EXPOSURE DRAFT

PREFACE TO THE FRAMEWORK AND STANDARDS ON INTERNAL AUDIT*

(Last date for comments – January 17, 2018)

The Internal Audit Standards Board of The Institute of Chartered Accountants of India (ICAI) invites comments on proposed revision to the Preface to the Framework and Standards on Internal Audit. Comments are most helpful if they indicate a clear rationale and, where applicable, provide a suggestion for alternative wording. Comments can be e-mailed at cia@icai.in; iasb.program@icai.in. Last date for sending comments is January 17, 2018.

* *The Preface to the Standards on Internal Audit was originally issued in November 2004, revised in July 2007. It is now being revised and would be mandatory from its effective date.*

PREFACE TO THE FRAMEWORK AND STANDARDS ON INTERNAL AUDIT

Contents

1.0 INTRODUCTION

1.1 This Preface to the Framework and Standards on Internal Audit has been issued to facilitate understanding of the scope and authority of the pronouncements of the Internal Audit Standards Board under the authority of the Council of the Institute of Chartered Accountants of India.

2.0 THE INTERNAL AUDIT STANDARDS BOARD (IASB)

2.1 The Institute of Chartered Accountants of India (hereinafter "ICAI" or "the Institute") constituted the "Committee for Internal Audit (CIA)" in February 2004, which in November 2005 was renamed as the "Committee on Internal Audit". In November 2008, the Council renamed the Committee on Internal Audit to the "Internal Audit Standards Board (hereinafter IASB or the Board)".

2.2 The objectives and functions of the IASB are as follow:

(i) To review the existing and emerging internal auditing practices worldwide and identify areas in which Standards on Internal Audit need to be developed.

(ii) To formulate Standards on Internal Audit so that these may be issued under the authority of the Council of the Institute.

(iii) To review the existing Standards and Guidance on Internal Audit to assess their relevance in the changed conditions and to undertake their revision, if necessary.

(iv) To develop Guidance Notes on issues arising out of any Standard, internal audit issues pertaining to any specific industry or on generic issues, so that those may be issued under the authority of the Council of the Institute.

(v) To review the existing Guidance Notes to assess their relevance in the changed circumstances and to undertake their revision, if necessary.

(vi) To formulate Implementation Guide/General Clarifications, where necessary, on issues arising from Standards.

(vii) To formulate and issue Technical Guides, Practice Manuals, Studies and other papers under its own authority for guidance of internal auditors in the cases felt appropriate by the Board.

(viii) To undertake research and promote knowledge dissemination in the area of internal audit.

3.0 FRAMEWORK GOVERNING INTERNAL AUDITS

3.1 Every standard setting process operates within a pre-defined framework which outlines certain fundamental aspects inherent to all the standards. This is essential to ensure a basic level of quality of content and a consistent application of the standards. The Framework Governing Internal Audits is, therefore, an overarching document to be read along with this preface. It applies to all the Standards on Internal Audit, which are implemented using the components outlined in the Framework.

4.0 STANDARDS ON INTERNAL AUDIT (SIAs)

4.1 The Standards on Internal Audit (SIAs) apply to all members of the ICAI while performing internal audit activity. Currently, Internal Audits are required as per §138 of the Companies Act, 2013, read with Rule 13 of Companies (Accounts) Rules, 2014. It stipulates certain class of companies to appoint an internal auditor (or a firm of internal auditors), as follows:

(a) Every listed company;

(b) Every unlisted public company having –

- (i) Paid up share capital of fifty crore rupees or more during the preceding financial year; or
- (ii) Turnover of two hundred crore rupees or more during the preceding financial year; or
- (iii) Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
- (iv) Outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

(c) Every private company having –

- (i) Turnover of two hundred crore rupees or more during the preceding financial year; or
- (ii) Outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

4.2 The law permits the internal audit to be performed either by an entity's own employee (i.e., personnel on the payroll of the organisation or its group company) or by a professional who is part of an external agency (e.g., a firm of practicing Chartered Accountants undertaking internal audit engagements). These SIAs apply to ICAI members in both situations, irrespective of whether the audit is conducted by them in the capacity of an employee or as a representative of an external agency (firm).

5.0 MANDATORY NATURE OF FRAMEWORK AND STANDARDS

5.1 The Council of the ICAI has mandated that all current SIAs will, over a period of time be made mandatory in a phased manner. These Standards, as and when fully mandated, will become minimum requirements that all members of ICAI must fulfil when performing internal audits.

5.2 The mandatory status of a SIA implies that while carrying out an internal audit, it shall be the duty of the members of the Institute to ensure that the SIAs are followed keeping in mind the following:

(i) Appropriate scoping and execution of internal audits to ensure compliance with the mandatory requirements of the SIAs;

(ii) Reporting basis to express that the internal audit has been conducted in accordance with the SIAs mandated by the ICAI.

5.3 If, for any reason, a member is unable to comply with any or part of the SIA requirement, or if there is a conflict between the SIA and a regulatory requirement, the audit report should draw attention to the material departures therefrom.

6.0 STANDARD SETTING PROCESS

6.1 The SIAs are developed, reviewed, exposed and finally approved through a comprehensive standard setting process which can be summarised in the 7 steps listed below.

6.2 The following are the key seven steps taken to prepare and issue SIAs:

1. IASB selects topic & Time-lines
2. Formation of Expert Group to draft Standards
3. Review of Exposure Draft of SIA by IASB
4. Exposure Draft open for comments for 30 days
5. Finalisation and submission to ICAI Council
6. ICAI Council deliberates and approves SIA
7. SIA is issued with final changes.

Details of each of the seven steps are elaborated under **Annexure 1**.

6.3 For a substantive revision of a Standard on Internal Audit, the aforementioned 7 step process of new standard is repeated. Subsequent to the issuance of an SIA, some aspects may require revisions which are not substantive in nature. The process followed for such limited revision will substantially be the same as that to be followed for formulation of a SIA, ensuring sufficient opportunity to interest groups and general public to provide their feedback.

7.0 CONTENTS OF THE STANDARDS

7.1 The IASB has taken a decision that all SIAs will be principle based and all revisions and new SIAs will incorporate this concept. To ensure a high quality output from the internal audit, the SIAs will specify the main purpose for issuing the Standard, along with the essential outcome which is required of the internal auditor in discharging their responsibilities.

7.2 Once the objective and required outcome of the standard is defined, the members will apply their best professional judgement in its sincere implementation on a "substance over form" basis. It will be left to the professional judgement of the internal auditor on how best to ensure the achievement of the substance of the SIA. Technical and Implementation guides issued by the IASB would help provide the necessary guidance and clarification in this regard.

7.3 A standard format is being used to capture the essence of each standard and ensure consistency through standard five sections as follows:

(i) Introduction: To provide a brief background and scope of the standard and its applicability;

(ii) Objective: Sets out the reasons for issuing the standards and why it is required;

(iii) Requirements: The desired outcome and what is essential to ensure compliance with the standard;

(iv) Explanatory Comments on Implementation and Application: Certain part of the Standard which needs to be elaborated, especially certain key words and terms; and

(v) Effective Date: Date from which the standard is to be applied and made mandatory.

7.4 The Standards on Internal Audit, as and when issued, will be numbered in a series format, as follows:

(i) 100 Series: Over-arching Pronouncements

(ii) 200 Series: Key Concepts

(iii) 300 Series: Internal Audit Process Standards

(iv) 400 Series: Specialised Area Standards

(v) 500 Series: Quality Control

(vi) 600 Series: Other Miscellaneous

8.0 GUIDANCE AND CLARIFICATIONS ON INTERNAL AUDIT

8.1 Guidance and Clarification Notes on internal audit are primarily designed to provide guidance to the members on matters of implementation or clarification on matters of applicability in certain circumstances.

8.2 IASB will therefore issue the following guides (as appropriate):

(i) Implementation Guide: Guidance on how best to conduct internal audit procedures to ensure that the SIA is implemented in a high quality manner, and how best to achieve the objectives of the SIA.

(ii) Technical Guide: Clarifications as to what extent the SIA applies in a certain industry or a particular situation, considering the technical or operational uniqueness of the same, and how best to achieve the objectives of the SIA.

8.3 The Guidance and Clarification Notes on internal audit are recommendatory in nature. A member should ordinarily follow these recommendations except where, under the unique circumstances, it may not be necessary or appropriate to do so.

8.4 The process for issuance of Guidance and Clarification Notes is the same 7 step process outlined under Annexure 1, (Details of Standard Setting Process) except, step 4 on Exposure Draft issuance may be omitted, if necessary.

8.5 The Guidance and Clarification Notes are issued under the authority of the Council of the Institute.

9.0 EFFECTIVE DATE

9.1 This Preface to the Framework and Standards on Internal Audits is applicable for all internal audits beginning on or after ……..

9.2 In the first year of its implementation, the Standards will be mandatory only for internal audits conducted on Listed Companies, and thereafter, these standards will become mandatory for internal audits conducted on all companies subject to internal audit as per Companies Act, 2013 (see Section 4.1).

9.3 Whenever any Standard on Internal Audit is issued by the ICAI for which a Guidance Note is already in existence, then the Guidance Note shall stand withdrawn from the date on which the Standard comes into effect.

ANNEXURE 1

DETAILS OF THE STANDARD SETTING PROCESS

1. **IASB Selects Topic and Time-lines**: The IASB, on a continuous basis, keeps identifying the broad areas in which the SIAs need to be formulated (and also the previous SIAs to be updated) and prepares a priority list and time lines for the preparation and issuance of the SIAs.

2. **Formation of Expert Group to Draft Standards:** In the preparation and drafting of the SIAs, the Board is assisted by the ICAI Staff and an Expert Group (EG) of professionals constituted by the IASB. In the formation of the EG, provision is made for the participation of a cross section of members of the Institute. In certain situations the Board may also consider having expert professionals on the EG, who need not necessarily be a member of the ICAI. The EG is generally chaired by a member of the IASB and convened by the IASB staff. The EG is responsible for preparing and finalising the Exposure Draft of the Standard ready for IASB review and approval.

3. **Review of Exposure Draft of SIA by IASB:** The Exposure Draft (ED) of the Standard is put up to the IASB for their review, deliberation and approval. On the basis of the deliberations of the Board, changes are made to the draft, and the final ED is made ready for exposure with a wide set of stakeholders.

   While formulating the SIAs, the Board takes into consideration the applicable laws, customs, business environment in India. The Board also, where appropriate, takes into consideration the international practices in the area of internal audit, to the extent they are relevant to the conditions existing in India.

4. **Exposure Draft Open for Comments for 30 days:** The Exposure Draft of the proposed Standard is issued for comments by the members of the Institute. The ED is also open for comments by non-members, including the regulators and other such bodies as well as general public. The ED is also published in the monthly Journal of the Institute and hosted on the website of the Institute wherefrom it is downloadable free of charge for comments by the professional accountants and the public. The Exposure Draft is also circulated to all the members of Council of the ICAI, the Institute's past Presidents, Regional Councils and their branches of the Institute for their comments. The Exposure Draft is also circulated to other external stakeholders as listed in **Annexure 2**.

   The Exposure Draft is normally open for comments for a period of at least 30 (thirty) days from the date of issuance, but this time line may be extended if considered necessary.

5. **Finalisation and Submission to ICAI Council:** After taking into consideration the comments received on the Exposure Draft, the staff of IASB will update the draft of the proposed Standard, take inputs of the EG (if appropriate) and after approval of the IASB, finalise the Standard for consideration by the Council of the Institute.

6. **ICAI Council Deliberates and Approves SIA:** The Council of the Institute will consider the final draft of the proposed Standard on Internal Audit and if necessary, modify the same in consultation with the Internal Audit Standards Board.

7. **SIA Issued with Final Changes:** The SIA will then be issued under the authority of the Council of the Institute.

ANNEXURE 2

LIST OF STAKEHOLDERS FOR INPUTS ON EXPOSURE DRAFTS

1. The Ministry of Corporate Affairs
2. The Reserve Bank of India
3. The Securities and Exchange Board of India
4. The Insurance Regulatory and Development Authority
5. The Comptroller and Auditor General of India
6. The Controller General of Accounts
7. The Central Board of Direct Taxes
8. The Central Board of Excise and Customs
9. The Institute of Cost Accountants of India
10. The Institute of Company Secretaries of India
11. Recognised Stock Exchanges in India
12. The Indian Banks' Association
13. The Standing Conference of Public Enterprises
14. The National Bank for Agricultural and Rural Development
15. The Indian Institute(s) of Management
16. The Telecom Regulatory Authority of India
17. The Central Registrar of Co-operative Societies
18. Various Industry bodies/associations, such as, The Confederation of Indian Industry, The Associated Chambers of Commerce and Industry, The Federation of Indian Chambers of Commerce and Industry, etc.
19. Any other body considered relevant by the IASB keeping in view the nature and requirements of SIAs.