

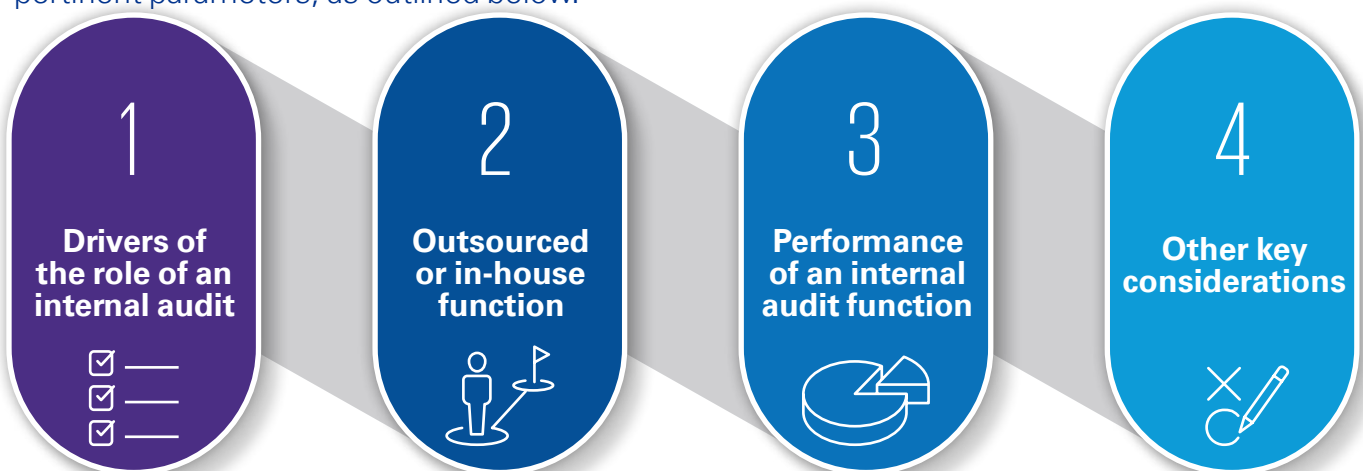
An audit committee's role in supporting and challenging the internal audit function

Board Leadership Center



Internal audit is an objective and independent assurance which helps an organisation, and the audit committee, achieve its desired objectives by enabling a systematic approach to assessing and improving the effectiveness of risk management, control, and governance processes. An audit committee is entrusted with the oversight of effectiveness of an internal audit function along with formulating the scope, functioning, periodicity, and methodology for conducting internal audit.

Proper execution of the oversight responsibilities requires audit committees to evaluate pertinent parameters, as outlined below.



Drivers of the role of an internal audit

The need for an internal audit function will typically depend upon the size and complexity of the organisations' operations, regulatory landscape¹, and other cost/benefit considerations. While undertaking its assessment of the need for an internal audit function, an audit committee would need to consider trends or current factors relevant to the organisation's operations, markets or other aspects of its external environment which have increased, or are expected to increase, and the risks faced by the organisation.

The key drivers to the role of an internal audit may include:

- Maturity of controls, and the business environment, in which an organisation operates
- Risk management processes laid down by the organisation
- Skills and experience of the internal audit team (in-house or outsourced, or sometimes, co-sourced).

¹Section 138 of the Companies Act, 2013 requires specified class of companies to mandatorily appoint an internal auditor to conduct internal audit of the functions and activities of the company.

2



Outsourced or in-house function

The decision as to whether an internal audit function should be outsourced or constituted in-house would largely depend upon the availability of skilled and experienced staff in the organisation, along with the desired specialisations. Outsourcing the function could enhance independence and objectivity of the function and can provide wide range of skills and experience which may not be practically feasible for a small in-house team. On the other hand, an external team may lack understanding of the business and may also be less willing to learn the intricacies of the company's operations, as typically they may have various internal audit assignments in their portfolio. In case of an outsourced internal audit function, the audit committee should ideally be involved in determining the scope and extent of outsourcing, the governance and monitoring mechanisms within the entity relating to internal audit, the selection of the outsourced internal audit service provider and more broadly ensure continued oversight of the internal audit activities.

An in-house internal audit function, coupled with cross-functional expertise, may enable better identification of internal issues and recommendations. Though at the same time, there may be a requirement of continuously upskilling the internal staff. To enable increased participation in the internal audit team, management may consider assigning the role of an internal audit chief for a two to three-year period. Similar rotation can be considered for other team members.

3



Performance of an internal audit function

The nature, scope, and extent of reporting of an internal audit may vary between organisations and no 'one size may fit all'. However, to facilitate effective performance of an internal audit function (in-house or outsourced) and meeting its overall oversight objective, an audit committee, at a minimum, could consider some of the given points:

- Participate in the appointment, or change of the head of internal audit, along with laying down criteria for their performance evaluation
- Actively contribute to the dimensions and approval of an internal audit plan. As may be appropriate, discuss and review the plan to accommodate changes if any, required during the year
- Ensure that the internal audit has access to all appropriate persons both at board level and across the company
- Hold regular discussions with the head of internal audit to identify key risks highlighted in the internal audit report and actions taken by the management to address such risks. This would involve application of professional skepticism on the part of the audit committee such that significant risks and issues are not overlooked
- Consider inviting internal audit head to all meetings discussing key developments in the organisation, for instance, new product launch, etc. and seek inputs on the challenges or process changes that it may demand for an internal auditor to deliberate and incorporate
- Look for warning signals in case there is a roll-over of internal audit plan year over year, especially in the current dynamic environment
- Evaluate the need for technical and other skill development of the internal audit team. If necessary, identify the key skills in the light of the evolving business environment, e.g. technology, cybersecurity, forensic audit, etc.

4



Other key considerations

In the wake of evolving technological landscape and to upskill the internal audit staff, an audit committee may consider introducing automation of repetitive processes. This would enable internal audit to focus on key areas involving use of significant judgement e.g. fraud risk assessment.

At the same time, an audit committee would need to ensure that the organisation has robust internal controls and systems in place, specifically, controls over financial reporting and IT controls to address significant risks that could arise due to such automation.

An audit committee should also encourage an internal audit function to be questioning the status quo. Adequate mechanisms should be laid down to measure performance of an internal audit function with setting strong accountabilities in case of failure to detect material risks and control failures. Some of these measures include:

- a. Access to suitably skilled resources, when required
- b. Number of iterations of internal audit reports
- c. External reviews
- d. Timeliness of key deliverables
- e. Percentage implementation of recommendations
- f. Use of appropriate enabling technologies.

Needless to say, with effective oversight and support of an audit committee, an internal audit function can foster transparent and good corporate governance in an organisation and can help achieve its strategic goals and objectives. While the internal audit function needs to ensure compliance with the internal audit framework, the internal audit function should also focus on delivering commercial benefits for the organisation by identifying opportunities for efficiency and cost saving and demonstrate an open attitude towards feedback and look to build a relationship of trust with the organisational leaders. An internal audit must have a 'buy-in' from the top management of the organisation to succeed.

Questions for an audit committee



While evaluating skills and experience of an internal audit function, has it been ensured that it has a right mix of internal audit skills, technical skills, industry or business knowledge, communication and other soft skills?

Whether proper assessment has been done as to whether the internal audit team should comprise of internal individuals, outsourced completely or partly outsourced to review specialised areas such as information technology controls?

Have you ensured that the role and responsibilities of internal audit team are clearly outlined in the terms of reference and regularly review it to incorporate changes aligned to the business, risks and control environment?

Have you assessed the need to hold any separate meeting with the head of internal audit to deliberate matters or as a follow-up on issues not clear at the formal audit committee meeting?

Have clear reporting responsibilities and accountabilities with proper oversight to independence and objectivity been laid for an internal audit function?

Has it been ensured that the internal audit function is not acting on behalf of the management and has direct access to the audit committee?

Have you ensured that internal audit has access to adequate resources, information and personnel?

Have you discussed and reviewed the potential key risk areas as highlighted in the internal audit report?

Is proper communication channel being articulated between internal auditor and statutory auditor?



We would like to thank our Audit Committee council members for their time in providing us with their valuable insights and perspectives that have contributed to preparing this point-of-view document.

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