



16 Internal Audit

Part 1- Internal Audit

QNO 352.000	<p>Sec 138-Applicability (Average Turnover of Past 3 Years) Old Course – (N08R, M15R, SM17, PM12, N17F, M18M, N22M, N23M)</p> <p>TITANIUM CNO – IA.025</p> <p>JKH Pvt Ltd, who is into the business of imparting coaching to CA students did not appoint any internal auditor for the year ended 31st March 2017. As on 31st March 2016, the company had paid up capital of ₹ 50 lakhs and reserves of ₹ 10 crores. Its turnover for the 3 years preceding the year ended 31st March 2017 was ₹ 75 crores. ₹ 145 crores respectively. As an auditor of the company for the year ended 31st March 2017, how would you deal with the above?</p> <p style="text-align: center;">OR</p> <p>PQR Ltd., a listed company and having an average annual turnover of more than ₹ 5 crore has no internal audit system. Give your views.</p> <p style="text-align: center;">OR</p> <p>ABC Pvt Ltd was involved in the business of manufacturing pipes and holdings. For financial year 2020-21 the company had the following turnover from its various segments and products: Segment Name Turnover Profit Steel / Iron Pipe Manufacturing 140 Crore 8 Crore Holdings and Civil Structure Accessories 25 Crore 50 Lakh PVC / Yellow Pipe Manufacturing 65 Crore 8 Crore During Financial Year 2021-22 the company's performance was considerably lower compared to FY 2020-21 due to competition and high prices. Turnover and Profit of the company for FY 2021-22 is given hereunder: Segment Name Turnover Profit Steel / Iron Pipe Manufacturing 60 Crore 2 Crore Holdings and Civil Structure Accessories 15 Crore 35 Lakh PVC / Yellow Pipe Manufacturing 35 Crore 3 Crore The company was fully financed through its own capital during both years. Kindly assess whether the company was required to appoint internal auditor as per section 138 read with Rule 13 of the Companies (Accounts) Rules, 2014 for FY 2021-22.</p>	
Answer	<p>Part III-Case Discussion & Evaluation</p> <p>As per section 138 of the Companies Act, 2013, read with Rule 13 of Companies (Audit and Auditors) Rules, 2014</p> <p>Part II-Requirements of Following Section 138</p> <p>As per section 138 of the Companies Act, 2013, the following class of companies (prescribed in rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:</p> <p>a. every listed company;</p> <p>b. every unlisted public company having</p> <p>(i) paid up share capital of more than one crore rupees or more during the preceding financial year; or</p> <p>(ii) turnover of two hundred crore rupees or more during the preceding financial year exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or</p> <p>(iii) outstanding deposits of twenty-five crore rupees or more at any point of time during the preceding financial year; and</p> <p>c. Every private company, having -</p> <p>(i) turnover of two hundred crore rupees or more during the preceding financial year; or</p> <p>(ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the</p>	

	<p>preceding financial year:</p> <p>Case 1</p> <p>Part III – Case Discussion</p> <p>In the instant case, JKH Pvt. Ltd. is having turnover of 260 crores during the preceding financial year which is more than the prescribed limit.</p> <p>Part IV – Conclusion</p> <p>Hence, the company has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit.</p> <p>Case 2</p> <p>Part III – Case Discussion</p> <p>In the instant case, PQR Ltd is a listed company and having an average annual turnover of more than ₹ 5 crores.</p> <p>As the company is a listed company, the provisions related to internal audit shall be applicable to the company. The turnover limit given has no relevance here.</p> <p>Part IV-Conclusion</p> <p>Therefore, the auditor will have to mention in his report the fact of not having such internal audit system by the</p> <p>Author's Note</p> <p>Only turnover of last year is important. Turnover of previous years other than that is of no use. Earlier previous three turnover was important as average of last three year was calculated to for CARO reporting on internal audit. Now there is no such requirement.</p>	
QNO 352.100	<p>Who can become internal auditor ? New Course – (SM23)</p> <p>TITANIUM CNO – IA.025</p> <p>After an illustrious career in Indian Audit & Accounts Service for about 25 years, Parvek, a postgraduate in law, has taken voluntary retirement from government service. Being in fine spirits, he wants to take responsibility in corporate sector. Chief financial officer looking at attractive compensation packages, he applied for such position in a leading listed company engaged in oil refining business. The Board of company is keen on him due to his impressive credentials.</p> <p>Can he be appointed in this leading position of said company?</p>	
Answer	<p>As per section 138 of Companies Act, 2013 the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.</p> <p>The Board can appoint any professional as may be decided by it. The applicant in question is a law postgraduate and he has spent 25 years of his career in Indian Audit & Accounts Service. Therefore, he has got the necessary experience and skills required for the said position. The Board would be in a position to appoint such a competent and experienced person in the field of auditing as its Chief Internal auditor.</p>	

	<p>Applicability of Internal Audit & Scope of Internal Audit New Course – (SM23)</p> <p>TITANIUM CNO – IA.025</p> <p>ABC Pvt. Ltd. company has outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint an internal auditor. Please guide him for the applicability of the same and who can be appointed as an internal auditor and what work would be reviewed by him</p>	
Answer	<p>Applicability of Internal Audit: Section 138 of the Companies Act, 2013 states that every private limited company is required to conduct internal audit if its outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.</p> <p>In view of above provisions, ABC Pvt. Ltd. is under compulsion to conduct internal audit as its loans or borrowings are falling under the prescribed limit.</p> <p>Who can be appointed as Internal Auditor- The internal auditor shall either be a chartered accountant or a</p>	

	<p>cost accountant, whether engaged in practice or not, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies.</p> <p>The internal auditor may or may not be an employee of the company.</p>	
QNO 352.600	<p>Reporting Approach <i>Internal Audit Plan</i> New Course – (SM23)</p> <p>TITANIUM CNO – Unique</p> <p>The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to present their internal audit plan for next financial year. What approach would Mr. A follow to prepare the internal audit plan for next year?</p>	
Answer	<p>The internal auditor should, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement to help him conduct the engagement in an efficient and timely manner.</p> <p>Internal audit plan should be developed in such a manner that all the business processes covering both financial as well as operational activities are reviewed by internal audit function within a defined time cycle. Also, ensuring that appropriate consideration is made and adequate balance is ensured to the following:</p> <ul style="list-style-type: none"> Risk underlying the business process. Value that the internal audit can provide to the organization. Effort involved in conducting the internal audit for a particular business process. Risk Appetite of the organization Coverage of all auditable areas within the defined time range. 	

	<p>Reporting Structure for Internal Auditor <i>Organization Structure</i> New Course – (SM23)</p> <p>TITANIUM CNO – Unique</p> <p>The XYZ Ltd has to appoint Mr. A as Chief Internal Auditor to lead the internal audit function for the company. The Managing Director of the company has asked the HR head to define the reporting structure of the Chief Internal Auditor so that he can discharge his duties objectively. Suggest the ideal reporting structure of the Chief Internal Auditor that he should propose to the Managing Director?</p>	
Answer	<p>HR Head need to evaluate multiple options and identify most suitable option in light of the relevant provisions, guidance and overall governance of the organization. HR head also need to evaluate different options for his administrative reporting and functional reporting of Chief Internal Auditor. The possible options to be considered and evaluated include Board of Directors, Audit Committee, Managing Director of the Company, Chief Executive Officer or Chief Financial Officer.</p> <p>As per section 138 of the Companies Act 2013, the internal auditor shall either be a chartered accountant or a cost accountant (whether engaged in the practice or not), or such other professional as may be decided by the Board to conduct an internal audit of the functions and activities of the company.</p> <p>As per the revised definition of the term 'Internal Audit' as per para 3 of the ICAI's Framework Governing Internal Audits, 'Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives'.</p> <p>Ref: para 3, 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.</p> <p>As per the requirement of the above stated provision, Chief Internal Auditor need to be independent of the operational activities and report directly to CEO or Managing Director for his administrative reporting purpose or another senior executive of Directors, and other senior executive of Chief Internal Auditor. It is the responsibility of the management. He is responsible for adding the compliance framework and not managing it. Similarly, he does not accept compliance related risks like directly engaging with regulator.</p>	

	<p>Appraisal of Organizational Structure Old Course – (N18M, N18E)</p> <p>TITANIUM CNO – IA.025</p> <p>Internal auditor makes an appraisal of organization structure to ensure that it is in harmony with the objectives of the entity, besides checking of financial transactions and operational activities of the entity. Elaborate.</p> <p style="text-align: center;">OR</p> <p>ABC Ltd. is engaged in manufacturing of Yarns and Towels. It sells its product in both domestic as well as in International Market. It has achieved turnover of 200 crores in the F.Y. 2016-17. Directors of the company realized that they are not managing the company professionally and thereby request your firm of Internal Auditors for appraisal of its organizational structure to ascertain whether it is in harmony with the objectives of ABC (P) Ltd. Comment.</p>	
Answer	<p>Review of the Organisation Structure -</p> <ul style="list-style-type: none"> Introduction, Harmony between Structure & Objectives <p>The internal auditor should conduct an appraisal of the organisation structure to ascertain whether it is in harmony with the objectives of the enterprise and whether the assignment of responsibilities is in consonance therewith.</p> <p>What to evaluate?</p> <p>For this purpose:</p> <ul style="list-style-type: none"> He should review the manner in which the activities of the enterprise are grouped for managerial control. It is also important to review whether responsibility and authority are in harmony with the grouping pattern. The internal auditor should examine the organization chart to find out whether the structure is simple and economical and that no function enjoys an undue dominance over the others. He should particularly see that the responsibilities of managerial staff at headquarters do not overlap with those of chief executives at operating units. He should examine whether there is a satisfactory balance between authority and responsibility of various executives. The internal auditor should examine the reasonableness of the span of control of each executive (the number of sub-ordinates that an executive controls). He should examine whether there is a unity of command i.e., whether each person reports only to one superior. Where dual responsibilities cannot be avoided, the primary one should be specified and the specific responsibility to each senior fixed. This must be made known to all concerned. Finally, he should evaluate the process of managerial development in the enterprise. This is a vital aspect in a fast-growing enterprise. 	

	<p>Internal Auditor Agreed to Ensure Compliance with Laws & Regulations New Course – (SM23)</p> <p>TITANIUM CNO – IA.025</p> <p>CA Deep is internal auditor of a listed company. The company wants to make sure that it is in compliance with SEBI requirements at all times and it is never on the wrong side of law. It asks its internal auditor to manage its compliance tracking system including directly corresponding with regulator in this regard. The profile and scope of internal audit agreed at time of appointment included 'compliance with laws and regulations'.</p> <p>Can he perform such type of activities in capacity of internal auditor of company?</p>	
Answer	<p>The Internal Auditor does not assume any responsibility to manage or operate the compliance framework or to take compliance related decisions. It is not responsibility of the Internal Auditor to execute or monitor compliance related risks (e.g., engaging directly with regulators, etc.).</p> <p>Although internal audit function provides independent assurance to enhance governance which includes compliance with laws and regulations), it does not assume operational responsibility of its compliance framework. It is the responsibility of the management. He is responsible for adding the compliance framework and not managing it. Similarly, he does not accept compliance related risks like directly engaging with regulator.</p>	

	<p>Independence of Internal Auditor Old Course – (N23M)</p> <p>TITANIUM CNO – Unique</p> <p>Consider the following statement: "The internal auditor of a company shall be free from any undue influences which force him to deviate from the truth. He shall be independent." Is above statement proper? If so, how independence of internal auditor can be established?</p>	
Answer	<p>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 auditor function and the internal auditor within the organization is a vital aspect of maintaining effective corporate governance. It is important to ensure that the internal audit function is free from any undue influence or pressure that may affect its ability to provide impartial and objective assessments of the organization's operations, risks, and controls.</p> <p>Therefore, the given statement is proper.</p> <p>To establish the independence of the internal auditor, several factors need to be considered. Firstly, the overall organizational structure of key personnel plays a crucial role. The internal auditor should be positioned in a way that allows them to operate independently and objectively. This includes having direct access to the Audit Committee, Board of Directors, and other senior executives. Secondly, the reporting line of the internal auditor is an important consideration. The Chief Internal Auditor should report to the highest level of authority within the organization, such as the CEO or the Board of Directors. This ensures that the internal auditor has the necessary authority and support to carry out their responsibilities effectively. Finally, the powers and authority derived from superiors further establish the independence of</p>	

	<p>the internal auditor. The internal auditor should have the necessary resources, budget, and support to conduct their work without any undue influence or pressure from senior executives or other stakeholders.</p>	
QNO 614.800	<p>Gathering Information & Performing Audit Checks New Course – (SM23)</p> <p>TITANIUM CNO – IA.075</p> <p>The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to perform detailed analysis of their expenses in previous year and report all risks and underlying issues that audit approach should internal auditor follow to identify such risks.</p> <p>Answer</p> <p>Direct Source: To the extent possible, Internal Auditor must obtain the information directly from the source. Advance Intimation: Adequate planning should be done and advance intimation should be made for any interim information needed for performing audit checks.</p> <p>Information Integrity: Internal Auditor must obtain the required information and perform checks to ensure correctness and integrity of information received.</p> <p>Perform audit checks</p> <ul style="list-style-type: none"> Analytical procedures: Internal Auditor should collate all data and perform analytical procedures to identify key trends and outliers. Analytical procedures should be performed in accordance with the Standard on Internal Audit (SIA) 6, Analytical Procedures. To the extent possible, relevant analytical tools may be used to perform review of the complete data for the audit period. 2A. Sampling: Wherever needed, Internal Auditor must select the sample in accordance with Standard on Internal Audit (SIA) 5, Sampling. 2B. Audit Testing: Detailed audit testing must be performed as per the audit work plan. Internal Auditor must ensure adequate evidences must be collected and stored in accordance to Standard on Internal Audit (SIA) 320, Internal Audit Evidence. 3A. Audit Issues: Internal Auditor must prepare detailed list of the identified audit issues and controls gaps. 3B. Interim Reports: Interim reports may be issued after proper review of the work performed as per the Standard on Internal Audit (SIA) 350, Review and Supervision of Audit Assignments. 4. Documentation: Adequate documentation of the internal audit work papers needs to be performed as per Standard on Internal Audit (SIA) 330, Internal Audit Documentation. 	

	<p>Content and Format of Internal Audit Report New Course – (SM23)</p> <p>TITANIUM CNO – IA.080 / IA.120</p> <p>The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to present their analysis on the implementation of recommendation of previous audit report and highlight critical areas which need immediate attention of Audit Committee? What should be the steps followed by internal auditor to address this requirement of Audit Committee?</p>	
Answer	<p>As per Standard on Internal Audit (SIA) 370 Reporting Results, reporting of internal audit results is generally undertaken on the following basis:</p> <ul style="list-style-type: none"> At the end of a particular audit assignment, an "Internal Auditor 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 addressee, with copies shared with local and executive management, as agreed during the planning phase. On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entire 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 audit, generally the Audit Committee. Some parts of the aforementioned Internal Auditor Reports may form part of the periodic (e.g. quarterly) report shared with the Audit Committee. <p>Accordingly, a typical internal audit report should include the following:</p> <ul style="list-style-type: none"> Audit Scope performed; Audit period Covered; Executive Summary; 	

	<ul style="list-style-type: none"> Summary of the critical findings; Detailed audit findings with elaboration on business impact and root cause of such issues; Rating of the highlighted issues (e.g. High / Medium / Low) in accordance to the rating criteria approved by Audit Committee; Audit recommendation to improve control environment and address the highlighted finding; Response received from the responsible functional authority containing action plan and target timescale for action. 	
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	<p>FOLLOW-UP BY INTERNAL AUDITOR New Course – (SM23)</p> <p>TITANIUM CNO – IA.140</p> <p>The XYZ Ltd is has appointed Mr. A to conduct their internal audit for new financial year. The Audit committee requested Mr. A to present their analysis on the implementation of recommendation of previous audit report and highlight critical areas which need immediate attention of Audit Committee? What should be the steps followed by internal auditor to address this requirement of Audit Committee?</p>	
Answer	<p>As per SIA 350 Monitoring and Reporting of Prior Audit Issues, the Chief Internal Auditor is responsible for continuously monitoring the closure of prior audit issues through timely implementation of action plans included in past audits. This shall be done with a formal monitoring process, elements of which are agreed with management and those charged with governance. The responsibility to implement the action plans remains with the management.</p> <p>In monitoring and reporting of prior audit issues, the responsibility of the Internal Auditor is usually in the form of an "Action Taken Report (ATR)" of previous audits".</p> <p>To address the requirement of Audit Committee in the given situation, Internal Auditor should assess the action taken against the previous audit findings and report a summary of the action taken by the management. Typical Action Taken Report may include the following:</p> <ul style="list-style-type: none"> Reference to the previous audit reporting containing the reported issues; Implementation Action agreed by the management along with target implementation date; Status of action taken by management. The same may be classified under implemented / Not implemented; Residual risk and rating for any unimplemented action Audit findings not implemented for long period of time Any critical audit finding that require immediate action for action or implementation 	

	<p>Can we rely on work of internal auditor, evaluating going concern? New Course – (SM23)</p> <p>TITANIUM CNO – Unique</p> <p>Up Down Limited is in doldrums since last two years. The demand for its products has declined drastically. The statutory auditor is of the view that situation has put into question going concern assumption of the company. Its internal auditor has helped management in devising a strategy to deal with such risks and come out of the situation. The plan includes venturing into different product lines using same plant with minor modifications. Further, internal auditor has also prepared estimates of revenue generation along with cash flows.</p> <p>Can statutory auditor place total reliance on work performed by internal auditor in this regard?</p>	
Answer	<p>The greater the judgment needed to be exercised in planning and performing the audit procedures and evaluating the audit evidence, the external auditor will need to perform more procedures directly because using the work of the internal audit function alone will not provide the external auditor with sufficient appropriate audit evidence.</p> <p>The appropriate use of going concern assumption requires significant judgment on part of statutory auditor.</p> <p>Therefore, statutory auditor cannot place total reliance on internal auditor's work in this regard and he should perform more procedures directly.</p>	

	<p>Attrition Rate Old Course – (M13E, M16M, N16R, PM17, N17R, N17M, M18M, N20M)</p> <p>TITANIUM CNO – IA.025</p> <p>The Managing Director of Beta Ltd is concerned about high employee attrition rate in his company. As the internal auditor of the company he requests you to analyse the causes for the same. What factors would you consider in such analysis?</p>	
Answer	<p>You have been appointed as an internal auditor of a company RSM Ltd. The Managing Director Rakesh is worried about employee attrition in large number. Rakesh requests you to analyse the causes for high employee attrition rate in his company. What factors would you consider in such analysis?</p> <p>The factors responsible for high employee attrition rate are as under:</p> <ul style="list-style-type: none"> Trainings & Work Culture <ul style="list-style-type: none"> Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices? (Outdated work culture, using Type 1 mixer) Timings <ul style="list-style-type: none"> Job Stress & work life imbalance (12 hours of work & 3 hours of travel, 6 hours of sleep, 2 hours of routine work, 1 hour for family) Seniors <ul style="list-style-type: none"> Whether the organization has properly qualified and utilized senior personnel for the various levels of works? (Inexperienced seniors & HRs) Unbearable behavior of Senior Staff (Shouting & Abusing) Colleagues <ul style="list-style-type: none"> Is the number of people employed at various work centre's excessive or inadequate? (Excess Staffing or Understaffing leading to strain on few) Salary & Schemes <ul style="list-style-type: none"> Low monetary benefits (Salary 30-40% lower than market) Lack of labor welfare amenities (No Deception, Health & Encouragement) Others <ul style="list-style-type: none"> Safety factors (Office is at remote location, prone to thefts) <p>Author's Note</p> <p>Answer has been rearranged to create a flow. Headings in Comics font are included by author for helping the students to understand and remember the answer</p>	