

# STANDARD ON INTERNAL AUDIT (SIA) 2

## BASIC PRINCIPLES GOVERNING INTERNAL AUDIT\*

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The following is the text of the Standard on Internal Audit (SIA) 2, *Basic Principles Governing 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 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 Standards shall become mandatory from such date as notified by the Council.

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## **Standard on Internal Audit (SIA) 2**

### **Introduction**

1. The purpose of this Standard on Internal Audit (SIA) is to establish standards and provide guidance on the general principles governing internal audit.
2. Paragraph 3.1 of the Preface to the Standards on Internal Audit, issued by the Institute of Chartered Accountants of India defines 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 risk management and internal control system.”
3. The other Standards on Internal Audit to be issued by the Institute of Chartered Accountants of India will elaborate the principles set out herein to give guidance on internal auditing procedures and reporting practices. Compliance with the basic principles requires the application of internal auditing procedures and reporting practices appropriate to the particular circumstances.

### **Integrity, Objectivity and Independence**

4. The internal auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity. He should maintain an impartial attitude. He should not only be independent in fact but also appear to be independent. The internal auditor should not, therefore, to the extent possible, undertake activities, which are or might appear to be incompatible with his independence and objectivity. For example, to avoid any conflict of interest, the internal auditor should not review an activity for which he was previously responsible. It is also expected from the management to take steps necessary for providing an environment conducive to enable the internal auditor to discharge his responsibilities independently and also report his findings without any management interference. For example, in case of a listed company, the internal auditor may be required to report directly to those charged with governance, such as the Audit Committee instead of

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the Chief Executive Officer or the Chief Financial Officer. The internal auditor should immediately bring any actual or apparent conflict of interest to the attention of the appropriate level of management so that necessary corrective action may be taken.

### **Confidentiality**

5. The internal auditor should maintain the confidentiality of the information acquired in the course of his work and should not disclose any such information to a third party, including the employees of the entity, without the specific authority of the management/ client or unless there is a legal or a professional responsibility to do so. The internal auditor, therefore, needs to ensure that there are well laid out policies and controls to protect confidentiality of the information.

### **Due Professional Care, Skills and Competence**

6. 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 reasonable 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.
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.

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### Work Performed by Others

9. The internal auditor would often need to delegate work to assistants. The internal auditor should carefully direct, supervise and review the work delegated to assistants. Similarly, the internal auditor may also need to use the work performed by other auditors or experts. Though the internal auditor will be entitled to rely on the work performed by other auditors and experts, he should exercise adequate skill and care in ascertaining their competence and skills and also in evaluating, analysing and using the results of the work performed by the experts. He must also look into the assumptions, if any, made by such other experts and obtain reasonable assurance that the work performed by other auditors and experts is adequate for his purposes. He should be satisfied that he has no reasons to believe that he should not have relied on the work of the expert. The reliance placed on the work done by the assistants and/ or other auditors and experts notwithstanding, the internal auditor will continue to be responsible for forming his opinion on the areas/ processes being subject to internal audit or his findings.

### Documentation

10. The internal auditor should document matters, which are important in providing evidence that the audit was carried out in accordance with the Standards on Internal Audit and support his findings or the report submitted by him. In addition, the working papers also help in planning and performing the internal audit, review and supervise the work and most importantly, provide evidence of the work performed to support his findings or the report(s).

### Planning

11. The internal auditor should plan his work to enable him to conduct an effective internal audit in a timely and efficient manner, ensuring that appropriate attention is devoted to significant areas of audit, identification of potential problems and appropriate utilisation of skills and time of the staff.

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12. The internal audit plan should be based on the knowledge of the business of the entity. The internal audit plan would normally cover aspects such as:
- (i) obtaining the knowledge of the legal and regulatory framework within which the entity operates;
  - (ii) obtaining the knowledge of the entity's accounting and internal control systems and policies;
  - (iii) determining the effectiveness of the internal control procedures adopted by the entity;
  - (iv) identifying the activities warranting special focus based on the materiality and criticality of such activities, and its overall effect on presentation of the financial statements of the entity;
  - (v) identifying and allocating staff to each of the above activities;
  - (vi) determining the nature, timing and extent of procedures to be performed;
  - (vii) setting the time budget for each of the above activities;
  - (viii) identifying the reporting responsibilities; and
  - (ix) benchmark against which the actual results of the activities, the actual time spent, the cost incurred would be measured.
13. A plan once prepared should be continuously reviewed by the internal auditor to identify any modifications to the plan required to bring the same in line with the changes, if any, to the audit universe. Audit universe comprises the activities, operations, units, etc., to be subjected to audit during the planning period.

### **Evidence**

14. The internal auditor should, based on his professional judgment, obtain sufficient appropriate evidence to enable him to draw reasonable conclusions therefrom on which to base his opinion or findings. Factors affecting the professional judgment include the activity under audit, possible errors and their materiality and the risk of occurrence of such errors.

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### Internal Control and Risk Management Systems

15. While the management is responsible for establishment and maintenance of appropriate internal control and risk management systems, the role of the internal auditor is to suggest improvements to those systems. For this purpose, the internal auditor should:
- (i) Obtain an understanding of the risk management and internal control framework established and implemented by the management.
  - (ii) Perform steps for assessing the adequacy of the framework developed in relation to the organisational set up and structure.
  - (iii) Review the adequacy of the framework.
  - (iv) Perform risk-based audits on the basis of risk assessment process.

Internal auditor may, however, also undertake work involving identification of risks as well as recommend design of controls or gaps in existing controls to address those risks.

### Reporting

16. 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, it would be more appropriate for him to bring the same immediately to the attention of the management.

### Effective Date

17. This Standard on Internal Audit is effective for all internal audits beginning on or after..... Earlier application of the SIA is encouraged.