Audit* issued in January 2010.

## Compendium of Standards on Internal Audit

### 1 Introduction

- 1.1 Compliance is a key concept in Internal Audit and this Standard seeks to clarify both, the concept and the responsibility of the Internal Auditor, Management and other Stakeholders, with respect to Compliance with Laws and Regulations (CLR), in line with their professional obligations.
- 1.2 Definition of Internal Audit in the “Framework Governing Internal Audits” (refer Para 3.1) indicates providing independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives as a key expectation from internal audit. This definition elaborates on the term Governance by clarifying how it includes “compliance with laws and regulations”.
- 1.3 Scope: This Standard applies to all internal audits conducted where compliance activities and framework is a subject matter of an audit, and is being assessed, evaluated and reported on by the Internal Auditor.

### 2 Objectives

- 2.1 The purpose of this Standard is to:
  - (a) Provide a common terminology by defining compliance terms to prevent ambiguity or confusion on the subject matter;
  - (b) Explain the responsibilities of the Board of Directors and management with regard to compliance, as mandated by law and regulations; and
  - (c) Specify responsibilities of the Internal Auditor, especially, when providing independent assurance on the compliance framework.
- 2.2 The overall objective of this Standard is to clarify the responsibilities of management and auditors over CLR, and the requirements which need to be met to assess, evaluate, report and provide independent assurance over the compliance framework.

### 3 Definition

- 3.1 Compliance is a term used to describe the process of following, in letter and spirit, the applicable laws and regulations. Any act contrary to the laid down laws and regulations, either through omission or commission and performed intentionally or unintentionally is a Non-

## **Compliance with Laws and Regulations**

Compliance (or violation) and may result in fines, penalties, litigation or other such consequences.

- 3.2 Compliance framework refers to the whole structure, systems and processes put in place to organise the various compliance activities and to integrate them seamlessly into the organisation.
- 3.3 Compliance activities, forming part of the framework, are designed to enhance the organisation's ability to, amongst others:
  - (a) Provide strategy, leadership and direction on compliances;
  - (b) Establish a culture of compliance throughout the organisation;
  - (c) Provide an organisation structure for assigning compliance resources and defining their responsibilities;
  - (d) Capture and maintain a comprehensive database of all compliance requirements;
  - (e) Encourage risk-based time prioritisation and effective completion of all compliance requirements;
  - (f) Ensure expertise and competence in the area of compliances;
  - (g) Exercise continuous monitoring and oversight on compliance completion; and
  - (h) Periodic communication of compliance matters and formal reporting of compliance status to management and those charged with governance.

## **4 Responsibility of the Board and Management**

- 4.1 The responsibility of the Board of Directors in the area of compliance is generally established by the prevailing laws of the nation. The responsibility of the management is established by both the prevailing laws and the oversight of the Board of Directors.
- 4.2 Companies Act, 2013, imposes overall responsibility on the Board of Directors with regard to Compliance. clause (f) of Section 134(5) concerning Directors' Responsibility Statement, thereof, stipulates the compliance requirements as follows:

*"the directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively".*

## Compendium of Standards on Internal Audit

4.3 Similarly, Section 205 of Companies Act, 2013 on “Functions of company secretary”, states:

*(1) The functions of the company secretary shall include, –*

*(a) to report to the Board about compliance with the provisions of this Act, the rules made thereunder and other laws applicable to the company;*

4.4 For listed companies, as per The Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (LODR), the Board of Directors of the Company have additional responsibilities on Governance. Chapter II, Regulation 4(2)(f) of LODR mandates the responsibilities of the Board of Directors, as:

*(ii) Key functions of the board of directors -*

*(7) Ensuring the integrity of the listed entity’s accounting and financial reporting systems, including the independent audit, and that appropriate systems of control are in place, in particular, systems for risk management, financial and operational control, and compliance with the law and relevant standards.*

In addition, under Chapter III, Section 6, it states,

*(1) A listed entity shall appoint a qualified company secretary as the compliance officer.*

Finally, under Chapter IV, Section 17 it states,

*(3) The board of directors shall periodically review compliance reports pertaining to all laws applicable to the listed entity, prepared by the listed entity as well as steps taken by the listed entity to rectify instances of non-compliances.*

*(8) The chief executive officer and the chief financial officer shall provide the compliance certificate to the board of directors as specified in Part B of Schedule II.*

4.5 Hence, compliance is seen as an essential element of business functioning, with severe consequences and penalties for non-compliance. Therefore, the overall responsibility for developing, implementing and monitoring the compliance framework rests with the Board of Directors and Management.

## Compliance with Laws and Regulations

### 5 Responsibility of the Internal Auditor

- 5.1 The nature and extent of internal audit procedures to be conducted in the area of compliance is dependent on the framework in place and the maturity of the processes. Where management has implemented a formal compliance framework, and unless specifically excluded from the audit scope (or technically not feasible), the Internal Auditor shall plan and perform internal audit procedures to evaluate the design, implementation and operating effectiveness of such framework so as to provide independent assurance to management and to those charged with governance (refer Para 6.1).
- 5.2 Where no formal compliance framework exists, the Internal Auditor shall design and conduct audit procedures with a view to highlight any exposures arising from weak or absent compliance activities and processes, make recommendations to implement and strengthen those processes and thereby, improve compliance (refer Para 6.2).
- 5.3 Where the independent assurance requires the issuance of an audit opinion over the design, implementation and operating effectiveness over compliance, this shall be undertaken in line with the requirements of SIA 110, Nature of Assurance, especially with regard to the need to have a formal compliance framework in place, which shall form the basis of such an assurance (refer Para 6.3).
- 5.4 While the primary objective of an internal audit is to strengthen the system and process of compliance, there may be instances where the Internal Auditor is asked to undertake compliance audit assignments with the primary objective of identifying any instances of non-compliances. In such situations, and where no formal compliance framework is in place, the Internal Auditor may not be able to provide a written opinion in line with requirements of SIA 110 "Nature of Assurance". Never-the-less a Summary of Findings may be possible, listing any instances of non-compliance identified as a result of the internal audit procedures undertaken. These findings shall be reported along with the following:
- the scope, listing all the specific laws and regulations tested;
  - audit procedures performed, sample selected, and population covered;
  - summary of the work performed; and

## Compendium of Standards on Internal Audit

- limitations, if any, on the responsibilities assumed by the internal Auditor, such as, inherent limitations in sample selection, or that a court of law is the ultimate authority in establishing legal interpretation of non-compliance, etc.

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

## 6 Explanatory Comments

6.1 **Auditing the Compliance Framework (refer Para 5.1):** Where there is a formal compliance framework in place, the work of the Internal Auditor shall be directed to ensure that, amongst others:

- (a) The organisation has designed the framework consistent with best-in-class and globally recognised frameworks;
- (b) The organisation has implemented various enabling mechanisms, such as:
  - (i) Issued compliance policies and implemented supporting procedures;
  - (ii) Set the right “tone at the top” with supporting messages/ activities;
  - (iii) Designed compliance structure, appointed compliance officers and assigned each compliance to a specific “compliance owners”;
  - (iv) Identified all laws and regulations applicable to the entity (created a database of compliances), risk assessed each for importance and priority, and embedded them into the relevant processes;
  - (v) Regularly conduct training programs for compliance officers and owners, covering knowledge and competency for effective compliance;
  - (vi) Implemented robust compliance systems, deploying technology (where possible), to monitor their progress

## Compliance with Laws and Regulations

and track their status, to document timely completion with relevant proofs and artefacts and to support timely escalations in case of slippages;

- (vii) Continuously tracks performance against compliance targets and goals with sufficient reviews and oversight mechanisms;
  - (viii) Established timely communication and periodic reporting systems and protocols, including issuance of self-assessment and compliance certificates.
- (c) The compliance system and processes in place are operating in an effective and efficient manner and help to ensure full compliance.

Any shortcoming shall result in recommendations for improvement and suggestions on how to make the compliance framework more efficient and effective in line with stated objectives.

### 6.2 **Auditing Compliance Activities and Processes (refer Para 5.2):**

Where management has not implemented any formal compliance framework, the Internal Auditor will conduct audit procedures over various compliance related activities which may be present (similar to those indicated under Para 3.3). These activities may be supported by certain enabling systems and processes (similar to those indicated under Para 6.1) and which may be recommended as desirable actions to be undertaken to establish a formal framework.

### 6.3 **Independent Assurance over Compliance Framework (refer Para 5.3):** In situations where a written assurance report is being issued, the Internal Auditor shall consider the following (as a basis for his opinion):

- (a) The linkage of the compliance framework with other frameworks like the Risk, Governance, Fraud, or Information Technology frameworks which may exist.
- (b) The process in place for self-assessment and certification from compliance owners as part of a continuous system of compliance.

## 7 **Effective Date**

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



**SECTION V**

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**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.**

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\* Issued in November 2018.

## Compendium of Standards on Internal Audit

### 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

## Compendium of Standards on Internal Audit

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.
2. Standard on Internal Audit (SIA) 15, *Knowledge of the Entity and its Environment*, issued in March 2009

## 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

## Compendium of Standards on Internal Audit

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

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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

## Compendium of Standards on Internal Audit

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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Annexure 2: Components of a Typical Internal Audit Charter	
Annexure 3: Components of a Typical Engagement Letter	

**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.**

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\* 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.

## Compendium of Standards on Internal Audit

### 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.

## **Compendium of Standards on Internal Audit**

In some cases, both the documents may exist, although where the complete internal audit function is out-sourced, the Engagement Letter covering the whole Internal Audit activity may be the only document in place.

### **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 approving authority for their review and approval.

## 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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\* The above is not a complete and exhaustive list and is presented only as an example of the nature of Objectives of Internal Audit.

## **Compendium of Standards on 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.

## Annexure 2

### 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 charged 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.

## **Compendium of Standards on Internal Audit**

- **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\*\*

### Contents

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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.**

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\* 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.

## Compendium of Standards on Internal Audit

### 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 to 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;

## 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

## Compendium of Standards on Internal Audit

not incorporate the finding of the Expert in his Internal Audit report. (refer Para 3.6).

- 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.

## **Compendium of Standards on Internal Audit**

### **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.

# **STANDARD ON INTERNAL AUDIT (SIA) 250\***

## **COMMUNICATION WITH THOSE CHARGED WITH GOVERNANCE**

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**This Standard on Internal Audit (SIA) 250, “Communication with Those Charged with Governance,” issued by the Council of the Institute of Chartered Accountants of India (ICAI) should be read in conjunction with the “Preface to Framework and Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.**

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\* Issued in September 2022

## Compendium of Standards on Internal Audit

### 1 Introduction

- 1.1 Standard on Internal Audit (SIA) 360 “Communication with Management” mandates the need to have an effective two-way communication with management for achievement of internal audit objectives. This Standard covers the need for a similar communication with “those charged with governance” on a periodic basis to ensure the achievement of objectives.
- 1.2 The term “Those Charged with Governance (TCWG)” refers to either an individual, or a body of individuals, or a separate legal entity with the responsibility for overseeing the strategic direction and accountability of the organisation.
- 1.3 Scope: This standard applies to all the Internal Audit activities including those provided by external service providers.

### 2 Objectives

- 2.1 The purpose of this standard is to:
  - (a) Provide a framework for continuous communication with those charged with governance;
  - (b) Indicate the need to conduct such communication in a process driven manner; and
  - (c) Establish certain essential matters which should be communicated to those charged with governance.
- 2.2 The overall objective of this Standard on Internal Audit is to emphasise the need for a continuous dialogue and discussion on essential internal audit matters between the Internal Auditor and TCWG in a process driven manner and to ensure that this communication is independent, definite, effective and timely.

### 3 Requirements

- 3.1 All communication with those charged with governance shall be independent, objective, effective and timely through an established relationship (refer Para 4.1).
- 3.2 The nature of communication is left to the professional judgements of the Internal Auditor and TCWG. However, a formal communication process, pre-agreed with TCWG, shall be put in place to facilitate effective and timely communication (refer Para 4.2).

## **Communication with those Charged with Governance**

- 3.3 Certain information considered important for communication is mandated by other Standards on Internal Audit, which shall be included in the list of essential matters for communication. In addition, certain information for communication may be mandated by laws and regulations which shall also be adhered to and included in the list of essential matters for communication (refer Para 4.3).
- 3.4 During the course of conducting audit assignments, the Internal Auditor may come across certain sensitive information or situations. These may require the attention of TCWG. The Internal Auditor shall discuss such sensitive matters with the Management and agree on a communication protocol of these with TCWG (refer Para 4.4).

## **4 Explanatory Comments**

- 4.1 **Communication Relationship (Refer Para 3.1):** The Internal Auditor shall ensure that an effective communication relationship is established and maintained with TCWG. This underscores the criticality of a free two-way information flow and the importance of maintaining a continuous professional and independent dialogue with TCWG.
- 4.2 **Nature of Communication (Refer Para 3.2):** The matters to be communicated, the form and manner, and periodicity of communication are best established between the Internal Auditor and TCWG. In this regard, a formal communication process shall be pre-agreed with TCWG, and include the following (indicative list):
- (a) form and content of communication (the “what”);
  - (b) manner and protocol of communication (the “who” and “how”);  
and
  - (c) timelines and periodicity of communication (the “when”).
- 4.3 **Essential Matters of Communication (Refer Para 3.2):** Certain matters which the Internal Auditor should consider as essential matters for communication may include the following (indicative list):
- (a) Annual Internal Audit plan, covering the scope, timing, methodology of audit assignments to be undertaken, along with resources and budgets of the internal audit department;
  - (b) Outcome of the risk assessment exercise conducted to develop the Internal Audit Plan;

## Compendium of Standards on Internal Audit

- (c) Periodic update on significant observations, with corrective action plans, as agreed with the auditee;
- (d) Details of the functioning of the internal audit department and a continuous update on their progress, status of performance and any resource or budget constraints;
- (e) Status update of prior audit issues, their timely closure with an Action Taken Report; and
- (f) Any other matters as per Standards on Internal Audit, laws and regulations and the professional judgement of the Internal Auditor.

4.4 **Dealing with Sensitive Matter(s) (Refer Para 3.4):** At times, the Internal Auditor may come across sensitive information with governance issues (such as, management override of controls, possible fraud indicators, etc). Also, sometimes the Internal Auditor may face sensitive situations where the audit scope is being limited by circumstances such as:

- (a) Significant delays by auditee, either due to unavailability of key personnel or required information;
- (b) Unreasonably short time given to complete the audit;
- (c) Extensive effort required to obtain sufficient and appropriate audit evidence; and
- (d) Restrictions or hurdles imposed on the internal auditor.

In such circumstance, the internal auditor shall communicate the concerned sensitive matter(s) with TCWG as per the pre-agreed laid down process and may even choose to issue a disclaimer on the scope of audit as per his professional judgment.

4.5 The Internal Auditor shall maintain all the documents as required by the Standard on Internal Audit (SIA) 330, Internal Audit Documentation. Oral communications with TCWG may be documented for records through written communication or as the minutes of meetings.

## 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.

## **SECTION VI**

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# **Standards on the Conduct of Audit Assignments (300 - 400 Series)**



# STANDARD ON INTERNAL AUDIT (SIA) 310\*

## PLANNING THE INTERNAL AUDIT ASSIGNMENT\*\*

### Contents

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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.**

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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.
2. Standard on Internal Audit (SIA) 15, *Knowledge of the Entity and its Environment*, issued in March 2009

## Compendium of Standards on Internal Audit

### 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<sup>1</sup> (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).

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<sup>1</sup> 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

## Compendium of Standards on Internal Audit

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.**

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\* 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.

## Compendium of Standards on Internal Audit

### 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.**

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\* Issued in November 2018.

\*\* Note: This Standard on Internal Audit (SIA) supersedes *Standard on Internal Audit (SIA) 3, Documentation*, issued in August 2007.

## Internal Audit Documentation

### 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,

## Internal Audit Documentation

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**

### Contents

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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.**

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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 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.

## Review and Supervision of Audit Assignments

### 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.

## **Compendium of Standards on Internal Audit**

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.

## Review and Supervision of Audit Assignments

### Annexure 1

#### Indicative List of Review and Supervision Activities

Review	Supervision
<ul style="list-style-type: none"> <li>• Audit Objectives as per the Engagement Letter (SIA 230)</li> <li>• Audit Plan (SIA 310)</li> <li>• Audit Programme</li> <li>• Work allocation</li> </ul>	<ul style="list-style-type: none"> <li>• Audit Objectives (SIA 230)</li> <li>• Audit Plan (SIA 310)</li> <li>• Priority and Sequence of planned audit procedures</li> </ul>
<ul style="list-style-type: none"> <li>• Sampling procedures and meeting of sampling objectives</li> <li>• Documentation evidencing performance of audit procedures with the identification of the performer (SIA 330)</li> <li>• Consideration of expert's work in the audit (SIA 240)</li> <li>• Sufficiency of quality and extent of audit procedures</li> <li>• Audit Observations with sufficient and appropriate audit evidence in reproducible form</li> </ul>	<ul style="list-style-type: none"> <li>• Documentation (SIA 330)</li> <li>• Audit observations</li> <li>• Reviewer's feedback to the audit team and its compliance</li> </ul>
<ul style="list-style-type: none"> <li>• Complex and technical audit issues</li> <li>• Drafts of audit observations with management comments, action plan and timelines</li> <li>• Audit report drafts and final audit report (SIA 370)</li> <li>• Follow up plan, procedures, timeline with concurrence of the management</li> </ul>	<ul style="list-style-type: none"> <li>• Complex and technical audit issues requiring supervisor's guidance</li> <li>• Rationale for excluding draft observations from audit reports</li> <li>• Final Audit report with follow up plan (SIA 370)</li> </ul>

# STANDARD ON INTERNAL AUDIT (SIA) 360\*

## COMMUNICATION WITH MANAGEMENT\*\*

### Contents

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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.**

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\* 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.**

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\* 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.

## **Compendium of Standards on Internal Audit**

### **2 Objectives**

- 2.1 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.
- 2.2 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

## Reporting Results

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.

## Compendium of Standards on Internal Audit

- 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.



## **SECTION VII**

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# **Standards on the Conduct of Audit Assignments (500 Series)**



# **STANDARD ON INTERNAL AUDIT (SIA) 520\***

## **INTERNAL AUDITING IN AN INFORMATION TECHNOLOGY ENVIRONMENT\*\***

### **Contents**

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**This Standard on Internal Audit (SIA) 520, “Internal Auditing in an Information Technology Environment,” issued by the Council of the Institute of Chartered Accountants of India (ICAI) should be read in conjunction with the “Preface to the Framework and Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.**

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\* Issued in September 2020.

\*\* This Standard on Internal Audit (SIA) supersedes Standard on Internal Audit (SIA) 14, *Internal Audit in an Information Technology Environment*.

## Compendium of Standards on Internal Audit

### 1 Introduction

- 1.1 This Standard deals with the responsibility of the Internal Auditor to conduct internal audit in an Information Technology (IT) environment.
- 1.2 An Information Technology Environment (ITE) exists when information is captured, stored and processed through automated means and is managed through various policies and procedures to support business operations and objectives. The two main components of ITE include:
  - (a) IT infrastructure (including, but not limited to, hardware, IT architecture, operating systems, communication network, storage systems); and
  - (b) Application software and data (including, but not limited to, Interface, Enterprise Resource Planning, Customer Relationship Management, Dealer and Channel Management System, E-commerce applications, Robotic Process Automation).
- 1.3 The overall objectives of an internal audit do not change in an ITE. However, the different nature of risks, and the controls required to mitigate those risks, do impact the audit approach and procedures deployed in the ITE. An audit in an ITE aims to evaluate an organization's IT risks and establish whether IT related controls are adequate to achieve organization's business objectives.
- 1.4 Scope: This Standard applies to internal audit assignments conducted in an IT environment, where the IT systems are managed by the company. A separate Standard on Internal Audit (SIA) 530 "Third Party Service Provider" covers those situations where the IT systems are managed by external third-party service providers.

### 2 Objectives

- 2.1 The objective of this Standard is to define the essential requirements for auditing in an IT environment so that:
  - (a) Audits are undertaken after due study and understanding of the Organisation's ITE, which covers the IT strategy, policies, operating procedures, the risks and governance mechanism in place to manage the ITE;
  - (b) An independent risk assessment, along with an evaluation of the controls required to mitigate those risks, forms the basis of the audit procedures; and

## **Internal Auditing in an Information Technology Environment**

- (c) The audit procedures, as designed and executed, are sufficient to allow an independent assurance, especially in the areas of (indicative list):
- Security and reliability of information.
  - Efficiency and effectiveness of information processing.
  - Analysis and reporting of the information.
  - Continuous access and availability of the information.
  - Compliance of the IT related laws and regulations.

2.2 The overall objective of performing an internal audit in an ITE is to provide independent assurance and help in making improvements in the ITE, thereby enabling the achievement of business objectives.

### **3 Requirements**

- 3.1 Internal Auditor shall gain an understanding of the business operations and the corresponding IT Environment. This information shall assist the auditor to perform an independent IT risk assessment and identify the nature of controls required to mitigate those risks, before commencing any IT audit activities (Refer Para 4.1).
- 3.2 Internal Auditor shall have or acquire the requisite qualifications, skillsets and experience to perform IT audits. Specialized skills in the areas of IT governance, Application Controls, Infrastructure reviews, IT Cyber Security and Data Privacy regulation are essential (Refer Para 4.2).
- 3.3 Internal Auditor shall assess the ITE to define the scope of the IT audit and identify internal controls relevant to the audit. An appropriate assessment of the level of risk shall form the basis for designing the nature, extent and timing of audit procedures (Refer Para 4.3).
- 3.4 Appropriate planning activities shall be performed by the Internal Auditor before commencing the field work. Key outputs of the planning phase are: A documented understanding of ITE, Risk Assessment, planned audit approach, project plan and resources in terms of skills and team members required (Refer Para 4.4).
- 3.5 As part of audit execution phase, Internal Auditor shall test the design, implementation and operating effectiveness of relevant IT controls and identify control gaps, operating deficiencies, and violations of procedures and laws, if any (Refer Para 4.5).

## **Compendium of Standards on Internal Audit**

- 3.6 Internal Auditor shall document the ITE understanding, scope of work, risk assessment, planning, testing and reporting related activities. Audit documentation as per SIA 330, "Documentation" will be prepared and retained (Refer Para 4.6).
- 3.7 The outcome of the audit procedures shall be shared with the process owners and action plans to address the areas of concerns drawn jointly. Internal Auditor's final conclusion along with an explanation of the basis of the conclusion shall be documented as part of the working papers (Refer Para 4.7).

## **4 Explanatory Comments**

- 4.1 **IT Understanding and Risk Assessment (Refer Para 3.1):** The Internal Auditor will gain an understanding of the business environment, business processes, relevance of IT to the business, in order to undertake an IT risk assessment. This Standard will cover the IT Infrastructure components (IT Architecture, hardware, interfaces, operating system, storage and network devices), the Applications deployed, the nature of computerized processing, IT organization structure and governance mechanism, etc. IT risk assessment will be undertaken to identify the areas of importance and special focus, along with the Internal Controls required to mitigate IT specific risks.
- 4.2 **Internal Auditor Credentials (Refer Para 3.2):** Internal Auditor will obtain a Diploma in Systems Audit (DISA) or equivalent qualification to develop relevant knowledge and skills to perform IT audits. Knowledge and experience about Enterprise Resource Planning (ERP) systems, Analytic tools, Core Banking Systems (CBS), operating system and databases, cloud and other emerging technologies, like Robotic process automation, block chain, Artificial Intelligence / Machine learning are important to perform an effective IT audit. These credentials may be acquired externally and made available for the audit.
- 4.3 **IT Audit Scoping (Refer Para 3.3):** An Internal Auditor will identify the scope of the IT audit procedures to be executed based on the understanding of the overall ITE, objectives of the IT audit, and results of the IT risk assessments performed. Key areas within the audit scope (such as business and IT processes, systems and applications, third party services, etc.), need to be clearly identified and

## **Internal Auditing in an Information Technology Environment**

documented. An illustrative list of audit areas to be considered for scoping is provided in **Annexure 1**.

- 4.4 **IT Audit Planning (Refer Para 3.4):** An Internal Audit Assignment plan including the IT audit approach, methodology and timelines will be defined, documented and maintained, based on the objectives and audit scope identified above. Use of emerging audit tools and techniques and related test procedures for better audit insights and efficiencies should be considered during this phase. Further, SIA 310, "Planning the Internal Audit Assignment" provides detailed description on objectives and outcomes of the planning exercise.

As part of establishing the audit approach, the Internal Auditor may consider various audit controls and procedures relevant to the ITE. An illustrative checklist of IT controls which can be reviewed and the nature of the audit procedures which can be applied by the Internal Auditor is given in **Annexure 2**.

- 4.5 **Audit Execution (Refer Para 3.5):** Internal Auditor will review the robustness of the IT environment and consider any deficiency in the design, implementation and operating effectiveness of IT controls by performing interviews, review of supporting documentation, review of system configuration, inspection, and physical walkthrough. Audit evidence can be obtained through applying technique like corroborative enquiry, review of system configuration and settings, performance of inspection of system, data and its report including use of data analytics tools or through evidence gathered through physical walkthrough. Evidence so obtained should be sufficient and appropriate, reliable and consistent and confirm the nature, timing and sufficiency of the audit procedures undertaken as per the internal audit plan and terms of engagement and aid in the supervision and review of the internal audit work. Further, SIA 320, "Internal Audit Evidence" provides detailed description on objective and requirement of audit evidence.

Internal Auditor will exercise due professional skill, care and diligence and use professional judgement and scepticism in applying appropriate audit methodology, audit procedures and sampling guidelines.

- 4.6 **Audit Documentation (Refer Para 3.6):** Audit test procedures conducted, conclusion reached along with the basis thereof shall be documented. Audit documentation shall include IT environment

## **Compendium of Standards on Internal Audit**

understanding and scoping, IT risk assessment, IT Audit planning, IT risk and controls matrix, IT test work papers, system generated reports with the supporting documents, evidences gathered and so on. Modern audit documentation tools may be used by the Internal Auditor to make the audit more efficient and effective.

- 4.7 **Management Discussion on Deficiencies (Refer Para 3.7):** Internal Auditor will consider any additional evidence or information, such as, risk mitigating measures provided by auditee before concluding on a test of IT controls. Additional procedures may be performed for understanding the root cause, assess impact on financials (if any). Final set of deficiencies along with the recommendations (if any) will be discussed with executive management for inputs (on remedial actions).

## **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.

## Internal Auditing in an Information Technology Environment

### Annexure 1

#### Illustrative List of Audit Areas to be considered as part of the Audit Scope while conducting an Internal Audit in an IT Environment

(Refer paragraph 3.3 and 4.3)

(This Annexure is illustrative in nature and does not form part of the Standard.)

S. No.	ILLUSTRATIVE AUDIT AREAS
1	<b>IT Strategy, Governance and Oversight Audit:</b> involves audit of controls around IT Governing Body - its structure and processes and practice for planning, budgeting and risk management, IT Strategy and its alignment with the entity's strategy and goals.
2	<b>IT General Controls (ITGC) Testing:</b> comprises of basic controls around application systems, underlying operating systems, database, and network infrastructure and its components. Examples of ITCGs include logical access security controls, change/ release management approval/ testing/ migration controls, and data centre and network operations related controls including job scheduling and monitoring, interface, cyber incident management.
3	<b>Automated Business Controls:</b> comprise of business cycle controls that are configured in the application. Some examples include Data entry and validation controls, Reasonable checks and logics, Completeness checks, Logical security/ access controls, Segregation of duties, Pre-and-post implementation audits, including audit of new system and controls (e.g. GST implementation, CRM, CBS, SRM, RPA, Blockchain, etc.)
4	<b>System Reports Testing:</b> which covers test logic, completeness and accuracy of reports is covered.
5	<b>IT Operations Audit:</b> comprises of controls within processes and services supported by organization's IT department. Examples include capacity planning and performance monitoring, system hardening procedures, batch job controls backup and restoration, IT helpdesk and problem management, and network monitoring administration related controls.

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6	<b>Cyber Security Audit:</b> comprises controls aimed to detect, protect, and recover assets from cyber-attacks and respond to such attacks. Examples include controls related to cyber security policies and procedures, cyber security organization, cyber risk management and compliance, social media policy, application, network and infrastructure, physical security, training and awareness, third party cyber risk management, business continuity, cloud security, bot assurance, cyber incident management, threat intelligence and vulnerability management, etc.
7	<b>Emerging Audit Tools and Technologies:</b> include data analytics, artificial intelligence, governance risk and compliance (GRC), Robotic Process Automation (RPA), workflow/ automated audit scripts, security monitoring/ threat intelligence, dash-boarding, etc.
8	<b>Compliance and Regulatory Requirement:</b> The audit may cover compliance to Information Technology Act, 2000 (including amendment in year 2008) on data privacy and compliance, software licencing requirement, data protection and data storage; Companies Act, 2013 for record retention; RBI/ IRDA/ TRAI Cyber regulations; Contract agreements with vendors and customers for software/ asset/ data and so on.
9	<b>Disaster Recovery and Business Continuity:</b> covers controls for data backup and storage required for recovery under the Disaster Recovery Management procedures which need periodic testing and so on.

## Internal Auditing in an Information Technology Environment

### Annexure 2

#### Illustrative Information Technology Controls to be reviewed during an Internal Audit in an IT Environment

(Refer paragraph 3.4 and 4.4)

(This Annexure is illustrative in nature and does not form part of the Standard.)

S. No.	ILLUSTRATIVE IT CONTROL PARAMETERS
<b>IT Governance and Strategy</b>	
1	Executive management is periodically updated with the values achieved from system implementation, specifically in the areas of: <ul style="list-style-type: none"><li>- The overall strategy, vision and maturity</li><li>- Assessment of system program's health through means of key performance indicators (KPIs) and key risk indicators (KRIs)</li><li>- Trends and anomalies regarding production concerns (e.g. capacity, downtime and other exceptions)</li><li>- Return on investments (ROI) and targets for further automation.</li></ul>
2	Presence of a formal methodology for evaluating a system solution prior to commencement of development activities and its approval by the authorized personnel on a periodic basis. The methodology shall contain details about how the business processes are inventoried, analysed and prioritized for system implementations.
<b>System Change Control</b>	
3	Application changes are appropriately tested and approved before being moved into the production environment.
4	Appropriate User Acceptance Testing (UAT) for the solution is performed with appropriate consideration of business input for design. The testing is executed and approved and signed off with prior acceptance. Documentation of test cases and approvals for each system solution is insured.
5	Access to implement changes into the application production environment is appropriately restricted and is segregated from the development environment.

## Compendium of Standards on Internal Audit

6	Management reviews and approves the results of the conversion of data (such as on balancing and reconciliation activities) from the old application system (or data structure) to the new application system (or data structure) and monitors that the conversion is performed in accordance with established conversion policies and procedures.
<b>IT Security and Logical Access Control</b>	
7	Presence of structured IT Policy and personnel are aware of the applicable policies.
8	All accounts used by system are unique and have been assigned to personnel with ultimate responsibility over the usage of the account(s). For each system, usage of its account is tracked and reviewed on a periodical basis. In case, shared accounts are used, compensatory controls are in place as appropriate.
9	Management approves the nature and extent of user-access privileges for new and modified user access, standard application profiles/ roles, critical financial reporting transactions, and segregation of duties.
10	Privileged-level access (e.g., security administrators) is authorized with appropriate restrictions.
11	Access to terminated / transferred users is removed/ modified in a timely manner.
12	Segregation of duties is monitored and conflicting access is either removed or mapped to mitigating controls which are documented and tested.
13	User accounts (in the system) and system privileges that have access to the IT environment system, solution, additional data storage facilities, log files are reviewed on a periodical basis and are documented. Any exceptions identified during the reviews are subject to corrective actions.
14	All key attributes of the security configuration are appropriately implemented.
15	System security parameters like password, audit log, access to super user profiles, critical programs, file, and data is adequately secured.

## Internal Auditing in an Information Technology Environment

<b>IT Back-up and Recovery</b>	
16	The System has adequately documented for backup, recovery procedures and schedules and the backup is adequately monitored.
17	System backup is adequately tested for recovery.
18	For disaster-recovery purposes, system applications have been prioritized and scheduled for recovery based on importance of the operation.
<b>IT Physical and Environmental Controls</b>	
19	Physical security procedures are implemented, only authorized users have access to data center, access to data center is monitored, environment control like, raised ceiling, humidity controls, smoke detection and automatic fire-extinguishing equipment is installed for protection against fire hazards.
<b>IT Inventory</b>	
20	There is a complete inventory of the following: Hardware: (such as Computers, File Servers, Printers, Modems, Switches, Routers, Hubs, etc.) Software: all software for each computer is logged with licenses and serial numbers.
21	There are written procedures for maintaining system inventory and updating its report with identification of a responsible authority.
22	Unused equipment is properly and securely stored. All Assets are adequately managed by AMC and/ or Inhouse to keep them in good working condition. Procedures to identify and dispose e-waste in compliance with applicable environmental laws in place.
<b>IT Operations</b>	
23	The information system identifies and handles error conditions in an expeditious manner without providing access to any information that could be exploited by adversaries.
24	Adequate procedures are in place to ensure compliance with legislative, regulatory and contractual requirements related to intellectual property rights and use of proprietary software products.

## Compendium of Standards on Internal Audit

25	Requirements for human resources are defined (such as recruitment role, profiles, training, retention strategy, third-parties involvement) and aligned with the automation strategy and roadmap. Operational teams are skilled and trained according to the required level of capability and capacity.
26	HR processes are in place to recruit, develop and retain IT human resources to ensure ongoing ability of staff to operate an IT control environment around automation solutions.
27	An overall real-time monitoring/ alerting framework/ mechanism is in place to detect any anomalies in the end-to-end operation of the IT system processes, controls, systems and data. Detailed logging is enabled to capture and review each system solution's transactions/ activities. Detailed logs are maintained to obtain last execution status in case the system solution fails.
28	Network administrator monitors the Network utilisation for response time, disk storage space, and Network utilization.
<b>IT Interface and Job Monitoring</b>	
29	All Systems interface and jobs are adequately monitored. Only authorised persons have access to schedule interface/ job and monitor the same to ensure appropriate, accurate and successful Interface and Job.
30	Only authorized users have access to update the batch jobs (including interface jobs) in the job scheduling software.
<b>IT Service Agreements</b>	
31	Vendor reliability is considered before purchasing IT system hardware and software. Vendor agreement cover relevant clause(s) to ensure confidentiality, integrity and availability of support. Agreements are signed with defined SLA and monitoring mechanism.
32	SLA with vendor are documented and monitored and there is adequate system to ensure service log is maintained to document and monitor performance of vendor support servicing.
33	System hardware and software purchase contracts include Statements regarding Vendor's support and licensing.
<b>IT Cyber Security Policy</b>	
34	The level of cyber protection established on servers and

### Internal Auditing in an Information Technology Environment

	workstations is determined and the monitoring of cyber-attack is undertaken by IT administration. Cyber protection is ensured through antivirus, DLP (Data Loss/ Leakage Prevention), and other Applications is updated on a monthly basis. Laptops and Remote login access, if issued, are ensured to have secured internet access.
35	Data privacy edit and validation check controls are designed and implemented. Privacy controls are designed and implemented as per Privacy Policy.
36	Network is adequately designed, tested and managed with the perspective of cyber security.
37	Data is adequately categorised and controls are configured and implemented as per DLP (Data Loss/ Leakage Prevention) policy.

# **STANDARD ON INTERNAL AUDIT (SIA) 530\***

## **THIRD PARTY SERVICE PROVIDER**

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**This Standard on Internal Audit (SIA) 530, “Third Party Service Provider,” issued by the Council of the Institute of Chartered Accountants of India (ICAI) should be read in conjunction with the “Preface to the Framework and Standards on Internal Audit”, “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.**

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\* Issued in September 2022

## Third Party Service Provider

### 1 Introduction

- 1.1 This Standard deals with the responsibility of the Internal Auditor and management with regard to risks arising from situations where some parts of the entity's business operations, processes and information reside with Third-Party Service Providers (TPSPs). They are External outsourced service provider to whom either full or some aspect of business function, operation or processing or activity is outsourced.

When any organisation (the "User Entity") outsources some aspects of its business operations and information processing to TPSPs who perform the business functions such as to collect, store and process, transmit, maintain and dispose information concerning the business it presents unique challenges of risk management for it.

- 1.2 These risks relate to, and can adversely impact, business processing, financial and operational management, information security, legal compliance, business continuity, etc. In such situations, the Information Technology (IT) systems (where this information resides) are, generally, being managed by the TPSPs and hence, not directly available to the User Entity. With increased reliance being placed by the User Entity on the TPSPs, there is a need to review and assess these risks, residing elsewhere, in an effective manner.
- 1.3 The nature and extent of work to be performed by the User Entity's Internal Auditor depends upon the importance of the business process and information to the organisation and the significance and relevance of the outsourced services in the view of audit. Also, the extent of work to be performed would depend on whether the TPSPs give assurance to their User Entities in the form of a "Third Party Audit and Assurance (TPAA) Report", which seeks to communicate about valuable information on the adequacy or otherwise of risk management and control environment prevailing at the TPSP.
- 1.4 Scope: This Standard applies to both the TPSPs and their User Entities and outlines the requirements for conducting an internal audit.

### 2 Objectives

- 2.1 The primary objective of this Standard is to prescribe the key requirements for providing an independent assurance over business

## **Compendium of Standards on Internal Audit**

operations at third party service providers. These requirements are in the nature of:

- (a) Assessment of risks associated with outsourcing, especially, in securing and protecting its information;
- (b) Evaluation of adequacy of controls to address risks of errors and irregularities with respect to financial, operational processing and reporting;
- (c) Cost and operational efficiencies in the collection, storage, processing and continuous availability of User Entities' information; and
- (d) Ensuring compliance with IT policies and standards, as well as contractual, statutory and regulatory requirements.

2.2 Another objective is to ensure quality independent audit reports on TPSP's Controls. These audit reports help the User Entity to develop a trust on the controls at the TPSP. Conversely, these reports also help to build a confidence with the TPSP in their own service delivery processes and controls.

2.3 Secondary objective of this Standard is to prescribe requirements for the Internal Auditor in evaluating the TPAA report provided by an Independent Auditor covering effectiveness of outsourced processes of TPSP.

### **3 Requirements**

3.1 The Internal Auditor shall study and evaluate the scope of TPSP's services, governance and oversight process in place to outsource and manage risks of deploying TPSPs, especially, risks arising from direct access and control over critical information of the User Entity (refer Para 4.1).

3.2 The Internal Auditor shall review both, the Pre-engagement and Post-engagement due diligence undertaken by the User Entity, including an assessment of the control environment at the TPSP. This review shall include a control assessment (especially an evaluation of controls retained, in-house and outsourced), so that a scope and audit plan can be defined to conduct a comprehensive audit procedures necessary at both, the User Entity and the TPSP (refer Para 4.2).

## **Third Party Service Provider**

- 3.3 A periodic independent risk assessment of each third-party arrangement shall be conducted by the management and reviewed by the Internal Auditor to ensure adequate mitigation steps and control activities are designed, implemented, and operated effectively (refer Para 4.3).
- 3.4 The Internal Auditor shall conduct an independent audit of the TPSP (where permissible), which shall include TPSPs' entity's level controls, IT controls and process controls. The audit scope shall cover periodic evaluation of the on-going performance monitoring controls and procedures to ensure desired level of service, control design, implementation and operating effectiveness. The review shall be undertaken in compliance with Standards on Internal Audit, especially, (SIA) 520 "Internal Auditing in an Information Technology Environment" (refer Para 4.4).
- In cases, where the TPSP uses another entity that performs functions or processes information that may be part of the User Entity's information system, the Internal Auditor may either review the same as part of own audit's scope or consider relying on the work of other auditors.
- 3.5 In case, the Internal Auditor is not performing an independent audit but obtains TPAA reports, the review of the TPAA reports shall be undertaken in compliance with Standard on Internal Audit (SIA) 240, "Using the Work of an Expert" (refer Para 4.5).

## **4 Explanatory Comments**

- 4.1 **Third Party Governance and Oversight (refer Para 3.1):** Internal Auditor of User Entities outsourcing to TPSPs shall review scope of outsourcing as well as third party's governance and oversight process. Certain key elements of the third-party governance and oversight process is as follows (indicative list):
- (a) Existence of a comprehensive database of all third-party arrangements and their respective business owners;
  - (b) The criteria for categorisation of each arrangement is based on various factors, such as, tenure of the relationship, past performance, qualifications and credentials, risk assessment, cost/benefits, etc.;

## Compendium of Standards on Internal Audit

- (c) Evaluation is conducted on the business criticality of the arrangement and the significance of the services provided to the User Entity, especially, its system of risk management and internal controls;
- (d) Objective manner of TPSPs', selection and appointment based on pre-defined criterion and based on merit;
- (e) The roles and responsibilities of the User Entity's officials charged with governance and oversight of these arrangements, and the manner in which they discharge their responsibilities, especially regarding ethical dealings;
- (f) Maintaining a summary of how the arrangements are established, and details of contractual obligations both, during and post termination of the arrangement and whether adequate independent legal review of the contract was undertaken;
- (g) Details of the Service Level Arrangements (SLAs) in place to ensure performance, quality, time, cost, etc. The manner in which SLAs are measured, verified and monitored for compliance;
- (h) Systems and controls through which all the information of the User Entity is collected, processed, stored, secured and continuously made available; and
- (i) Overview of the nature of governance and oversight mechanisms in place at the TPSP to protect the User Entity's information, including details of any TPAA reports to be provided by TPSP to the User Entity or allowing the User Entity with a right to audit and seek information as required from time to time.

4.2 **Third Party Due Diligence (refer Para 3.2):** The User Entity management should undertake a due diligence of the governance, risks, and control environment at the TPSP, especially, its ability to provide a highly reliable and secure IT system. Apart from conducting a back-ground check of the TPSP, an assessment should be made to evaluate their ability to conduct business with high-integrity, and in a safe and secure manner and in compliances with all laws and regulations. Where management does not undertake such due diligence, the Internal Auditor shall make recommendations for such an exercise.

### **Third Party Service Provider**

At times a TPAA report issued by an independent service auditor can provide assurance of the reliability of the IT systems in place, in this case the Internal Auditor should review the reliability of the TPAA report, with respect to the scope and audit procedures undertaken. Post engagement of the TPSP, procedures should be undertaken to on-board TPSP staff and management to implement the systems and controls necessary to ensure a seamless service in line with expectations. For activities outsourced, a review of the controls should be undertaken for pre-transition and post transition.

- 4.3 **Third Party Risk Assessments (refer Para 3.3):** An independent risk assessment of the third-party relationship shall be performed by the Internal Auditor, taking into account the nature of the service provided and its criticality to the overall business management and financial reporting. For example, a TPSP of the User Entity, such as, a call centre, may not be engaged in any financial transaction processing, it may still have access to the User Entity's customer database containing business critical information, and hence explores with the risk of data-breach.

Similarly, where the arrangement includes provision of staff by the TPSP to the User Entity, a review of the risks involving contractual staff are in place (including risk mitigation steps, such as, background checks).

Aspect of Non-disclosure agreement for protecting the information may also be covered as part of the risk assessment. The Internal Auditor will review the controls at the TPSP and highlight any missing or weak controls over such vulnerabilities and any steps required to strengthen the controls. The contractual arrangements with the TPSP should permit the Internal Auditor to conduct such a risk assessment, including necessary internal audit procedures outlined in the scope of outsourced services at reasonable frequency.

- 4.4 **Third Party Performance Monitoring (refer Para 3.4):** The Internal Auditor shall undertake a review of the steps taken by the management to periodically monitor the performance of the TPSP, in line with the SLAs and other legal stipulations. In addition, there shall be a regular assessment of any independent reviews undertaken at the TPSP by its auditor, issuing TPAA reports.

The Internal Auditor will gather sufficient and reliable evidence to confirm adequate mitigation of risks arising from the outsourcing of

## **Compendium of Standards on Internal Audit**

services to the TPSP. Monitoring by the management needs to be a continuous and an on-going exercise and the comprehensiveness of assessment would depend on the risk rating of the service organization.

- 4.5 **Evaluation of Independent Third-party Audit and Assurance Report (refer Para 3.5):** The Independent TPAA report submitted by TPSP shall be evaluated considering the risks assessed with outsourcing and corresponding processes and controls. There are certain activities or processes which may be retained by the User Entity, and the auditor shall review the controls retained by the User Entity to form an overall opinion on controls.

The Internal Auditor shall ensure that a review of the TPAA report is undertaken in compliance with Standard on Internal Audit (SIA) 520, "Internal Auditing in an Information Technology Environment".

## **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.

## **SECTION VIII**

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# **Standards on Internal Audit (As on July 1, 2013)**



# STANDARD ON INTERNAL AUDIT (SIA) 5 SAMPLING\*

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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 260<sup>th</sup> 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*.

## Compendium of Standards on Internal Audit

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

## Sampling

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.

## Compendium of Standards on Internal Audit

### 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 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

## Sampling

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.

## **Compendium of Standards on Internal Audit**

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.

## Sampling

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 judgement 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**

## **Compendium of Standards on Internal Audit**

**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.**
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

## Sampling

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.

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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 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.

## Sampling

- 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.

### 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.

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

**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.

## **Sampling**

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.

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

## 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 20<sup>th</sup> 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.

**Appendix 4**

**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.

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

**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.

# STANDARD ON INTERNAL AUDIT (SIA) 6

## ANALYTICAL PROCEDURES\*

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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 260<sup>th</sup> 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.

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

## Compendium of Standards on Internal Audit

### 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.

## Analytical Procedures

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.**

## Compendium of Standards on Internal Audit

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

## **Analytical Procedures**

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.

### **Compendium of Standards on Internal Audit**

- 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.

## **Analytical Procedures**

17. The extent of reliance that the internal auditor places on the results of analytical procedures depends on the following factors:
- 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 dispel 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

## Compendium of Standards on Internal Audit

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.

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

## Compendium of Standards on 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<sup>1</sup>.

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<sup>1</sup> 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 other 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

## Compendium of Standards on Internal Audit

- 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.

## Quality Assurance in 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**

## Compendium of Standards on Internal Audit

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**

## Quality Assurance in 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

## **Compendium of Standards on Internal Audit**

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*.

## Compendium of Standards on 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,**

## Consideration of Fraud in an Internal Audit

**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.

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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

## Consideration of Fraud in an Internal Audit

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.

### *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.**

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### ***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.

### ***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) 18 RELATED PARTIES\*

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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 the 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 260<sup>th</sup> 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.

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\* Published in the March 2013 issue of *The Chartered Accountant*.

## Compendium of Standards on Internal Audit

### 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

## Related Parties

- (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

## **Compendium of Standards on Internal Audit**

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

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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;
  - (c) Request management to identify all the transactions with the related party;

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- (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.
  - (c) Evaluating the reasonableness of any significant assumptions on which the assertion is based.

## Related Parties

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.