

SCHOOL OF STUDIES IN COMMERCE
VIKRAM UNIVERSITY, UJJAIN (M.P.)

CLASS: B.B.A. (HONS.) 4TH SEM.
SUBJECT: CORPORATE AUDITING
TITLE OF TOPIC: INTERNAL AUDIT
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TOPICS

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INTERNAL AUDIT

MEANING

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 organization.

The term internal audit has been defined as "an independent appraisal of activity" within an organization 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 organization 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 organization and is carried out by the salaried staff, who are qualified to conduct professional audit. Being the employee of the organization he has to ensure that there is no waste in the organization. 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.

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, measure, 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.

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 of 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.

EVALUATION OF INTERNAL AUDIT BY STATUTORY AUDITOR

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.

Internal audit v/s statutory audit

1. 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.
2. 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.
3. 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 cooperation 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 organization. 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:

S.N	INTERNAL AUDIT	STATUTORY AUDIT
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1.	Internal audit is the arrangement within the organization 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.
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	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.
4.	Being an employee of the organization internal auditor is answerable to the management. His duties, responsibilities etc. regarding 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.	The rights, duties, responsibilities and liabilities of auditors are governed by the provisions of law. The auditor is independent of management.
5.	The internal auditor	The statutory auditor is

<p>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>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>
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DISTINGUISH BETWEEN INTERNAL CHECK AND INTERNAL AUDIT

S.N	INTERNAL CHECK	INTERNAL AUDIT
0.		
1.	Internal audit is the arrangement within the organization to verify on continuous basis the correctness and truthfulness of the transactions by the salaried staff.	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.	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.	It is specific defined job.
4.	All the persons in the organization are involved	Specific persons are appointed

	to maintain the internal check system.	to the internal audit.
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