

Board paper No.2024/733/06/J

Board Meeting No. 74

Date 28th June 2024



INTERNAL AUDIT POLICY & PROCEDURES MANUAL

Version III

Owner – Internal Audit Department

Approval – Board of Directors

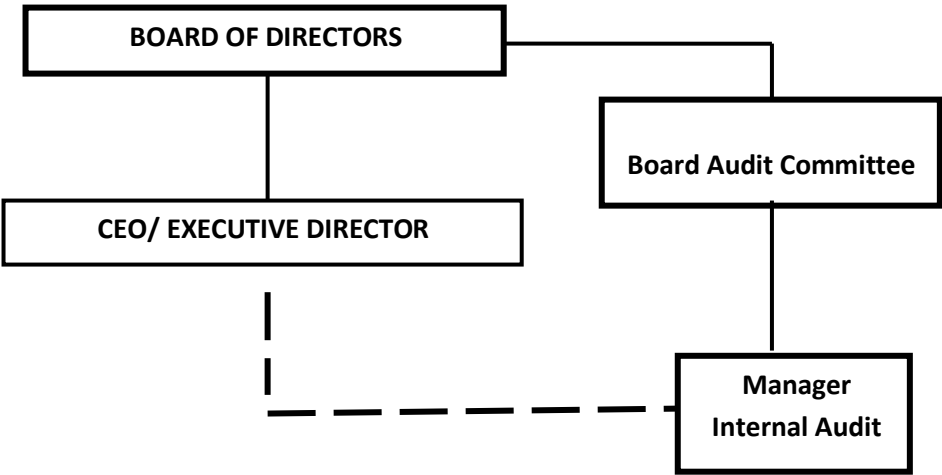
Revived & Approved on 28th June 2024

Table of contents

Section	Contents
01.	Mission
02.	Objective
03.	Structure
04.	Responsibility & Authority
05.	Independence
06.	Objectivity
07.	Confidentiality
08.	Code of Ethics
09.	Standards of conduct
10.	Scope of the Internal Audit function
11.	Responsibility for detection of errors and irregularities
12.	Services provided by the Internal Audit
13.	Professional proficiency
14.	Audit planning
15.	Audit process
16.	Evidential matter
17.	Types of samples
18.	Synopsis and purpose of the manual

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REPORTING LINES – INTERNAL AUDIT



Functional _____
Administrational - - - - -

INTERNAL AUDIT – PROCEDURES MANUAL

1. MISSION

The mission of the Internal Audit Department is to provide independent and objective reviews and assessments of the business activities, operations, core operational and financial systems and internal controls of LCB Finance PLC (Herein after referred to as the Company). The Internal Audit Department accomplishes this mission by conducting operational, financial and performance audits, selected in the course of the process of risk identification and assessment. The audits finally decided upon for coverage by the Internal Audit are reviewed and approved by the Board Audit Committee in the form of an Annual Audit Plan.

2. OBJECTIVE

The Internal Audit Department conducts independent reviews and appraisals of the company's procedures and operations. These reviews provide the management and Board of Directors with an independent appraisal of the various operations and systems of control. The reviews also help to ensure that the company resources are used efficiently and in assisting LCB Finance to achieve its corporate mission as decided upon by the Board of Directors. The Internal Audit Department strives to perform this service with professional care and with minimal inconvenience to operational staff and with no abrasion to its relationship with Heads of Departments or their staff and geared essentially for improvement of process controls and consequent management assurance.

Internal Audit have authority of access to all operations, records, property and staff at all and every location.

3. STRUCTURE OF THE INTERNAL AUDIT DEPARTMENT

The Internal Audit department is headed by the Head of Internal Audit who reports directly to the Audit Committee and functions as the Secretary of the Audit Committee. The audit officers working in the Department report to the Manager of Internal Audit. Audit department is administrated by CEO/ Executive Director.

4. RESPONSIBILITY AND AUTHORITY

The Internal Audit function has been established on the direction of the Board and on the basis of CBSL requirements and derives its authority directly from the Board Audit Committee which is a subcommittee of the Board. The Internal Audit Department reports directly to the Board Audit Committee. The scope of the responsibility of the Internal Audit Department is decided and defined by the Board of Directors and the Board Audit Committee. Internal Audit staff is authorized to carry out a comprehensive Internal Audit Programme approved annually by the Board Committee and the Manager of Internal Audit is responsible for keeping the concerned Board Audit Committee and Board of Directors informed of serious exceptions, control lapses and other matters of significance.

Internal audit shall carry out investigation of matters related to the company, based on the instruction of the Board / Audit committee or the Chief Executive Officer (CEO). However, no operational work shall be carried out by Internal Audit without the approval of the Board / Audit Committee. A separate record shall be kept of such assignments, and the periodic report to the Board / Audit Committee should include list of such assignments, highlighting any significant observations.

5. **INDEPENDENCE**

In order to maintain independence and objectivity, the internal audit function has no direct responsibility or any authority over the activities or operations that are subject to audit review. Internal Audit therefore, do not take management decisions, rather they make recommendations to management, nor do they write procedure manuals or establish control procedures, but will comment upon them.

6. **OBJECTIVITY**

The Internal Audit is a service function organized and operated primarily for the purpose of conducting audits in accordance with professional standards. Evidence gathered in the course of these audits forms the basis of opinions, recommendations and other information furnished to the impacted Heads of department, Management and Board Audit Committee.

Observations and recommendations furnished by the Internal Audit will indicate the adequacy of internal control, degree of compliance with established policies and procedures per Manual of Procedures and industry best practices and / or their effectiveness in achieving organizational objectives. The internal audit may also recommend cost effective alternatives for the management to consider in improving efficiency in any area highlighted and identified in the course of an audit.

7. **CONFIDENTIALITY**

Information obtained during an internal audit is deemed confidential. Some areas may require special arrangements when examining and reporting to maintain confidentiality. The Internal Audit will handle all information obtained during an audit review in the same prudent manner as would the original custodian of this information. The Internal Audit will respect the value and ownership of information received and will not disclose any information without appropriate authority and adhere to any policy / procedure defined in the company unless there is a legal or professional obligation to reveal information.

Internal Audit reports are considered as confidential. They are circulated to the respective Head of departments, Regional Managers, and Branch Managers and to the Management and Board Audit Committee as required. Any other individuals interested in an audit report may gain access only through the Manager of Internal Audit who if deemed necessary will do so in consultation with and authority of the Board Audit Committee. Internal Audit staff is expected to be prudent with all information obtained in the course of an audit when discussing matters pertaining to the audit or any other matters connected with company. Internal Audit staff will always be discreet and limit conversations connected with their audits exclusively to the appropriate officers. The Internal Audit staff has an obligation not to discuss indiscreetly any information obtained in the course of audit assignments within or outside of the company.

8. CODE OF ETHICS

The Internal Audit staff will comply with any professional or company established Code of conducts and Ethics as well as policies set out by the company management. In addition, the internal audit staff will always uphold the following:

- a) **Integrity**- Establish trust and thus provide the basis for reliance on the judgment of the internal audit. Be tactful, honest, objective and credible in all relationships.
- b) **Objectivity** - Display the highest level of professional objectivity in gathering, evaluating and communicating information of the area or aspect under audit review and examination. Make balanced and impartial assessments of all the relevant circumstances involved and not be influenced in any way by individual interests or by others in forming judgments and conclusions.
- c) **Confidentiality** – Respect the value of ownership of information received. Not disclose any information without proper authority unless compelled to do so for legal or professional reasons.
- d) **Competency** – Apply the required knowledge, skills and experience in performing internal audits and continually strive to improve the proficiency, effectiveness and quality of an audit.

9. STANDARDS OF CONDUCT

The internal audit will adhere to the following basic standards of conduct:

- a) **Service** - Commitment to carry out all responsibilities with an attitude of the best possible service towards company and functional Head of departments/ staff while maintaining a sincere and dignified attitude, conduct, diplomacy and manner of speech.
- b) **Excellence** – Uphold a high standard of service and commitment to quality in performing all audit assignments and investigations.
- c) **Leadership** –Provide a noteworthy example to emphasize high ethical and moral standards.
- d) **Professionalism** – Conduct audits and communications in the course of audits / investigations in a manner that reflects favorably on the Internal Audit department and the individual dealt with. Exercise skill, integrity, maturity and absolute tact& diplomacy.

10. SCOPE OF THE INTERNAL AUDIT FUNCTION.

While carrying out their duties the internal audit staff is responsible for maintaining a systematic, disciplined approach to evaluate and improve effectiveness of internal controls, and should include the following:

- a) Developing and maintaining a comprehensive Audit Programme complying with required accounting standards, policies, procedures and CBSL and other regulatory directions and guidelines.

- b) Effectively communicating the results of audits and reviews by preparing concise, timely reports inclusive of recommendations for modification & strengthening of procedures, controls, systems, policies and accounting procedures as warranted by audit findings.
- c) Establish and maintain quality assurance to evaluate internal audit operations which should include the following:

Uniformity of working papers prepared, audit sampling, review of working papers, report preparation and review, report communication and circulation, record retention and follow up of responses.

11. **RESPONSIBILITY FOR DETECTION OF ERRORS AND IRREGULARITIES.**

The management is primarily responsible for maintaining controls to prevent and discourage perpetration of fraud. Internal Audit is responsible for examining and evaluating the adequacy and effectiveness of those controls. Audit procedures in isolation are not designed to guarantee the detection of fraud.

An error is an unintentional mistake in financial statements or records which includes arithmetical or clerical mistakes in the records and accounting data from which financial statements or other statements / reports are prepared and mistakes in the application of accounting principles and oversight or misinterpretation of facts.

An irregularity is an intentional distortion of financial statements or other reported data or the misappropriation of assets including cash.

If Manager of Internal Audit or other senior officer is of the view that a material error or irregularity exists in an area under audit review or in any area at the company, the implications of the error or irregularity and its disposition should be reviewed in concurrence with the director concerned, Management and Board Audit Committee when it is established that an irregularity exists and extent of the issue determined.

12. **SERVICES PROVIDED BY INTERNAL AUDIT.**

The primary function of the Internal Audit is to implement a programme of regular audits as approved by the Board Audit Committee in the form of an Annual Audit Plan. Other functions include special assignments, investigations and consultations where required.

- a) **Operational audits-** Operational audits comprise of critical reviews of operating processes, procedures and internal controls for mitigation of risks in the areas reviewed. These audits include review of the use of resources to ascertain whether they are utilized effectively and efficiently to achieve the corporate mission and objectives.
- b) **Process audits – Critical** examination of core processes, highlighting control lapses and risks, improved documentation, simplification / customer orientation and effective resource utilization.
- c) **Compliance audits** –These audits determine the extent to which mandatory procedures,

standards, regulations and directions / guidelines are adhered to and submission of observations and recommendations thereon.

- d) **Financial audits**- These audits review accounting and financial transactions to determine whether commitments, authorization and receipt and disbursements of funds are properly and accurately recorded and reported. The audits also determine whether there are adequate controls over cash and other assets and whether adequate process controls exist on acquisitions and use of resources. Internal financial audits do not express professional opinions on the fairness of financial statements unlike in external audits.
- e) **Investigative audits** – These audits are done to identify existence of control weaknesses, recommending corrective action to prevent occurrence of possible irregularities and resultant losses. In carrying out these audits, necessity arises to contact outside parties to ascertain facts needed for conclusions to be reached.
- f) **Technology audits** – These comprise mainly of IT audits as detailed in the IT audit plan, ascertaining access controls and other security audits, system development life cycle audits and applications system audits, Change Management Audits including patch management and disaster recovery plans, data base management system including system back up procedures and general security of data inclusive of segregation of duties and super user monitoring. The purpose of these audits is to evaluate accuracy, effectiveness and efficiency of data processing, data integrity and storage systems.

13) **PROFESSIONAL PROFICIENCY**

Professional proficiency is the responsibility of the individual auditor assigned for an audit. Manager of Internal Audit and senior staff will assign each audit to the appropriate individual auditor who possesses the required knowledge, skills and disciplines to conduct the audit effectively.

The Internal Audit staff has a professional obligation to select and attend forums, workshops and seminars, training sessions on auditing, fraud detection and risk controls and training sessions on modified or new computerized systems in order to maintain individual proficiency to carry out their audits effectively. Manager of Internal Audit and senior staff are responsible for providing appropriate audit supervision in the course of ongoing audits. Supervision is a continuous process initiated with the planning process of audits and concluded with the completion of the audit assignment and final communication / management response. Supervision should include signing off all working papers and audit documents.

14) **AUDIT PLANNING**

14.1 Developing the Audit Plan

Manager of Internal Audit is responsible for developing and implementing a risk-based Audit Plan covering all auditable areas, including compliance and regulatory requirement reviews. The Audit Plan is a document which details specific audits or assignments to be performed by the Internal Audit Department.

After review, the Audit Plan is presented to the Board Audit Committee for approval, annually prior to the commencement of each financial year. The development of the Audit Plan includes the review of risk assessment especially of the core processes. The Audit Plan is updated, modified and changed whenever such changes are deemed necessary for effective audit control. The Board Audit Committee will be notified of all significant changes in the Audit Plan.

The majority of the audits is preplanned audits. But occasions may arise where unplanned / unscheduled audits need to be conducted. These audits too would be conducted after planning and determining the required audit approach.

15) **AUDIT PROCESS**

Although every audit is unique, the audit process is usually similar and covers nine basic stages. Through these stages the Internal Audit will determine ways to minimize risks and increase efficiency in the area audited. Involvement of the Head of department and staff concerned is critical in the audit process. An audit could result in a certain amount of time being diverted from the department/ area audited. In carrying out an audit a key objective is to minimize this time to avoid any inconvenience or disruption of ongoing routine work of the department concerned. The nine stages covered in the audit process are briefly as follows.

- i) **Plan** - The Internal Audit department will develop an Audit Plan based on a review of all pertinent information available. Sources would include risk assessment, evaluation and records, management information and guidance where required.
- ii) **Notify** – The Internal Audit will inform the staff concerned of the audit (other than in instances where an element of surprise is required) and use the required tact and diplomacy in obtaining the cooperation of the staff involved.
- iii) **Test** – This includes staff interviews, review of procedures and manuals, compliance with standards, regulatory requirements and assessing adequacy of controls throughout the process involved and transaction testing to the required extent.
- iv) **Communicate**–As far as possible keep the department / staff updated on the status of the audit regularly. Some errors of a clerical nature can be addressed immediately for correction but subsequently reported.
- v) **Draft** – The draft of the report should include the scope of the audit, objectives, summary and opinion, findings and recommendations.
- vi) **Review** – The draft report will be reviewed by the Audit Officer responsible for improvement / correction where necessary and submitted to Manager of Internal Audit within a reasonable time frame for final review.
- vii) **Distribute** - The final report will be sent to the Head of department or Manager concerned for response.

- viii) **Management response** – A target date is fixed for management response for finalization of the report within 14 working days. Copies will be sent to the CEO/ Executive Director if matters of significance are noted.
- ix) **Verifying** – The responses received will be checked and commented on where required and submitted to the Management in the event of significant deviations or serious control lapses / irregularities. Deviations will be noted for reverification of rectifications effected and to highlight repetitive deviations. In the case of exceptions noted at branch audits the exceptions will be presented and discussed with the Managers prior to submitting them to the Management meetings and brought up at other forums where Branch Managers participate. After receipt of management responses, report on an auditable entity should be presented to the audit committee.

16. EVIDENTIAL MATTER

16.1 COLLECTION AND RETENTION OF EVIDENCE

Evidential matter obtained in the course of field work provides the documented basis for audit conclusions and opinions, observations and recommendations as highlighted in an audit report. The Internal Audit Department needs to act objectively, exercise due professional care and collect sufficient relevant information to provide a sound basis for audit observations and recommendations. Auditors need to gather evidence required for effective completion of the audit.

The decision on the quantum of evidence required and the type of evidence to look for, needs the auditor's judgment based on experience, knowledge and intuition. A thorough knowledge of the concepts underlying audit evidence will help the auditor to improve audit quality and efficiency of the audit process.

Working papers should provide the basis for audit observations and views and taken as evidential matter. These require the following attributes:

- a) Information is factual and adequate for a prudent, informed person to reach the same conclusion as the auditor.
- b) Information obtained is reliable and the best attainable through the use of appropriate audit techniques including ACL & BI tool derived information.
- c) Relevant information supports the audit findings and recommendations and is consistent with the audit objectives.
- d) Information is adequate and acceptable when the auditor is called upon to answer questions on the reported findings, conclusions and recommendations.

16.2 Types of evidence

If the evidence supports the basic needs of adequacy, competence and relevance, such evidence may be used to support the auditor's findings. Following types of evidence is obtained in the course of an audit:

- i) **Physical evidence** – Obtained through observations and inquiry.
- ii) **Testimonial evidence** – Based on interviews and statements obtained from persons involved.

- iii) **Documentary evidence** – Consists of procedure Manuals, reports, minutes and endorsements, memoranda, contracts, extracts from accounting or other records, documentation and process flow charts, systems, operations and organizational structure.
- iv) **Analytical evidence** – Evidence secured by analysis of information collected by the auditor through excel or other means including reports derived from ACL.

16.3 **DOCUMENTATION OF EVIDENTIAL MATTER**

Professional practice of internal auditing requires that working papers reflect the details of evidence on which the auditor has relied. The Internal Auditor must maintain adequate documentation of the audit including the basis and extent of planning, the work performed and the results and findings of the audits. This will facilitate the working papers to serve both as tools to aid the auditor in performing his work and as written evidence of the work done to support the auditor's report. Information included in working papers should be adequate and relevant to provide a sound basis for audit findings and recommendations.

In the process of collecting evidence, the auditor is required to perform audit testing. The auditor is not required nor would it be practically possible to test the entire population involved. Audit sampling should be employed. Audit sampling is performing an audit test on less than 100% of the population involved. In 'sampling' the auditor accepts the risk that some or all errors will not surface and conclusions drawn could therefore be distorted. The type of sampling used and the no. of items selected should be based on the auditors' understanding of the relative risks and exposures of the area audited.

17) **TYPES OF SAMPLES**

- a) **Statistical or probability sampling** – allows the auditor to stipulate with a given level of confidence, the condition of a large population by reviewing only a percentage of the total items in the population. Several sampling techniques are available including stratification ensuring that the sample is representative of the population.
- b) **Attribute sampling** – used when the auditor has identified the expected frequency or occurrence of an event. (Example - vouchers not authorized)
- c) **Variable sampling** – used when the auditor samples for value in a population which varies from item to item.
- d) **Judgment sampling** – used when it is not essential to have a precise determination of the probable condition of the population or when it is not possible, practical or necessary to use statistical sampling.

18) SYNOPSIS AND PURPOSE OF THE MANUAL

The Internal Audit manual is intended to provide the Internal Audit staff at all levels with an overview of the organization of the department, the strategic role of the internal audit function in governance, monitoring and control, procedure for managing audits, communication and interaction with the management, value addition and assurance.

The manual outlines the following aspects:

- Rationale and role of the Internal Audit function.
- Organizational and staff structures of the Internal Audit dept.
- Broad categories of audits generally handled.
- Code of conduct for the Internal Audit staff.
- Planning and execution of audits

The manual is also intended to provide an insight of the internal audit function to Head of departments, the role of the internal audit vis-a-vis their functional activities and the benefits derived by way of improvements to controls and procedures and remedying possible risks highlighted at operational and process audits.

This manual should be reviewed annually or as and when the need arises to meet the requirements of the company by the Internal Audit Department with the concurrence of the Board Audit Committee

RECOMMENDATION

Recommended to the Board of Directors for adoption

Assistant Manager
Internal Audit Department

CEO/ Executive Director