

CHAPTER 8 - Concepts of Various Audit

AUDIT

Financial

Compliance

- (1) Statutory
- (2) Cost

- (1) Secretarial
- (2) Corporate Governance
- (3) CSR
- (4) Internal
- (5) Takeover
- (6) Insider Trading
- (7) Cyber
- (8) Information Technology
- (9) Forensic
- (10) Social
- (11) Environment
- (12) Labour

#1

Corporate Governance Audit

- ① Accountability
- ② Responsibility
- ③ Transparency
- ④ Fairness
- ⑤ Shareholder interest

↓
Good practices in a Company

→ Need

- Reputation
- Investor's trust

→ Scope

- Board structure
- Financial
- Non-financial
- Risk
- Control Environment

→ Responsible

Audit Committee

Sec 177

(*)

Regⁿ 18 of SEBI (LODR)



Applicability

1. listed Co.
2. Every Public Co. having -
 - a) PUSC \geq 10 cr or more, or
 - b) Turnover \geq 100 cr or more, or
 - c) Borrowings exceeding 50 cr.

Composition

- ① Min 3 directors, max $\frac{2}{3}$ ID
- ② Financially literate
- ③ Chairman - ID - present in AGM

Q # Role of Audit Committee :

- a) Recommendation for appointment, remuneration and terms of appointment of Auditor.
- b) Review Annual financial statement and Auditor's report before submission to the Board.
- c) Review that financial statements give a true & fair view of the affairs of the Company.
- d) Review Quarterly financial statements.
- e) Review Independence of Auditor.
- f) Review Auditor's performance and monitoring of Internal control system.
- g) Approval of Related Party transaction (RPT).
- h) Verification of Inter-corporate loans & investment.
- i) Valuation of Asset, if necessary.
- j) Review of functioning of Whistle-Blower Mechanism.

Checklist of Corporate Governance Audit

1. Accountability

- Separation of Ownership & control
- Board accountable to Shareholders
- Management ^{Executive} accountable to Board
- Audit Committee policies
- Independent Directors have powers to play their role effectively

2. Responsibility

- Policy on stakeholder's right, social responsibility
- Board's responsibility includes review and guiding of corporate strategy, risk policy, Annual Budgets & Business Plan.

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3. Transparency

- Disclosures on all Material matters
- Information about the rights attached to all series and class of shares
- Company has a policy for making political contribution
- Company has Insider Trading Disclosure
- Remuneration Policy

4. Fairness

- Equitable treatment with Minority
- Procedure for effective resolution of violation
- Fair market practice code

5. Shareholder Interest

- Right to participate ~~in~~ and be sufficiently informed about material corporate changes.
- Any change in capital structure which enables the shareholder to exercise disproportionate control should be disclosed.
- Shareholder should be allowed to exercise their ownership rights
- Minority should be protected from abusive actions of Majority.
- Director's should disclose if they have any material interest in the transaction.

#12 Secretarial Audit

Section 204

- ① Applicability → Listed Co.
- Public Co. - $\left\{ \begin{array}{l} PUSC \geq 50 \text{ cr} \\ \text{(or)} \\ \text{Turnover} \geq 250 \text{ cr} \end{array} \right.$
- every Co. - $\left\{ \begin{array}{l} \text{O/b loans} \geq 100 \text{ cr} \\ \text{\& borrowing} \end{array} \right.$

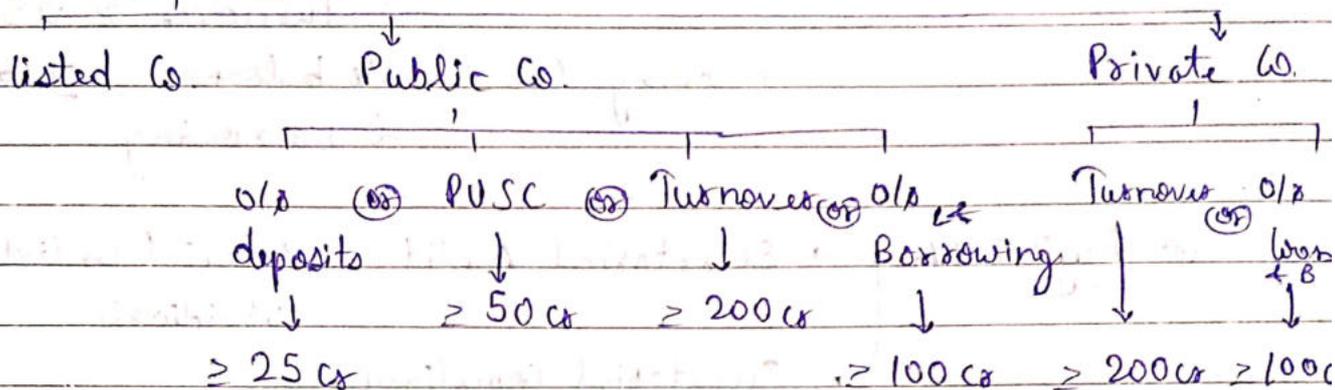
- ② Regⁿ 24A → Secretarial Audit - Material unlisted^{*} subsidiaries
- Secretarial Compliance report → Annually (to Stx)

③ format of Report - [MR-3]

* Material unlisted subsidiary → Income / Net worth > 10% of consolidated Income / Net worth of the Co.

#3 Internal Audit

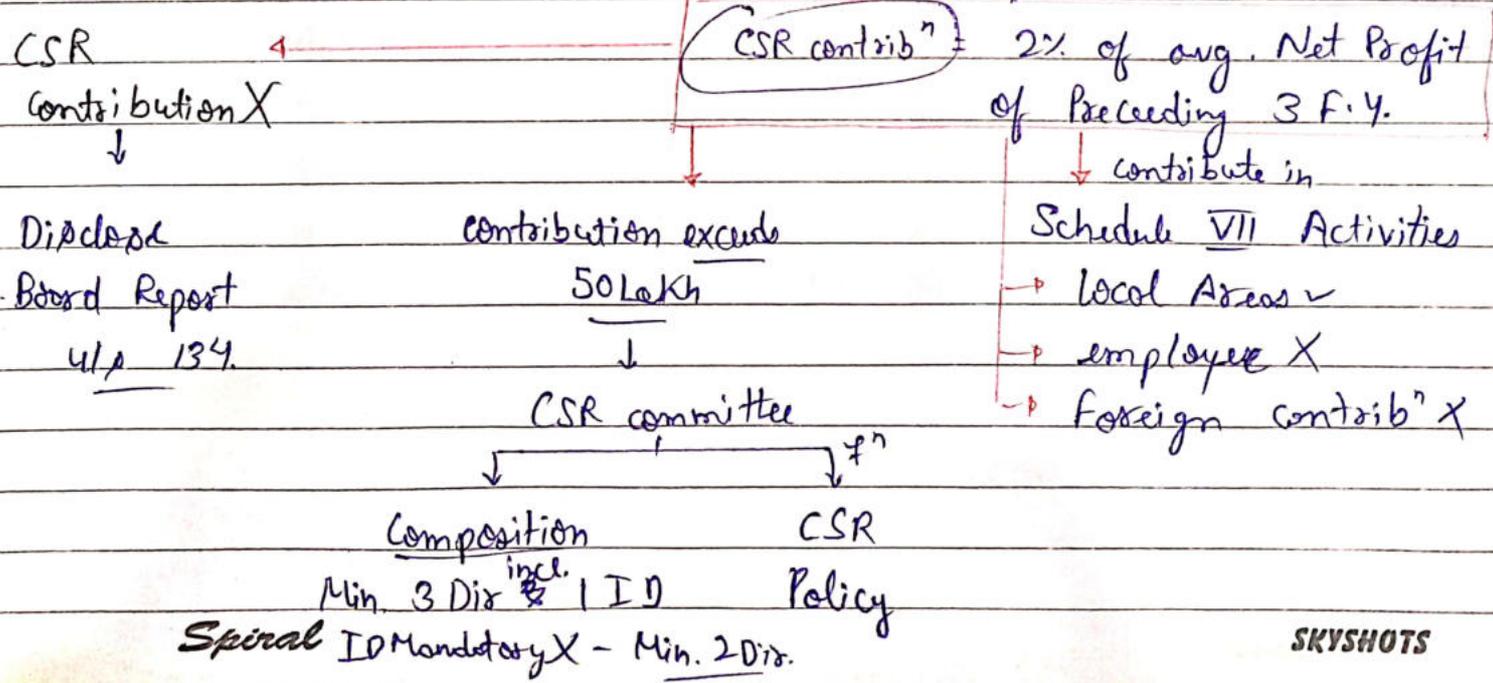
- ① Evaluation of effectiveness of Internal Control system of the organisation.
- ② Section 138
- ③ Applicability



#4 CSR Audit

Section 135

Every Co. — Net Worth ≥ 500 cr
 Turnover ≥ 1000 cr } during J.P.F.Y.
 Net Profit ≥ 5 cr



Date.....

⇒ Checklist of CSR:

- a) If CSR is applicable as per Section 135 (1).
- b) If CSR yes, whether Company has contributed 2% of average Net Profit of 3 preceding f.y.
- c) If contribution exceeds 50L, CSR committee has been formed by Board of Directors.
- d) If yes, whether CSR committee constitute of minimum 3 directors with at least 1 Independent Director, however independent director is not mandatory minimum 2 or more director.
- e) If CSR policy has been formed by company & approved by Board of Director.
- f) If CSR committee has suggested the CSR expenditure in CSR policy.
- g) If company has contributed towards CSR through CSR policy.
- h) If activities in which company has made the CSR contribution is in pursuance of activities specified in Schedule VII.
 - i) If company has disclosed CSR policy, CSR committee & its composition on the website.
 - j) Board's Report includes an Ann Annual Report on CSR.
 - k) Company has complied with all the applicable CSR rules.

CSR Audit

Purpose

- ① Compliance
- ② Transparency in Monitoring
- ③ Internal Control
- ④ life-cycle
- ⑤ Financial Review

Methodology

- ① Review of CSR policy, committee, governance structure, monitoring or evaluation
- ② Interacting with beneficiaries
- ③ Review of identification of Beneficiary and Budget allocation.
- ④ Review of CSR expenditure. [Cost: administrative cost, direct expenditure, IA cost]

#5 Cyber Audit

a) Cyber Audits are conducted to minimise any financial loss or damage that will be cost to the reputation in case of failure of system.

b) Cyber Audit includes:

Protection of sensitive data to IP

Protection of Network

Accountability of Device on which Data is stored.

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o Scope of Cyber Audit

- i) Data Security policies and Database
- ii) Security controls are established
- iii) Data loss prevention measures are deployed
- iv) Incident response programme is implemented
- v) Network control

➔ Dimensions of Cyber Audit :

- a) Management
- b) Risk Management
- c) Internal Audit.

a) Management

In any organisation, management has a duty that cyber security control exists in the organisation and operate effectively.

b) Risk Management

The objective of Risk Management is to assess the risk and first clearly communicated and second identified the areas to address the risk.

c) Internal Audit

They have the most important role to play in independent review and in understanding and communicating to the Board any cyber security risks that exist.

→ Checklist of Cyber Audit

- a) Personnel security
- b) Physical security
- c) Account and password management
- d) Confidentiality & encryption of data
- e) Compliance & Audit.

a) Personnel Security

- i) Policy of Background check
- ii) Staff wears ID card
- iii) Current picture on ID card
- iv) Access levels are identified on the badge
- v) Getting off the access

b) Physical Security

- Co. has policies to limit unauthorised access
- (Co.) → policy → specify methods to control Physical Access
- Access to computing Area is controlled.

c) Account & Password Management

- Policies for electronic authentication
- only authorised personnel have access to computer.

d) Confidentiality of Data

- Protects sensitive data through encryption
- Co. retains both Hard Copy & soft copy

e) Compliance and Audit

- ↳ compliance with established policies & procedures
- ↳ Co. has tested disaster plan
- ↳ Management regularly reviews list of individuals with ~~per~~ physical access
- ↳ Co. frequently reviews & revises security documents.

#6 Environmental Audit

• Environment means Air, Water and land. The Purpose of environment Audit is to ensure compliance with applicable environment laws, identify implementation gaps by the management and take corrective Actions

• Environmental Audit are generally categorised into 2 types:

- (i) Compliance Audit
- (ii) Management System Audit.

(i) Environment Compliance Audit :

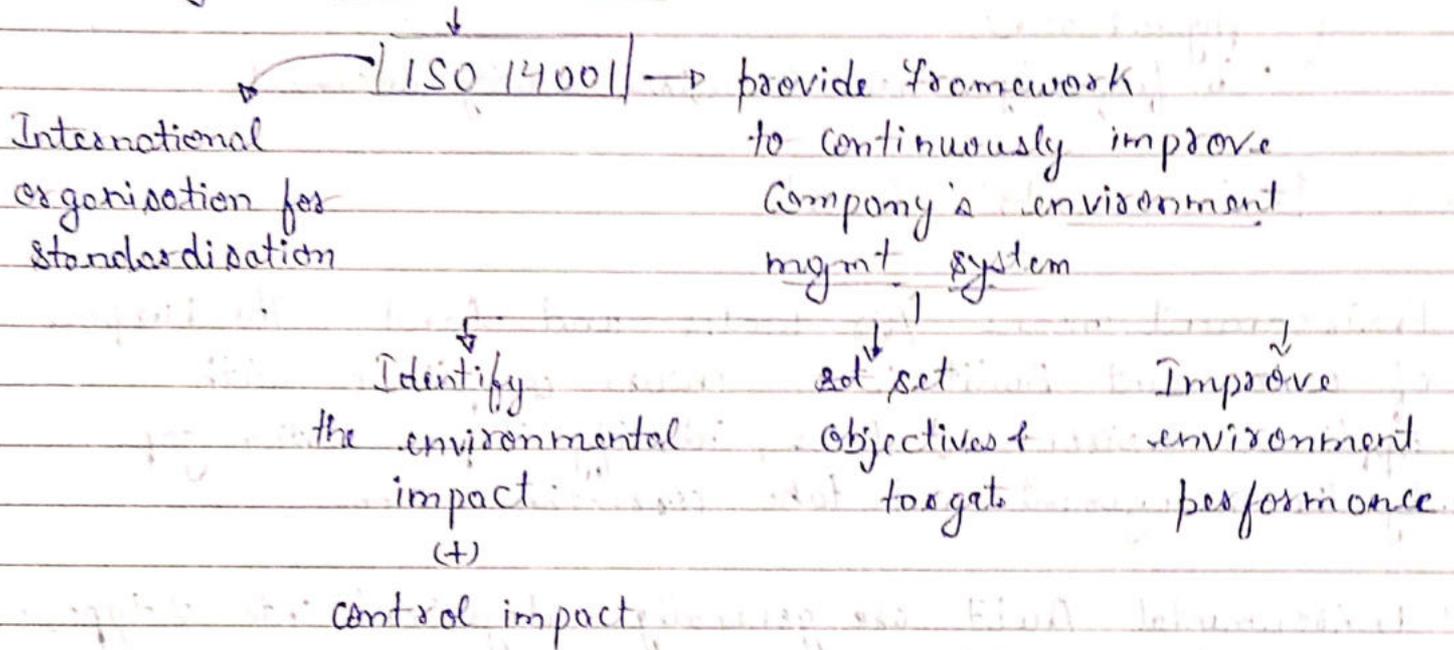
The objective of environment Compliance Audit is to ensure compliance with applicable laws, rules and regulations.

Following laws are covered under Environment compliance Audit :

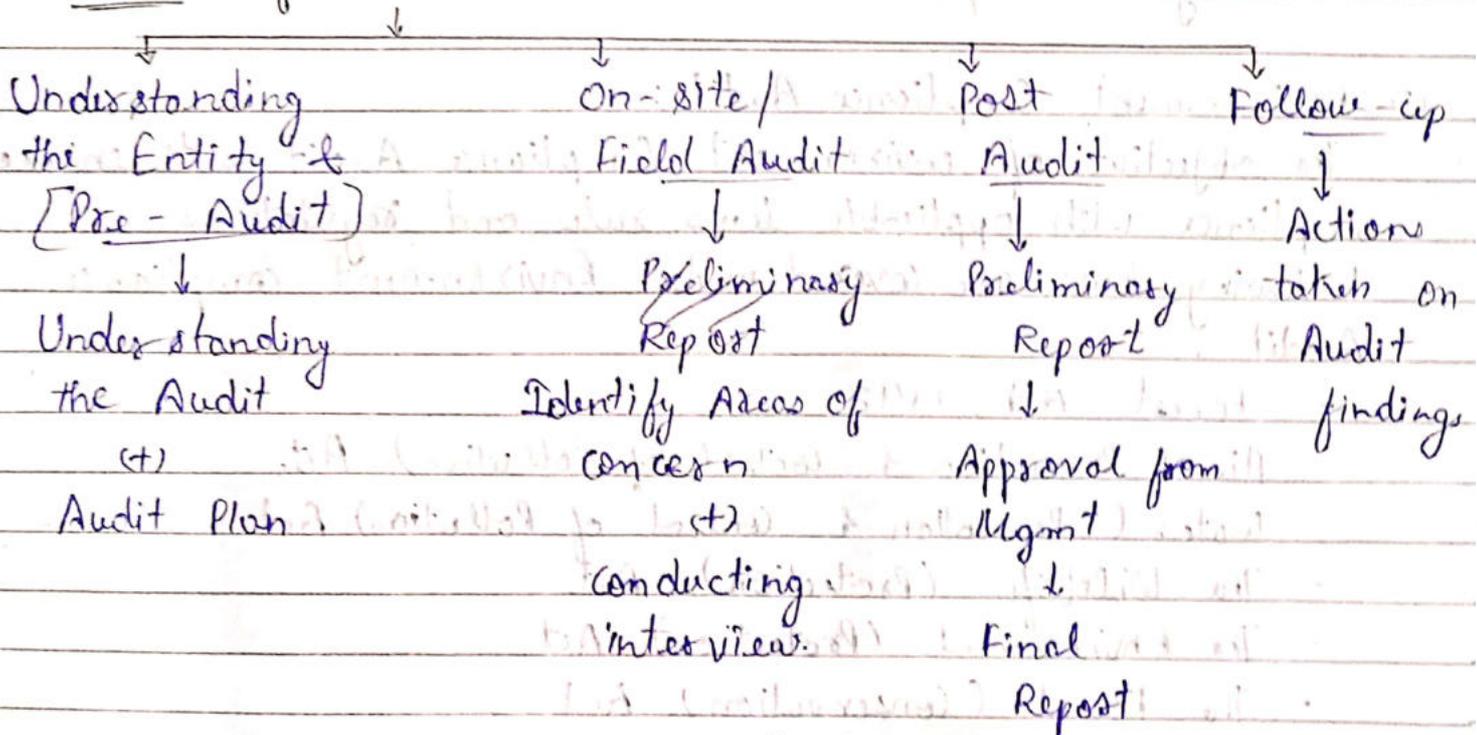
- Forest Act, 1948
- Air (Prevention & Control of Pollution) Act.
- Water (Prevention & Control of Pollution) Act
- The Wildlife (Protection) Act
- The Environment (Protection) Act
- The Forest (Conservation) Act
- The Public Liability Insurance Act
- The Motor Vehicles Act

- The Poison Act
- The Indian Boilerless Act

(iii) Management System Audit



• Process of Environment Audit



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• Checklist of Environment Audit

A. Environment Policy :

- Company have defined & documented Environment policy
- Company Policy has significant environment aspects
- Commitment
 - ↳ improvement
 - ↳ Prevent Pollution
 - ↳ Compliant
- Documented
- Available to Public.

B. Environment Aspects

- Environment aspects are identified
- Aspects related to significant environmental aspects are considered
- Environmental Aspects are:
 - Air
 - Waste water
 - Soil
 - Toxic material

C. Legal Requirements

- Compliance with laws/rules/regulations
- Procedure to develop & implement legal requirement
- Licences & approval →
 - ① Air Permit
 - ② Waste Water
 - ③ Dangerous Goods
 - ④ Environment fee
 - ⑤ Permission from Regulatory Authorities

#7 Forensic Audit

i) Forensic Audit requires highly-specialized & detailed knowledge of fraud investigation techniques and ~~the~~ legal framework. It is a tool used for thorough investigation of financial frauds and crimes.

ii) It is conducted in 2 phases:

(a) Investigation Phase

In this phase, Auditor investigates, looks into the accounts and identify defects.

(b) Litigation Phase

At times, fraud detected are resolved by company itself but when legal recourse is needed, support of forensic Auditors are taken during litigation because their opinion is treated as an expert-witness by the court.

iii) Purpose of Forensic Audit :

(a) Corruption — { Conflict of Interest
Bribery
Extortion

• Conflict of Interest
fraudster uses his influence for personal gains

• Bribery
offering money to get their work done.

• Extortion
Demanding money to award work to other party

(b) Asset Misappropriation :

Misappropriation of cash, ~~fake~~^{fake} invoices, payment to ghost employees

(c) financial statement fraud :

Manipulation of financial statements.

e.g: Satyam Scam.

[p.g- 8-49]

→ Syp

⇒ Symptoms of fraud ⇒ Internal Indicators ⇒ Final Categories of report.

- | | | |
|--|---|---|
| a) Delayed submission of returns, informat ⁿ etc. | a) Delay in finalizat ⁿ of A/c's | a) Identify type of fraud that has been operating |
| b) Delayed remittances into Bank | b) frequent change in Accounting policies | b) fraudster (s) involved |
| c) Non-preparation of BRS | c) Continuing losses | c) financial loss suffered by client |
| d) Lifestyle of promoters/ Directors | d) over drawal of loans or advances | d) Gathering evidence to be used in court proceedings |

⇒ Checklist on Forensic Audit

- ① Nature of fraud - corruption, assets, misappropriation or financial statement?
- ② fraud detected is at the management level or employee level.
- ③ Reason or motive behind the fraud.
- ④ Who is responsible for checking if all the things are in order in regular intervals?
- ⑤ How is the internal check on transactions, ^{cash} raising of invoices etc?

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- ⑥ Whether Bank entries are reconciled on regular basis?
⑦ Whether Bank statements do not have any discrepancy?

#8 Social Au

⇒ Fraud Triangle → It is a forensic Audit tool that assist in identifying fraud through three elements - Motive, Ability to carry out fraud and justification.

Fraud risk is the vulnerability of the organisation against the 3 element in Fraud Triangle.

#8

#8 Social Audit

a) Social Audit is a review of Company's effort towards social responsibility. The purpose of social Audit is to enhance local governance and promote accountability and transparency in local bodies.

b) Implications of Social Audit

- Creates an impact upon governance and provides voice to stakeholders.
- Social Audit is conducted to enhanced local governance and promote accountability & transparency in local bodies.
- Social Audit promotes democracy where decision is made according to the consent & understanding of all concerned (beneficiaries).

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c) Objectives of Social Audit

- Physical & financial gaps b/w needs and resources
- Awareness among beneficiaries
- Effectiveness of local Development programme
- estimation of opportunity cost for stakeholders
- Improve the effectiveness of programs designed to enhance community development.

d) Checklist on Social Audit

- Whether Company has policies for development of Societies?
- Whether the policy has been scrutinised on regular basis?
- whether physical & financial gaps between needs & resources available is identified. ?
- Whether voice of stakeholders is considered?
- Whether Company has taken necessary actions over them. ?

e) Steps for Social Audit

- Clarity of purpose and goal of the local Body
- Identifying stakeholders
- Interacting with Beneficiaries
- Performance Indicators
- Establishment of Group of Trusted people including elderly, Teachers and those who are independent to verify & Judge if decisions of social audit have been implemented.
- The findings of social Audit should be shared with all local stakeholders.

#9 Insider Trading Audit

Checklist

- (i) Appointment of Compliance Officers
- (ii) Code of Conduct (+) Administration of Code of Conduct
- (iii) Code of practice for fair disclosures of UPSI
- (iv) Code is placed on the website.
- (v) Company follows Chinese wall policy & procedure
- (vi) Compliance officer has
 ← Received
 → Reviewed
 } Trading Plan
- (vii) Compliance officer has notified Trading Plan to Stx
- (viii) Co. received initial disclosure from
 { Promoters
 Directors
 KMP
 } - within 7 days
- (ix) Co. received continual disclosure
 { Promoter
 Director
 } of transaction ↑ IOL within 2 w.D
- (x) Any other prevention with respect to Insider Trading as adopted by the Co.

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#10 Information System Audit / IT Audit.

i) Information System Audit is an ongoing - process of evaluating controls, collecting and evaluating evidence to determine whether a computer system safeguards assets, maintain data integrity, allows organizational goals to be achieved effectively, and uses resources efficiently

ii) Audit consists of an evaluation, examination and testing of following areas:

- a) Database access controls (e.g: database configuration, account access to the database, roles defined in database)
- b) Anti-virus / Anti-malware controls
- c) Back up / Restore procedures
- d) IT privileged access control (e.g. System Administrator or root access)
- e) Network controls (e.g: running configurations on switches & routers, use of Access control list)

iii) Checklist of IT Audit

- A. Management Controls
- B. Operational Controls
- C. Organisational controls
- D. Application controls

A. Management Controls ← [this taken care of by Director / Committee i.e. Mgmt]

1) Security policy

- Whether a company has a security policy which examines the risk. (IT risk)

2) Constitution of Committee

- Whether company has a committee for implementation of security policy which consist of CIO (Chief informatⁿ officer) & at least one member from the director and user HODs.

3) Business Continuity Planning

- Auditor has to examine all the possibilities of threat to the computers due to temporary or permanent breakdown

4) System Development Methodology

- Any change that is made in the system should be properly understood, tested and documented.

B. OPERATIONAL CONTROL ← [How computers are operate & in which environment it operates]

1. Monitoring Physical Asset

- Whether company frequently monitors physical assets and if there is any discrepancy the same is immediately addressed.

2. Ensure environmental controls

- Proper air-conditioning [and] ^{Power} ~~power~~ condition is timely reviewed.

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- Whether cable connections and electronic points are functioning properly.

C. Organizational Controls

- Whether the roles/responsibilities and duties of IT department and CIO (Chief Info officers) are properly defined.

D. Application Controls

- Whether each computer system has its own set of control for input, output and processing.

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CHAPTER 16: Due Diligence

- i) Due-Diligence is the investigation in the affairs of the company to avoid post-transaction risk.
- ii) Due-Diligence is done to conduct SWOT Analysis and ensure that parties involved have provided necessary information for the transaction.
- iii) It covers activities relating to pre-transaction and post-transaction covering all the aspects of Past, Present and future of business.

(iv) SWOT Analysis

- a) Generally, the SWOT analysis of any business carried out as a part of due diligence to reveal the strengths and weakness.
- b) A thorough due-diligence helps to reveal any of the negatives, but the process of due-diligence rarely goes smoothly because parties reluctant to share information.

ie. up for sale

c) Target Company, is rarely eager to reveal information to other party and wants to keep this information confidential from its competitors, customers & employees

In a Instance

- d) The Acquirer / Buyer who aims to get new market of customers with the transactions wants to make sure that

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target Company (seller) has a good relationship with existing customers but

- e) Because of the reluctance to share information, Parties enter into confidential nature of transactions, and once purchase price is agreed upon, the prospective buyer enters into Conditional agreement with a due-diligence clause with the target business, in which buyer has a limited period to conduct due-diligence.
- f) If information found is not acceptable to the potential buyer, there might be re-negotiation of the initial terms
- g) Again after due-diligence, the goal is to either re-affirm the purchase price or re-negotiate and the ultimate goal is to make a rational decision based on facts.

Due Diligence

Need

Scope

- | | |
|--|--|
| <ul style="list-style-type: none"> a) To confirm that the Business is what as it appears b) To create a Trust between two unrelated parties c) To reduce the risk of post transaction d) To investigate into affairs of Business as a prudent Business person e) To confirm all material facts related to the business f) Negotiation price concessions g) To evaluate legal & financial risks <u>Spiral</u> of the transactions. | <ul style="list-style-type: none"> a) To determine tax structure & its implications b) To assess the commercial & Technical feasibility c) To assess the resource availability of Business d) To synergise the b/w the organisations. e) litigation & Assessment of feasibility of pursuing litigation f) Financial statements g) <u>Assets</u> - real & intellectual prop., Brand value etc. SKYSHOTS |
|--|--|

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h) To determine compliance with relevant laws & disclose any regulatory restrictions on the proposed transactions.

h) Unpaid tax - liens &/or Judgement.

i) Past business failures & consequential debt

i) To ascertain the appropriate purchase price.

j) Exaggerated credentials/ fraudulent claims

j) To discover liabilities or risks that may be deal-breakers

k) Misrepresentations or character issues

k) To analyze any potential anti-trust issues that may prohibit the proposed M & A.

l) Reputation, goodwill & other intangible assets

(vi) Factors to be kept in mind while conducting Due Diligence.

a) Objective & Purpose

1. Be clear about your expectations.
2. Ensure if you have resources to make the business succeed and you are willing to put all the hard work.
3. Whether you will get an opportunity to put your skills and experience to put use.
4. Learn about the industry in which you are interested through media reports and journals.

b) Planning the schedule

1. Decide the steps to be followed in Due-Diligence
2. Areas to be checked
3. Aspects to be checked
4. Material information to be requested from seller.

c) Negotiations for Time.

Seller might try to rush the process but Buyer will negotiate for the time to analyse crucial financial and legal aspects.

d) Risk Minimisation.

Auditor checks all the material information and considers following aspects:

1. Background of Promotes
2. Senior Management
3. Organizational Strategy
4. Risk Management System
5. Technological Advancement
6. Adequate Infrastructure
7. Optimum utilization of resources.

e) Information from external sources.

Auditor will examine information from customers & vendors of the organisation and if any flaws are identified it will help to renegotiate the terms.

f) limit the report with only material facts

All the material facts collected during Due-Diligence will be prepared in the report.

g) Structure of Information

Information in the report has to be properly structured to have a better understanding on related matters.

(vii) Challenges in conducting due - Diligence

- a) Non-Availability of Information
- b) Lack of Time
- c) Non-cooperation by the employees.

(viii) Stages of Due - Diligence

a) Pre-Diligence. [1st stage]

1) Letter of Intent

- areas
- Docs → maintain + collect
- Due-Diligence report
- Timelines.

2) NDA

3) Receive Document from the Co. (+) Verify the Co from the checklist already given to the Co.

4) Identify the issues

5) Organise Paper → Data room will be created.

b) Due - Diligence [2nd stage]

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Outcomes of Due - Diligence Report are following :

→ Deal Breaker : Non-compliances that may lead to criminal proceedings.

→ Deal Diluter : Findings show that these are non-compliances leading to quantifiable penalties & diminishing/

deducing the value of Company

- Deal Conditioner: Non-compliances that are rectifiable and requires the investor to create a cautious path.
- Deal Maker: Compliances with applicable laws and ~~clean~~ ^{clean} report.

(ix) Types of Due-Diligence:

(a) Legal Due-Diligence:

It means investigating legal aspects of the company including liabilities. In legal Due-Diligence following documents will be verified:

- MOA/ AOA
- Minutes of Board Meeting
- Minutes of General Meeting
- Contract and Agreement
- Statut Maintenance of Statutory Registers
- Related Party Transactions
- IPO/ FPO / Prospectus in compliance with SEBI regulations
- Borrowings & Investment of Company
- Details of Associate and Subsidiary Companies
- Returns filed with ROC
- Organization Chart
- Pending litigations
- Payment of Dividend
- Details of all the Guarantees to which the Company is a party.

Date.....

→ Scope of legal Due-Diligence:

- Company law
- Income Tax law
- Labour law
- Environment law
- Commercial laws (SOGA, ICA etc)
- IPR
- RBI
- FEMA
- FCRA, etc.

(b) Environmental Due-Diligence

- ① Due-Diligence is the investigation in the affairs of the Company to avoid post-transaction risk.
- ② Environmental Due-Diligence - investigating into affairs of the Company to understand environment risk and check compliance with applicable laws, rules and regulations.

③ Applicable Environmental laws:

- i) Environment Protection Act, 1986
- ii) Forest Conservation Act, 1980
- iii) National Green Tribunal, 2010
- iv) Air (Prevention & Control of Pollution) Act, 1981
- v) Water (Prevention & Control of Pollution) Act, 1974
- vi) Public Liability Insurance Act, 1991

④ Following would be verified to avoid environmental risk:

- ii) Permits & licences
- iii) Copies of all correspondence with authorities

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- (iii) Compliance with applicable laws, rules and regulations
- (iv) Assessment of site conditions
- (v) Hazardous substances being used
- (vi) Litigation or investigations pending against the company

(c) Labour Due - Diligence.

(1) Due - Diligence - Def "

(2) Labour Due - Diligence.

In labour Due - Diligence, the purpose is to identify gaps and non-compliance with applicable labour laws and regulations.

↓
labour laws

↓
Verify.

- | | |
|-------------------------------------|---|
| (i) Employee Compensation Act, 1923 | (i) Compliance with labour laws & regulation |
| (ii) Payment of Wages Act, 1936 | (ii) Maintenance of records & docs |
| (iii) Payment of Bonus Act, 1965 | (iii) Record of important informat ⁿ and Job - description |
| (iv) Maternity Benefits Act, 1961 | (iv) Agreement regarding termination of employment. |
| (v) Minimum Wages Act, 1948 | (v) Employment contract and changes to employment contract. |
| (vi) Industrial Dispute Act, 1947 | |
| (vii) PO SH Act, 2013 | |

(d) FCRA Due - Diligence.

↳ NGO → Foreign funding

↓
Registration

↓
Prior approval

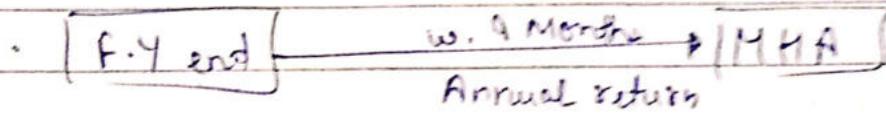
↓
Syndicate

↓
Take approval before every transaction

↳ w. 6M
↓
Renew

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- Ministry of Home Affairs (MHA) grant registration
(or) prior approval.



e) Information Technology due - diligence

- Purpose of IT Due-Diligence is to identify security gaps and uncover IT risk

• IT Due-Diligence covers following:

- i) Information Security Measure
- ii) Data Security Policy
- iii) Network control
- iv) Wireless and Remote Access facility
- v) Incident Management

(x) Techniques of Due-Diligence

→ Analysing the objectives of Company.

The first step is to be sure about the objectives of the project which will help to collect and analyse the exact information required.

→ Know your client

Every organisation and Business have certain risk and it is important to know your client to identify the risks associated with them

Date.....

→ Examination of financials of the organisation
Following financial Records of the organisation will be examined:

- (i) Balance Sheet
- (ii) Profit & loss A/c
- (iii) Income statement
- (iv) Inventory
- (v) Debt
- (vi) Tax

→ Inspection of Documents

To get a better understanding of the organisation all the important documents, information and records will be examined.

→ Actions taken to control any Risk.

In any organisation it is important that risk is identified and steps are taken to control the Risk.

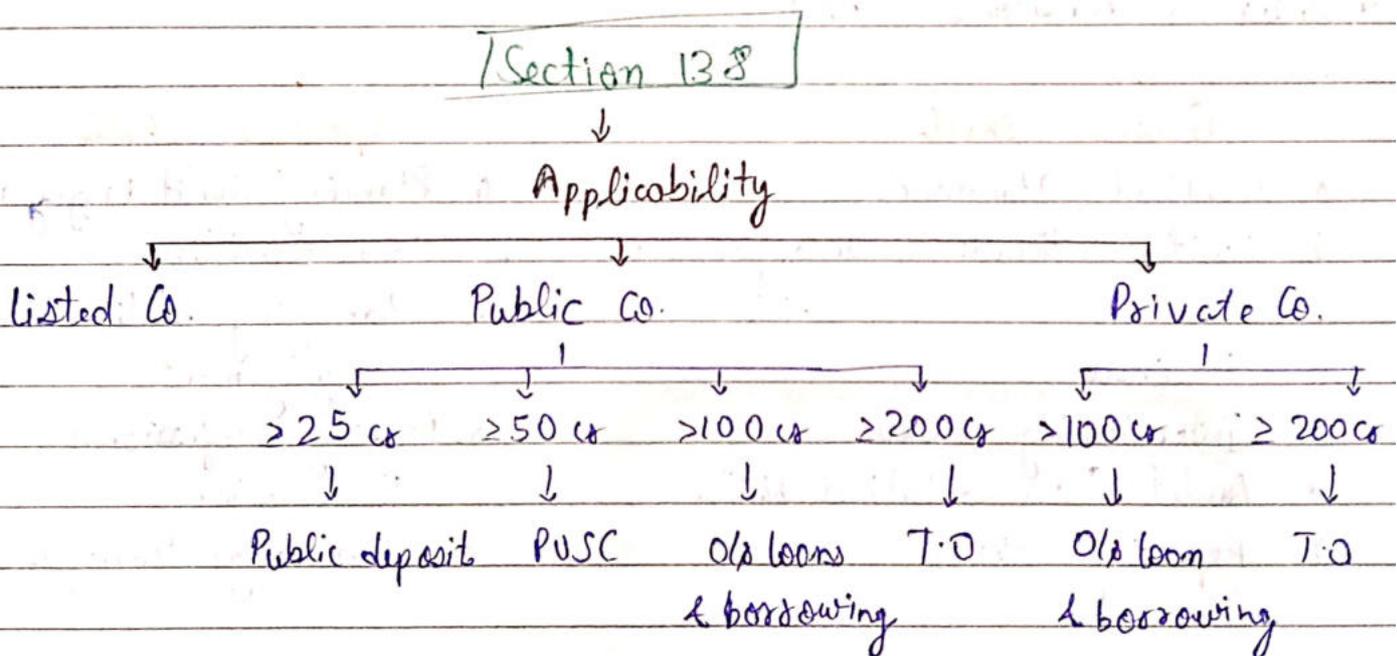
→ Responding to incidents.

Even if Company makes significant efforts, Risk may arise. It is important to verify how the organisation identify, mitigate and correct any fall-out providing support to consumers.

Date... 13/08/2024

CHAPTER 14: Internal Audit & Performance Audit

- Internal Audit is independent review of an organisation to bring systematic approach and improve the effectiveness of Internal Control system and risk management in an organisation.
- Internal Audit evaluates:
 - a) Internal control system
 - b) Effectiveness & efficiency of operations
 - c) safeguarding the Asset.
 - d) Compliance
 - e) Financials



Date.....

→ Terms of Reference

Audit Manual → approved by BOD,
recommended by Audit Committee

• Terms of reference should provide clarity about its:

1. Objective
2. Role & Responsibilities within the Organisation
3. Scope of Work
4. Accountability of the Audit Committee
5. Accessibility to the Board & Audit Committee
6. Unfettered access to all information, people & records

→ Internal Auditor's Skill

General Skills

- a. Technical Standards
- b. Positive attitude & Interpersonal Skills
- c. IT skills
- d. Interviewing skills
- e. Audit Documentation skills
- f. Reporting skills

Specific Skills

- a. Planning Audit Engagement
- b. Team Building
- c. Managing Audit engagement
- d. Making Professional Presentations
- e. Knowledge Management

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→ Objectives of Internal Audit.

• The Objective of Internal Audit is to check the internal control and risk management system in the organisation to implement effective control system.

• Following are the objectives of Internal Audit:

1. Extent of compliance with relevant statutory requirements
2. Evaluating Internal Control
3. Effectiveness & Efficiency of operations
4. Compliance with laws and regulations
5. Safeguarding of Assets
6. Reliability of financial & Management reporting
7. Identifies potential threat and assesses risk
8. Decides on response to risks like implementation of control.
9. Determine risk area of the organisation
10. Establish risk management framework
11. Assurance on the effectiveness of Risk Mgmt framework

→ Scope of Internal Audit

(i) Review of Internal Control System and Procedure

a) Internal Auditor shall review effectiveness of Internal Control system of the organisation and determine if it is ^{in-line} ~~in-line~~ with organizational structure.

b) Internal Auditor should review & analyse internal control in terms of cost & benefit

(ii) Compliance with laws, rules & regulations:

a) Company and functional head are supposed to comply with applicable laws rules and regulations and Internal Auditor will review policies & procedures established in the organisation to ensure compliance with laws, rules & regulations.

b) Internal Auditor examines the adequacy of system and periodical review of existing policies to evaluate effectiveness.

(iii) Reliability & integrity of financial & operating information:

Internal Auditor will examine the reliability and integrity of financial & operating information and methods used to identify and report such information.

(iv) Safeguarding the Assets of the Company:

Internal Auditor will examine & verify the existence of Assets and means used to safeguard the Assets of the Company against fire, theft or any other illegal act.

Auditor will review the control system for Tangible Assets and Intangible Assets.

(v) Economic & efficient utilisation of resources:

a) IA will examine if norms have been established for measuring the economic and efficient utilisation of resources.

b) IA examines if there is understating, over-stating or under-utilising of resources.

Date.....

(vi) Review of Organisational structure (Hierarchy of accountability)

- a) IA verifies whether there is clear division of authority & responsibility. There should be a proper balance b/w the control at different levels. (proper balance of control)
- b) IA should examine if the organisational structure is in-line with the objectives of the company

(vii) Accomplishment of established goals for operations

- a) IA should examine and review overall objectives of the organisation to evaluate if they are easily attainable. IA checks if objectives are expressed both Monetary & Non-Monetary wise to facilitate planning & execution.
- b) Auditor will review the operations of the organisation & if they are consistent with established objectives.

→ Internal Audit Core principles.

- (i) Integrity
- (ii) Independence
- (iii) Objectivity
- (iv) Competency
- (v) Effective communication
- (vi) Adequately resourced (skills)
- (vii) Continuous improvement
- (viii) Promotes organisational improvement
- (ix) Future focus
- (x) Risk based assurance

Date.....

⇒ Recommended Controls to prevent & detect fraud and
Educate to improve the Organization's Fraud
Awareness.

1. Segregation of Duties
2. Rotation of Duties
3. Mandatory Vacation
4. Treat employees well
5. Regular Audits
6. Background checks
7. Whistleblower hotline
8. Code of Conduct.

⇒ Independence of Internal Auditors

(i) Independence and Objectivity are the core principles of Internal Audit. It allows auditor to perform the Audit work effectively without compromising on the quality and without being influenced by the others.

(ii) As per Section 138 of the Co's Act, 2013; Internal Auditor may or may not be the employee of the Co. but he must have adequate independence.

(iii) However it should be noted that Internal Auditor cannot be expected to have same degree of independence as external auditor while expressing his opinion on financial information.

(iv) Following factors affect the independence of Internal Auditor:

- a) Business Relationship
- b) Employment with Audit Client
- c) Prior work with Audit client
- d) Gift & Hospitality
- e) Family and personal relationship

→ Internal Audit Techniques:

(i) Review of Operating Environment

Internal Auditor understands how the Company operates to get an idea about the business practices & ethical practices of the Company by referring to Audit's report and other documents.

(ii) Review Controls

Auditor will check if Company has proper internal control structure and it is reviewed on regular basis.

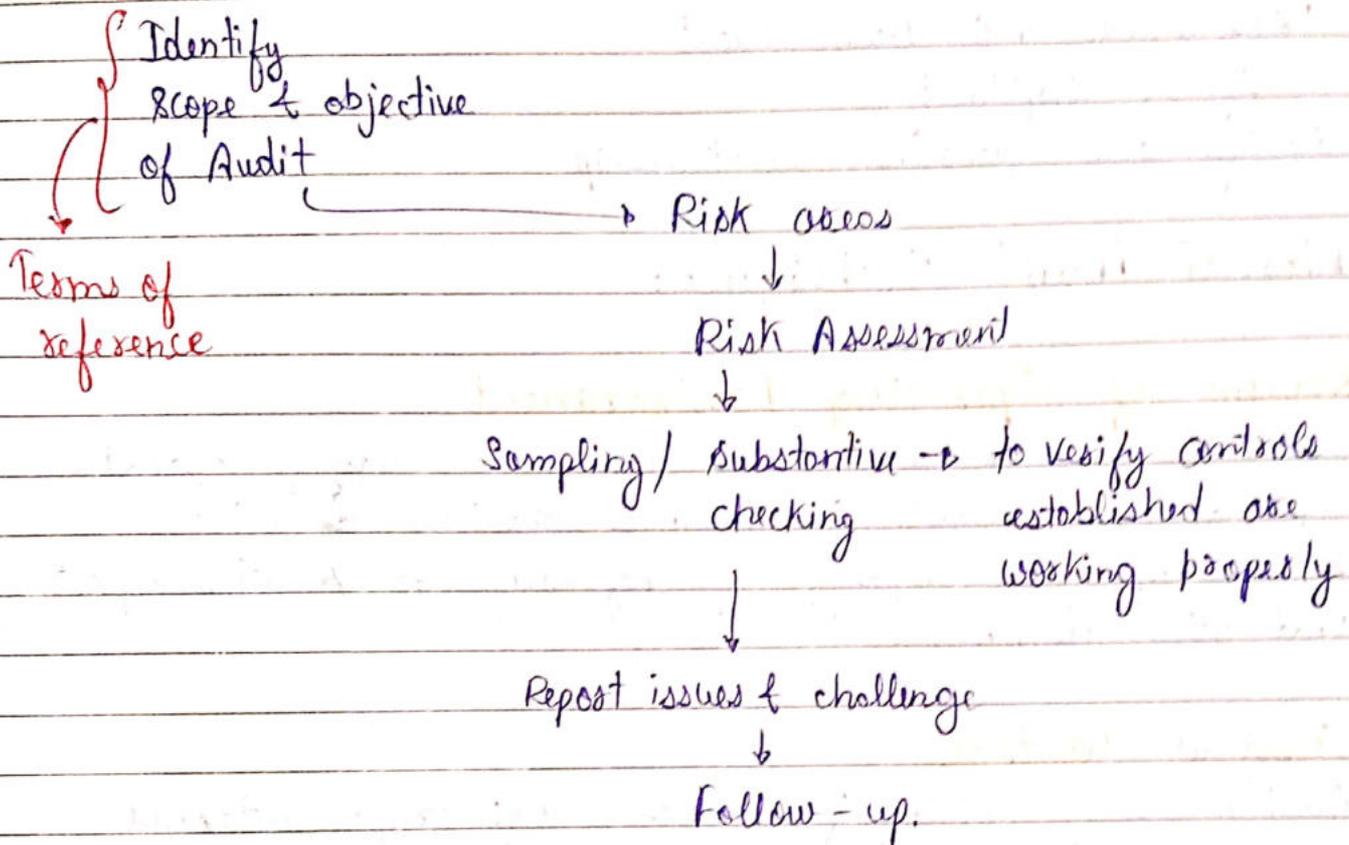
(iii) Test Internal Control

Internal Control system will be tested to check the adequacy & effectiveness of control.

(iv) Account Details

Internal Auditor will ensure the financial statements of the Company are not mis-stated and gives a true and fair view of the affairs of the Company.

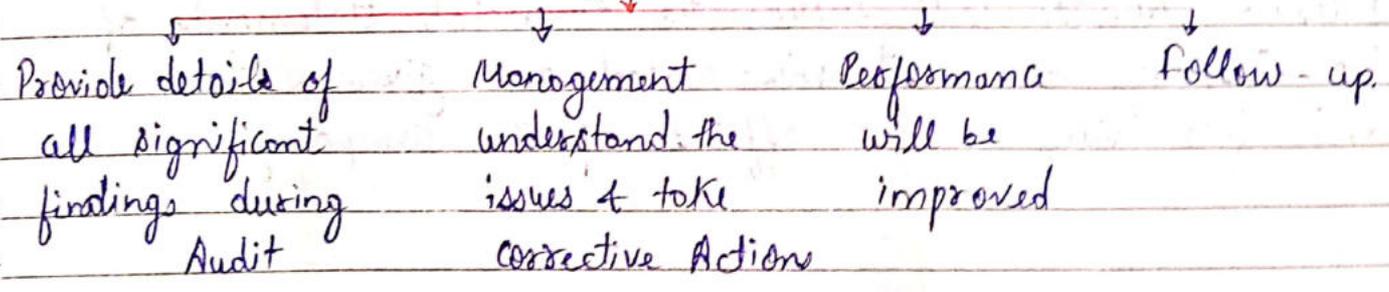
→ Internal Audit [Process]



→ Report - Writing

↓
Communicating the findings of Internal Audit with Mgmt

Objective



Date.....

• Internal Audit report is a 4-step ~~process~~ process:

- a) What is wrong?
- b) Why it is wrong?
- c) How to correct it?
- d) What will be done?

⇒ Role of Internal Auditor in -

(i) Internal Control.

✓ Internal Control means effective policies & procedures are adopted by the company to ensure compliance, manage risk and safeguard the assets of the company.

✓ Objectives:

- a) Transactions are performed with the authorization of Management.
- b) If there is a difference between recorded assets and existing assets then necessary actions are taken.
- c) Safeguarding the assets of the company.

• To ensure Internal Control mechanism it is important to constitute Audit Committee which will evaluate the internal control & risk management. According to Companies Act, 2013 and SEBI (LODR) Regulation; it is the role of Audit Committee to review the observations of IA about Internal Control system before submission to Board.

✓ The Internal Auditor has to ~~focus~~ ^{focus} in evaluating internal controls and making recommendations for effectiveness & efficiency. The role of Internal Auditor in internal control includes:

Spiral

SKYSHOTS



- ✓ The role of Internal Auditor in Internal control includes:
- evaluating effectiveness & efficiency of internal control
 - recommending new controls
 - Using control framework
 - Developing control self-assessment.

lec 4

(iii) Risk Management *

[3M]

✓ Internal Auditor evaluates risk organisation's risk management process and verifies if management ~~pro~~ performs risk assessment activities as a part of ordinary course of business.

✓ Internal Auditor will evaluate each of the activity performed by management for risk assessment including planning, budgeting, accounting or lending practices to report and monitor the risk identified.

(iii) Corporate Governance *

✓ Internal Auditor is considered as one of the 4 pillars of Corporate governance.

✓ Corporate Governance includes best ethical & management practices in a company.

✓ Primary focus of Internal Audit is to help the Audit Committee and Board of Directors to perform their responsibilities with respect to corporate governance effectively.

→ Appraisal of Management Decisions.

(ii) Management is responsible for decision making maintaining internal controls and accountable to shareholders.

(iv) The objective of assessment by internal auditor is to assess the internal control and risk management process of the organisation and provide an independent assurance to shareholders that organisation's risk have been mitigated.

(iii) Internal Auditor is an important management tool for following reasons:

- a) Internal Auditor ensures effectiveness & efficiency of operations of the organisation.
- b) ensures compliance with laws, rules & regulations
- c) ensures adequacy & reliability of financial and operational data.
- d) ensure effective internal control in the organisation
- e) Internal Auditor independent appraisal & review of Management ensures the reliability of information and reporting system of Management.

(iv) Steps in appraisal of Management Decision

- a) Whether decisions of Management are well-defined
- b) In case of major investments all possible options were considered.
- c) These potential options are analysed and reviewed in terms of risk, benefits, cost and uncertainties
- d) Whether a consensus decision is taken after all the alternatives are analysed.

Date.....

- e) Whether the selected alternative is implemented efficiently.
- f) Whether the objectives & expected outputs have been clearly defined and specified in the policy of the company.

→ Performance Assessment.

- (i) The Assessment of Internal Auditor's performance begins with reviewing management expectations & achievement.
- (ii) Measurement of performance of Internal Auditor ensures high standards of Audit, execution and linking auditor's performance to organisation's mission & objectives.
- (iii) Performance Assessment should be done on the basis of following:
 - a) Areas covered in the Audit
 - b) Time-period of Audit
 - c) Accuracy of findings of auditor
 - d) Feedback of Audit findings
 - e) Audit recommendation

→ Role of CS as on Internal Auditor

- (i) Ensures compliance with laws, rules & regulation.
- (ii) ensure proper compliance with accounting standard.
- (iii) ensure Audit of companies financial statements & Books of Account.
- (iv) Safeguarding the Assets of the Company.
- (v) fair representation by the Management.

Chapter 4: legal framework governing Company Secretaries

→ Disciplinary Mechanism

A. Disciplinary Directorate

Director (Discipline) → (conducts inquiry)

(if Prima-facie case)

forward matter

I Schedule

II Schedule

B. Board of Discipline
4/21A

C. Disciplinary Committee
(It can take matters of Both I-Schedule & II Schedule)

Summary disposal procedure will be followed

- Presiding officer → President / Vice-President of Council
- 2 Members to be nominated by CG
- 2 Members to be nominated against members

OOBH to the Member

(ask)

(Order)

Director (Discipline)

Further investigation

- 1) Reprimand
- 2) Removal of Name - 3M
- 3) fine - 1Lakh

- ① Reprimand
- ② Permanent Suspension from ROM
- ③ Fine - 5L

Board of Discipline

Disciplinary Committee

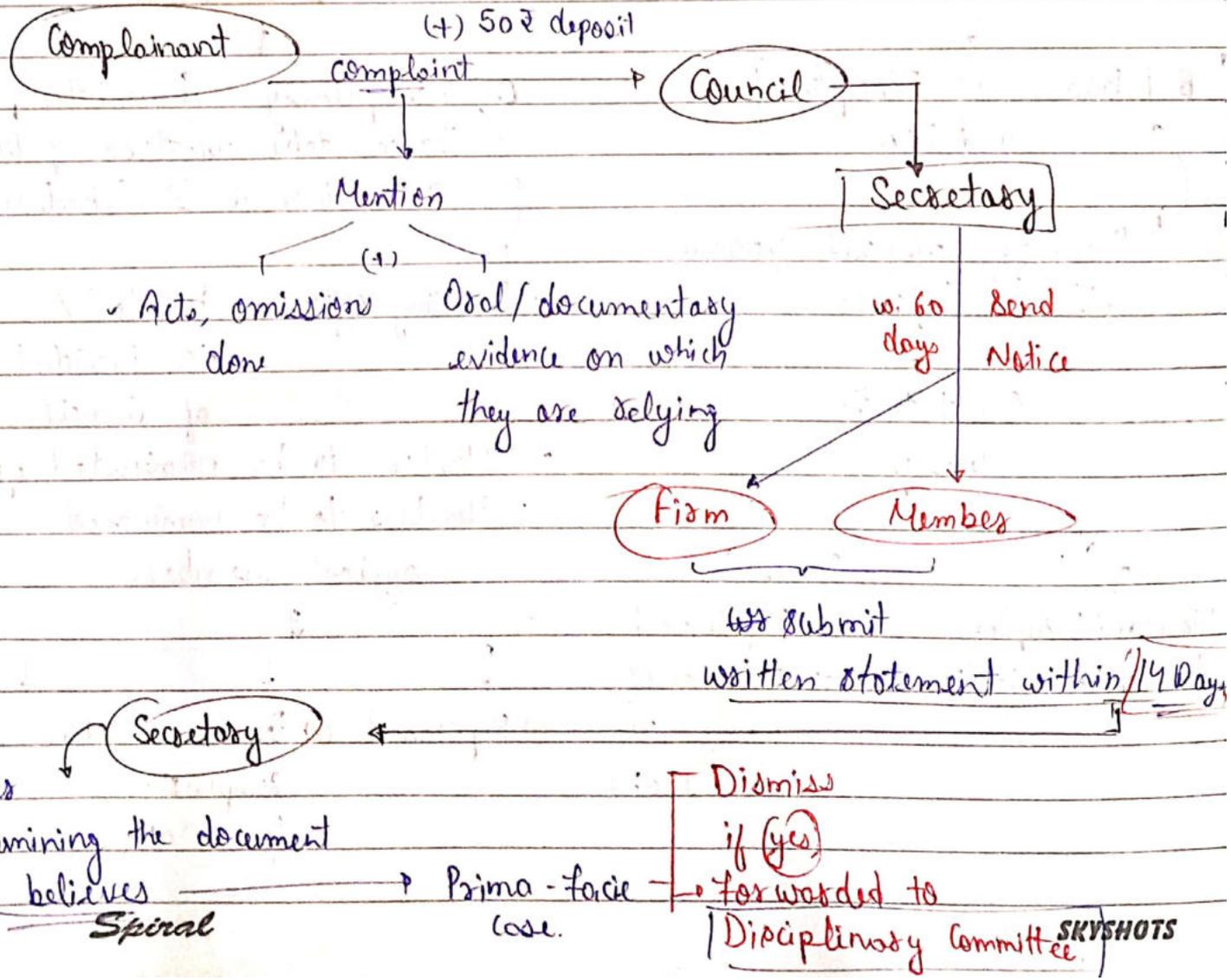
ORDER

w. 90 Days | Appeal (by aggrieved Member / Director (Discipline))

Appellate Authority
(as deq designated by ICAI)

- ① Confirm / Modify / set-aside
- ② Impose / reduce the penalty
- ③ Order further inquiries

Regⁿ 15 of CS Act.



Date.....

then / Disciplinary Committee

- 1) Call for evidence
- 2) Examine witness on oath.

↓
OOBH will be given, Members can represent either individually or through legal representatives

↓
Disciplinary Committee will submit the report to Council, if Council believes a further inquiry will be initiated or if in the opinion of Council member is guilty of misconduct opportunity of being heard will be given & necessary orders will be passed. However if the member is not guilty, the matter will be dismissed.