


INTERNAL AUDIT AN OVERVIEW



Dr. B. K. Vatsaraj
Chartered Accountant

Present Scenario

- The bursting of the financial asset bubble and the resulting economic downturn provided powerful lessons about risk and risk management to many of the world's most prominent companies; as such risk management has been lifted to the top of nearly every board's agenda.
- Companies are embracing a more strategic, top-down view of risk management and integrating Internal Audit into their overall plans.

- 
- As such, they are evaluating whether Internal Audit can provide the appropriate oversight needed to address emerging risks and continue to focus on execution and growth strategies.
 - In a time of constrained resources, refining the internal audit function is yielding risk-management and business process improvements.
 - Many discussions and debate's have arisen from the increased fraud incidents throughout organizations.
 - The evolving face of Internal Audit in India highlights the need for more robust and independent assurance processes.

The Purpose of Internal Auditing?

- “Eyes and Ears”
- “Policeman”
- “Watchdog”
- “Consultant”
- “Catalyst”



Thrust Is To Be On:

- Better Corporate Governance
- Greater Accountability
- Transparency

Will Mean

- Enhanced Responsibility of Professionals and the Board mainly Independent Directors
- *Therefore More Responsibility*
 - *Internal Auditors and*
 - *Statutory Auditors*

Enhancing Board Effectiveness

❖ **Principals of good governance**

- ❖ *Culture of the Board Room*
- ❖ *The behaviour of Directors and*
- ❖ *The issue of Recruitment*

❖ **Therefore the Strong Audit Committee**

Enhancing Board Effectiveness

- ❖ **Strong Audit Committee which can take aggressive position with respect to shareholders value**
- ❖ *“A great board member, at least in my opinion is someone who on one hand does ask the tough questions and holds financial accountability for his performance but also provides advice, counsel and some sort of mentorship and support to the management.”*

A question to the audience Independent Directors... Are they Effective..?????



everybody join in™

Independent Directors... Not Effective...!



Boardroom Culture in India

- ❖ Independent directors could be divided into three categories
- ❖ **Category I: Nodders**
- ❖ **Category II:** There are directors who are truly independent in the sense that they express their views clearly, fearlessly and frankly, regardless of what the chairman, or whoever has dictated their appointment, thinks. They take to heart Sam Goldwyn's famous one-liner: "I want everyone to tell me the truth, even if it costs him his job."

Boardroom Culture in India

- ❖ **Category III:** The vast majority of independent directors fall between these two extremes. These are people to a large extent conditioned by culture — the culture of not expressing dissent very forcefully.
 - ❖ *board directors who say little or nothing in the boardroom, preferring instead to raise their concerns after the meeting.*
- ❖ *“Many directors are afraid of looking stupid or asking a stupid question — maybe something they ought to have known — or sometimes they’re afraid to confront the management.”*

Few Thoughts On Internal Audit



Paradigm Shift In The Role Of Internal Auditor

From Reactive	To Proactive
From Books	To Business
From Vouchers	To Systems
From Sales	To Value Addition
From Economic Value Addition	To Value Creation
From Quantity of Earnings	To Quality of Earnings
From Delayed Accuracy	To Quick Estimate
From Internal Control	To Internal Co-operation
From Compliance with Standard Accounting	To Compliance with Accounting Standards
From Tax Planning	To Tax Compliance
From a Checker	To a Consultant

Cont'd

From Compliance	To Competency
From Foe	To Friend
From Fault Finder	To Facilitator
From Net Profits	To Cash flow
From Large Cash as a source of "comfort"	To cause for "concern"
From You v/s We	To All of us
From Stern Look	To Smile
From Internal Audit	To External Internal Audit
From Professional	To Partner
From Consultant	To Core Group Member
From Long Report	To Crisp Elevator Pitch
From Conceptualization	To Execution

What Is IA?

- An independent management function,
- Involving a continuous and critical appraisal of the functioning of the entity.
- To suggest certain improvements and value additions
- To strengthen the governance mechanism of the entity, strategic risk management and internal control system
- To provide assurance regarding transparency and reporting.

Need For IA

- Increased size and growing complexity of businesses
- Enhanced compliance requirements
- Focus on risk management and internal controls to manage them
- Stringent norms mandated by regulators to protect investors
- Growth of unconventional business models
- Intensive use of information technology.
- An increasingly competitive environment.

Benefits Of IA

- Tells you the health & quality of the system
- Identify the root of the problem & plan for corrective and preventive actions with timeline.
- Achieve better allocation of resources.
- Able to avoid potentially big problems.
- Learn what an auditors look for
- Continuous improvement



Objectives

- Compliances -external and internal



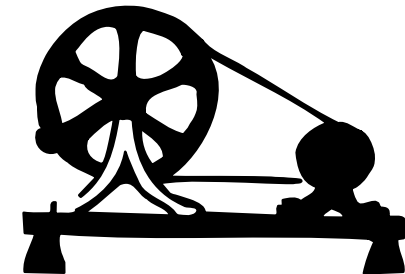
- Optimization of resources, costs and processes



- Risks and controls



- Governance processes and ethical practices



Is IA Mandatory?

Companies Act - 1956

- ❖ Internal audit was not expressly provided in the Act except u/s 292A a brief reference and responsibility was placed on the Audit Committee for comments on the Internal Control system of the Company.
- ❖ However, in Companies Auditors Report Order (CARO) 2003 issued u/s 227(4A) of the Act, the External Auditors were required to comment upon the effectiveness of the Internal Audit system for applicable companies.

Companies Act – 2013

- ❖ An express provision about Internal Audit recognizing the utility of such an audit in terms of better internal control and corporate governance, is now made:-
- ❖ **Section 138 of Companies Act 2013:-**

Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.

Further, it is also stated that the Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

APPLICABILITY OF INTERNAL AUDIT

Companies Act – 1956

Paragraph 4(vii) of CARO - “In the case of listed companies and/or other companies having a paid-up capital and reserves exceeding `50 lakhs as at the commencement of the financial year concerned or having an average annual turnover exceeding 5 Crores for a period of the three consecutive financial year concerned, whether the company has an internal audit system commensurate with its size and nature of its business.”