

## Unit - 3

# INTERNAL CONTROL, INTERNAL CHECK AND INTERNAL AUDIT

### 3.1 INTERNAL CONTROL

Internal Control comprises of the plan of the organization and all the co-ordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies.

Internal Control can be defined as a system designed, introduced and maintained by the company's management and top-level executives, to provide a substantial degree of assurance in achieving business objective, while complying with the policies and laws, safeguarding the assets, maintaining efficiency and effectiveness in regular operations and reliability of financial statements.

An internal control is a procedure or policy put in place by management to safeguard assets, promote accountability, increase efficiency, and stop fraudulent behaviour. In other words, an internal control is a process put in place to prevent employees from stealing assets or committing fraud.

#### Definition :

1. "Internal control comprises of the plan of organization and all the coordinate methods and measures adopted within a business to safeguard its assets, check the accuracy and reliability of its accounting data to promote operational efficiency and to encourage adherence to prescribed managerial policies."

- The American Institute of Certified Public Accountants

2. "Internal Control is best regarded as indicating the whole system of controls, financial and otherwise, established by the management in the conduct of a business, including internal check, internal audit and other forms of control".

- W.W. Bigg

### 3.2 CHARACTERISTICS OF INTERNAL CONTROL

1. There should be a well-developed plan of organization with delegation of proper responsibilities at various levels of operational hierarchy.
2. There should be a scientifically developed system of record procedures with a view to maintain reasonable control over assets, liabilities, revenues and expenses.
3. A system of healthy practices and traditions is also necessary for the performance of duties and activities of various departments of the organization.
4. The personnel engaged in the business should be of high quality and character with a deep understanding of their responsibilities and a proper background of training and ability. This is necessary because controls are exercised by personnel engaged in the business.
5. There should be managerial supervision and reviews of the company's financial operation and positions at regular and frequent intervals by means of interim accounts and reports and operating summaries etc.

### 3.3 SCOPE OF INTERNAL CONTROL

1. **General Financial Control :** This control includes a proper efficient system of accounting, adequate supervision, recording and duplicating systems, good efficient staff and the maintenance of healthy relationships amongst the staff.
2. **Cash Control :** The system includes certain important aspects of control for receipts, payments and balances held. A proper system of internal check must operate at all stages. There may be specially deputed officials including the internal audit staff to exercise checks at regular and irregular intervals. Effort should be made to avoid misappropriation of cash.
3. **Employee Remuneration :** The system must cover all sections of employee remuneration and maintenance of records for remuneration, their preparation and methods of payment should be brought under tight control. So pacific instructions must be issued to the staff concerned.
4. **Trading Transactions :** These refer to the purchases, sales etc. So in respect of these transactions, effective procedure should laid down for acquisitions, handling and accounting of goods purchased or sold.
5. **Fixed Assets :** Capital expenditure on fixed assets should be kept under strict check and supervision. The authority right from sanctioning of capital expenditure to its use should be clearly defined so that any type of misappropriation by officials of the organization can be reduced to the minimum.
6. **Stock Maintenance :** Stocks of raw materials, work-in-progress and finished goods should be properly maintained and accounted for. Regular stock taking procedures are quite helpful as means of independent, checks and reconciliation of records.

7. **Investments** : The procedures of control in regard to investments cover such measures as authorization, recording and maintaining record of investments held and safeguarding the documents of title.

### 3.4 OBJECTIVES/NEED/PURPOSE OF INTERNAL CONTROL

Let us now understand the purpose of Internal Control from different points of view :

#### From Auditor's Point of View

It is very important from the Auditor's point of view to study and evaluate the system of internal control. To obtain an adequate understanding of the internal control system, that must be tested. The Auditor has to determine whether audit is possible, if yes, then he should determine the scope of audit.

#### From Client's Point of View

1. **Providing Reliable and Accurate Data** : Internal control system provides reliable and accurate data that is necessary for decision making and to run business activity efficiently.
2. **Safeguard of Business Assets** : Adequate internal control system safeguard business assets, in absence of it, assets of the company may be stolen, misused or accidentally destroyed.
3. **Control of Wastage** : Internal control system within organization is necessary to discourage and stop non performing business activities and to protect business from wastage is all aspects of the business.
4. **Rules and Procedures** : Internal control system insures that rules and procedures are to be followed by business personnel.

### 3.5 INTERNAL CONTROL AND THE AUDITOR

An auditor is mainly concerned with the evaluation of the internal control system in force so that he may be able to know :

1. Whether mistakes, errors and frauds are likely to be located in the ordinary course of business.
2. Whether an effective internal auditing department exist or not.
3. How far and how adequately the management is discharging its function in so far as correct recording of transaction is concerned.
4. How extensive examination he should carry out in different areas of accounting.
5. How far administrative control has a bearing on his work.
6. What should be the appropriate audit programme in existing circumstances.

To what extent reliability can be placed on the reports, records and the certificates of the management.

Whether some suggestion can be given to improve the existing control system.

Therefore we can conclude by saying that internal control is a broad term which includes internal check, internal audit, and other forms of control.

### 3.6 ADVANTAGES OF INTERNAL CONTROL

Internal control helps to protect the assets of the business from misuse, theft, accident etc.

Internal control helps to implement management policies to attain corporate goals.

Internal control helps the auditor in his/her work detecting all the errors and frauds which are committed in the books of accounts.

Internal control helps to increase the accuracy and reliability of financial statement and books of accounts.

Internal control helps to regulate the work of staffs through division of work among the staffs in a scientific manner which helps to make the daily works of staffs effective.

Internal control helps the management to prepare and implement effective plans by providing correct and fact information.

Internal control helps to put moral pressure on staffs.

### 3.7 LIMITATIONS OF INTERNAL CONTROL

1. Management decision to choose cost effective control system may reduce the effectiveness of internal control system.

2. There are chances of misuse by a person of authority who is operating on internal control system.

3. Objectives of internal control systems may be defeated by manipulation of management.

4. Since internal control system is involved in routine transactions, irregular transactions may be overlooked.

5. Changes in conditions may affect the effectiveness of internal control system.

### 3.8 INTERNAL CONTROL QUESTIONNAIRE

An internal control questionnaire is basically a comprehensive list of questions, covering every aspect of the client's system, the answers to which will enable the auditor to assess the internal controls in operations. To facilitate the assessment, the questions are asked in a form whereby the answer 'Yes' is satisfactory, whereas the answer 'No' appear to indicate a weakness.

### Characteristics of Internal Control Questionnaire

1. The internal control questionnaire will be drafted as far as possible in a form whereby the questions can simply be answered 'Yes/No/Not Applicable'
2. Though the internal control questionnaires are normally in a standardised pre-printed form for particular types of enterprises, their application to individual clients in a skilled matter requires the attention of senior staff.
3. The internal control questionnaire will require reviewing and updating at regular intervals and on the basis of changing situations, amendments are required to be made to the system.
4. Staff responsible for the completion or review of internal control questionnaires should be required to sign and date them. This both fixes responsibility and indicates the date on which answers to questions were obtained.
5. 'No' answers will require attention at the subsequent evaluation stage. They will also frequently require cross-reference to systems notes and a letter of weaknesses, as well as to the internal control evaluation.

### 3.9 FORMAT/SAMPLE INTERNAL CONTROL QUESTIONNAIRES

#### ACCOUNTS PAYABLE

	Yes	No	NA
1. Is control established over incoming vendor invoices?			
2. Are receiving reports matched to the vendor invoices and purchase orders, and are all of these documents kept in accessible files?			
3. Are charges for services required to be supported by evidence of performance by individuals other than the ones who incurred the obligations?			
4. Are extensions on invoices and applicable freight charges checked by accounts payable personnel?			
5. Is the program to be charged entered on the invoice and checked against the purchase order and approved budget?			
6. Is there an auditor of disbursements who reviews each voucher to see that proper procedures have been followed?			
7. Are checks adequately cross referenced to vouchers?			

8.	Are there individuals responsible for accounts payable other than those responsible for cash receipts?			
9.	Are accrual accounts kept for items which are not invoiced or paid on a regular basis?			
10.	Are unpaid vouchers totaled and compared with the general ledger on a monthly basis?			

**PURCHASING**

		<b>Yes</b>	<b>No</b>	<b>NA</b>
1.	Is the purchasing function separate from accounting and receiving?			
2.	Does the organization obtain competitive bids for items, such as rental or service agreements, over specified amounts?			
3.	Is the purchasing agent required to obtain additional approval on purchase orders above a stated amount?			
4.	Are there procedures to obtain the best possible price for items not subject to competitive bidding requirements, such as approved vendor lists and supply item catalogs?			
5.	Are purchase orders required for purchasing all equipment and services?			
6.	Are purchase orders controlled and accounted for by prenumbering and keeping a logbook?			
7.	Are the organization's normal policies, such as competitive bid requirements, the same as grant agreements and related regulations?			
8.	Is the purchasing department required to maintain control over items or dollar amounts requiring the ADECA to give advance approval?			
9.	Under the terms of OMB Circular A-87, certain costs and expenditures incurred by units of State and local governments are allowable only upon specific prior approval of the grantor Federal agency. The grantee organization should have established policies and procedures governing the prior approval of expenditures in the following categories.			

<ul style="list-style-type: none"><li>a. Automatic data processing costs.</li><li>b. Building space rental costs.</li><li>c. Costs related to the maintenance and operation of the organization's facilities.</li><li>d. Costs related to the rearrangement and alteration of the organization's facilities.</li><li>e. Allowances for depreciation and use of publicly owned buildings.</li><li>f. The cost of space procured under a rental-purchase or a lease-with-option-to-purchase agreement.</li><li>g. Capital expenditures.</li><li>h. Insurance and indemnification expenses.</li><li>i. The cost of management studies.</li><li>j. Preagreement costs.</li><li>k. Professional services costs.</li><li>l. Proposal costs.</li></ul>			
<p>10. Under the terms of OMB Circular A-87 (formerly FMC 74-4) certain costs incurred by units of State and local governments are <u>not</u> allowable as charges to Federal agency grants. The grantee organization should have established policies and procedures to preclude charging Federal grant programs with the following types of costs.</p> <ul style="list-style-type: none"><li>a. Bad debt expenses.</li><li>b. Contingencies.</li><li>c. Contribution and donation expenditures</li><li>d. Entertainment expenses.</li><li>e. Fines and penalties.</li><li>f. Interest and other financial costs.</li><li>g. Legislative expenses.</li><li>h. Charges representing the nonrecovery of costs under grant agreements.</li><li>i. The expenses of a State Governor or chief executive of a political subdivision.</li></ul>			

### 3.10 INTERNAL CHECK

An internal check is a part of internal control. Internal check is the process of arrangement of duties of various staffs of a business in such way that work is automatically checked by the next staff while performing their duties. Frauds which are committed by a staff are automatically detected and corrected by another staff. So, it helps a lot in the work of final audit. For example, a staff records the expenditure in a book and another staff posts them into ledger, another staff checks and verifies the ledger and payment is made by another staff. So, the work of one staff is checked by another staff while performing their works so that errors and frauds committed by one staff are detected and prevented by another staff.

Internal Check is an integral function of the internal control system. It is an arrangement of duties of the staff members in such a way that the work performed by one person is automatically and independently checked by the other.

### 3.11 OBJECTIVES OF INTERNAL CHECK

Following are the objectives of internal check system:

1. To eliminate the frauds and errors which may be committed by the staffs.
2. To prevent misappropriation of cash or stock.
3. To ensure the reliability of information produced by the accounting system.
4. To detect errors and frauds promptly which helps to minimize their effects in long term.
5. To exercise moral pressure over the staffs.

### 3.12 ESSENTIAL CHARACTERISTICS OF INTERNAL CHECK SYSTEM

Certain qualities are needed to make an internal check system more effective and efficient. Such qualities are known as features of internal check system which are as follows:

1. **Division of Work :** Before applying test check it is necessary to divide the entire tasks among the staffs in such a way so that work can be checked automatically by the another staff. Like, when staff takes the responsibility of purchase, then another staff should make its payment.
2. **Provision of Check :** An organization should set up such provision, so that work can be checked by the another staff. An officer can check the work of one staff by transferring to the staffs and again.
3. **Use of Devices :** In this modern world, various devices can be used to do various function like use of time record machine, wage determination machine etc. An organization should use such machines which help to make work of internal check easier.



4. **Self-balancing System** : An organization can use self-balancing ledger accounts which helps to make the work of internal check easier. Its effectiveness depends on its management.
5. **Change in Work** : An organization needs to transfer the staffs from one place to another place so that the work of previous staffs can be checked by the later staff which helps to make the internal check system effective.
6. **Specialization** : Every staff may not have such specialized knowledge to maintain accounts properly. So, an organization should give training to increase their skill so that internal check can be made more effective.
7. **Control** : There is more chance of frauds where there is direct contact of consumer or public. So, a manager can keep eyes in those works so that internal check system can be made more effectively.

### 3.13 ADVANTAGES OF INTERNAL CHECK

1. **Advantages to an Auditor** : If internal check system is effective, an auditor can apply test check rather than checking the books of accounts in details. So, auditor can save his time and labour which simultaneously saves the cost.
2. **Advantages to Businessman** : Following advantages can be achieved by the businessperson from internal check system:
  - ♦ Internal check detects errors and frauds which increase the morale of honest staffs. It helps to increase the production and reduce the cost. So, it helps to increase sales and profitability.
  - ♦ Staffs know the real position of the business. So, it helps to maintain good relation between staffs and managers.
  - ♦ Internal check system assures the owners in the accuracy and reliability of books of accounts.
3. **Advantages to Business** : Internal check system is beneficial to the business also. So, the advantages which can be achieved by the business are as follows:
  - ♦ Right, responsibility and duties of staffs are clearly defined under the internal check system. So, they perform work whole heartedly which reduces the chances of errors and frauds and increases profit.
  - ♦ Internal check system is based on the principle of division of labor. So, the work of business can be completed easily at minimum cost.
  - ♦ Work of every staff is checked automatically. So, the staffs remain honest which increases the profitability of business.
  - ♦ Every book of accounts remains correct, so final account can be prepared in less time, cost and labour.

### 3.14 DISADVANTAGES OF INTERNAL CHECK

Internal check system is useful to every stakeholder of the business even though it has some disadvantages which are as follows:

1. Under internal check system, every staff wants to complete her/his work in time. So, s/he performs work in hurry which leads errors.
2. Under internal check system, once work is checked by the another staff, the latter detects errors and frauds. So, there are chances of conflict between or among the staffs.
3. Staffs may form a group for personal benefits which leads to delay in work and increases errors and frauds.
4. Small organizations cannot use internal check system because it needs more staffs which increase the cost.

### 3.15 INTERNAL CHECK AND AUDITOR

The nature and extent of the scope of the Auditor's work depends upon the system of Internal Check in an organization. The system of Internal Check will determine the reliability on work which an Auditor can place. The External Auditor is ultimately responsible for the final accounts.

The Internal Check system cannot relieve the Auditor of his contractual responsibilities in case anything goes wrong in the final accounts, therefore it is the duty of the Auditor to check the whole transaction in detail. A good Internal Check system may relieve the Auditor of detailed checking and he can utilize the saved time to any other work of more importance.

### 3.16 INTERNAL CHECK WITH REGARD TO CASH TRANSACTIONS

#### Cash Receipts

A Cashier deals with the following tasks concerning cash receipts “

- ♦ Record cash receipts immediately upon the receipt of cash.
- ♦ He is not authorized to keep cash with him.
- ♦ He is not allowed to make any expenditure out of it.
- ♦ Cash receipt should be deposited in to bank on daily basis.
- ♦ Cashier should not be allowed to do primary entry in the books.

#### Cash Sales

Cash Sales may be of three types. They are :

1. Sales at the Counter
2. Sales by Travelling Salesmen
3. Postal Sales

### 1. Sales at the Counter :

- ♦ Every Salesman who is authorized to do cash sales should be specifically demarcated.
- ♦ Four copies of cash receipt should be generated out of which three will be handed over to the customer out of which customer will give one copy to cashier at the time of payment and one copy to gatekeeper at the time of delivery of goods and exit from gate and one copy will be retained by the customer.
- ♦ Three sales summaries will be prepared, one by the Salesman, second by the Cashier and the third by the Gatekeeper to tally the cash sales on daily basis.
- ♦ All Cash Sales should be deposited into bank on daily basis without any failure without deducting any expenditure or commission out of it.
- ♦ Cash received (as per cash recording machine), cash sales and amount deposited into bank should be same.

### 2. Sales by Travelling Salesmen

- ♦ Pre-numbered rough cash receipt book should be issued to every salesman for the collection of debt or advance from customers.
- ♦ Final receipt should be sent to customers directly.
- ♦ Without making any deduction, salesmen should deposit all the cash at the head office on daily basis without any fail.
- ♦ Regular reconciliation of account should be made with customer.
- ♦ To avoid any fraud every salesman should be replaced and transferred regularly to other areas.

### 3. Postal Sales

- ♦ Postal sales should be recorded in separate register.
- ♦ A separate register should be maintained to record the cash received against postal sale.
- ♦ Cash received through postal sale should be deposited into bank separately.
- ♦ Regular and careful checking of the sale and payment register should be done by an officer of the company.

### Cash Payments

Consider the following points while doing Internal Check for cash payments :

1. Excluding petty cash payments, all payments should be made through cheques, Demand Drafts, RTGS (Real Time Gross Settlement), NEFT (National Electronic Fund Transfer) or any other banking mode as available time to time.

2. Person making payments should have no connection with the receipt of cash.
3. Every paid bill or voucher should be stamped as "Paid" to avoid double payments for same bill or voucher.
4. Confirmation of balances from creditors should be made directly.
5. Cash receipt should be obtained for each payment.
6. For petty cash payments petty cashier will be responsible instead of main cashier.
7. Petty Cash should be maintained on Imprest system.
8. In absence of cash receipt, proper bill or voucher should be obtained from the petty cashier.
9. Petty cash book should be checked by the Cashier frequently.
10. Bank reconciliation should be done on a regular interval.
11. Pay-in slip to deposit cash in bank should be filled by the Cashier not by the person who is going to deposit the cash.

### 3.17 MAINTENANCE OF WAGE RECORDS

- **Time Recording Clock:** A time office at the entrance of the factory records the time of entry and exit of each worker with the help of a recording clock. The worker puts his card in the slot of the clock and the date and time are recorded on this card.  
In this way correct and clear record of time spent in the factory is put on the card.
- **Token System:** Under this system, a token duly numbered is issued to each worker who keeps it hanging on this board meant for the purpose. When he enters the gate, time keeper records his attendance in the attendance register.
- **Attendance Card:** In some business houses, attendance card are issued to workers. He drops the card in the box meant for the purpose, and collects in the evening. The time office/gate keeper records his attendance on the card.
- **Piece work record:** When wages are paid on the basis of work done, a job card is issued to each worker and the amount of work done by a worker is recorded on this card under the signatures of workman and foreman.
- **Over time Record:** When a worker is given overtime work, he is issued on overtime slip on which details about his name, duty time etc., are given by the works managers duly certified by the foreman of the department. In some cases, time card or job card has separate place to note the overtime work. A separate record is also maintained for overtime work which is submitted to the time office at the end of the month.

**Preparation of Wage Sheet:** At the end of the jobs, job cards/attendance register job cards, overtime slips etc. are submitted to the wage department which prepares the wage sheet on the basis of these records separately for time wages and for piece wages. Wage sheets of different departments are prepared separately. After preparing the wage sheet, they should be checked by another person.

**Precautions:** The person who checks the wage sheets should see that :

- ♦ No fake names are included in the sheet,
- ♦ Wage rates are not overstated or deductions are not understated,
- ♦ Over time wages are calculated correctly and
- ♦ Wages are paid only to the person concerned.

All the essential particulars should be entered in the wage slips which should have columns for :

1. Name
2. Number/code number allotted to him and his address
3. Total time worked
4. Details of work
5. Rate
6. Total amount of wages
7. Bonus
8. Overtime, if any
9. Deductions
10. Net amount payable

**Payment of Wages:** On the wage day, wage sheets are passed over to the cashier who with draws the necessary amount form the bank for payment of wages. The cashier should take the following precautions :

1. No person associated with the preparation of wage sheet should take part in payment of wages.
2. As far as possible, pay -pocket should be prepared for each worker.
3. Payment of wages should be made only to the worker concerned.
4. Foreman of the department should be present at the time of payment of wages to avoid impersonation of workers who are absent on that day.
5. Workers who are absent may collect their wages next day or any other person may collect any body's pay pocket on the basis of a letter of authority duly authorized and attested by the worker.

### 3.18 INTERNAL CHECK WITH REGARD TO PURCHASES

**Requisition :** The procedure for issuing purchase requisitions should be specified. The head of the department, who is in the need of goods, should fill in a requisition slip duly signed and then should send it to the purchases department. The details about the quantity, is quality and the time by which the goods must be supplied be clearly mentioned in the requisition slip.

**Enquiry :** Purchase department makes an enquiry about the terms and conditions of purchases from different suppliers. For this purpose tender are generally invited. But, who shall open and accept the tenders, should be clearly specified. At a rule, the lowest tender should be accepted and accordingly a decision be taken.

**Purchase Order :** The Purchase Department places orders which should be recorded in the Purchase Order book. Four copies of purchase order should be prepared. One copy will be sent to the vendor, second to the store department, third copy to the Accounts department and fourth one will be retained by the purchase department itself. A responsible officer should review the purchase order, before signing by the authorized person or director.

**Receipt of Goods :** On receipt of goods, the purchase department should be properly inspect them, and there after an entry in the goods inward (Receipt) book, the same should be sent to the stores. Concerned department should be informed about the receipt of the goods.

**Making the Payments :** The Purchase Department should thoroughly check the invoices and send the same to accounting department for payment. The accounting department should compare the invoice with the purchase order and Incoming Inspection Report and should also verify the calculation.

The Accounts Department should enter the invoice in the Purchase Book. Only responsible official should draw cheque for the payment of invoice. At the time of signing, a signing authority must verify that correct payment is made. If some portion of the goods is returned to the supplier, a proper entry must be made in the Purchase Return Book. A Credit Note to that effect must be obtained from the supplier and accounts section must adjust the payment accordingly.

A good system of internal check with regard to purchase will prevent the following types of irregularities, errors and frauds.

- i. **Fictitious Payment :** Fictitious Purchase may be recorded in the purchase book and the payments withdrawn may be misappropriated.
- ii. **Double Payment :** Some invoices may be recorded twice and double payment made may be misappropriated.
- iii. **Artificial inflation in Profits :** Goods purchased may not be entered in the period so as to inflate profits.
- iv. **Artificial reduction in Profits :** Goods not received in one period may be entered as purchases so as to show profits less than the actual.

### 3.19 INTERNAL CHECK WITH REGARD TO STORES (STOCK)

The Stores Department has the charge of preserving and issuing stores to different departments. Proper control of stores is very much essential to prevent pilferage (small theft) and misuse. Therefore, the internal check system in relation to stores must be given careful attention.

The following general rules may be followed to ensure effective check on the stores.

1. **Location of Stores :** Store should be located at a convenient place. It should have proper stores facilities so that goods may not be misplaced, misused or wasted.
2. **Receipts of Stores :** On receiving stores, the Stores Department will prepare a 'Goods Received Note' in triplicate.

One copy will be sent to the Purchase Department.

Second copy will be sent to Accounts Department.

The third will be retained by the Stores Department itself.

All the details about stores should be noted on the note. Stores should be properly checked after their receipt.

3. **Preservation of Stores :** Goods received should be stored at their allotted racks. The system of Bin Cards should be used to show the receipts, issues and balance of stores. Such Bin Cards may be kept hanging on the places where stores are preserved. Stores inventory software may be used on computer for item stored.
4. **Issue of Stores :** No item from the stores should be issued to any person without formal requisition or demand note from some authority. Only authorized person should be allowed to remove articles from the stores according to the requisition. The Stores Officer should be seated near the gate so that all issues may be made under his supervision. For the materials or stores returned from the job or the department. Material return note should be written and properly accounted for. Likewise, Material Transfer Notes should be used for the materials transferred from one department or job to another. The gate keeper should be instructed not to allow any material out of the factory without necessary permit from the Store- Keeper or Invoice of Sales Department.
5. **Recording :** After the issue of materials from the stores, the Store Issue Requisition should be sent to the Stores Accounts Section for proper records there. The Bin Cards should be checked out compared from time to time with stores records.

### 3.20 INTERNAL AUDIT

Internal audit is an audit conducted on behalf of the management of an enterprise with the object of assisting the management discharge of responsibilities effectively and involves an examination and evaluation of various activities of the enterprise. It is a review of the operations and records, sometimes continuously undertaken, within a business, by specially assigned staff.

Many large organizations have a system of internal audit within the organization as a integral part of internal control. Internal auditing is a staff function rather than a line function and the internal auditor does not exercise direct authority over other persons in the organization.

### 3.21 OBJECTIVES INTERNAL AUDIT

The objectives of the internal audit can be summarized as follows :

1. To verify the correctness, accuracy and authenticity of the financial accounting and statistical records presented to the management.
2. To confirm that the liabilities have been incurred by the organization in respect of its valid and legitimate activities.
3. To comment on the effectiveness of the internal control system and the internal check system in force and to suggest ways and means to improve these systems.
4. To facilitate the early detection and prevention of frauds.
5. To examine the protection afforded to company's assets and use of them for business purpose.
6. To identify the authorities responsible for purchasing assets and other items as well as disposal of assets.
7. To ensure that the standard accounting practices which have to be followed by the organization are strictly followed.
8. To undertake special investigation for the management.
9. To assist management in achieving the most efficient administration of the operation by establishing procedures by complying with company's operating policies.

### 3.22 ADVANTAGES OF INTERNAL AUDIT

The advantages of internal audit are as follows :

1. Staffs remain alert because their work shall be checked by the internal auditor. So, accounting remains correct.
2. Internal audit helps to detect errors and frauds and provides suggestions to improve them which help the management to take corrective action.
3. Internal audit detects the misuse of resources in time which helps to reduce unnecessary expenses.
4. Internal audit checks the efficiency of staffs which helps to increase the efficiency of them.
5. Internal audit checks the books of accounts, detects errors and frauds and helps in its correction which makes the act of final auditor easier.
6. Internal audit increases the morale of honest staff because evaluation of performance of any staffs will be made at any time.



### 3.23 EXTERNAL AUDIT

External Audit which is obligatory for every separate legal entity, where a third party is brought to the organization to perform the process of Audit and give its opinion on the Financial Statements of the company. Here the working scope is determined by the respective statute.

### 3.24 DIFFERENCES BETWEEN INTERNAL AUDIT AND EXTERNAL AUDIT

	Internal Audit	External Audit
Meaning	Internal Audit refers to an on-going audit function performed within an organization by a separate internal auditing department.	External Audit is an audit function performed by the independent body which is not a part of the organization.
Objective	To review the routine activities and provide suggestion for the improvement.	To analyse and verify the financial statement of the company.
Conducted By	Employees	Third Party
Auditor is appointed by	Management	Members
User of Report	Management	Stakeholders
Opinion	Opinion is provided on the effectiveness of the operational activities of the organization.	Opinion is provided on the truthfulness and fairness of the financial statement of the company.
Scope	Decided by the management of the entity.	Decided by the statute.
Obligations	No, it is voluntary	Yes, according to Indian Companies Act
Period	Continuous	Once in a year
Checks	Operational Efficiency	Accuracy and Validity of Financial Statement

### 3.25 INTERNAL CHECK VS. INTERNAL AUDIT

Basis	Internal Check	Internal Audit
<b>Meaning</b>	Internal Check is an arrangement of duties allocated in such a way that the work of one person is automatically checked by another.	Internal Audit is an independent appraisal of the operations and records of the company.
<b>Object</b>	The purpose of Internal Check is to prevent or minimize the possibilities of errors, frauds or irregularities.	The purpose of Internal Audit is to detect the errors and frauds which have already been committed.
<b>Need for Separate Staff</b>	For internal check, no new appointment is made. It, in fact represents only the arrangement of duties of the staff in a particular way.	For carrying out Internal Audit, separate staffs of employees are engaged for the purpose.
<b>Nature of Work</b>	Internal Check, on the other hand, represents a process under which the work goes on uninterruptedly and the checking too is more or less automatic.	The work involved in the Internal Audit is just like that of a watch man. Internal auditor has to report, from time to time, to the management about the various inefficiencies and suggest improvements. It is also his duty to see that the internal check system does not become static.
<b>Timing of Work</b>	Internal Check is an operation during the course of transaction.	Internal Audit starts when the accounting process of different transactions is finished.
<b>Scope of work</b>	The scope of Internal Check is very limited.	The scope of Internal Audit is comparatively broad.
<b>Involvement</b>	A large number of employees are needed for the implementation of Internal Check System.	Whereas, a much smaller number of persons are needed for implementing Internal Audit implementation.

### 3.26 INTERNAL CONTROL VS. INTERNAL AUDIT

Internal control is a system that comprises of control environment and procedure, which help the organization in achieving business objectives. On the other hand, **internal audit** is an activity performed by professionals to ensure that internal control system implemented in the organization is effective.

Basis	Internal Control	Internal Audit
<b>Meaning</b>	Internal Control refers to the methods and procedures implemented by the management to control the operations, so as to assist in achieving the business objective.	Internal Audit alludes to the auditing program adopted by the firm, to review its financial and operating activities by the professional.
<b>What is it?</b>	System	Activity
<b>Verification</b>	One person's work is verified by another.	Each and every component of work is verified.
<b>Time of checking</b>	As soon as the transaction is recorded checking is performed.	Checking is done after the work is performed.
<b>Objective</b>	To ensure compliance with management policies.	To detect fraud and error.
<b>Scope of work</b>	The scope of Internal Check is very limited.	The scope of Internal Audit is comparatively board.

### 3.27 INTERNAL CHECK VS. INTERNAL CONTROL

Internal check refers to the way of allocating responsibility, segregation of work, where work of the subordinates is checked by the immediate supervisors to verify that the work is carried out according to the company policies and guidelines. Internal checks are carried out on a day to day basis, and a number of internal checks are implemented with regard to many aspects such as cash, sales, and purchases.

Internal control is the system implemented by a company to ensure the integrity of financial and accounting information and to make sure that the company is progressing towards fulfilling its profitability and operational objectives in a successful manner. The main reason that internal control procedures are in place is to ensure that the management is ideally positioned to identify and mitigate the risks the company is faced with in order to safeguard company assets.

<b>Basis</b>	<b>Internal Check</b>	<b>Internal Control</b>
<b>Meaning</b>	Internal Check is an arrangement of duties allocated in such a way that the work of one person is automatically checked by another.	Internal Control refers to the methods and procedures implemented by the management to control the operations, so as to assist in achieving the business objective.
<b>Scope</b>	The scope of Internal Check is very limited.	The scope of Internal Check is very limited.
<b>Nature</b>	Internal checks are implemented at all organizational levels such as tactical and operational level.	Internal controls are designed and documented at the corporate management level.
<b>Timing of Work</b>	Internal Check is an operation during the course of transaction.	As soon as the transaction is recorded checking is performed.