KIRTANE & PANDIT

Overcoming the Challenges in Internal Audit

- Fellow Member of the ICAI & holder of Advanced Diploma in Management Accounting from CIMA, London.
- 10 years of post-qualification experience in the field of Internal Audits, Risk Advisory, Statutory Audits, Tax Audits.
- Partner at a well-known CA Firm Kirtane & Pandit LLP, leading the practice of Internal Audits & Risk Assurance for mid-size and large corporations pan India, which include listed companies, privately held entities, Govt corporations as well as MNC's.
- Managing Committee Member of the Bombay Chartered Accountants' Society (BCAS) for 2022-23
- Convenor of Internal Audit (IA) Committee of the BCAS 2022-23
- Member of the IA Committee of WIRC ICAI for 2022-23
- Core Group Member of the BCAS since past 8 years
- Contributor to the illustrious 'BCAS Referencer' annual publication on the subject of Auditing for the past 5 years.
- Speaker at prestigious forums such as IASB-ICAI, WIRC, NIRC, SIRC, BCAS etc on the core subject of 'Internal Audit' and a technical contributor to the ICAI's publications.
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According to the Institute of Internal Auditors (IIA), "the role of internal audit is to provide independent assurance that an organization's risk management, governance, and internal control processes are operating effectively." The purpose of carrying out an Internal audit in today's world is to detect areas of concern in the business processes of an organization and to report them to the Management and the Board or Audit Committee as the case may be, at periodical intervals. Prompt and stringent action taken by the Management on critical findings reported by the Internal Auditors would signify a desirable top down approach which would in turn, serve as a deterrent for wrongdoers within the organization and help keep a real time check on the risk score parameters of the various business processes which are being audited. Keeping in mind the rising trend of frauds and control lapses, it can be said that Internal Auditors have an important role to play in internal controls management by way of carrying out risk based internal audits in line with the defined COSO Framework and Standards of Internal Audit (SIA). Internal Audit has been known to be the third level of defense as per the IIA, the first level consisting of process owners who own and manage risks whereas the second level comprising of those functions who monitor the first line. Internal Auditors are known as the eyes and ears of the Board, be it a large corporation or a promoter driven company. However, Internal Audit comes with its own set of challenges.Let us now look at some of the key practical challenges faced by Internal Auditors as part of our day to day functioning and our experience of having dealt with a varied base of clientele spread across multiple industries.

Legacy Practices Vs Documented Sop's

On accepting an internal or process audit assignment, the first step for auditors is to procure the set of Standard Operating Procedure (SOP) document / Manual / Process Flowchart. The nomenclature might differ across industries however the intent of having an SOP on record is the same viz. an approved document that contains pre-defined instructions that serve as guidelines for the various processes within a department or division. However, the challenge posed to auditors is when such SOP documents are either not on record or in draft stage. This may lead to operational inefficiency on account of lack of benchmarking of the set of processes to be audited. Furthermore, the maturity of processes at promoter driven or emerging corporates is comparatively lesser than companies which are significantly larger, older or multi-national in nature. Legacy practices prevail at promoter driven companies whereby the process owners and members of management are well aware of their roles and responsibilities for day to day operations however no documented process would typically exist on record. It creates an opportunity for Internal Auditors to deep dive and understand the processes in this scenario by way of walkthroughs or interviews and the opportunity to provide value addition is to create the set of SOP and benchmark them in line with industry standards owing to the Internal Auditors' experience with other companies in the same sector. This add-on service would add immense value to promoter driven companies in their pursuit of scaling their operations.

Resistance To Change

As part of our internal audit, there may be multiple recommendations / suggestions that may arise as an outcome of our reporting. A wise auditor would suggest corrective action based on the practicality of such suggestions being implemented in its true sense. However, there may be instances where the process owners would not agree with the observations in addition to the implication or risks as pointed out by the Internal Auditors. The challenge in this case is the resistance to change by the Management. How can an auditor ask the operational personnel to change their process – although unsaid at times, the reaction can be largely captured during report discussions. Again, such instances of resistance to change would be prevalent largely in promoter companies or SME's where the processes are not documented clearly. The flipside is that Auditors also need to amend their practices at times, to remain relevant with the Company 's expectations from the IA function. Resistance to change can impact both sides.

The root cause analysis (RCA) is an integral activity which internal auditors must carry out. An acceptability of the internal audit function and its role is far more accepted in larger organisations. This creates an opportunity for internal auditors to showcase their skills and add value to emerging corporates and SMEs. RCA can be bifurcated into three parts – People, Business Processes and IT. Merely repairing the leak might resolve the problem for the time-being but if an auditor does not understand in the problem in depth, it may serve as a challenge in the long term and such anomalies might re-occur as repeat observations in future audits. The outcome of the RCA activity will act as a aid while explaining the gravity of the observation/anomalies found, during the internal audit while interacting with the auditee teams. One can overcome the challenges by using lesser jargons and by stepping into the shoes of the process owner.

Internal Audit Is More Of A Compliance Requirement / Cost Centre

As per the Section 138 of the Companies Act 2013, certain eligible companies need to under go the internal audit mandatorily. However in other cases, it may be carried out as part of a good governance practice as intended the Board or Audit Committee. The challenge lies in the latter. Although the Board may intend introducing Internal Audit from a good governance viewpoint, the mid level management and process owners may not support such endeavours and gradually, it is evident by ways of data not being provided to auditors, walkthroughs not arranged, lack of timely response to queries, absence of process owners during the crucial period of field work and analysis etc. Such instances show the seriousness with which, the internal audit function is viewed internally. Challenges are meant to be overcome. It is the skill of the auditor to reverse this negative undertone. Suggesting cost control measures, process improvements, automation of processes and other tangible recommendations which can be easily measured, are mostly welcomed by process owners . This can change the outlook of IA being a cost centre to being a profit centre instead in the minds of the auditee.

Pressure On Audit Fees Vs Work Expected

There is an inverse ratio at times where the lesser the audit fees, more are the expectations from the Board. The auditor needs to arrive to a consensus with the client in such cases and curtail the scope to tackle critical focus areas in each process audited, which in turn would make it a win-win for both sides. The fees are subjective and differ in each case. The auditor must apply his or her judgement and tread the path carefully.

Focus On Financial Audit Instead Of Process Based Risk IA

Historically, Internal Audit has been seen as a pre-requisite to Statutory Audit and hence, widely known to cover transaction audit which includes ledger scrutiny of the books of account along with verifying vouchers, invoices etc. With the advent of Risk Based Internal Audit, it is imperative for Internal Auditors to cover business or operational functions from a risk controls perspective The challenge is to introduce risk based internal audit in organisations where Internal Audit has largely been focusing on financial aspects alone.

Investment Constraints

The result of an internal audit of a particular process may lead the auditee to a crossroad – whether to live with the inherent risk involved or to invest in system upgradations viz. introducing an ERP etc. However, this may differ from company to company based on the investment capabilities of the organization and the vision for the future. In terms of the challenge in this scenario, the choice would lie with the auditee organization alone despite the auditors doing their best to suggest the best approach possible to mitigate risks.

Importance Of Clear Communication

The 3 hours of the exam are most crucial in the life of a student, which decides the possibility of success or failure, irrespective of the number of months or years invested by the student. The same may be said in case of Internal Auditors. We may invest our team's time and energies in auditing various processes and might be the best at it however, if the outcome is not communicated effectively to the stakeholders, the true intent may never come to the forefront. Being a good communicator is one of the most integral traits an internal auditor should possess. There may be numerous other challenges in the course of an internal audit engagement, linked to the changes in the company, their sector, global ups and downs or most recently, owing to the COVID-19 pandemic. The goal should be to think ahead; to progress from being an internal auditor today to a trusted business advisor in the future.

- CA Samit Saraf

Overview of Kirtane & Pandit LLP

Kirtane & Pandit LLP, Chartered Accountants (KPCA) is an Accounting, Auditing & Consulting firm with a widespread established network of financial experts across India. With the "Step ahead, Always" motto, we partner your growth journey with the delivery of sound financial solutions & value added approach.

With an extensive experience of 65+ years, we deliver a wide range of professional services in the areas of Assurance, Accounting & Advisory to listed & reputed companies from varied industries across the globe.

We are registered members of PCOAB, SEC, US & feature in the A category firm list published by the RBI.

- **6** decades of Experience
- Operating across India with **7** Offices
- **33** Partners
- **700+** Team of Professionals & experts
- Client spread across **30+** Industries
- Multinational Clientele parented from **17+** countries

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