

A Review of Basic Principles of Internal Audit

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Abstract

This paper attempts to study how an **internal audit** offers **risk** management and evaluates the effectiveness of a company's internal controls, corporate governance, and accounting processes. The Association of Independent Certified Public Accountants (AICPA) Professional Standards uses "consider" when the member is required to think about various matters, whereas "evaluate" is used when the member is to assess and weigh the importance of the matter. "Determine" is used when a member is to arrive at a conclusion and make a decision. An internal audit plan is a document defining the scope, coverage and resources, including time required for an internal audit over a defined period. The internal auditor, in consultation with those charged with governance, including the audit committee, develop and document a plan for each internal audit engagement, to conduct the engagement in an efficient and timely manner. In case the entire internal audit or the particular internal audit engagement has been outsourced, the internal auditor should ensure that the plan is consistent with the terms of the engagement. The internal audit plan should be comprehensive and consistent with the goals and objectives of internal audit function laid down in the internal audit charter and expectation of Management. Internal audit plan should also reflect risk management strategy of the entity. A plan once prepared should be continuously reviewed by the internal auditor to identify any modifications required to bring the same in line with the changes, if any, in the audit environment. The internal auditor should document the changes to the internal audit plan in consultation with those in charged with governance. The internal auditor should obtain a level of knowledge of the entity sufficient to enable him to identify events, transactions, policies and practices that may have a significant effect on the financial information. Internal Audit operates within The Institute of Internal Auditors (IIA) International Standards for the Professional Practice of Internal Auditing ("Standards" or "Red Book") including the IIA's Definition of Internal Auditing, Code of Ethics, Rules of Conduct and Quality Assurance Improvement Program. Internal Audit utilizes the Committee of Sponsoring Organizations of the Treadway Commission (COSO) control framework(s), Internal Audit's procedure manual, and when required and not otherwise in conflict with the Standards, the Generally Accepted Government Auditing Standards ("Yellow Book"). The IIA's Practice Advisories, Practice Guides, and Position Papers will guide operations as applicable. Internal Audit will adhere to Southern Oregon University's relevant policies and procedures, but in the event of conflicting direction, the Standards shall prevail.

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Key words : Internal auditing, Strategy of internal audit function, internal auditor

Introduction

"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes." - The Institute of Internal Auditors'

Quality Assurance and Improvement Program

IIA Standards require the creation and maintenance of a Quality Assurance and Improvement Program. The Standards currently require an assessment by a qualified independent reviewer or review team from outside the organization at least every five years. Until the first successful assessment it is not appropriate for Internal Audit to state "in conformance with the Standards," or "in conformity to the Standards" in its reports.

Code of Ethics

Internal Auditors are expected to apply and uphold the following principles as defined in the IIA Code of Ethics:

Integrity - The integrity of Internal Auditors establishes trust and thus provides the basis for reliance on their judgment.

Objectivity - Internal Auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal Auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.

Confidentiality - Internal Auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

Competency - Internal Auditors apply the knowledge, skills, and experience needed in the performance of internal auditing services.

Rules of Conduct

- Integrity - Internal Auditors:

Shall perform their work with honesty, diligence, and responsibility.
Shall observe the law and make disclosures expected by the law and the profession.
Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.
Shall respect and contribute to the legitimate and ethical objectives of the organization.

Objectivity - Internal Auditors:

- Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.
- Shall not accept anything that may impair or be presumed to impair their professional judgment.
- Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

Confidentiality - Internal Auditors:

- Shall be prudent in the use and protection of information acquired in the course of their duties.
- Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

Competency - Internal Auditors:

- Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
- Shall perform internal auditing services in accordance with the International Standards for the Professional Practice of Internal Auditing.
- Shall continually improve their proficiency and the effectiveness and quality of their services.

Objective:

This paper intends to explore and analyze **Internal audits** that provide management and board of directors with a **value-added service where risks and flaws** in a process may be caught and corrected prior to external audits.

Internal Audit : the corporate “police function.”

The Internal Audit Standard Board of the ICAI has, with other pronouncements, issued five Standards on Internal Audit (SIAs) in November 2018. The SIAs are a set of minimum requirements that apply to all members of the ICAI while performing internal audit of any entity or body corporate. However these are not mandatory to be undertaken by other professional bodies such as Cost Management Accountants and Company Secretaries.

Need for Standards on Internal Audit

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.

The following internal audit related pronouncements have been issued:

- Preface to the Framework and Standards on Internal Audit
- Framework Governing Internal Audits
- Basic Principles of Internal Audit
- Standard on Internal Audit (SIA) 210, Managing the Internal Audit Function
- Standard on Internal Audit (SIA) 220, Conducting Overall Internal Audit Planning
- Standard on Internal Audit (SIA) 310, Planning the Internal Audit Assignment
- Standard on Internal Audit (SIA) 320, Internal Audit Evidence
- Standard on Internal Audit (SIA) 330, Internal Audit Documentation

As per Framework Governing Internal Audits issued by ICAI, 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”

1. Basic Principles of Internal Audit- 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.

◆ **Meaning**

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.

◆ **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.

The principles can be in a nutshell: If internal auditors or the internal audit activity is prohibited by law or regulation from conformance with certain parts of the Standards, conformance with all other parts of the Standards and appropriate disclosures are needed. If the Standards are used in conjunction with standards issued by other authoritative bodies,

internal audit communications may also cite the use of other standards, as appropriate. In such a case, if inconsistencies exist between the Standards and other standards, internal auditors and the internal audit activity must conform with the Standards, and may conform with the other standards if they are more restrictive. Implementation Standards are also provided to expand upon the Attribute and Performance standards, by providing the requirements applicable to assurance (A) or consulting (C) activities. Assurance services involve the internal auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding an entity, operation, function, process, system, or other subject matter. The nature and scope of the assurance engagement are determined by the internal auditor. There are generally three parties involved in assurance services: (1) the person or group directly involved with the entity, operation, function, process, system, or other subject matter — the process owner, (2) the person or group making the assessment — the internal auditor, and (3) the person or group using the assessment — the user. Consulting services are advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client. Consulting services generally involve two parties: (1) the person or group offering the advice — the internal auditor, and (2) the person or group seeking and receiving the advice — the engagement client. When performing consulting services the internal auditor should maintain objectivity and not assume management responsibility. Work performed by others, documentation, planning, evidence, internal control & risk management systems and reporting, which governs the internal auditor's professional responsibilities. The internal auditor should not disclose any information acquired during his course of work, to any outside party including the entity's employees without obtaining permission from the entity.

The internal auditor is expected to either have such skills and competence or obtain them with the help of technical knowledge obtained through study and formal courses, as are necessary for the purpose of discharging his responsibilities. The internal auditor should carefully direct, supervise and review the work delegated to assistants. The internal auditor may also have to rely on the work of other auditors or experts. He should be satisfied that he has no reasons to believe that he should not have relied on the work of the expert. The internal auditor should, based on his professional judgment, obtain sufficient appropriate evidence to enable him to draw reasonable conclusions therefrom to support his opinion or findings.

Conclusion

Internal auditing is conducted in diverse legal and cultural environments; within organizations that vary in purpose, size, complexity, and structure; and by persons within or outside the organization. While differences may affect the practice of internal auditing in each environment, conformance with The IIA's International Standards for the Professional Practice of Internal Auditing (Standards) is essential in meeting the responsibilities of internal auditors and the internal audit activity. 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.

The internal audit documentation must enable an individual (external or internal), having no previous connection with the internal audit, to obtain an understanding of the audit plan, scope, timing of execution, findings and conclusion drawn from the evidences obtained. All significant matters which require exercise of judgment, together with internal auditor's conclusion thereon should be included in the internal audit documentation. It should cover all the important aspects of an engagement viz., engagement acceptance, engagement planning, risk assessment and assessment of internal controls, evidence obtained and examination/evaluation carried out, review of the findings, communication and reporting and follow up. Audit universe/ audit territory representing the potential range of activities and operations to be audited should also be reviewed periodically. Based on the scope of the engagement, deciding the resource allocation, preparation of the audit programme listing the procedures essential to meet the objectives of the internal audit plan should be made. The standards explain the basic principles i.e. Integrity, objectivity and independence, confidentiality, due professional care, skills and competence,

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