

INTERNAL CONTROL

STRUCTURE

- 5.1 Objectives
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- 5.3 Meaning and definition of internal control
- 5.4 Forms of internal control
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5.1 OBJECTIVES:

After studying this unit you will be able to

- Explain the meaning and objectives of internal control.
- Enumerate the features of a good internal control system.
- Distinguish between internal audit and statutory audit.
- Describe the meaning and objectives of internal check system.
- Device system of internal check with regard to cash sales.
credit sales, wages and salaries, purchases, stock etc.
- Explain the duty of the auditor with regard to internal check.
- Understand audit in respect of computerised environment.

5.2 INTRODUCTION

Internal control is another important area of auditing. Internal control refers to a number of checks and controls exercised in a business to ensure its efficient and economic working. In this unit you will learn the meaning and objectives of internal control and internal check. You will also learn various system of internal check and generally understand audit in respect of computer environment.

5.3 MEANING AND DEFINITION OF INTERNAL CONTROL

Internal control is an important tool of management. It assists the management in the performance of its various functions. It means the built in cross-checks in the system supplemented with proper supervision and internal audit carried out by the staff appointed by the organisation. These days business has become more complex both in nature and size and the management finds it difficult to get correct information about the various aspects of the business. Internal control assures the management that the information supplied to it is reliable and accurate. The internal controls are exercised to ensure the accuracy and the reliability of accounting data and other records, to identify weaker areas of operation and to improve them to increase operational efficiency of the business, to safeguard its assets and to ensure orderly conduct of business.

The American Institute of Public Accountants has defined internal control as the plan of organisation and all the co-ordinate methods, and measures adopted within a business to safeguard its assets, check the accuracy and the reliability of its accounting data, promote operational efficiency and encourage adherence to prescribed managerial policies. A system of internal control extends beyond those matters which relate directly to the function of the accounting and financial departments.

The Institute of Chartered Accountants of England and Wales defines internal control as "internal control means not only internal check or internal audit, but the whole system of control financial and otherwise, established by management in order to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible accuracy and reliability of its records".

If we analyze the above definitions it would be evident that internal control is a broad term with a wide coverage. It consists of a number of checks and controls which are exercised in a business to ensure its efficient and economic working. Thus internal control involves a sort vigilance and directions over important matters like budget and finance, purchase and sales and internal administration by the management.

Every business enterprise is expected to devise a suitable system of internal control in order to carry on the business in an efficient and orderly manner. These controls are accounting control, budgetary control, statistical analysis and internal checks and internal audit. In simple words, it means number of checks and controls over the various activities of a business. Generally, a system of internal control will include all those measures which assist a business enterprises to fulfill the following objectives.

Objective of internal control

- To minimize, if not completely eliminate, wastage and inefficiencies in business operations and to safeguard the assets of the business.
- To ensure high degree of accuracy and reliability of accounting data and promote operational efficiency.
- To measure how far the policies of the management are being implemented, and
- To evaluate the efficiency of performance in all aspects of business activities and to highlight the weaknesses.

5.4 FORMS OF INTERNAL CONTROL

Various forms of internal control help in ensuring correct and reliable records of transactions and operational efficiencies. Let us discuss them in detail.

Accounting control

It ensures correct and reliable records of transactions in conformity with normally accepted accounting principles. Such controls comprise primarily the plan of organisation and the procedures and records that are concerned with and directly related to the safeguarding of assets and liabilities of financial records. Accounting financial controls include budgetary control, standard cost control, self balancing ledger, bank reconciliation and internal checks and internal auditing.

Accounting controls deal with the process of recording of transactions, safeguarding the assets and adherence to prescribed managerial policies

Administrative control

The scope of this control is very wide. They also include accounting controls. Such controls comprise of the plan of organisation that are concerned mainly with operational efficiencies. In short they may include anything from plan of organisation to procedures, record keeping, distribution of authority and the process of decision making. They include controls viz. Time and motion studies, quality control through inspection, statistical analysis and performance evaluation etc. An auditor should make a careful review of accounting controls as they have a direct bearing on the reliability of the financial statements. He is primarily concerned with the accounting controls.

Internal control and auditor

The position of the auditor regarding internal control has been stated in the statement of auditing practices issued by the Institute of Chartered Accountants of India which says "the duty of safeguarding the assets of a company is primarily that of management and the auditor is entitled to rely upon the safeguard and internal controls instituted by the management, although he will take into account the deficiencies, he may note therein while drafting his audit program". It clearly means that an auditor is concerned only with the evaluation of internal control to know its strength and weaknesses. In case he finds that the internal control

system is inadequate, he should then plan to carry out detailed examination of those areas where the system is weak. It is therefore necessary for the auditor to acquaint himself fully with the internal control in force and their actual operation. It will help him in the formulation of his audit program. He may also bring the shortcomings of the internal control system to the notice of the management.

Requisites of a good internal control system

The following are the essential requisites of a good internal control system :-

- i. A well developed plan of organisation with proper delegation of functional responsibilities should be advised. No internal control system can be effective without such plan of organisation.
- ii. A scientific system of authorisation and record procedure should be developed with a view to provide proper control over assets, liabilities, revenue and expenses of the organisation. It should be developed in such a fashion as to ensure that a) assets are under proper custody and they are not improperly applied, b) expenditures are incurred on getting proper authorisation and c) revenues received are duly accounted for.
- iii. A system of healthy practices and traditions should be developed with a view to discharge the duties and functions of the various departments of the organisation smoothly.
- iv. Since internal control system is to be exercised by the personnel employed in the organisation, there should be a team of people with sound character and integrity who are properly trained and capable of discharging their responsibilities.
- v. Constant managerial supervision and periodical review of the system should be introduced with a view to make the system more efficient and effective.

1. Check Your Progress

1. Define internal control
2. Distinguish between accounting control and administrative control.
3. State whether each of the following is true or false:
 - a) Internal control is different from internal check.
 - b) Internal control does not include accounting control
 - c) Internal control is compulsory in all business organisation
 - d) Internal control include quality control and time and motion studies.
 - e) An effective internal control system helps external auditor to design suitable audit.

5.5 INTERNAL AUDIT

Internal audit is described as the verification of the operations within the business by a specially assigned staff. It is an important tool of management to evaluate the correctness of records on a continuous basis in an organisation.

The term internal audit has been defined as "an independent appraisal of activity" within an organisation for review of operations as a basis of service to management. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls.

According to Howard F. Stettler, "internal auditing is an independent appraisal activity within an organisation for the review of operations as a service to management."

The overall objective of internal auditing, therefore, is to assist the management in the effective discharge of their responsibilities by

furnishing them with objective analysis, appraisals, recommendations and pertinent comments concerning the activities reviewed. **In short internal audit assures the management that the system of internal check and other types of controls are effective in design and operation.**

Thus, internal audit is a thorough examination of the accounting transactions to ensure that-

- The transactions are properly recorded.
- The accounts are maintained systematically and
- There is no possibility for manipulation of accounts or misappropriation of property of the business.

In modern times, an internal auditor carries a new task. The traditional function of checking the arithmetical correctness of the accounts with the help of vouchers and documents and verification of few items such as stock, cash and fixed assets is not sufficient. The duty of internal auditor now is to chart the procedure, examine the efficiency and work on programs of improvement of assessing the effectiveness of controls. He is expected to plan and arrange his task for effective functioning, set clear objectives of his own section, phase his objectives, gain the confidence of the management and demonstrate the value of his functions in areas of performance.

The internal audit is carried out generally in the same manner as is followed for a professional audit. However, it varies in form from enterprise to enterprise according to its size and specific needs. It is installed in large organisation and is carried out by the salaried staff who are qualified to conduct professional audit. Being the employee of the organisation he has to ensure that there is no waste in the organisation. Internal auditor has to follow the provisions of law, standard auditing practices and procedure prescribed for professional auditors and by the professional bodies controlling the audit system in the country. At the same time internal auditor must be aware of the policies and programs of the enterprise he should be professionally competent to carry out a detailed examination of the working of the business. Equipped with professional expertise and knowledge of the business, he will be in a better position to make the internal audit system more effective.

5.5.1 Objectives of internal audit

The main objectives of internal audit are as under:-

- To verify the correctness and authenticity of the financial records and statistical records presented to the management.
- To ensure that the standard accounting practices are strictly followed in the organisation.
- To facilitate early detection of errors and frauds.
- To ensure that all the transactions have been carried out under a proper authority and by persons authorised for the same in the business.
- To review the system of internal check from time to time to advise the management on improvement of the system and to undertake special investigation for the management.
- To confirm that the liabilities have been incurred by the organisation for legitimate activities.

Thus, efficiency of internal audit depends on the efficiency of the staff employed for the purpose, internal audit can be effective only if the internal auditor is given wider authority to investigate the transactions not only from financial angles but also from other organizational activities. Internal auditor should report directly to the top management. He must operate independently of the accounting and other staff. He must be given an independent status as an important functionary and a part of the management.

5.5.2 Internal audit v/s statutory audit

Internal audit helps the statutory audit to a large extent. Both the internal auditor and the statutory auditor have a common interest as far as authenticity of the accounts are concerned. However soundness of internal audit relieves the statutory auditor from detailed checking.

The internal auditor reviews the operations and performs such functions as evaluation, compliance, verification and ensures that policies, procedures, rules and other type of controls of the business are carried out efficiently.

He is helpful to statutory auditor in the matter of examination of books of accounts. Generally, the statutory auditor accepts some of the detailed checking made by the internal auditor. However, the area of co-operation between internal auditor and statutory auditor is somewhat limited as the statutory auditor has a responsibility under law to various authorities, while the internal auditor is responsible only to the management. The statutory auditor has to carry out his duties in accordance with standard accounting and auditing practices and provisions of law which govern the organisation. Before accepting the checking of accounts and other documents carried out by internal auditor, the statutory auditor must undertake such test checks necessary to find out the effectiveness of internal audit.

Both internal auditor and statutory auditor carry out examination of records and documents and make physical and other verifications. Despite these similarities there are differences in the status, responsibilities, approach and scope of work of internal auditor and statutory auditor.

Differences between internal audit and statutory audit-

The following are the points of differences between internal audit and statutory audit:

Internal audit	Statutory audit
1. Internal audit is the arrangement within the organisation to verify on continuous basis the correctness and truthfulness of the transactions by the salaried staff.	Statutory audit is the examination of the books of accounts of the business by an external auditor and to report that the profit and loss account and balance sheet are drawn according to provisions of law and the financial statements reveal the true and fair view of the results of operations and financial state of affairs of the business.
2. Internal audit is not compulsory.	Statutory audit is compulsory in case of business houses incorporated under the Companies Act and other acts. Statutory audit can be carried out only by those who are qualified for appointment as per the provision of the Companies Act and other acts.
3. Internal audit is carried out by the staff appointed by the business enterprises. It is not necessary that the internal audit staff should possess the qualification prescribed for professional auditor	The rights, duties, responsibilities and liabilities of auditors are governed by the provisions of law. The auditor is independent of management.
4. Being an employee of the organisation internal auditor is answerable to the management. His duties, responsibilities etc. regarding	

<p>audit work are determined by the management. The management can increase the powers and authority of the internal auditor. Similarly it can also curtail his powers.</p>	
<p>5. The internal auditor points out irregularities in the procedural aspects and suggests ways and means to rectify the same. He assures that the financial operations and other types of control in force are carried out in conformity with the accounting systems.</p>	<p>The statutory auditor is concerned with the legality and validity of the transactions of business. His audit work is based on the financial statement prepared by the business.</p>

5.6 INTERNAL CHECK

Internal check is a system enforced in business under which the recording of business transactions is arranged in such a manner that the work of one staff member will automatically be checked by others in the course of recording of transaction itself.

Spicer and Pegler have defined a system of internal check as "an arrangement of staff duties whereby no one person is allowed to carry through and record every aspect of a transaction such that without collusion between two or more persons., fraud is prevented and at the same time possibilities of errors are reduced to a minimum". De Paula has defined internal check as "a continuous internal audit carried on by the staff itself by means of which the work of each individual is independently checked by other member of the staff."

Thus, under internal check system the staff duties are so arranged that no one person is allowed to record every aspect of the transactions and the entire work is distributed among the various members of the staff in such a manner that the work of one person is automatically checked by others.

The essential elements of internal check are as under-

- Existence of checks on day to day transactions.
- The check is to be carried out continuously as a part of the routine system.
- The work is divided among the staff and each staff is assigned a specific task.
- The work of each staff though independent is complementary to the work of another.

The system of internal check is increasingly recognised by the auditor specially when the size of the concern is large. The existence of effective internal check system relieves the external auditor of detailed checking to a larger extent. The extent to which an external auditor can depend upon the system of internal check is based on the procedural tests applied by him to find out the effectiveness of the system. However the auditor can not be relieved of his responsibility if he was found guilty of negligence regardless of the fact that he had tested the internal check in existence in the organisation before he had accepted it as correct.

5.6.1 Objectives of internal check

- To reduce chance of fraud and errors that may be committed by any member of the staff and make it more difficult. If any fraud is to be committed two or more persons must collude together.
- To detect fraud and errors easily and correct them promptly.
- To exercise moral pressure among the members of the staff.
- To allocate duties and responsibilities of every person in such a way that he can be taken to task for any lapse on his part.
- To increase overall efficiency of the members of the staff by assigning duties based on the principle of division of labour.

- To have an accurate and reliable record of all business transactions.

Essentials of good internal check system

- No single staff shall have absolute control over recording of all the aspects of business transactions by himself.
- The same staff shall not be allowed to have access to all books of accounts as well as physical custody of the assets.
- Each member of the staff should be made responsible for a specific work.
- All officials and employees holding responsibility towards cash, securities or stock should be encouraged to proceed on annual leave to prevent the concealed fraud.
- The duties of the members of the staff should be changed from time to time.
- Attempt should be made to introduce mechanical devices to prevent mis-appropriation of cash.
- Each transaction should pass through a definite route and through several hands.
- All books, vouchers, documents should be classified and made available for easy reference.
- Proper record must be maintained of the incoming and outgoing of goods from the business premises.

- Self balancing ledger system should be introduced to make the system more efficient and effective.
- No undue importance should be given to any staff member and too much reliance on any staff member should be avoided.
- Division and allocation of duties among the staff members must provide for an automatic check by others.

5.6.2 Internal check as regard cash sales

Since chances of committing fraud in connection with cash sales are greater, it calls for devising an efficient and effective system of internal check. Cash sales may be affected in various ways like a) sale at counter, b) postal sales, i.e. sales under mail order, and c) sales by representative and agents. The system of internal check to be followed in each case is discussed below.

- One salesman should be appointed to look after one counter independently and should be made responsible for sales effected in his counter.
- Each salesman must be issued with a separate cash memo book. The cash memo book must be printed in different colours to identify different counters of the business.
- Each salesman must maintain a sales sheet. He should record therein the sales effected by him. The summary of cash sales effected by him must tally with the cash memos issued by him.
- Cash memos are to be issued with carbon copies.
- The salesman must not receive cash on the cash memos issued by him.

- All payments on the cash memo of the salesman must be made by the customer at the cash counter.

Sales are to be effected in the following manner

1. Three copies of the cash memo must be issued to customer
2. The customer must present the three copies of cash memo to the cashier at the time of making payment
3. The cashier must verify the particulars and satisfy himself regarding the total payment with reference to rates and quantity.
4. The cashier on receiving the payment in cash will place a rubber stamp on all the copies of memos as "cash paid".
5. He will retain one copy with himself and hand over the other two copies to the customer.
6. The customer must present the cash memos to the delivery department to collect the goods purchased.
7. The delivery department will put rubber stamp on the memos as "goods delivered". It will retain one copy as an evidence for delivery and hand over another copy of the memo to the customer.

At the end of the day's working, the sales man, the cashier and the gate keeper should prepare the summary and submit to the manager or officer incharge. If these summaries tally, the accounts are certified as correct.

Postal sales i.e. sales under mail order

This includes following aspects:

- All sales made by post i.e. V.P.P should be recorded in a separate register to be maintained for the purpose.
- The goods returned, if any, should also be recorded in the register.
- The total amount of cash receipts including advance, if any, against the mail orders should be entered in the register and the same should be deposited into the bank.
- All the entries in the V.P.P. register should be checked by some responsible officer and special inquiries should be made in respect of those goods against which cash has not been received.
- There should be proper filing of mail orders received and the cash book should be checked with these mail orders.

Sales by representative and agents

It is the practice in big business houses to employ representative and agent to promote sales and to collect the amount due from debtors. The system of internal check to be introduced in this connection should be as follows:

1. The representatives and agents should be authorised to issue rough receipts to the customers against cash received from them. However, the final receipt should be issued only by the head office.
2. The customers should be advised to communicate directly with the head office if they do not get the final receipt within a reasonable time period.

3. The representatives and agents should be instructed to remit the amount of cash collected by them to the head office without any delay.
4. The representatives and agents must not be allowed under any circumstances to deduct their commission or any other expenditure from the amount of cash collected by them. The bill for commission and other expenses should be submitted to the head office.
5. As a matter of routine the head office should send periodical statements of accounts to the customer with a view to apprise them of the latest position.
6. The representatives and agents should be advised to submit periodical statements to the head office showing therein the amount of sales made by them, the amount of cash collected by them and the names of the defaulters.
7. The head office should issue reminders to those defaulting customers who have failed to clear their dues.
8. The representatives and agents must not be allowed to operate from a fixed place. On the contrary, they should be transferred from time to time to other place in order to increase their efficiency and to avoid the possibility of committing fraud.

5.6.3 Internal check as regards purchases

Since chances of committing fraud in connection with the purchases of goods by a big business house are greater, it calls for devising an efficient and effective control system of internal check. In this connection one should be familiar with the purchases procedure which should be as under.

- The department requiring the material should fill in the purchase requisition indicating the quantity and quality to the purchase department.
- The purchase department on the basis of the requisition will send out enquiries to the various suppliers asking for quotation.
- On receipt of quotations the order will be placed on the best vendor taking into account the quality, period of delivery, competitive prices etc.
- On receiving the order the vendor shall execute the order. The supplies will be received by the stores department.
- On receipt of goods it will be verified with reference to the order with the goods received memo issued by the stores department. If the supplies are made according to the order the delivery note and invoice sent by the supplier will be forwarded to accounts department with endorsements for the goods received and taken to stores.
- The invoice will be passed for payment by a senior officer after verifying the terms and conditions of the supply with reference to rates and quality and other expenses detailed.

Keeping the above points in view, the following system of internal check is suggested with regards to purchase:

- There should be separate purchase department.
- Purchase order are to be issued only against indents received from the various department of the business.
- All orders should be placed in writing. The order form must be preferably a printed form containing full details.

- The orders must be made in quadruplicate. One copy of the order is to be sent to the supplier. The second copy is to be sent to the concerned department which has placed the indent for supply; third copy is to be sent to account department and the fourth copy is to be retained by the purchase department for future reference.
- All orders for purchase, should be signed only by the purchase manager or the person authorised for this purpose.
- All orders should contain the seal of office.
- The goods received should be inspected with the copy of the order.
- The goods received are to be examined with delivery notes and supply invoices of the seller regarding quantity, quality and rates.
- The purchase department should make an endorsement putting rubber stamp on the suppliers bill with reference to goods received.
- After inspection and examination 'Goods Received Note' is to be prepared for each lot of purchase. The inspection note should also be attached to it.
- Endorsement must be made by the purchase manager or the authorised official (of stores department to take the goods into stock.
- The stores department should acknowledge receipt of goods and send the same to the order department.
- All packages of incoming goods are to be opened only in the presence of a responsible official.
- The stores officer on verification of the correctness of the goods received should enter them in the stock register.

- Generally a rubber stamp containing the following certificate will be placed on the suppliers bill and signed by the purchase manager

"Certified that goods are received as per Order

No,.....Dated.....and taken to stock vide Folio No,..... of stock register No,....."

- The Payment on purchases must be made only after accounts department verifies the invoice, goods received note and purchase order.
- The accounts department should impress a rubber stamp on invoices which are passed for payment.
- A separate purchase register is to be maintained by the purchase department
- Ledger clerk should have no access to physical stock register or cash to avoid manipulation of accounts.
- For inter-branch purchase or inter-company purchases transfer notes should be issued.
- All Purchases that are made by employee for the personal use must be accounted for separately.
- A separate return outward book is to be maintained to record the return of goods to suppliers.
- Credit notes are to be issued for adjusting claims. The purchase department should send a copy of credit note to accounts department.

- A purchase ledger control account is to be maintained. Ledger account should be checked periodically against the suppliers statements.
- A perpetual inventory control method should be adopted to avoid excess quantity and to maintain minimum quantity.
- Where goods are delivered directly to locations or place of work not controlled by the purchase department, the invoices are to be passed by the purchase department only after examining the certificate of receipt of stock from the authority to whom the goods are delivered.

In general the purchase department must place purchase orders on the basis of indents, record the order in the purchase day book, enter the goods received in the goods inward book and send the invoice of the supplier alongwith the inspection report and goods received notes to the accounts department for payment.

Internal check as suggested above will avoid irregularities in purchase and minimize, if not completely eliminate, manipulation of accounts by entering fictitious purchase or entering invoice twice or misappropriating the discount or commission allowed by the suppliers.

5.6.4 Internal Check as regards Sales

The organisation of the sales department depends on the system of selling and distribution of goods. Unless the department is organised properly there are greater possibilities for suppression of sales and manipulation of accounts. Goods can also be misappropriated. Hence, a well-knit system of internal check is necessary which may be in the following manner::

- 1) Sales must be executed against order received from customers.
- 2) All incoming orders shall be numbered and filled and confirmation of the orders received be sent to the customers.
- 3) Proper record is to be maintained for the orders received, order under execution/executed/refused.
- 4) The sales shall be authorised by responsible officials after scrutiny of the order and assessing the portion of supply of goods as well as the terms and conditions of sales accepted by the customer.
- 5) All sales orders shall contain invoices prepared in quadruplicate. One copy is to be retained by the sales department, one to be sent to the customer, one to the accounts department and the last copy to despatch section for despatch of goods.
- 6) Separate departments should deal with cash sales and credit sales.
- 7) In the case of credit sales a separate register should be maintained of the customers with financial standing. The credit sale is to be allowed only after scrutiny of the customer's order for supply of goods on credit.
- 8) Periodical statement of the outstanding balance due towards the customer be sent and confirmation obtained from them.
- 9) Regular reminders for payment shall be made to the customers reminding them of their dues.
- 10) Amount due from the customer shall be written off as bad unless all methods of recovery are exhausted.
- 11) The responsible official shall be entitled to treat a debt as bad.

- 12) The sales invoice clerk shall have no access to physical stock or accounting records.
- 13) The credit note shall be prepared only after ascertaining the fact from the despatch section and the sales department for the goods received back from the customers. Credit notes are to be prepared in quadruplicate. One is to be retained with the invoice department, second copy is to be sent to despatch department, third copy to the sales department and fourth copy to the customer.
- 14) In case sales are cancelled, a notice is to be given to the despatch department to stop despatch of goods.
- 15) The invoice can be cancelled only by the sales department. All sales invoices must be printed and numbered in serial order.
- 16) The sales ledger shall be maintained by a separate clerk.
- 17) Periodical statements should be sent to debtors.
- 18) In the case of credit sales regular confirmation should be obtained from the customers regarding the outstanding balances. The confirmation of balances must be verified by a senior person other than the ledger clerk.
- 19) A sales ledger control account shall be balanced with the control account periodically.
- 20) A sales ledger control account in the general ledger shall be maintained.
- 21) Credit to employees can be allowed only after proper authorization from the management.

- 22) Separate department should be set up to deal with sales on consignment, hire purchase, goods on sales or return etc.
- 23) The stock held by the agents should be verified periodically with the statements received from the agents.
- 24) The goods sent on sale or return basis but unsold on the date of the balance sheet should not be treated as sales but unsold stock.

Internal check system with regards cash received on sales is suggested under the caption "cash sales". The internal check of the sales department included the suggestions given for internal check on cash sales.

5.6.5 Internal Check as regards Wage Payment

In big organization, the work regarding the maintenance of various type of wage records, computing the amount of wages and the payment of wages to the right persons are of significant importance. It is, therefore, necessary to design a proper system of internal check regarding wages payment to minimize the dangers of fictitious names, errors in wages records and misappropriation of money. The following system of internal check is suggested:

- 1) Workers should be employed only after the written order of the Personnel Officer or the appointing authority. A copy of the appointment order be endorsed to the wage preparing section.
- 2) Separate staff should record attendance of workers, control of leave, payment of overtime and disbursement of pay packets. Each staff member shall be responsible to enter relevant information in the wage sheet. He should also put initials for the work completed by him.
- 3) The wage sheet shall contain columns for recording relevant information with regard to payment of wages such as name of the employee, designation, period for which wages are paid, rate of pay,

amount of basic pay, dearness allowance, house rent allowance, compensatory allowance and other allowance, gross salary drawn, deductions (there should be separate columns indicating the nature of deductions) and net amount payable and signature of employees, for acknowledging the payment.

- 4) Separate records should be maintained for each worker indicating the date of appointment, scale of pay, rate of pay, etc. Copies of orders relating to increase in pay, promotions and punishments, deduction in wages on account of Provident Fund, Loan, Medical, Ground Insurance etc. shall be endorsed to wage preparing section.
- 5) Separate job cards are to be maintained for recording the work performed by the worker.
- 6) Each worker is to be given a pay slip indicating the gross wages and net wages.
- 7) Separate register is to be maintained for recording the name of workers who may be allowed to work overtime. No worker shall be allowed to work overtime without the prior sanction of the proper authority.
- 8) Time recording clocks shall be installed at the main gate of the factory for recording the arrival and departure of workers.
- 9) The rosters of workers for each work should be prepared and copy of the same be sent to the wage preparing section.
- 10) Late arrival of workers shall be entered in a separate register and the same be sent to the personnel section for future reference.
- 11) Proper watch and ward arrangement is to be maintained to record the arrival of the workers and the time of leaving the factory.

- 12) The rate of wages of each worker is to be periodically checked with reference to rate card.
- 13) All calculations regarding gross wages and net wages payable after deduction are to be checked by an independent person.
- 14) In the wage sheet the names of workers, rates of pay, the period for wage to be paid shall be entered by one person. The calculations regarding gross wages payable shall be made by another person. The deductions under various heads shall be made by a third person. The net wages payable and the checking of the wages sheet with reference to leave deductions etc. should be made by a senior staff member. The wages sheet shall be signed by the authorised official.
- 15) If the wages are to be paid on the basis of piece wage system, the actual work done by each worker must be maintained on a job card to be given to each worker. These cards should be counter signed by the foreman of the department and the store department to which the goods produced are delivered.
- 16) The wage sheet shall be prepared in triplicate. One copy shall be endorsed to pay master, the second copy to the account section and final copy shall be retained by the wage preparing section.

5.6.6 Internal check system and auditor

The soundness of the system of internal check and the way it is put into operation in the organisation are matter of great importance for the auditor. In case the system of internal check is effective the work of the external auditor becomes quite easy. He is relieved of the detailed and routine checking of the transaction as the internal check system takes care of the same. In case the internal check system is not effective, then the auditor should have to decide the extent of detailed checking to be undertaken in order to satisfy himself about the authenticity of the business records. It is, therefore, necessary for the auditor to study the system in force in the organisation; this he can do by applying few test checks and if the results are satisfactory he can depend on the internal check system. In case the internal check system in force is weak or defective then he should carry out detailed checking of the accounting

records. In case he does not do so he may be held liable for all the undetected errors and frauds. He should not show any negligence in his duty. He should design the audit program keeping in view the weak links of the system. He should also suggest the changes to the management strengthening the system of internal check. It should be noted that the existence of a sound internal check system in an organisation helps the auditor to a great extent in audit work, but does not reduce his legal liability at all.

5.6.7 Distinguish between internal check and internal control

Ans. Point	Internal check	Internal control
1. Meaning	It is a system of allocation of responsibility, division of work and methods of recording transactions, whereby the work of one employee is checked continuously by another.	It is the system of control established by the management in order to carry on business in an orderly and efficient manner, ensure adherence to management policies, safeguard assets and completeness of records.
	It is a part of Internal Control.	It includes Internal check and Internal audit.
2. Relation	It is arrangement of book-keeping and Clerical duties.	It includes the essence of Internal check and internal audit.
3. Essence	Checks are automatic and continuous.	It includes the implementation of Internal check and Internal audit.
		It includes Internal check and Internal audit.

4.How are they implemented.	Checks are objective.	
5. Nature		

5.6.8 Audit in respect of computer environment (E.D.P. audit).

The principal object of the audit is to ensure that the accounts on which the auditor is reporting show a true and fair view of the state of affairs at a given date and of the results for the period ended on that date. The essential features of an audit appropriate for medium or large sized concerns are :-

- a) An evaluation of the system of accounting and internal control to ascertain whether they are appropriate for the business and properly record all transactions
- b) The making of such tests and enquiries as are considered necessary to determine whether the systems are being operated correctly.
- c) An examination of account in order to verify :-
 - i) The title, existence and value of the assets appearing in the balance sheet and to verify that all liabilities are correctly included therein.
 - ii) That the result shown by the profit and loss account is fairly stated.

And to ensure that such accounts are in accordance with the underlying records and comply with the appropriate statutory requirements.

The overall scope and objective of an audit does not change in an E.D.P. environment. However, the use of a computer changes the processing and storage of financial information and may effect the organisation and procedures employed by the entity to achieve adequate internal control. Accordingly, the procedures followed by the auditor in his study and evaluation of accounting system and related internal controls and nature, timing and extent of his other audit procedures may be affected by an EDP environment.

The prime objective of EDP audit is to determine whether computer system safeguard assets, maintain data integrity, achieve organizational goals effectively and consume resources efficiently. A proper system of internal control is necessary to ensure that the objectives are met. It may be remembered that the overall objectives and scope of an audit does not change in an EDP environment. However, the use of a computer changes the processing and storage of financial information and may affect the organisation and procedure employed by the entity to achieve adequate internal control.

The auditor should take the following steps in addition to the normal audit procedure while auditing the computerised accounts.

- 1) Computerised accounting involves the code list for various types of accounts. The auditor should obtain the list of such codes and ensure that they are correctly used.
- 2) In manual accounting procedure each and every stage of recording the transactions is visible viz Preparing vouchers, passing entry, posting in ledger, casting, balancing, grouping, pre-paration of trial balance and final accounts. However, when the accounts are computerised it is not possible for the auditor to check each and every stage of recording the transactions as every thing is done by the computer behind the screen. Therefore, in such a situation it becomes necessary for the auditor to ensure that the functioning of the computer is correct and reliable. For this purpose he should select a sample of some transactions for processing and should compare the results obtained through computer processing with predetermined result.
- 3) In case of computerised accounts, the records of transactions are stored on floppy disks as back up data. These disks are affected by

heat, dust etc. The auditor should ensure that proper precautions have been taken by the client for the safe custody of such disks.

- 4) He should ensure that client has made a proper arrangement for protecting the computer data from "Virus".
- 5) He should ensure that there is proper control over the use of computers by the various users through "Passwords"
- 6) He should ensure that there is proper maintenance of computers by doing servicing at regular intervals. This will reduce the chances of break down and losses of records.
- 7) The accuracy of computer output depends upon the correctness of input. He should ensure that there is a proper system for checking of the output with the inputs on a regular basis.
- 8) Lastly, he should ensure that changes in software programs are carried out by authorised person only and such changes are properly noted for future reference.

5.7 INTERNAL CONTROL

MEANING & PURPOSE

Control is a basic human requirement and it has existed throughout the ages in different facets of human activity. Business as such is a complex process and has grown even more complex with the technological advancement of the society. The formalization of the concept of internal control in the sphere of business administration is a comparatively recent phenomenon.

In the sphere of a business, control is an accepted device for optimum utilization of the resources and opportunities for maximisation of profits. All operations of a business are carried on with the help of human agents and equipment; both these factors need supervision so that the

tasks assigned to them are properly carried out and avoidable wastes and losses do not occur to eat up the fruit of the enterprises.

The internal control required by a sole proprietor of small business is not identical with that required for a large industrial organization. A small trader having a grocery shop hardly needs more than one or two assistants. He decides work to be done by the assistants. He always knows his own stock, cash and bank position. He has the knowledge of daily sales. He himself knows the sources for purchases. He keeps the record of the debtors and creditors. The assistants merely help him in delivering goods to customers or to arrange the goods in proper order.

From the above, it can be observed that control is entirely centralized with the owner and there is no significant delegation of duties. However, as the business grows in size it soon reaches a stage where the owner can no longer keep himself intimately informed about the detailed operations of his business, activities of the employee and their discharge of their responsibilities. To cope with the increasing size and volume of business, he has to employ more and more people and for systematically carrying on the business, he has to specify the tasks for each person. For remote operations he has also to rely upon these people, for carrying out the work, for the custody of the materials, documents and equipments entrusted to them. He has also to ensure that the equipment and facilities are properly maintained. For this purpose, he has to give shape to a form of organization from which he would be in a position to know the board details of the work involved and the persons responsible for such work. Also, he has to work out a plan of delegation of duties and authority for the simple reason that, for anything and everything. People need not come to him for advice or decision, because, under such circumstances, he would not be able to find time to apply his mind to matters of more importance.

Human behavior is such that if it is not under some sort of regulation or control, it often tends to depart from the proper path. It needs to be kept under systematic watch not only for ensuring that the employee does his work, but also to see that he does it in the manner laid down for the purpose and handles the materials and equipments with proper care.

REVIEW OF INTERNAL CONTROL

A review of internal control can be done by a process of study, examination and evaluation of the control system installed by the management. The first step involves determination of the control and procedures laid down by the management. By reading company manuals, studying organization charts and flow charts and by making suitable enquiries from the officers and employees, the auditor may ascertain the character, scope and efficacy of the control system. To acquaint himself about how all the accounting information is collected and processed and to learn the nature of controls that makes the information reliable and protect the company's assets, calls for considerable skill and knowledge. In many cases, very little of this information is available in writing; the auditor must ask the right people the right questions if he is to get the information he wants. It would be better if he makes written notes of the relevant information and procedures contained in the manual or ascertained on enquiry.

To facilitate the accumulative of the information necessary for the proper review and evaluation of internal controls, the auditor can use one of the following to help him to know and assimilate the system and evaluate the same:

- (1) Narrative record;
- (2) Check list;
- (3) Questionnaire; and
- (4) Flow chart;

(1) The narrative record is a complete and exhaustive description of the system as found in operation by the auditor. Actual testing and observation are necessary before such a system is in operation and would be more suited to small business. The basic disadvantages of narrative records are:

- 1. To comprehend the system is operation is quit difficult.
- 2. To identify weaknesses or gaps in the system
- 3. To incorporate charges arising on account of reshuffling of manpower, etc.

(2) A check list is a series of instruction and/or answer. When he completes instruction, he initials the space against the instruction. Answers to the check list instruction are usually Yes, No or Not applicable. This is again an on the job requirement and instructions are framed having regard to the desirable element of control. A few examples of check list instruction are given hereunder:

1. Are tenders called before placing orders?
2. Are the purchases made on the basis of a written order?
3. Is the purchase order form standardized?
4. Are purchase order forms are pre-numbered?
5. Are the stock control accounts maintained by persons who have nothing to do with:

- (1) Custody of work;
- (2) Receipt of stock;
- (3) Inspection of stock; and
- (4) Purchase of stock?

The complete check list is studied by the principle/manager/senior to ascertain existence of internal control and evaluate its implementation and efficiency.

(3) Internal control questionnaire is a comprehensive series of questions concerning internal control. This is the most widely used from for collecting information about the existence, operation and efficiency of internal control in an organization.

An important advantage of the questionnaire approach is that oversight or omission of significant internal control review procedures is less likely to occur with this method. With a proper questionnaire, all internal control evaluation can be completed at one time or in sections. The review can more easily be made on an interim basis. The questionnaire form also provides an orderly means of disclosing control defects. It is the general practice to review the internal control system annually and record the review the detail. In the questionnaire, generally questions are so framed that a 'Yes' answer denotes satisfactory position and a 'No' answer suggests weakness. Provision is made for an explanation or further

details of 'No' answers. In respect of questions not relevant to the business, 'Not applicable' reply is given.

The questionnaire is annually issued to the client and the client is requested to get it filled by the concerned executives and employees. If on a perusal of the answers, inconsistencies or apparent incongruities are noticed, the matter is further discussed by auditor's staff with the client employees for a clear picture. The concerned auditor then prepares a report of deficiencies and recommendation for improvement.

(4) A flow chart is a graphical presentation of each part of the company's system of internal control. A flow chart is considered to be the most concise way of recording the auditor's review of the system. It minimises the amount of narrative explanation and thereby achieves and consideration or presentation not possible in any other form. It gives bird's eye view of the system and the flow of transactions and integration and in documentation, can be easily spotted and improvements can be suggested.

It is also necessary for the auditor to study the significant features of the business carried on by the concern: the nature of its activities and various channels of goods and materials as well as cash, both inward and outward, : and also a comprehensive study of the entire process of manufacturing, trading and administration. This will help him to understand and evaluate the internal controls in the correct perspective.

ADVANTAGES

Auditors' right to rely on Internal Control: The duty of safeguarding the assets of a Company is primarily that of the Management and the Auditor is entitled to rely upon the safeguards and Internal Controls instituted by the Management, although he will, of course, take into account any deficiencies he may find therein while drafting his Programme.

Audit Assurance: The Auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has infact been recorded. -

Integral part of Audit Programme: The examination and evaluation of the Internal Control System is an indispensable part of the overall Audit Programme.

Audit Planning: The Auditor should gain an understanding of the accounting system and related Internal Controls and should study and evaluate the operations of these Internal Controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.

Role of review: The review of Internal Controls will enable the Auditor to know –

(a) Whether errors and frauds are likely to be located in the ordinary course of operations of the business;

(b) Whether an adequate Internal Control System is in use and operating as planned by the Management;

(c) Whether an effective Internal Audit department is operating;

(d) Whether any administrative control has a bearing on his work (e.g. when there is a weak control over

Worker recruitment and enrolment, there is a likelihood of including dummy names in the wages sheet which is relevant for the Auditor); (e) Whether the controls adequately safeguard the assets; (f) How far and how adequate is the Management effectively involved in discharging its function of correct recording of transactions is concerned;

(g) How reliable the reports, records and the certificates to the Management can be; (h) the extent and depth of the examination that the Auditor needs to carry out in the different areas of accounting;

(i) What would be the appropriate audit technique and audit procedure in the given circumstances; (j) what* are the areas where control is weak and where it is excessive; and (k) whether some worthwhile suggestions can be given to improve the control system.

(ii) **AUDITORS DUTIES**

Role of the Auditor vis-à-vis Internal Control can be summarized as under -

Management Responsibility: The duty of safeguarding assets of a Company is primarily that of Management. The Auditor is entitled to rely upon • safeguards and Internal Controls instituted by the Management.

Necessity for Evaluation: The Auditor is interested in ascertaining that transactions are executed in accordance with the Management's authorisation, all transactions are recorded properly and assets are adequately safeguarded. Therefore, the examination and evaluation of the Internal Control System is an indispensable part of the overall audit Programme.

Assurance: The Auditor needs reasonable assurance that the accounting system is adequate and that all the accounting information which should be recorded has in fact been recorded in a correct, proper and timely manner. Internal Control normally contributes to such assurance.

Audit Planning and Programme: The Auditor should gain an understanding of the accounting system and related Internal Controls. He should study and evaluate the operations of these Internal Controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures. He can formulate his entire audit programme only after he has had a satisfactory understanding of the Internal Control System and its actual operation.

Review: If the Auditor reviews the Internal Control System of the client, he will be in a position to bring to the Management's notice, the weaknesses in the system and suggest measures for improvement. During the course of his audit, he may also ascertain how far the weaknesses have been removed.

Audit Procedure: Proper understanding of the Internal Control System enables the Auditor to decide upon appropriate audit procedure to be applied in different areas. In areas where Internal Control is considered weak, he might extend certain tests to cover a large number of transactions or other items than he otherwise would examine and at times may perform additional tests to gain necessary satisfaction.

Test Checking: In deciding upon a plan of selective checking (test checking or sample checking), the existence and operation of Internal Control System is of great significance.

Reporting: Under CARO, the Statutory Auditor of a Company has to report on the following aspects relating to Internal Control

(a) Is there an adequate Internal Control System commensurate with the size of the Company and the nature of its business, for the purchase of Inventory and Fixed Assets and for sale of goods and services?

(b) Whether there is a continuing failure to correct major weakness in Internal Control System?

A senior assistant of X & Co. Chartered Accountants developed an audit Programme without evaluating the Internal Controls of T Ltd. When the Partner asked the reason, he stated that the controls were developed by the General Manager (Finance) of T Ltd., who is also a Chartered Accountant and who had written a few books on subinterval Control" and therefore there is no need to review the said controls. State your viewpoints.

1. A proper understanding of the Internal Control System enables the Auditor to decide upon the nature, extent and timing of the appropriate substantive audit procedures to be performed.
2. Although Internal Control is Management's responsibility, the Auditor-
 - (a) Should independently gain an understanding of the accounting system and related Internal Controls and
 - (b) Should study and evaluate the operation of those Internal Controls upon which he wishes to rely in determining the nature, timing and extent of other audit procedures.
3. Where the Auditor concludes that he can rely on certain Internal Controls, his substantive procedures would normally be less extensive than would otherwise be required. It may also differ as to their nature and timing.
4. Where Internal Control is weak, the Auditor might choose such an auditing procedure / test that might not be required otherwise. He might extend certain tests to cover a large number of transactions or other items than he otherwise would examine at times and perform additional tests for his satisfaction.
5. Just because the Internal Control was developed by a Chartered Accountant who had also authored a book on Internal Control is of no significance and does not absolve the Statutory Auditors' duties. The Auditor must independently understand and evaluate the Internal Controls to develop a proper audit Programme.

REVIEW OF INTERNAL CONTROLS

INHERENT LIMITATION OF INTERNAL CONTROL

Internal control can provide only reasonable, but not absolute, assurance that the objectives stated above are achieved. This is because there are some inherent limitations of internal controls, such as:

- (a) Management's consideration that a control be cost effective;

- (b) The fact that most controls do not tend to be directed at transactions of unusual nature;
- (c) The potential for human error;
- (d) The possibility of circumvention of controls through collusion with parties outside the entity or with employees of entity;
- (e) The possibility that a person responsible for exercising control could abuse that authority, for example, a member of management overriding a control;
- (f) The possibility that procedures may become inadequate due to changes in conditions and compliance with procedures may deteriorate;
- (g) Manipulations by management with respect to transactions or estimates and judgements required in the preparation of financial statements.

INTERNAL CONTROL SAMPLES FOR SALES & DEBTORS, PURCHASES & CREDITORS, WAGES & SALARIES

Sales and debtors

The primary Internal Control measures in relation to Sales & Debtors are -

- j. All documents like Invoices, Delivery Challans, etc. should be serially numbered and missing documents promptly investigated.
- Despatch, sales and invoicing functions are to be segregated.
- Delivery Challan shall be verified by the carrier before dispatch.
- 4. Delivery Challan shall be verified with customer's Purchase Order before dispatch and serially filed.
 - 5. Customers' acknowledgement for goods despatched must be promptly obtained.
 - 6. Invoices prepared for all deliveries are to be sent to customers within a reasonable time.
 - 7. Prices on invoices must be as per standard-price list and all unusual discounts / price reductions should be duly authorised.
 - 8. Proper recording of returned goods should be made and Credit Notes duly authorised and verified with *j* related invoices.
 - 9. Adequate records shall be maintained for part deliveries.
 - 10. Listings in Sales Ledger balances shall be regularly balanced with Control Account.

11. Cheque received by post are to be recorded and bearer cheques must be stamped "A/c Payee only".
12. Record of receipts shall be duly verified with the bank pay-in-slip after deposit and also with the Cash Book.
13. Duties of personnel responsible for recording Sales Ledgers, receipts of cash and issue of receipts shall be segregated.
14. Cash takings/collections have to be matched with invoices.
- J 5. Segregation of duties shall be defined between persons recording transactions and extracting balances.
16. Listings of Sales Ledger Balances shall be reconciled periodically with Control Accounts, by independent persons.
17. Ageing analysis shall be prepared and checked. Old balances should be followed up.
18. Statements shall be regularly sent, reconciliation with customer balances prepared at regular intervals and reconciling items shall be followed up.
19. Credit limits shall be checked before orders are accepted.

Important Internal Control measures in relation to Purchase & Creditors are -

Orders shall be supported by authorised requisitions and duly approved by a responsible official.

Tenders should be invited before placing orders.

Purchase orders have to be pre-numbered and serially controlled.

Goods Receiving Department should be adequately staffed to inspect, record and store goods received.

Goods Received Notes have to be pre-numbered and serially controlled.

The following duties should be segregated-

- (a) Preparing Goods Received Notes;
- (b) Recording goods received on Stock Records;
- (c) Custody and authorizing issue of stores;
- (d) Verification of Goods Received Notes with Invoices.

Invoices shall be verified with rates on Purchase Orders and calculations should be checked before posting.

Goods Received Notes lying unmatched with invoices shall be duly followed up and liabilities for goods

Received at year-end should be duly recorded.

Invoices should be recorded in an Invoice Register only upon receipt.

Suppliers' Statements shall be regularly reconciled.

Listings in Purchase Ledger Balance shall be reconciled periodically with the respective Control Accounts.

DISTINGUISH BETWEEN

INTERNAL CHECK	INTERNAL CONTROL
(1) Internal check means the arrangement of work different employees in such a manner that work of any person is automatically checked by another person is doing his duty.	(1) Internal control is the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in an orderly manner, safeguard its assets and secure as far as possible the accuracy and reliability of its records.
(2) It on going continuous process.	(2) Internal control is a wider term which includes internal check, internal audit, etc.
(3) It is applicable to both, small & large organizations.	(3) Generally it is more applicable to large organizations where there are many departments.
(4) Relatively it is cheaper.	(4) Relatively setting up of internal control system is costly and time consuming.

INTERNAL TEST CHECK V/S INTERNAL CHECKS

PARTICULARS	TEST CHECK	INTERNAL CHECK
1. MEANING	it stands for the method of auditing when instead of a complete examination of all the transaction recorded in the books of account only some of the transaction are selected and verified.	It refers to a system of book-keeping and arrangement of staff duties in the organization in such a manner that no one person can completely carry through a transaction and record every aspect thereof.
2. INSTITUTED BY	It is an audit procedures performed by the auditor in respect of only selected group of transactions.	It is a series of procedures laid down by the management.
3.OBJECTIVE	The purpose is to aid auditors to check and draw conclusions about the voluminous transactions.	Its objective is to facilitate management functions.
4. FRAUD & ERRORS	It helps the auditor to unearth frauds and errors without checking all the transactions.	It is instituted to prevent frauds and errors.
5. MGMT CONTROL	Management has no control over the test checks carried out by the auditors.	Internal controls are subject to review, appraisal and changed by the management.

INTERNAL AUDIT**MEANING:**

It is a review of the operations and records, sometimes continuously undertaken, within a business, by specially assigned staff. But internal audit must not be confused with internal check. Internal check consists of a set of rules or procedures that are part of the accounting system, introduced so as to ensures that accounts of a business shall be correctly maintained and the possibility of occurrence of frauds and errors eliminated. On the other hand, internal audit is a through examination of the accounting transactions as well as that of the system according to

which these have been recorded, with a view to reassuring the management that the accounts are properly maintained and the system contains adequate safeguards to check any leakage of revenue or misappropriation of property or assets and the operations have been carried out in conformity with the plans of the managements. However, the routine process by which an internal audit is carried out is broadly the same as those followed for professional audit. But internal audit often differs in its scope and emphasis: it is more managerial and accounting; also its form is varied, depending on the size of the organization. For instance, whereas a professional auditor is primarily concerned with the legality or validity of transactions entered into by a business an internal auditor in addition is expected to ensure that the standards of economy and efficiency are being maintained. On that accounts, the internal auditor must ascertain that orders for the purchase of stock are placed only after inviting tenders, sales are effected at the highest ruling rates, standard procedures as regards requirement of staff are followed, losses in manufacturing process suffered during the period under review are not higher than those in the earlier periods and so on. He must further confirm that there has been no leakage of stocks or of any other assets, reconciling the physical balance. The nature and extent of checking, that he should carry out, also would depend on the size and type of the business organization.

BASIC PRINCIPLES OF ESTABLISHING INTERNAL AUDIT

The basic principal of establishing internal audit in a business concern are-

1. Independence : the internal audit department should have an independent status in the organization. He may be required to report directly to the board of directors.
2. Objectives: the objectives of the internal audit function should be made very clear and unambiguous. The objectives should be properly communicated so that internal audit is not viewed as “over-the-shoulder check” by other departments.
3. Clarity in Scope: the scope pf internal audit department must be specified in a comprehensive manner. The department must at all times, have authority to investigated from the financial angle, every phase of organizational activity under any circumstances.

4. Definition of Duties: The internal audit Department's duty is to review operations as part of the internal control system. It should not be involved in performance of executive actions.
5. Internal Audit Department: The size and qualification of staff of the internal audit department should be commensurate with the size of the business. The cost of internal audit department should not exceed the benefits expected to be derived from it.
6. Reporting: The Programme of internal audit should be time-bound. There should be provisions for periodic reporting on various operational and other aspects.
7. Follow Up and Review: There should be sufficient scope for the follow up actions on the various points raised in internal audit report. Top management should take active part in ensuring compliance with actions points raised in the report.
8. Relationship with statutory auditor: The copy of the internal audit report should be made available to the statutory Auditor, who can deal with the same in the manner as he deems fit.

OBJECTIVES

- (1) To verify the accuracy and authenticity of the financial accounting and statistical records presented to the management.
- (2) To ascertain that the standard accounting practices, as have been decided to be followed by the organization, are being adhered to.
- (3) To establish that there is a proper authority for every acquisition, retirement and disposal of assets.
- (4) To confirm that liabilities have been incurred only for the legitimate activities of the organization.
- (5) To analyse and improve the system of internal check; in particular to see (1) that it is working; (2) that it is sound; and (3) that it is economical.
- (6) To facilitate the prevention and detection of frauds.
- (7) To examine the protection afforded to assets and the uses to which they are put.

- (8) To make special investigation for management.
- (9) To provide a channel whereby new ideas can be brought to the attention of management.
- (10) To review the operation of the overall internal control system and to bring material departures and non-compliances to the notice of the appropriate level of management; the review also generally aims at locating unnecessary and weak controls for making the entire control system effective and economical.

As per SAP-7 The scope and objectives of internal audit vary widely and are dependent upon the size and structure of the entity and the requirements of its managements.

Normally, however, internal audit operates in one or more of the following areas:

- (a) Review of accounting system and relating internal controls: the establishment of an adequate accounting system and related controls is the responsibility of managements which demands proper attention on a continuous basis. The internal audit function is often assigned specific responsibility by management for reviewing the accounting system and related internal controls, monitoring their operation and recommending improvements thereto.
- (b) Examination for management of financial and operating information: This may include review of the means used to identify, measures, classify and report such information and specific inquiry into individual items including detailed testing of transaction, balances and procedures.
- (c) Examination of the economy, efficiency and effectiveness of operations including non-financial controls of an organization: Generally, the external auditor is interested in the results of such audit work only when it has an important reliability of the financial records.
- (d) Physical examination and verification: The would generally include examination and verification of physical existence and condition of the tangible assets of the entity.

EVALUATION OF INTERNAL AUDIT BY STATUTORY AUDITOR**USEFULNESS OF INTERNAL AUDIT****INTERNAL AUDIT V/S EXTERNAL AUDIT**

(1) The role of internal audit function within an entity is determined by management and its prime objective differs from that of the external auditor who is appointed to report independently on financial information. Nevertheless, some of the means of achieving their respective objectives are often similar and, thus, much of the work of the internal auditor may be useful to the external auditor in determining the nature, timing and extent of his procedures.

(2) The external auditor should, as part of his audit, evaluate the internal audit function to the extent considers that it will be relevant in determining in nature, timing and extent of his compliance and substantive procedures. Depending upon such evaluate, the external auditor may be adopt less extensive procedure than would otherwise be required.

(3) By its very nature, the internal audit function cannot be expected to have the some degree of independence as is essential when the external auditor expresses his opinion on the financial information. The report of the external auditor is his sole responsibility, and that responsibility is not by any means reduced because of the reliance he place's on the internal work.

DISTINGUISH BETWEEN:

INTERNAL CHECK	INTERNAL AUDIT
(1) Internal check is not a specific check, but the duties of different persons are so arranged that a person's work is automatically checked by another person while carrying out the normal duty.	(1) Internal audit is specifically done to check that the accounts are properly maintained and the systems are in control.
(2) Internal check does the preventive job i.e. internal check is derived so that frauds and errors are prevented.	(2) Internal audit does the detective job of identifying frauds and errors and rectifying them.
(3) It is more of process in a day to day functioning of the business.	(3) It is specific defined job.
(4) All the persons in the organization are involved to maintain the internal check system.	(4) Specific persons are appointed to the internal audit.

