SCHOOL OF STUDIES IN COMMERCE

VIKRAM UNIVERSITY, UJJAIN (M.P.)

CLASS: B.B.A. (HONS.) 4th SEM.

SUBJECT: CORPORATE AUDITING

TITLE OF LECTURE: AUDIT OF EDUCATION INSTITUTIONS

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TOPICS

66. Internal Audit in an Information Technology Environment

67. Internal Audit using Computer Assisted Audit Techniques (CAAT)

INTERNAL AUDITING ASPECTS in an educational institution

Overall Approach of Internal Audit of an Educational Institution with reference to Standards on Internal Audit

Internal audit is a management function having the high level objective of serving management's needs through constructive recommendations in areas such as, internal control, risk, utilization of resources, compliance with laws, management information system, etc. An effective and continuous internal audit function plays a key role in assisting the board to discharge its responsibilities of accomplishment of objectives and goals of the organization through ethical and effective governance. Internal audit also plays an important role in providing assurance to management on the effectiveness of risk management.

A successful internal audit is based on sound planning and an environment of positive alliance and communication between the auditee and the internal auditor. The internal audit procedure is similar in most engagements. Auditee involvement is important at all stages of the internal audit process. The following paragraphs describe the steps to be followed for conducting internal audit of an educational institution.

Engagement Letter

Before the commencement of audit, the internal auditor must obtain an engagement letter from the auditee. The engagement letter should be approved by an appropriate level of management i.e., the Board of Directors or Board of Trustees or a relevant Committee thereof such as the Audit Committee, to ensure that the objective of independence of the internal auditor and corporate governance is met while carrying out the internal audit activity. Standard on Internal Audit (SIA) 8,*"Terms of Internal Audit Engagement"* to provides guidance in respect of terms of engagement of the internal audit activity.

Specific Considerations while Planning Internal Audit of an Educational Institution

Standard on Internal Audit (SIA) 1,*"Planning an Internal Audit"* *e* xplains the planning process to be followed by an internal auditor before the start of internal audit. While preparing the internal audit programme of an educational institution, the internal auditor should give due consideration to the accounting system and the internal control system in place. The audit tests planned by the internal auditor will vary with the level of the accounting systems and the internal control systems deployed in the educational institutions.

In case of educational institutions run as not-for-profit organizations, honorary office bearers generally run such organizations. These office bearers are usually pre-occupied with their own affairs and they do not have any pecuniary interest in the organization as office bearers. Therefore, such institutions can be highly susceptible to frauds by the lower and middle level employees. While planning the audit the internal auditor must take into consideration these factors and apply the compliance and substantive procedures accordingly. It may, thus, be concluded that the internal auditor needs to exercise an extra bit of safeguard while planning and conducting the internal audit of an educational institution.

Knowledge of the Educational Institution and its Environment

As per Standard on Internal Audit (SIA) 15,*"Knowledge of the*

Entity and its Environment", for reviewing key risks and entity-wide processes, systems, procedures and controls and determining the nature, timing and extent of internal audit procedures, an internal auditor must have knowledge of the economy, the entity's business and the entity's operating and regulatory environment.

An illustrative list of information required during the internal audit of an educational institution is as under:

(a) Legal form of the organisation and its Memorandum of Association,
Articles of Association, Rules and Regulations.
(b) Laws, regulations, rules and standards that regulate an educational institution.
(c) Current industry developments.
(d) Organizational structure.
(e) Administrative and accounting personnel.
(f) Changes in nature of activities e.g., change in number and type of courses offered by the educational institution.
(g) Chart of accounts and accounting manual.
(h) Policy and procedures manual.
(i) Long term leases, contracts and commitments.
(j) License agreements and recognitions.
(k) Enrollment procedure.
(l) Physical facilities offered by the institution, e.g., library, canteens, playgrounds, furniture, computers, mess, workshops, laboratories, dormitories, staff quarters, etc.
(m) Placement and training programmes offered.
(n) Inspection reports of license authorities such as, AICTE, MCI, affiliating universities.
(o) Opinions in prior audit reports and other reports of statutory auditor
e.g., report under section 10(23C) and 12 in Form 10B.
(p) Observations in external auditor's management report.

Risk Assessment and Internal Control in an Educational Institution

According to Standard on Internal Audit (SIA) 13, *"Enterprise Risk Management"* , the role of the internal auditor in relation to risk management is to provide assurance to management on the effectiveness of risk management. The role of the internal auditor is to ascertain that risks are appropriately defined and managed. Some of the common risks recognized in an educational institution are as under:

(i)*Regulatory Risks* **-** Risks which affect the sector e.g., compulsory regulatory non-compliances under various statutes, changes in the Government policies, etc. The non-compliances can result into revocation of recognition leading to closure of institution, levy of penalties, loss of funding for expenditure incurred or loss of tax exemption benefits, etc.

(ii)*Institution-wide risk* **-** Risks which affect the institution, e.g., enrollment growth, additional capital requirement, additional requirement of funds for operating activities, non-availability of information, high turnover in key personnel, reputation risk with parents, major financial problems, competition, etc.

As per Standard on Internal Audit (SIA) 13,*"Enterprise Risk Management",* the scope of the internal auditor's work in assessing the effectiveness of the enterprise risk management would, normally, include:

(a) Assessing the risk maturity level both at the entity level as well as the auditable unit level;

(b) Assessing the adequacy of and compliance with the risk management policy and framework; and

(c) For the risks covered by the internal audit plan:

(i) Assessing the efficiency and effectiveness of the risk response, and

(ii) Assessing whether the score of the residual risk is within the risk appetite.

Standard on Internal Audit (SIA) 12, *"Internal Control Evaluation"*, the Bonus of designing, maintaining, and documenting an internal control system is on the management. The internal auditor should examine the continued effectiveness of the internal control system through evaluation and make recommendations, if any, for improving that effectiveness.

As mentioned before, the educational institutions are generally susceptible to frauds more than other types of organizations. It is also generally observed that in such organizations the internal controls are either very weak or not in place due to lack of proper management and administration. It is very important that the internal auditor should obtain an understanding of the control environment in which the institution operates.

As per Standard on Internal Audit (SIA) 12, *"Internal Control Evaluation"*, the broad areas of review by the internal auditor in evaluating the internal control system, inter alia, are:

- Mission, vision, ethical and organizational value system of the entity;
- Personnel allocation, appraisal system, and development policies;
- Accounting and financial reporting policies and compliance with applicable legal and regulatory standards;
- Objective of measurement and key performance indicators;
- Documentation standards;
- Risk management structure;
- Operational framework;
- Processes and procedures followed;
- Degree of management supervision;
- Information systems, communication channels; and

• Business Continuity and Disaster Recovery Procedures.

Perhaps one control that has universal application in any environment and in any circumstances is segregation of duties. The flow of activities must be regulated in such a manner that no single person in the organization is able to control all the activities in that chain and for this purpose, all non compatible duties must be in different hands. Separate persons should be involved in issuing the receipt and receiving the cash, recording the transaction and maintaining the physical control over the cash/cheques in hand. The fees is the major source of income for the educational institutions, therefore, controls must be high in this area.

Management Control Aspects

Students Count is the Key Control Mechanism

The main source of revenue in an educational institution is from the
students. The control on the student's records is the key control mechanism for ensuring that the revenue is recorded completely and correctly. Since various departments,*viz.* , accounts department, academic (daily attendance), registrar, examination department, etc. maintain separate records for the students on roll, it is imperative that all these records are reconciled to ensure that the student's strength is the same at all places.

The second important factor is the prompt charging of expenditures to the student accounts. As discussed earlier, expenses are incurred on the students continuously by various departments, such as the class teacher, the games section, the housekeeping section/the hostel warden, etc. All such expenses must be promptly charged to the account of the student, as sometimes the students may leave the educational institution in the middle of the term. Before handing over the transfer certificate and refunding the security, it must be ensured that the student has paid all his dues. The controls and procedures for forwarding of such details by the various departments to the centralized accounts section must be very clear, so that there is no loss on this account.

Budgetary Control

The financial management of the educational institution, like any other entity, may effectively be undertaken by resorting to budgeting. Apart from serving as a tool for forecasting and planning, it also serves as an important feedback tool at the end of the financial period through generation of variance analysis. Control on revenue items can be effectively exercised through budgets and periodic variance reporting serves as an important management information report.

Another crucial aspect, which may be taken into account in the preparation of budgets, are the provisions contained in Section 11 of the Income Tax Act, 1961, which require an institution to utilize a prescribed percentage of its funds for charitable purposes so as to be eligible for exemption from the income tax. It is essential that the management should be aware of the provisions of the Income Tax Act, 1961, so as to be able to gauge the impact of non-utilization of funds in accordance therewith. Monthly track of the variances should be kept by the management so as to ensure that the application of the required percentage is done before the year-end. Non-utilization of funds would entail tax liabilities on the unutilized portion. A sample computation of income with details of calculation of application of income under section 11 has been enclosed as:

The internal auditor may perform the following steps in checking the budgeted prepared by the institution:

(a) The internal auditor should study the reasons for variances between the budgeted and the actual figures periodically.

(b) The internal auditor should look out for significant variances.

(c) Detailed analysis should be made for significant variances by the internal auditor.

(d) The internal auditor should suggest appropriate actions for the variances so found.

(e) In case the budget is revised, the internal auditor should study the amendments made to the existing budget.

(f) The internal auditor should verify that both favourable and unfavourable variances were duly approved by the appropriate level of authority.

Internal Audit Evidence

Standard on Internal Audit (SIA) 10 *"Internal Audit Evidence"* lays down that the internal auditor obtains evidence by performing one or more of the following procedures:

- Inspection
- Observation
- Inquiry and confirmation
- Computation
- Analytical Review

The internal auditor should evaluate whether he has obtained sufficient appropriate audit evidence before he draws his conclusions therefrom. The internal audit evidence should enable the internal auditor to form an opinion on the scope of the terms of the engagement.

Sampling

In forming an opinion, the internal auditor may obtain internal audit evidence on a selective basis by way of statistical or non-statistical sampling methods, in accordance with the principles laid in Standard on Internal Audit (SIA) 5, *"Sampling"* . The internal auditor should design and select an audit sample, perform audit procedures thereon, and evaluate sample results so as to provide sufficient appropriate audit evidence to meet the objectives of the internal audit engagement.

Analytical Procedures

The Analytical Procedures have special significance in the internal audit of an educational institution. This is for the simple reason that most of the expenses incurred or revenue earned has direct correlation with a key statistic, i.e., the number of students on roll of the institution. Standard on Internal Audit (SIA) 6, *"Analytical Procedures",* deals with the nature and purpose of analytical procedures, analytical procedures as risk assessment procedures and in planning the internal audit, analytical procedures as substantive procedures, analytical procedures in the overall review at the end of the internal audit, extent of reliance on analytical procedures and investigating unusual items or trends.

At the planning stage, the analytical procedure may serve as a very important guide to obtain an understanding of the entity and its environment and in identifying specific risk areas. These procedures are meant to be used on the financial information in conjecture with the non-financial information. The internal auditor may use these procedures to establish relationship between variables such as, students and receipts, teachers and students, boarders and area of hostel, boarders and mess expenditure, etc.

In case, the significant fluctuations or relationships are inconsistent with other relevant information or that deviate from predicted amounts, the internal auditor should investigate and obtain adequate explanations and appropriate corroborative evidence. For example, the per head mess expenditure may have increased substantially despite no change in the prescribed diet by the management or the total fees receipts may not have increased in the same proportion as the increase in number of students, despite no significant increase in fees waiver given by the management during the current year. In all such cases, the internal auditor should investigate and document all such inconsistencies with all the corroborative evidence collected during the course of the internal audit. An illustrative list of Analytical Ratios for an educational institution has been given as **Appendix 8**.

Documentation

Standard on Internal Audit (SIA) 3, *"Documentation"* states that the internal auditor should document matters, which are important in providing evidence that the audit was carried out in accordance with the Standards on Internal Audit and support his findings or the report submitted by him. Internal audit documentation should also record the internal audit charter, the internal audit plan, the nature, timing and extent of audit procedures performed, and the conclusions drawn from the evidence obtained. The internal auditor retains the ownership of the internal audit documentation. Management and other designated personnel may seek access to the internal audit documentation of the internal audit department subject to the approval of the internal auditor and client or such other third party may seek access if there is any legal or regulatory requirement or as may be permitted by the client.

Reporting

As per Standard on Internal Audit (SIA) 4, *"Reporting"* , after the performance of internal audit procedures, the internal auditor summarizes the audit findings, conclusions and suggestions and issues the report to the appointing authority. If there is a limitation on the scope of the internal auditor's work, the internal auditor's report should describe the limitation.

In case the educational institutions are being run as companies, the Board of Directors will constitute the persons who are charged with governance. Similarly, in the case of societies or trusts, the members of the Governing Body/Board of Trustees shall constitute such group. The internal auditor may find the possibility that some members of the management may be involved in the fraud or misappropriation of the institution's funds. In such cases, the internal auditor shall have to exercise his judgment in taking a decision regarding the person to whom such misdeeds may be communicated.

The internal auditor may also be required to report the audit findings to the donors of the grants to the educational institutions for verifying as to whether the institution utilized its funds for the charitable objective for which it exists and that no part of its funds were distributed for the personal benefit of members or trustees, etc. Chances of mis-utilisation of funds may be high in cases where the Board members are inter-related or from the same family. The donors of endowment funds scrutinize the audited statements to verify as to whether the funds were spent for the purposes for which they were granted or donated. Often such donors or government agencies prescribe additional reporting formats that need to be certified by auditors with a view to being assured about the utilization of funds. Such reporting may be annual or for periods less than that.

Follow-up Review and Report

Follow-up review is performed by the internal auditor to ensure that all internal audit issues mentioned in the internal audit report were resolved. The review will be concluded with a follow-up report with details of action taken by the auditee in resolving the original audit issues as well as unresolved audit issues. The follow-up report will then be issued to the auditee.

The general procedures of an internal audit have not been purposely covered in the following paragraphs. The procedures are illustrative in nature and would require adequate modification to address internal audit requirements of a particular educational institution depending upon the nature, size and other factors.

Revenue

An internal auditor should study and evaluate the system of internal control relating to revenue in an educational institution, particularly the following aspects:

(i) The systems and procedures relating to generation of revenue including authority to fix fees structure, offer scholarships/fees concessions and other terms of collection.

(ii) Accounting procedures relating to recognition of revenue.

Receipt Books

In a manual environment, a receipt is issued to the student in lieu of the payment received. It is imperative that a physical control over the receipt books is maintained. In case of most of the frauds, it has been observed that the cashier maintains parallel sets of receipt books to siphon off the money. The receipt books must be in the custody of the stores and it must be serially numbered. A new receipt book should be issued only when the old receipt book is exhausted. Cancelled receipts should be available in the receipt book with all copies. In no case, more than one receipt book should be used at one time. Another very effective control to manage the fees would be to compulsorily receive the fees through bank demand drafts, and fees should be received in cash only for petty amounts.

Billing Control

The system of billing being followed by the educational institution should be watertight and should ensure that bills are raised to each and every student at the end of the term. It must be also be ensured that accounts of all students are being debited with the fee that is to be recovered from them, and the cases wherever exceptions are found, are supported by appropriate management authorizations.

Discount/Scholarships

The educational institution may sometimes conceive a policy of allowing discounts to poor students or scholarship to meritorious students. It should be ensured that any such discount/scholarship be allowed only with authorization from the appropriate designated authority for this purpose.

Fee Waiver

The management, generally, has clear policy for the defaulters which encompasses imposing fine for late payment and more severe consequences by way of striking off the name from the roll for continuous default. It must be ensured that any relief from such penalties be allowed only with proper authorization. The collection of the fine, therefore, in all the defaulting cases should be ensured unless relief has been granted in written.

It is imperative on the part of the internal auditor to invariably communicate internal control weaknesses to the management and his opinion on the possible effect of such weakness in institution's control environment. An illustrative Internal Control Checklist has been enclosed as **Appendix 9**.

Verification

Examination of Records

The internal auditor should examine the adequacy and efficacy of cut-off procedures to ensure that the transactions of receipt pertaining to the period under internal audit are recorded in that period and not in a preceding or subsequent period. The internal auditor may examine the admission documents and receipts pertaining to a few days immediately before the year-end and verify that the related receipts have been recorded as income of the period under internal audit.

The internal auditor should examine selected entries in the receipt records with reference to the related receipts, university roll sheets, other supporting documents such as the attendance registers and concession/scholarship approval notes, and admission records. He should compare the actual fees charged with authorized fees structure or with the authorization by the appropriate official of the institution, as appropriate.

Selected entries in the fees refunded account should be examined with reference to the attendance register and authorization from appropriate authority as per the terms and conditions governing the refund policies. Selected scholarship/concession cases should be examined with reference to entries in the receipt records and authorization from appropriate authority. It should be examined that in the case of provisional admissions, revenue is recognized only when the admission is regularized on compliance with the conditions prescribed. Where the fees is receivable in installments and includes an element of interest, the internal auditor should examine whether the interest element has been excluded from the amount recorded as fees income.

The internal auditor should also carry out the following additional procedures in the case of fees received in foreign currency:

(a) Examine that fees received in foreign currency is recorded at the exchange rates prevailing at the time of receipt.

(b) Obtain a written representation from the management to the effect that the institution has complied with the legal and regulator requirements relating to FEMA/FCRA.

Revenue arising from services rendered (e.g., books provided, examination fees, library fees, lab charges, tuck shop, stationery, etc.) and from interest, dividends and royalties should be examined with reference to the related agreements and other supporting documents.

The internal auditor should verify realizations subsequent to the date of the balance sheet. This would help him in identifying cases of unrecorded revenue. If the fees collection is outsourced by the institution to a collection agent, the internal auditor should at regular intervals closely scrutinize fees collection records for any omission or erroneous collection of fees.

Analytical Procedures

The internal auditor may carry out the following analytical procedures in relation to revenue:

(a) Compare the amount of revenue for the current year, class-wise and batch-wise, with the corresponding figures for previous years with appropriate adjustments for the change in fees structure and new students/drop outs.

(b) Compare the ratio of concessions and scholarships to total receipts for the current year with the corresponding figures for previous years.

(c) Compare the amount of dividend/interest/royalty for the current year with the corresponding figures for previous years.

(d) Compare the ratio of income on investments to average investments for the current year (separately for each major type of investment) with the corresponding figures for previous years.

Procedures for Specific Areas

Tuition Fees

The major portion of the revenues of an educational institution is contributed by the tuition fees from the students. The analytical procedures may prove to be extremely effective and efficient method for auditing the total fees collected during the year. In order to verify the tuition fees collected from the students it is imperative that the number of students on the roll is first verified. Normally, these roll lists are available from a number of sources, *viz* ., accounts department, registrar, university enrollment lists, teacher's attendance registers, examination roll lists, etc. Each of these records is prepared by different departments and, therefore, the reconciliation of all these records may serve as a check giving a very high degree of reliability.

The next important step in verification of the tuition fees would be to obtain the fees structure adopted by the institution which has been approved by the appropriate authority, for example Governing Body, Government/Approving authority, as applicable to the institution. The total fees collected may now be verified by using the above figures. A very useful method of checking the total fees is by multiplying the per head fees with the number of students and thus arriving at the gross figure. This gross figure may be verified with the total balance under that ledger account and if any variance is found, the investigation thereof may result in more information coming out before the internal auditor. There may be variance because of discount/scholarship or dropouts, etc. The internal auditor must verify whether the discount/scholarships have been given based on management approvals or guidelines prescribed for this purpose. Any other variance must also be reconciled keeping in mind the concept of materiality and risks involved. Other substantive procedure may be adopted after evaluating the results of the compliance procedures.

Similarly, other fees such as Admission fees, Affiliation and Development fees, Examination fees, Sports fees, Hostel fees, Boarding charges, Mess Income, Transportation Income, etc. may be verified adhering to the above mentioned procedure.

Registration Fees/Sale of Prospectus

Unlike tuition fees, the registration charges/sale of prospectus cannot be verified with reference to the number of students. This is often a weak area where revenue leakage can occur. The management generally ignores the sale proceeds of prospectus, and other miscellaneous receipts. This in turn encourages malpractices in the recording and collection of such revenue. Further, it is observed in many of the educational institutions a large number of copies of prospectuses are distributed complimentary to attract students. The internal auditor therefore, cannot fully verify the revenue recorded under this head. Appropriate procedures to audit the revenue under this head would be to evaluate the total prospectus issued during the year with the prospectus issued free of cost. A variance with the results for the previous years may be significant and the internal auditor may evaluate it appropriately. Secondly, the internal auditor can compare the percentage of number of students who took admission during the year to the total number of students who paid the registration charges from last year.

Fines

The internal auditor may apply the following internal audit procedures
to audit the income from fines:

(a) Check the procedure of identification of fines due and ensure that all fines are levied and collected as per policies laid down by the appropriate authority.

(b) Check the list of fines to be charged from students.

(c) Verify the number of students and the amount of fine due per student.

(d) Check the internal control procedures to ensure that there is no leakage of fines collected directly by the respective department.

(e) In case, fines are directly paid by students to the Head of department, verify the appropriateness of method of communication and deposit of funds to the Accounts Department.

Canteen Income

The internal auditor may apply the following internal audit procedures

to audit the canteen income earned:
(a) Check the records maintained for the canteen operations to support all financial transactions.
(b) Verify the inventory controls and the physical counts.
(c) Verify and check the allocation of expenses, such as, equipment depreciation, rental charges, breakage, theft, spoilage and administrative expenses.
(d) Review the agreements and contracts in case the canteen is run by an outside party.
(e) Verify leakages that may take place, e.g., by way of non-deductions from staff or excessive consumption of food in the mess, despite fixed menus which are helpful in providing some measurement of the likely consumption of food articles.
(f) Review the approvals/disapprovals of the changes in the operation of the canteen, for example change in the price of goods, shift in responsibilities of the Canteen Staff, etc.
(g) Compliance with laws and regulations applicable for operation of canteen, for example, The Prevention of Food Adulteration Act & rules, 1954, The Shops and Establishment Act, VAT Act, Service Tax, etc.
(h) Review of Inspection and Maintenance Reports

Revenue from Sale of In-House Publications

In respect of sale of publication material, the internal auditor should evaluate the system of recording sales, maintaining inventory of publications, MIS reports, if any, etc. The evidence in the form of publisher's statements, VAT returns, third party confirmations, etc. may be relied upon.*Revenue from Seminars, Workshops, Consultancies and Management Development Programmes*

Revenue from seminars, workshops, consultancies and management development programmes should be verified by the internal auditor by charting the list of all the events organized department-wise during the relevant period. The internal auditor should also examine the attendance record of participants. The internal auditor should verify the entrance/ registration fees and the course fees charged from the participants. The registration fee will comprise of amount recovered from participants on account of seminar kit, beverages and lunch. The cost of accommodation, local travel, pre/post seminar tours are separately charged from the participants.

Revenue from Franchisee Fees

In respect of franchising revenue, the internal auditor should examine the basic records maintained by the franchisor in respect of the franchisee, the agreements entered into with them, the product fee and regular fee chargeable. The product fee from all franchisees should be tabulated and the amount attributable to the relevant period should be worked out. In respect of franchise fee in the form of percentage share in revenue, the internal auditor should examine the audited financial statements/certificates of the franchisees. The internal auditor should also examine the calculations and compliance with service tax regulations.

Grants/Donations

The internal auditor may apply the following audit procedures to audit the donations/grants received:

(a) Check the donations received with the copies of receipts.

(b) Check sanction letters for any conditions attached with the donations.

(c) Verify the grants received from the Government or other authorities with reference to all the correspondences.

(d) Examine the statements submitted for utilization of grant.

Expenses

The internal auditor examines the internal controls over payments with reference to the following:

(a) Review of vision, mission, ethical and organizational value system of the institution;
(b) Segregation and rotation of duties;
(c) Procedures for authorization;
(d) Maintenance of records and documents;
(e) Accountability for, and safeguarding of, assets; and
(f) Independent checks.

An illustrative Internal Control Checklist has been enclosed as **Appendix 9**.

Verification

The substantive procedure for verification of the expenses involves:

(a) Test of individual transactions which are often carried out on a sampling basis, depending on the internal auditor's assessment of the effectiveness of the internal controls.
(b) Examine the entries in the cash book/cash payments summary with reference to the related payment vouchers.
(c) In respect of payments by cheque, examine the numerical sequence of the cheques issued during the specified period, i.e., whether all the cheques issued during the period had been properly accounted for.
(d) Review the cash book or cash payment summary sheets for any unusual items and look into the same.
(e) Apply appropriate analytical procedures to judge the overall reasonableness of the recorded payments.
(f) Examine whether the payments have been properly classified and disclosed under appropriate account heads in the financial statements in accordance with the recognised accounting principles.

In case the statute governing the organisation lays down any guidelines in this behalf, also examine whether the disclosure of the payments in the financial statements complies with such requirements. For example, if the exemption is claimed under section 12A of the*Income Tax Act, 1961* , the internal auditor has to report all the payments made to the specified persons.

Verification of Expenses Based on Student Strength

A number of expenses also have correlation with the student strength. Such expenses can be verified by multiplying per student charges with the respective student strength. An example could be mess food bill paid to the catering contractor, which can be correlated with the number of students in the hostel. Another example could be of transport charges paid to a bus contractor, which could be correlated with the number of students using institution-arranged transport.

Procedures for Specific Areas

Payroll and Benefits

Some of the basic points to consider while auditing the payroll and benefits are:

(a) Review organizational structure, payroll operation procedures, and the sufficiency that there exists proper separation of duties and proper supervisory reviews in the organization, to ensure that an effective payroll function has been established by the organization.

(b) Obtain the list of current employee information relating to name, designation, unique employee number, payroll account number, and salary amount.

(c) Verify the documentation of rate of pay, rate of overtime, total input hours, authorization policies, payroll deductions, preparation and approval of time sheets, leave tracking system (including approvals), termination procedures of employees.

(d) Check the employee data maintained in the information system for its accuracy and appropriateness as well as ensure that proper documentation is also maintained.

(e) Verify the procedure of periodically updating the employee data with the necessary approvals.

(f) Verify the procedure of maintaining the confidentiality of the employee data.

(g) Obtain an understanding of employee benefits and post-employment benefits like pension, provident fund, etc. offered to the employees by the institution.

(h) Verify the procedure of valuation and disclosure of employee benefits with reference to Accounting Standard (AS 15), *'Employee Benefits'* .

(i) Obtain a general understanding of the hiring and termination process and how payroll is affected.

(j) Review the personnel records maintained by HR and Payroll.

(k) Review the required hiring documents (for example, applications received, offers made, accepted and declined, personnel requisition, etc.) for employees hired.

(l) Ensure that any new employee related to the management or Board or owners is hired on the approval from the higher authority as well as disclosed as related party in the financial statements.

(m) Ensure all employees' current job descriptions are as per requirements of the institutions.

(n) Review the procedure of considering reference checks provided while recruitment of personnel.

(o) Review the personnel file maintained for work records (for example, hours worked, time reports, etc.)
(p) Review the contracts of the employees hired on part time basis and ensure that they are paid for the period they are employed as per the terms of their contract.
(q) Review the standard operating policy to ensure reporting of any work related grievances. (For example, stress, bias, etc.)
(r) Review the policy pertaining to payment of employees for overtime and test check the following:

(i) Necessary prior approval from authorized supervisor is obtained. (ii) Proper documentation of overtime details is maintained. (iii) Determine and document how the payment of overtime is made.

(s) Examine the budget approved and reconcile the budgeted figures with actual payroll costs and where applicable, obtain the reasons for significant deviations. Check the reporting procedure of all significant deviations.
(t) Check the monthly reconciliations between financial records and payroll prepared by both the departments.
(u) Check the procedures for ensuring compliance with laws and regulations, for example, deduction of TDS.
(v) Scrutinize HR database (for hiring and firing of employee) and payroll database (for paying employee) to ensure that there are no ghost employees.

Other Expenditure

Other than payroll, an educational institution incurs Educational and
Academic expenditure, Administrative expenditure, Occupancy expenditure and Promotional expenditure. The internal auditor

should follow the following procedures while auditing these types of expenses:

(a) Compare the balances of each significant expense account with the comparable balance for the preceding period and with the budgeted balance for the current period. Examine unusual fluctuations.

(b) Compare current period relationships between accounts (e.g., total expenses as a percentage of revenue, etc.) with the comparable relationships for the prior period and with budgets. Examine unusual fluctuations.

(c) Analyze comparative expense calculations on a per unit basis (e.g., academic expenditure or cost of utilities per student, transportation expenses per student, space utilsation ratios, etc.). Examine unusual fluctuations.

(d) Review all expense accounts to determine whether year end accrual is appropriately recorded.

(e) Check expense account balances to the appropriate analyses of balance sheet accounts (e.g., rent expense to accrued rent, etc.).

(f) Check source documents (invoices) along with supporting forms and documents of all major expenses with amounts recorded in accounting records to ensure that all expenditures incurred during the period have been properly recorded.

(g) Ensure that the capital expenditure has not been booked as revenue expenses and vice-versa.

(h) Authorization by appropriate authority to all the expenses

should be
confirmed.
(i) Check to ensure that no expenditure on personal account is debited
as expenses.

Fund Balances

The fund balances of an institution may exist in various forms. The
internal auditing aspects to be kept in mind in respect of each of these are elaborated as under:

Restricted Funds

Restricted Funds normally consist of donations received and grants
sanctioned with conditions attached to the manner of the utilization. This
restriction may specify that the funds be spent only for specified purposes, whether revenue or capital in nature. The correspondence attached to each receipt as well as the sanction letters accompanying the grants need to be verified by the internal auditor to ascertain the restrictions and verify the utilization of the grants in accordance therewith. Any misutilisation of funds may lead to claims against the institution, which may in extreme cases affect the financial viability of the institution.

Designated Funds

Designated Funds represents appropriation made by the institution
with the purpose of accumulating funds for specific purposes. The internal auditor must evaluate evidences to establish the authority under which such appropriation was carried out as well as the purposes for which it was done. Extremely reliable

evidence in respect thereof is the minutes of the meeting of the governing body of the institution in which the appropriation of the funds was approved. Normally, all such appropriations are recorded in the Board meetings called for approving the financial statements. The internal auditor must verify that the classification of funds appropriated has to be in accordance with the purposes and amounts approved in the Board meetings.

The internal auditor should also verify that the fund balances and the bank accounts in which the funds so appropriated are parked, reconcile with each other. Any discrepancy will mean that the accounting treatment has not been correctly followed or it may require verification of the actual utilization of funds.

Liabilities

The internal auditor may employ the following procedures for verifying liabilities:

(a) Examination of records
(b) Direct confirmation procedure
(c) Examination of disclosure
(d) Analytical Procedures
(e) Obtaining management representations

Loans and Borrowings

For an educational institution, the major outflow of funds is for the
capital expenditure. Therefore, the borrowings of an educational institution comprise of the term loans taken for construction of buildings, infrastructure facilities, acquisition of plant and machinery, furniture, etc.

The following points are important in internal audit of loans and

borrowings:
(a) The internal auditor should verify that the loans obtained are within
the borrowing powers of the institution and in accordance with the
Memorandum and Articles of Association/Rules/Bye-laws of the
institution.
(b) The internal auditor should examine the relevant records to evaluate
the validity and accuracy of the loans. The examination of minute
books would constitute an important source of audit evidence for the
same.
(c) The internal auditor should examine the reconciliation of the book
balances with the statements of the lenders. Balance confirmation
procedures should also be adopted.
(d) The internal auditor should examine the documents, if any,
evidencing any charge created in respect of loans and borrowings.
He should particularly examine compliance with the requirements of
the applicable statute regarding creation and registration of charges
in case of companies formed under section 25 of the Companies Act,
1956.
(e) In case the institution has accepted deposits, the internal auditor
should examine whether the applicable directives issued by the
Reserve Bank of India or other appropriate authorities are

complied with.

(f) The internal auditor should examine whether the loan is classified as secured only when the same is secured against any asset belonging to the institution.

(g) In case the installments of long term loans falling due within the next twelve months have been disclosed in the financial statements, the internal auditor should verify the correctness of the amount of such installments.

(h) The internal auditor should examine the hire purchase agreements for the purchase of assets to verify the correctness of the outstanding amounts. The future installments under hire purchase agreements for the purchase of assets may be shown as secured loans.

(i) The deferred payment credits should be verified with the relevant agreements. The internal auditor should also verify the copies of hundies/bills accepted.

Creditors and Other Current Liabilities

The following points can be useful in internal audit of creditors and other liabilities:

(a) The internal auditor should carry out appropriate procedures to judge the adequacy of the relevant cut-off procedures e.g., he may examine the documents relating to goods received a few days immediately before the year end and check whether the related invoices have been recorded as purchase in the year under audit.

(b) The internal auditor should look into the difference, if any, between the total of the creditors balances as per creditor's ledger with the related control account.

(c) The internal auditor should examine the relevant correspondence /other documentary evidence to verify the validity, accuracy and completeness of creditors/ acceptances.

(d) The internal auditor should pay special attention to long outstanding items, unadjusted claims for short supplies, poor quality, discount, commission, etc., and liabilities not correlated/adjusted against related advances. He should also examine authorization and correctness of transfers from one account to another.

(e) The internal auditor should examine any unusual payments around the year-end, especially if the entries have been reversed in the subsequent period.

(f) The internal auditor should review transactions in the immediately succeeding period to identify/ confirm material liabilities outstanding at the balance sheet date.

Fees Received in Advance

Usually an educational institution charges fees before the semester gets started. Such fees is received in advance from the students

and as it
does not relate to the period under internal audit, it should not be treated as income but shown as liability in the financial statements. Further, this fees should also be not shown in the respective student accounts because the amount is not required to be repaid back to the student but is to be disclosed in the Current Liabilities as 'Fees received in Advance'.

The following are important points in audit of fees received in advance:

(a) Obtain and examine the list of students from whom fees has been received in advance.

(b) Check the opening balance outstanding in the 'Fees received in Advance' account and ensure that the said amount is reversed and charged to income and expenses account.

(c) In case where the student at the time of admission has deposited fees for more than one year, obtain the detailed year wise list of students and examine the balance outstanding at the 'Fees received in Advance' account as well as year-wise income to be recognized.

(d) In case any student has left the institution, ensure the fees received in advance from that student have been transferred to his/her respective student's account.

Caution Money and Security Deposits

The following are important points can be useful in audit of caution money and security deposits:

(a) Confirm that caution money and other deposits paid by the students on admission have been shown as liability in the balance sheet and not transferred to revenue, unless they are not refundable.

(b) Examine the accounting procedure of caution money received from and paid to the students.

(c) Verify the caution money registers for entries made for receipts and payments and ensure that the registers reconcile with the financial records. Verify the details mentioned in the registers, like student's name, year of receipt, total amount, cheque details, due date of payment, etc.

(d) Check the documentation required to be maintained for the caution money paid to the students.

(e) Examine the communication procedure between various departments of the institution before the caution money is paid, for example, how does the library in-charge communicates with the accounts department regarding library fines.

(f) Verify whether the deposits, such as caution money, security, laboratory security, etc. are received from the students.

(g) Ensure that such deposits are not mixed up with the fees received account.

(h) Check the student's account to whom the caution money is being paid, to ensure that no dues like fees, fines, recoveries for on account of lost library books, etc. are recoverable. Verify that only

net amount is being paid to the student.
(i) Check whether the No Dues Certificate has been obtained from all departments of the institution.
(j) Check that all the necessary approvals have been obtained from the appropriate authority before the payment of caution money.

Unutilized Grants

In case the grant received earlier was not utilized for the designated purpose, then the grant may become refundable. In such instance, the internal auditor should obtain the original donor letter and its specification. In case, the grant becomes refundable, the accounting treatment will depend upon the mode followed by the educational institution at the time of receipt of income. Accounting Standard (AS) 12 *"Accounting for Government Grants"* , issued by ICAI.

Assets

Fixed Assets

Fixed Assets in the shape of land, building, and equipment constitute a major chunk of the assets of an educational institution. The audit procedures with respect to verification, valuation and disclosure are discussed in following paragraphs:

Verification

The verification of fixed assets consists of (a) examination of records, and (b) review of physical verification of such assets conducted by the management. The following are important procedures in this regard:

(a) The opening balances of fixed assets should be verified from relevant records e.g., schedule of fixed assets, ledger or register balances.

(b) Check whether the institution is in compliance with Accounting Standard (AS) 10, *"Accounting for Fixed Assets"* .

(c) Acquisition of fixed assets and improvements to the existing ones should be verified with reference to supporting documents such as, orders, invoices, receiving reports and title deeds.

(d) Review of the lease agreements, valuation and disclosure of fixed assets acquired on lease with respect to Accounting Standard (AS) 19, *"Leases "*.

(e) Self constructed fixed assets, improvements and capital work in progress should be verified with reference to the supporting documents such as contractor's bills, work-order records and independent confirmation of the work performed. All incidental costs incurred with respect to use should be capitalised.

(f) Expense accounts (e.g., repairs and renewals) should be scrutinized to ascertain that new capital assets and improvements have not been included therein.

(g) Where fixed assets have been written-off or fully depreciated in the year of acquisition/ construction, the internal auditor should examine whether these were recorded in the fixed register before being written-off or depreciated.

(h) In respect of fixed assets retired i.e., destroyed, scrapped or sold, the internal auditor should examine whether:

(i) The retirements have been properly authorized and appropriate procedures for invitation of quotations have been followed, wherever applicable;

(ii) The asset and depreciation accounts have been properly adjusted;

(iii) The sale proceeds, if any, have been fully accounted for; and

(iv) The resulting gains or losses, if material, have been properly adjusted and disclosed in the profit and loss account.

It is possible that certain assets, which were destroyed, scrapped or sold during the year have not been recorded. The internal auditor may use the following procedures to ascertain such omissions:

(a) Review of work orders/physical verification reports to trace any retirements.

(b) Examination of major additions to ascertain whether they represent additional facilities or replacement of old assets, which may have been retired.

(c) Making enquiries of key management and supervisory personnel.

(d) Obtaining a certificate from a senior official and/or managers that all assets scrapped, destroyed or sold have been recorded in the books.

Ownership of assets such as, land and buildings should be verified by examining the original title deeds. The title deed should be in the name of the Society/Company, where they own the educational institutions. In case, other persons such as solicitors or bankers hold the original title deeds, confirmation should be obtained directly by the internal auditor through a request signed by the client. The internal auditor should also verify if the vehicles are registered in Road Transport Office (RTO) in the name of the institution.

It is the responsibility of the management to carry out physical verification of fixed assets at appropriate intervals in order to ensure that they are in existence. However, the internal auditor should satisfy himself that such verification was done. For this purpose, he should observe the verification being conducted by the management, wherever possible. He should also examine the written instructions issued to the staff by the management and the relevant working papers. The internal auditor should also satisfy himself that the persons conducting the verification, whether the employees of the organization or outside experts (if employed), had the necessary competence.

The internal auditor should examine whether the method of verification was reasonable in the circumstances relating to each asset.
Where the fixed assets can be moved and where verification of all assets cannot be conducted at the time, they should be marked with distinctive numbers.

The internal auditor should examine whether the frequency

of
verification was reasonable in the circumstances of each case. Where the
assets are few and can be easily verified, an annual verification may be
considered reasonable. However, where the assets are numerous and
difficult to verify, verification, say, once every three years by rotation so
that all assets are verified at least once in every three years, may be
sufficient. The internal auditor should test-check the records of fixed assets with the physical reports. He should examine whether the discrepancies noticed on physical verification have been properly dealt with.

Valuation and Disclosure

The internal auditor should ensure that fixed assets have been valued and disclosed in the financial statements according to the generally accepted bases of accounting which are determined by law, professional pronouncements and prevailing practices governing educational institutions.

The internal auditor should test check the calculation of depreciation. The total depreciation arrived at should be compared with that of the preceding years to identify reasons for variations. The internal auditor should, particularly, examine whether the depreciation charge is adequate, keeping in view the generally accepted basis on accounting for
depreciation.

Revaluation of fixed assets implies restatement of their book values on the basis of a systematic scientific appraisal, which would include ascertainment of working condition of each unit of fixed assets, technical estimate of future working life and the possibility of obsolescence. Independent and qualified persons such as engineers, architects, etc usually make such an appraisal. To the extent possible, the internal auditor should examine these appraisals. As long as the appraisals appear reasonable and based on adequate facts, he is entitled to accept the revaluation made by the experts.

Where several assets have been purchased for a consolidated price, the internal auditor should examine the method by which the consideration has been apportioned to the various assets. In case this has been done on the basis of an expert valuation, he should examine whether the same appears reasonable and is based on adequate facts. Where an organization owns assets jointly with others (e.g., the office building being owned jointly by two companies), the internal auditor should examine the relevant organization's share in such assets.

The internal auditor must review the fixed assets for impairment; wherever changes in circumstances indicate that the carrying amount may not be recoverable. Valuation of the impaired asset should be made as per Accounting Standard (AS) 28, "*Impairment of Assets*" , where the assets whose carrying value exceeds the recoverable value are written down to the recoverable amount and the impairment loss is recognized.

Intangible Assets

An educational institution may develop or acquire an intangible asset
like copyrights, patents, designs, trademarks, etc. during its course of
activity or it may develop application software like an Accounting Software, Library Software, etc. The scope of work of an internal

auditor may cover the development of an intangible asset starting from its inception stage to its implementation in the organization covering monitoring of operations, racking progress, recommending improvements, etc. The *"Technical Guide on Internal Audit of Intangible Assets"* covers these aspects in details. Some important procedures to be carried out by an internal auditor are as follows:

(a) Review the policies and procedures relating to intangible assets for example authorization policy, purchase policy/in-house development, deployment process, retirement and disposal policy, etc.

(b) Review the efficiency and effectiveness of use of intangible assets.

(c) Review the systems established to ensure compliance with laws, regulations, contracts, policies and procedures relating to intangible assets including copyrights, trademarks, patents and designs to determine whether the institution has complied with them or not. Monitor compliance with laws and regulations relating to intangible assets with particular reference to unauthorized use of intangible assets of others, e.g., patents, trademarks, computer software, etc.

Review in-house procedures for protecting intangible assets e.g., implementation of code of conduct to be followed by employees, vendors, consultants etc.

(d) Review the means of safeguarding intangible assets.

(e) Review the recordkeeping and accounting of intangible assets.

The internal auditor should examine whether items included as

intangible assets in the financial statements meet the definition of, and
recognition criteria for, intangible assets as laid down in Accounting
Standard (AS) 26,*'Intangible Assets'* . The internal auditor should also
scrutinize whether any amount of intangible assets which was supposed to be capitalized, have not been charged off to revenue account.

Investments

Investments constitute a significant portion of the assets of an organization. The investments are held under statutory requirement such as Section 11(5) of the *Income Tax Act, 1961* and may also be required to be maintained in case of restricted funds as per the directions of the donor. Sometimes the University requires a college to maintain investments for a particular course.

The investments could be short term or long term in nature.
Short term investments are, normally, made to deploy temporary surplus
funds in view of the peculiar fund flow position of an educational institution. The short term investments may be classified as current assets and normally valued at market value. The decline in the value of long term investments, other than permanent, is normally not adjusted from the book values. The following paragraphs cover internal audit procedures with respect to investments.

Verification of Transactions

The internal auditor must verify the transactions of investments with regards to the investment policy of the organization. The internal auditor should examine whether the legal requirements relating to investments have been complied along with any other conditions relating to investments which restrict or qualify the right of ownership and/or disposal of investments. Where the organization is claiming exemption from income tax, the internal auditor must examine whether the compliance with the provisions of the Income Tax Act, 1961, regarding the investment of the surplus funds is complied with or not. Where the amount of purchase/sales of investments are substantial, the internal auditor may check the prices paid/received with reference to the market rate.

Physical Inspection

The internal auditor should carry out a physical inspection of investments in the form of fixed deposits, shares, debentures or other securities. The physical inspection of scrips should normally be carried out at the close of business on the last day of the year. If this is not possible, of course, in such a case adjustments for transactions during the intervening period will be required. The internal auditor must check whether the investments held are in the name of the educational institution. The internal auditor should also consider the following important aspects:

(a) Where a substantial number of investments are held by the institution in its custody, the internal auditor should carry out a surprise inspection of investments in hand at least once during the year, in addition to the year-end verification.

(b) Where investments belonging to third parties are also held by the institution besides its own investments (e.g., banks may hold share scrips of customers as security against loans and advances), the internal auditor should ensure that such investments are properly identified and segregated at the time of physical inspection.

(c) Where the scrips relating to shares, debentures or other securities are with a custodial/depository organization, the internal auditor should examine the certificate issued by it confirming the holdings of the institution. He should also examine the reconciliation of balances as per the records of the institution and those as per the certificate of the custodial or depository organization.

(d) Where banks on behalf of the institution hold the investments, the internal auditor should examine the certificates/ confirmations received from the banks. Such certificates/ confirmations should preferably be received directly by the internal auditor.

(e) Where investments are held by a third party other than banks on behalf of the institution the internal auditor should examine whether there is a justification for such other party to hold the scrips. In such a case, physical inspection of the relevant documents may be made to the extent possible. In any case, evidence of securities held by third parties should be examined.

(f) If investments are held otherwise than in the name of the

institution
(e.g., in the name of nominees/ trustees), the internal auditor should
ascertain the reasons therefore and examine the relevant
documentary evidence supporting real/ beneficial interest of the
institution in the investments e.g., written confirmations from the
nominees/ trustees.

Valuation and Disclosure

The internal auditor should examine whether the investments have
been valued according to the recognized accounting principles. Accounting Standard (AS) 13,*'Accounting for Investments'* , issued by the ICAI, deals with accounting for investments in the financial statements of enterprise and related disclosure requirements. The internal auditor should also examine whether the disclosure of investments in the financial statements is in accordance with the statutory requirements, if any. For example, Schedule VI to the Companies Act, 1956, contains detailed requirements relating to disclosure of investments.

To ascertain the fair value market value of investments (this may be required while determining the value of investments for balance sheet purposes), reference may be made to the official quotations of the stock exchange in the case of quoted securities. In the case of unquoted
securities, the internal auditor should examine whether the method adopted is one of the recognized methods of valuation of securities, e.g., break-up value method, capitalization-of-yield method, yield-to-maturity method, etc.

The internal auditor should examine whether any specific aspects relating to investments are required to be reported upon as per the provisions of the relevant statute governing the institution. For example, as per the provisions of section 227(1A) of the Companies Act, 1956, the internal auditor of a company (other than an investment company or a banking company) should enquire whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company.

Inventories

An illustrative list of inventory registers maintained in an educational
institution is as under:
(a) Printing and Stationery
(b) Hardware
(c) Sanitary
(d) Electrical
(e) Fixtures and Furniture
(f) New Construction (for construction materials)
(g) Mess Equipments and Utensils
(h) General
(i) Lab Equipments
(j) Sports and Gym
(k) Physics Lab (for items issued to Lab)
(l) Chemistry Lab (for items issued to Lab)
(m) Daily maintenance receipt (for items issued for maintenance)
(n) Repairs (for items sent for repairing).

An internal auditor should:

(a) Examine the internal control over the receipt, issue, maintenance, leakage, etc. of the inventories.

(b) Verify the above mentioned inventory registers from the following documents:

(i) Copy of Purchase Orders
(ii) Challans/Duplicate Bills File
(iii) Stores Issue Slips
(iv) Material Inward Register
(v) Bill Dispatch Register (for bill sent to accounts/purchase department)
(vi) Issue and Received Register (for items issued but to be retuned back).

(c) Check the opening balances of the items.
(d) Verify the Gate Entry Register for items purchased or sent outside the premises for repairs, etc.
(e) Verify the list of defective/scrapped/destroyed items and the loss to be recognized in the income and expenditure account.
(f) Inspect reports of physical inspections carried out by the Inventory Management Department, Accounts Department, etc.
(g) Check that the inventory has been valued and disclosed in the financial statements according to the generally accepted bases of accounting which are determined by law, professional pronouncements and prevailing practices governing educational institutions. The internal auditor may refer to Accounting Standard (AS) 2, *"Valuation of Inventories"*.

Cash and Bank Balances

The internal auditor should carry out the following procedures:

(a) The internal auditor should carry out physical verification of cash at
the year-end. Where this is not feasible, verification may be carried
out, on a surprise basis, at any time around the date of the balance
sheet. In such a case, the internal auditor should examine whether the cash balance as shown in the balance sheet reconciles with the
physically verified cash after making adjustments for cash receipts
and payments during the interim period. Besides physical verification
at or around the date of the balance sheet, the internal auditor should also carry out surprise verification of cash during the year.

The following aspects of physical verification of cash may be noted:

(i) All cash balances in the same location (petty cash, cash of sister concerns/ staff societies, etc.) should be verified simultaneously.

(ii) If IOUs or other similar documents are found during physical verification, the internal auditor should seek explanations from the management regarding the reasons for such documents remaining pending. These should not be shown as cash in hand (but classified as short term advances).

(iii) The quantum of torn or mutilated currency notes should be examined to determine whether any provision for loss on this account is required.

(b) If the internal auditor finds that the organization is consistently

maintaining an unduly large balance of cash-in-hand, he should carry out surprise verification of cash more frequently. The internal
auditor must be familiar with the written policies on the limits of holding cash. He should also examine the reasons for maintaining such large balances having regard to the normal working requirements of the organization. Normally, the educational institution follow the policy of depositing the fees received in cash on the following day into the bank account maintained for the purpose. A large balance of cash in hand may point to possession of unrecorded funds by members.

(c) The internal auditor should vouch the cash payments made over the
limits assigned requiring appropriate approvals.

(d) The internal auditor should advise the organization to send a letter to
all its bankers to confirm the balances directly to the internal auditor
including those relating to dormant accounts as well as accounts closed during the year.

(e) The internal auditor should examine the bank reconciliation statements as at the year end. He may also examine the reconciliation statements as at other dates during the year. He should, particularly, examine whether the cheques issued but not presented and the cheques deposited but not cleared have been duly accounted for in the bank statements of the subsequent period. In case this is not so, he should examine whether the entries need to be reversed. The internal auditor should pay special attention to items, which are outstanding for unduly long periods and should consider whether such items require an adjustment/ write off.

(f) Where post dated cheques have been shown as collections, the
internal auditor should ask for reversal of the entries. Similarly,

post
dated cheques issued by the organization should not be accounted
for as payments.
(g) The internal auditor should examine the bank statements relating to accounts which are apparently inoperative to ensure that no transactions have taken place in such accounts which have not been recorded in the books of account.
(h) In case of unduly large number of deposits or issue of cheques in
the last few days of the year, the internal auditor may consider obtaining confirmations from the parties concerned. Similarly, where
there are a large number of cheques on hand at the date of the balance sheet and a sizeable proportion has subsequently remained
un-deposited/ un-cleared, the internal auditor may consider obtaining
confirmations.
(i) The internal auditor should examine relevant receipts/ certificate
/bank advices in respect of fixed deposits or other types of deposits.
(j) Remittances in transit should be examined with reference to their
adjustments in the bank statements of the subsequent period.

Other Current Assets

An educational institution, if following an accrual based accounting
shall charge the students for the fees due in the current financial year.
Such fees if not received can either be represented in the name of Fees

receivable or the balances of students in the Balance Sheet. Such amount
should be evidenced with the list of student accounts from which the fees has not been received. The internal auditor may follow the following steps for audit of fees receivables:

(a) Check that the opening balances of fees receivable account have been transferred to the respective student accounts.

(b) Verify whether the fees receivable is recorded correctly during the current periods.

(c) Examine the next year's transactions and fees receipt books to ensure that the current year fees have been booked.

Security Deposits

As stated above, an educational institution may be required to deposit some security to other institution, government, local authority for conducting some course or exam. Further, an amount may be placed before any other department/agency for obtaining connection such as telephone connection, gas connection, etc. At the time of giving a security deposit, the receipt should be obtained and retained till such deposit gets refunded. A list should be prepared for the security deposits given and should be verified with the evidences.

Contingent Liabilities

Some of the contingent liabilities arising in case of an educational institution are:

(a) Amount indeterminable in respect of pending income tax assessments.

(b) Additional liability arising due to sales tax, service tax demand on completion of assessments or non-deduction of Provident

Fund/ESI
by the contractors.
(c) Amount indeterminable in respect of pending court cases by/against
ex-employees or students.
(d) Claims against the institution in the courts/consumer courts not
acknowledged as debts.
(e) Guarantees given.
(f) Guarantees issued by banks on behalf of the Institution.
(g) Non-deduction of TDS on provisions due to pending payments with
the parties.
(h) Claim of refunds by the students.
(i) Claims of retirement benefit by employees.
(j) Cause of action arising out of breach of laws and regulations under
which the institution operates or due to non-fulfillment of conditions
for getting recognitions.
(k) Capital commitments.

The internal auditor should:
(a) Inquire the management about their knowledge of unrecorded
commitments or contingent liabilities.
(b) Ascertain the amount of contingent liability as discussed with the
management.
(c) Ensure that all contingent liabilities are raised or disclosed in the
financial statements.
(d) Verify last year's contingent liabilities and ensure that these
have been duly considered for the current year's account.

Internal Auditor’s Role in Corporate Governance

Corporate Governance may be defined as a set of systems, processes and principles which ensure that an entity is governed in the best interest of all the stakeholders. It ensures commitment to values and ethical conduct of business; transparency in business transactions; statutory and legal compliance; adequate disclosures and effective decision making to achieve corporate objectives. Corporate Governance is about promoting corporate fairness, transparency and accountability.

Corporate Governance in an educational institution means emphasising on accountability, transparency, strict costing measures and quality education, student security, bringing in latest technology to benefit students and being self-sufficient. The internal auditors are required to evaluate and offer recommendations to improve governance processes by delivering:

(a) Assessment of governance policy of the management.
(b) Assessment of mission, objectives and goals of the institution.
(c) Evaluation of Risk and Internal control framework and suggesting best practices ideas.
(d) Detailed analysis of business processes and controls, policies and procedures and code of conduct.
(e) Sources of information for fraud and irregularities, and reporting their effectiveness to the audit committee.

(f) Review of compliance framework, their activities and issues.

Reporting of Frauds, Errors, Irregularities and Illegal Acts in an Educational Institution

The following types of frauds, errors, irregularities and illegal acts are commonly found in an educational institution:

(a) Charging capitation fees from students, where not allowed.

(b) Plagiarism - Availability of restricted data, violation of intellectual property rights or leakage of critical information on internet, for example, examination papers, course papers, essays or research notes.

(c) Sale of question papers and answers by employees, faculty, publisher, etc.

(d) Reproduction and distribution of unauthorized valuable documents, such as college diploma certificates or transcripts of student's records.

(e) Professional misconduct, educational malpractice including inappropriate changes in institution's curriculum, misuse of institution's resources and deliberate falsification of records.

(f) Teachers accepting cash payments for giving candidates extra time or other kind of assistance during examinations.

(g) Theft and tampering of records.

(h) Fabrication with falsification of data, records and credentials by a faculty member at the time of employment.

(i) Misappropriation of assets.

(j) Phantom Billing – Billing for work that was not performed or services that were never rendered.

(k) Double Billing – Error of charging a student twice for fees of a year.

(l) Phantom Employees – Charging for employees that were not

on the
job.
(m) Obtaining a contract through kickbacks, for example, accepting
bribes from publishing houses for ordering text books.
(n) Improper use of grant money or misuse of government funding.
(o) Sanction of grant through improper means such as inflate the number of students or publish superior results of student performance.

Responsibilities of the Internal Auditor

Standard on Internal Audit (SIA) 11, *"Consideration of Fraud in an Internal Audit"* , lays down that the primary responsibility for prevention and detection of frauds rests with management and those charged with
governance. They achieve this by designing, establishing and ensuring
continuous operation of an effective system of internal controls. An internal auditor should use his knowledge and skills to reasonably enable him to identify indicators of frauds. However, the internal auditor cannot be expected to possess the expertise of a person with specialized knowledge and skills in detecting and investigating frauds. It is essential for the internal auditor to gain an understanding of the components of the system of internal control which would keep him to assess the risk of frauds.

The internal auditor should help the management fulfill its
responsibilities relating to fraud prevention and detection. The following
paragraphs discuss the approach of the internal auditor regarding this:

(a) The internal auditor should obtain an understanding of the various aspects of the control environment and evaluate the same as to the operating effectiveness.

(b) The internal auditor should obtain an understanding of the policies and procedures adopted by the management to identify risks that can affect the achievement of the objectives of the entity and to distinguish risks from opportunities and evaluate the effectiveness of these policies and procedures. In the context of prevention of frauds, the internal auditor should, specifically evaluate the policies and procedures established by the management to identify and assess the risk of frauds, including the possibility of fraudulent financial reporting and misappropriation of assets.

(c) The internal auditor should assess the operating effectiveness of the policies and procedures established by the management to identify, capture and communicate relevant information to the concerned persons in the entity to enable them to make timely and effective decisions and discharge their responsibilities efficiently.

(d) The internal auditor should assess whether the controls implemented by the management to ensure that the risks identified are responded to as per the policy, or the specific decision of the management, as the case may be, are in fact working effectively and whether they are effective in prevention or timely detection and correction of the frauds or breach of internal controls.

(e) The internal auditor should evaluate the mechanism in place for supervision and assessment of the internal controls to identify instances of any actual or possible breaches therein and to take corrective action on a timely basis.

(f) The internal auditor should carefully review and assess the conclusions drawn from the audit evidence obtained, as the basis for his findings contained in his report and suggest remedial action. In case, the internal auditor comes across any actual or suspected fraud or any other misappropriation of assets, he should immediately bring the same to the attention of the management.

(g) The internal auditor should document fraud risk factors identified as being present during the internal auditor's assessment process and document the internal auditor's response. If during the performance of the internal audit fraud risk factors are identified that cause the internal auditor to believe that additional internal audit procedures are necessary, the internal auditor should document the same.

The internal auditor should carry out the following procedures

which
would help him to identify fraud risk factors:
(a) Review of personal accounts of employees and officers.
(b) Ensure that the management has taken the following steps:

(i) Incorporate a formal fraud control policy.
(ii) Ensure that there is proper system of prevention and detection of fraud, e.g., whistleblower policy should be made with the objective of providing employees, investors, suppliers, lenders, service providers, etc. an avenue to raise complaints.
(iii) Train employees, such as train tellers not to accept unusual transactions from insiders
(iv) Encourage questioning and reporting of unusual transactions.
(v) Place a confidential hotline.
(vi) Sharing of information.
(vii) Exercise due care and reasonable safeguards to prevent fraud. (viii) Direct supervision and control.
(ix) Communication of fraud to vendors and business partners.

Transactions with Related Parties

As per Accounting Standard (AS) 18, *"Related Party Disclosures"* issued by the Institute of Chartered Accountants of India, related parties
are considered to be related if at any time during the reporting period one party has the ability to control the other party or exercise significant
influence over the other party in making financial and/or operating decisions. AS 18 deals only with related party relationships described in
(a) to (e) below:

(a) Enterprises that directly, or indirectly through one or more

intermediaries, control, or are controlled by, or are under common control with the reporting enterprise (this includes holding company,
subsidiaries and fellow subsidiaries).
(b) Associates and joint ventures of the reporting enterprise and the
investing party or venturer in respect of which the reporting enterprise is an associate or a joint venture.
(c) Individuals owing, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise and relatives of any such individual. *'Relative'* in relation to an individual, means the spouse, son, daughter, brother, sister, father and mother who may be expected to influence, or be influenced by, that individual in his/her
dealings with the reporting enterprise.
(d) Key management personnel and relatives of such personnel
(e) Enterprises over which any person described in (c) or (d) is able to
exercise significant influence. This includes enterprises owned by directors or major shareholders of the reporting enterprise and enterprises that have a member of key management in common with
the reporting enterprise.

Section 6 of Companies Act, 1956 , lays down that a person shall be
deemed to be a relative of another, if, and only if,
(a) They are members of a Hindu undivided family; or
(b) They are husband and wife; or
(c) The one is related to the other in the manner indicated in Schedule IA.

Section 2(41) of Income Tax Act, 1961, lays down that *'Relative'* in relation to an individual, means the husband, wife, brother or sister or any lineal descendant or descendant of that individual. Further, a person shall be deemed to have a substantial interest in a business or profession if:

(i) In case of company, the person, at any time during the year, carries not less than 20% of the voting power.

(ii) In any other case, the person, at any time during the year, is beneficially entitled to not less than 20% of the profits of such business or profession.

As already mentioned, the educational institutions, generally, exist solely on a not-for-profit basis. Such institutions generally exist either as a Society or as a Section 25 company. More so, because the affiliation conditions/regulations governing such institutions are very clear in this respect that the educational institution must run for charity and not for profiteering. However, it is quite common that the trustees or the promoters of such institutions who contribute substantial amount for setting up the institution are also the members of the governing body. These members are in privileged position to misuse the funds meant for the institution. In case of an educational institution, the following can be the related parties:

(a) Enterprises that directly or indirectly, control, or are controlled by, or are under common control with the educational institution, for example, sister educational or vocational institution, etc.

(b) Individuals owing, directly or indirectly, an interest in the voting power of the reporting enterprise that gives them control or significant influence over the enterprise and relatives of any such individual, for example, two societies having a same set of

trustees.
(c) Key Management Personnel and relatives of such personnel for
example directors, trustees, etc.

The responsibility for identification and disclosure of related parties and related party transactions is of the management. However, the internal auditor must perform the following procedure for related party transactions:

(a) Obtain sufficient audit evidence regarding the identification and
disclosure by management of related parties that are material.
(b) Review information provided by the management regarding the
related parties.
(c) Review the institution's procedure for identification of related parties.
(d) Review with the management, of the financial statements before
submission to the Board of Directors for approval, with reference to
disclosure of any related party transactions.
(e) Review prior year working papers for names and transactions of
related parties.
(f) Inquire affiliation of directors, key management personnel, officers
with other entities.
(g) Review minutes of meetings and other statutory records, such as
Director's Interest Register, etc.
(h) Review shareholders records to determine the names of principal
shareholder or obtain a list of principal shareholders from the

share
register.
(i) Review the institution's Income tax returns.
(j) Review any other agreements entered into by the institution.
(k) Review the related party transactions and disclose material transactions with promoters or management or subsidiaries or relatives, etc. that may have possible conflict with the interests of the institution.

In case there are any unusual transactions with the related parties, the internal auditor must ensure that the same are reported and disclosed in the financial statements. The internal auditor must check transactions regarding related parties relating to abnormal terms of trade, such as excessive salary, unusual prices, interest rates, vehicle logs, use of property of the institution, guarantees and repayment terms or transactions that lack an apparent logical business reason for their occurrence or those that are of high-volume or significant amounts with certain customers or suppliers as compared with others, for example an internal auditor can compare the remuneration payable to a trustee with the remuneration payable to the unrelated personnel employed within the institution having similar background, qualifications, experience, etc. Similarly the internal auditor can verify the interest paid by the institution to the key management personnel with regards to the interest rate charged by the financial institutions or third party in the similar circumstances.

The following documents must be placed for the consideration of

the
Audit Committee:
(a) A statement of all related party transactions in the ordinary course of
business.
(b) Details of material individual transactions with related party which
are not in the normal course of business.
(c) Details of material individual transactions with related party which
are not on an arm's length basis together with the management's justification for the same.

The reporting requirement of the entities may require disclosing the
related party disclosures. The following instances in this context are
relevant:
(i) Accounting Standard (AS) 18, *"Related Party Disclosures"* prescribes the following disclosures in respect of the transactions with related parties:
(a) Name of the transacting related party;
(b) A description of the relationship between the parties;
(c) A description of the nature of transactions;
(d) Volume of the transactions either as an amount or as an appropriate proportion;
(e) Any other elements of the related party transactions necessary for an understanding of the financial statements;
(f) The amounts or appropriate proportions of outstanding items pertaining to related parties at the balance sheet date and provisions for doubtful debts due from such parties at that date; and
(g) Amounts written off or written back in the period in respect of debts due from or to related parties.

(ii) The*Companies Act, 1956* places significant emphasis on the concept of related parties and incorporates regulatory provisions for
the same in various sections embodied in that Act. To illustrate:

(a) Section 297 provides for Board's sanction in cases of contracts in which directors are directly or indirectly interested.
(b) Section 299 requires such interested directors to disclose their interest at Board meetings.
(c) Section 300 debars interested directors from voting on such resolution pertaining to matters in which they are interested.

As per, Standard on Internal Audit (SIA) 17,*"Consideration of Laws
and Regulations in an Internal Audit",* compliance with laws and regulations is an inherent part of the functioning of an entity. Since the role of an internal auditor is to carry out a continuous and critical appraisal of the functioning of an entity and suggest improvements thereto, the identification of non-compliance with laws and regulations is also an inherent part of his responsibilities. Thus, the scope of an internal audit is also affected by the statutory or regulatory framework in which the institution operates.

The internal auditor is required to consider at the time of planning and performing audit procedures as well as evaluating and reporting the results thereof, that any non-compliance by the institution with laws and regulations under which it operates may materially affect the financial statements and in some cases, may affect significantly the functioning of the institution. Yet, at the same time, that internal auditor cannot be expected to detect the non-compliance with all laws and regulations.

An example of serious non-compliance with laws, in the case of educational institution could be non-compliance with the terms and conditions under which affiliations, registration, etc., was granted to the entity to operate as an educational institution. Such non-compliance could be so significant as to effect going concern assumption. To illustrate, the regulatory environment in India is oriented towards allowing educational institutions to be run only by not-for-profit organizations. Any violation of this basic character by engagement in activities with the purpose of profiteering would automatically result in withdrawal of affiliations from the regulatory bodies. Further, this would also mean loss of benefits in the shape of exemption of taxes such as Income Tax, Wealth Tax, Municipal Taxes, etc. which are normally granted only to charitable entities. Other illustrations of breach of terms may be charging of higher fees than prescribed or payment of salaries to teachers at a rate lower than
prescribed. All this could mean withdrawal of registrations/affiliations, which would effectively lead to ceasing of operations. There might be violation of laws which may not be as serious but may have limited financial impact, such as penalties for unauthorized constructions, non filing of tax returns, etc. Further, the internal auditor must check the statutory compliances under the*Service Tax, the Prevention of Food Adulteration Act & Rules, 1954, Shop & Establishment Acts, VAT Acts* in case of establishment of a canteen.

Internal Audit in an Information Technology Environment

According to Standard on Internal Audit (SIA) 14,*"Internal Audit in an Information Technology Environment"* , the overall objective and scope of an internal audit does not change in an information technology (IT) environment. However, the use of a computer changes the processing, storage, retrieval and communication of financial information and the interplay of processes, systems and control procedures which may affect the internal control systems employed by the entity. The internal auditor should consider the following aspects in an information technology environment:

(a) The extent to which the IT environment is used to record, compile process and analyze information; and (b) The system of internal control in existence in the entity with regard to:

- The flow of authorized, correct and complete data to the processing centre;
- The processing, analysis and reporting tasks undertaken in the installation; and
- The impact of computer based accounting system on the audit trail that could otherwise be expected to exist in an entirely manual system.

The internal auditor should obtain an understanding of the significance and complexity of the IT activities and the availability of the data for use in the internal audit. This understanding would include such matters as:

(a) The information technology infrastructure [hardware, operating systems and application software, etc.] used by the entity including changes, if any, therein since last audit.

(b) The significance and complexity of computerized processing in each

significant application.
(c) Determination of the organizational structure of the client's IT activities and the extent of concentration or distribution of computer processing throughout the entity, particularly as they may affect segregation of duties.
(d) Determination of the availability of data, source documents, and computer files.

The internal auditor should obtain an understanding of the IT environment and whether it influences the assessment of inherent and control risks. The internal auditor should evaluate the reliability of the internal control systems. The internal auditor should review whether the information technology system in the institution considers the confidentiality, effectiveness, integrity, availability, compliance and validity of data and information processed. The internal auditor should also review the effectiveness and safeguarding of IT resources, including people, applications, facilities and data. The internal auditor should review the robustness of the IT environment and consider any weakness or deficiency in the design and operation of any IT control within the institution, by reviewing various reports generated, physical access records, logical access controls, application controls, IT Policy, etc. If the internal auditor is not able to rely on the effectiveness of the IT environment, he may perform such substantive testing or test of IT controls.

Information Technology systems may generate reports that might be useful in performing substantive tests (particularly, analytical procedures). The potential for use of computer assisted audit techniques may permit increased efficiency in the performance of internal audit procedures, or may enable the auditor to economically apply certain procedures to the entire population of transactions.

Internal Audit using Computer Assisted Audit Techniques (CAAT)

The major progress in the electronic data processing and a continuous development of range of internal auditing services have created
a greater use of computers by the internal auditor to achieve his audit
objectives more efficiently. Computers are useful where there is voluminous data and processing involved and statistical sampling is to be done. The tests which were previously performed manually by the internal auditor can now be done by the use of computer assisted audit techniques (CAAT). The computer assisted audit techniques help the internal auditor to improve the quality of audit as well as sharpen his capabilities to perform special reviews for management.

CAATs may be used in performing various auditing procedures, including the following:

(a) Tests of details of transactions and balances, for example, the use of
audit for recalculating interest or the extraction of invoices over a certain value from computer records;

(b) Extract analytical reports and perform analytical procedures, for
example, identifying inconsistencies or significant fluctuations;

(c) Tests of general controls, for example, testing the set up or configuration of the operating system or access procedures to the program libraries;

(d) Sampling programs to extract data for audit testing, data sorting and charting;

(e) Stratification of data - numeric, date, character;

(f) Tests of application controls, for example, testing the functioning of a programmed control;

(g) Re-performing calculations performed by the institution’s accounting systems and confirmation of calculations;

(h) Use of macros;

(i) Aging analysis;

(j) Detect duplicates and gaps;

(k) Compare files for variances; and

(l) Operate through a wide network of branches and departments, which are geographically dispersed.