

# STANDARD ON INTERNAL AUDIT (SIA) 230 OBJECTIVES OF INTERNAL AUDIT\*

## Contents

	Paragraph(s)
Introduction .....	1
Objectives .....	2
Requirements .....	3
Explanatory Comments .....	4
Effective Date .....	5
Annexure 1: Indicative List of Objectives of Internal Audit	
Annexure 2: Components of a Typical Internal Audit Charter	
Annexure 3: Components of a Typical Engagement Letter	

**This Standard on Internal Audit (SIA) 230, “Objectives of Internal Audit” issued by the Council of the Institute of Chartered Accountants of India should be read in conjunction with the “Preface to the Standards on Internal Audit,” “Framework Governing Internal Audits” and “Basic Principles of Internal Audit” issued by the Institute.**

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**\*Note:** This Standard on Internal Audit (SIA) supersedes *Standard on Internal Audit (SIA) 8, Terms of Internal Audit Engagement*, issued in December 2008.



## 1. Introduction

1.1 The objectives of internal audit vary widely and depend on the size, structure, and complexity of the entity subject to internal audit. These objectives are also influenced by laws and regulations and specific requirements of management and, in most cases, defined by those charged with governance.

1.2 In the case of Companies required to appoint an Internal Auditor as per Section 138 of the Companies Act, 2013, Rule 13(2) of Companies (Accounts) Rules 2014, states:

*“The Audit Committee of the company or the Board shall, in consultation with the Internal Auditor, formulate the scope, functioning, periodicity, and methodology for conducting the internal audit.”*

Hence, in these class of companies, the Audit Committee or the Board, in conjunction with management and the Chief of Internal Audit, is expected to exercise the responsibility to formulate the objectives of internal audit.

1.3 In the case of other organisations not covered under Rule 13, those who appoint the Internal Auditor (e.g., the owners, the promoters, the Board of Trustees, etc.) would generally define the objectives of internal audit.

1.4 While the specific objectives of any internal audit may vary from company to company, these objectives are generally consistent with the overall definition of “Internal Audit”, which as defined under Para 3 of “Framework governing Internal Audit”, issued by the ICAI, states as follows:

*“Internal audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organisational objectives.”*

Para 3.2 of the Framework also indicates how the nature of internal audit services may go beyond assurance to include an advisory (consulting) role.

Annexure 1 to this Standard provides an indicative list of the Objectives of Internal Audit mentioned in Standard on Auditing (SA) 610, “Using the Work of an Internal Auditor”, issued by Auditing & Assurance Standards Board, ICAI. Companies may choose some or all of these objectives, or even add something new as per their requirements or legal/ regulatory

## Standard on Internal Audit (SIA) 230

mandates.

- 1.5 Scope: The current law in India permits internal audit to be performed either by an entity's own employee (i.e., personnel on the payroll of the organization 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). Hence, the manner in which the objective of internal audit is defined in each situation may vary. This Standard applies to all ICAI members in both situations, irrespective of whether the internal audit is conducted by them in the capacity of an employee or as a representative of an external audit firm.

## 2. Objectives

2.1 The purpose of defining the Objectives of Internal Audit are to:

- (a) Document the formation and functioning of the Internal Audit activity and the terms of the out-sourced internal audit arrangement;
- (b) Provide clarity to the Internal Auditor and its stakeholders regarding the nature of the internal audit set-up and its working;
- (c) Ensure linkage between what is expected of the Internal Auditor and how those expectation can be met within the Framework governing Internal Audits; and
- (d) Promote better understanding on key operational areas, such as, accountability and authority, roles and responsibility, and such other functional matters.

2.2 Once the objectives of internal audit are defined, they help to establish the operating parameters within the overall internal audit agenda. These objectives and operating parameters are formally recorded in one of these two documents:

- (a) An Internal Audit Charter, primarily designed for the in-house team of internal auditors and its stakeholders; and
- (b) An Engagement Letter, is a formal agreement signed with the out-sourced internal audit service provider.

In some cases, both the documents may exist, although where the complete internal audit function is out-sourced, the Engagement Letter covering the whole Internal Audit activity may be the only document in

## Objectives of Internal Audit

place.

### 3. Requirements

- 3.1 Every Internal Auditor shall be guided by a document that defines the Objectives of Internal Audit. It is the duty of the Chief of Internal Audit to have in place a written Internal Audit Charter documenting the formation and functioning of the internal audit activity. (refer Para 4.1).
- 3.2 Where part of the internal audit activity is out-sourced, the Chief of Internal Audit shall have a formal Engagement Letter defining the terms of engagement and documenting the nature of the arrangement with the external internal audit service provider. If the internal audit activity is completely out-sourced, the Engagement Partner will be acting in the capacity of the Chief of Internal Audit, who shall ensure a formal Engagement Letter documenting the terms of engagement. (refer Para 4.2).
- 3.3 The Chief of Internal Audit shall ensure that the Internal Audit Charter is reviewed and approved by those charged with governance (the Board of Directors, or the Audit Committee of the Board). In the case of the Engagement Letter, the Engagement Partner shall ensure that the formal agreement with the terms of engagement shall have the approval of the competent authority, as per the company's Delegation of Powers. Where the complete internal audit activity is out-sourced, then this approval shall come from those charged with governance (the Board of Directors, or the Audit Committee of the Board).
- 3.4 It is important that the governing body members and other stakeholders are aware of, and in agreement with, the Objectives of Internal Audit and other relevant portions of the Internal Audit Charter and Engagement Letter. This information shall be communicated to all stakeholders through formal channels of communication.
- 3.5 The Internal Audit Charter and the Engagement Letter shall be reviewed periodically by the Chief of Internal Audit and the Engagement Partner to ensure its relevance to the changing times or circumstances (e.g. change in scope). If found necessary, the proposed amendments to these documents shall be put up to the approving authority for their review and approval.

## Standard on Internal Audit (SIA) 230

### 4. Explanatory Comments

- 4.1 **Internal Audit Charter (refer Para 3.1):** The formation and functioning of the internal audit activity within the organisation is noted in a formal document called the Internal Audit Charter. It defines the objectives of internal audit (in line with the definition of Internal Audit) and other important aspects of the functioning of the Internal Audit activity. It also provides clarity to the Internal Auditor regarding the manner in which the internal audit work is undertaken and how the auditor's responsibility is to be discharged.

An indicative list of areas covered in the Internal Audit Charter is as follows:

- (a) Mission and Vision of the Internal Audit function
- (b) Purpose and Objectives of Internal Audit
- (c) Reporting Structure and Independence
- (d) Scope and Approach
- (e) Accountability and Authority
- (f) Roles and Responsibility
- (g) Quality Assurance and Conformance with SIAs.

Further explanation of each of the above-mentioned areas is given as **Annexure 2**.

- 4.2 **Engagement Letter (refer Para 3.2):** The Objectives of Internal Audit and other terms of engagement of the external service provider are documented in a formal agreement referred to as the Engagement Letter. The Engagement Letter is signed by the Engagement Partner along with the appointing authority of the Company.

An indicative list of terms of engagement, covered in an Engagement Letter, is as follows:

- (a) Purpose and Objectives of Internal Audit
- (b) Independence and Objectivity
- (c) Scope and Approach
- (d) Accountability and Authority
- (e) Roles and Responsibility

## Objectives of Internal Audit

- (f) Limitations and Confidentiality
- (g) Quality Assurance and Conformance with SIAs
- (h) Reporting and Compensation
- (i) Ownership of Working Papers
- (j) Termination of Arrangement

Further explanation of above-mentioned areas is given as **Annexure 3**.

- 4.3 A signed Engagement Letter shall be obtained prior to commencement of any audit work.

### **5. Effective Date**

- 5.1 This Standard is applicable for internal audits beginning on or after a date to be notified by the Council of the Institute.

## Annexure 1

### Indicative List of Objectives of Internal Audit<sup>1</sup> (as per Standard on Auditing (SA) 610, “Using the Work of an Internal Auditor” issued by Auditing & Assurance Standards Board, ICAI).

#### Scope and Objectives of the Internal Audit Function (Refer Para. 3)

A3. The objectives of internal audit functions vary widely and depend on the size and structure of the entity and the requirements of management and, where applicable, those charged with governance. The activities of the internal audit function may include one or more of the following:

- **Monitoring of internal control.** The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation and recommending improvements thereto.
- **Examination of financial and operating information.** The internal audit function may be assigned to review the means used to identify, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
- **Review of operating activities.** The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non- financial activities of an entity.
- **Review of compliance with laws and regulations.** The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.
- **Risk management.** The internal audit function may assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.
- **Governance.** The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and

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<sup>1</sup> The above is not a complete and exhaustive list and is presented only as an example of the nature of Objectives of Internal Audit.

## **Objectives of Internal Audit**

effectiveness of communication among those charged with governance, external and internal auditors, and management.

## Annexure 2

### Components of a Typical Internal Audit Charter

- **Mission and Vision of the Internal Audit (IA) Function**

This indicates the long-term view of the Internal Audit function, in line with its reason for existence.
- **Purpose and Objectives of Internal Audit**

Explains what the Internal Audit function hopes to achieve in a certain period of time. These objectives cover the internal audit definition and are usually in line with the Objectives of the Organisation in a similar period of time. (Refer Annexure 1).
- **Reporting Structure and Independence**

This section explains where the Internal Audit function is placed within the overall Organisation Structure of the Company and whom it reports to (both functionally as well as administratively). It also clarifies how the independence of the function is assured through limitations on responsibilities which may be assigned (such as that seeking active business support) but might compromise on independence. (Refer Para 3.1. of “Basic Principles of Internal Audit”).
- **Scope and Approach**

The scope of the internal audits shall be consistent with the goals and objectives of the internal audit function and also in line with the nature and extent of assurance to be provided by the Internal Auditor. Any entities/units excluded from the scope shall be clearly noted. The approach is generally a risk-based audit approach, with a system and process focus. (Refer Para 3.6 and 3.7 of “Basic Principles of Internal Audit”)
- **Accountability and Authority**

The Internal Auditor may be held accountable for certain deliverables beyond providing basic assurance, such as, improving the control environment, reducing risk ratings or improving compliances level, etc. These should be clearly spelt out. Along with accountability, comes the authority and the powers required to conduct audits without any undue hindrances, engaging external experts and receiving all information and system access on time.

## Objectives of Internal Audit

- **Roles and Responsibility**

All the key job functions and activities are spelt out in this section, which are usually in line with the objectives of the Internal Audit function.

- **Quality Assurance and Conformance with SIAs**

This section indicates the importance of ensuring high quality audit work and procedures, including how the audit procedures will be conducted in conformance with ICAI pronouncements applicable at the time. It also notes the checks put in place to ensure reliability and credibility of the output.

**Components of A Typical Engagement Letter**

- **Purpose and Objectives of Internal Audit**

This section indicates what the Internal Audit engagement hopes to achieve in the set period of time. These objectives are mostly defined by those charged with governance and appointing the Internal Auditor. (Refer Annexure 1).

- **Independence and Objectivity**

This section defines the reporting structure and reporting protocol of the Internal Auditor. It also clarifies how the independence of the Internal Auditor is assured through assignments which don't compromise on his independence. (Refer Para 3.1 of "Basic Principles of Internal Audit")

- **Scope and Approach**

The scope of the internal audits shall be consistent with the goals and objectives of the internal audit and in line with the nature and extent of assurance to be provided. Any entities/units excluded from the scope shall be clearly noted. The approach is generally a risk-based audit approach, with a system and process focus. (Refer Para 3.6 and 3.7 in "Basic Principles of Internal Audit")

- **Accountability and Authority**

The Internal Auditor is accountable to deliver the outcome of his work to the appointing authority or those charged with governance. Where the laws and regulations require, the internal auditor may also be required to report directly to external authorities. Along with accountability, comes the authority and the powers required to conduct audits without any undue hindrances and to receive all information and system access on time.

- **Roles and Responsibility**

All key job functions and activities get clearly spelt out in this section, which are usually in line with the objectives of the Internal Audit function.

- **Limitations and Confidentiality**

Limitations on liabilities which the auditor is exposed to and the manner of determination of the same should be included in this section. Obligations on part of the Internal Auditor to maintain confidentiality of information

## Objectives of Internal Audit

collected and on part of the Company to keep the audit report confidential is also covered here.

- **Quality Assurance and Conformance with SIAs**

This section indicates the importance of ensuring high quality audit work and procedures, including how the audit procedures will be conducted in conformance with ICAI pronouncements applicable at the time. It also notes the checks put in place to ensure reliability and credibility of the output.

- **Reporting and Compensation**

All requirements with regards to the nature of reports to be issued, the type of assurance to be provided, the timing, or periodicity of reports and the recipients is clearly noted here.

The basis upon which the compensation is established, the manner of its review, the ancillary charges (cost reimbursements, taxes, etc.) and how these are to be determined are all covered here.

- **Ownership of Working Papers**

This section clarifies the understanding regarding the ownership of working papers. Where a formal internal audit report is issued (with or without assurance), the ownership of the working papers should be retained by the Internal Auditor. (Refer SIA 330, "Internal Audit Documentation")

- **Termination of Arrangement**

The time period of appointment, the timelines for completion of all assignments and the cessation of the arrangements should be covered in this section.