

SHERSHAH COLLEGE, SASARAM
AUDITING
BBA PART I, PAPER III
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INTERNAL AUDIT:

Meaning: Internal audit is a review of operations and records undertaken within a business by specially assigned staff. It is a post-transaction review to evaluate the correctness of records and the effectiveness of operations on a continuous basis in an organization.

The term 'internal audit' has been defined as the independent appraisal of activity within an organization for the review of accounting, financial and other business practices as a protective and constructive arm of management. The work of internal auditor is more or less the same as that of external or professional auditor. Being the employee of the organization, s/he has to see that there is no waste and inefficiency in the organization. S/he has to make efforts to find out the weakness of the internal control and internal check system followed in the organization and suggest necessary improvements.

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.

Objectives Of 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.

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 helps 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.

Differences Between Internal Audit And Statutory Audit

Both of them check books of account, detect errors and frauds even though they have certain differences which are as follows:

1. Appointment

An internal auditor is generally appointed by the management but statutory auditor is appointed by the shareholders or Annual General Meeting.

2. Legal Requirement

Internal audit is the need of management but it is not legal obligation but statutory audit is the legal requirement.

3. Qualification

An internal auditor does not required specific qualification as per the provision of law but qualification of statutory auditor is specified.

4. Conducting Of Audit

Internal audit is of regular nature but final audit is conducted after the preparation of final account.

5. Status

An internal auditor is a staff who is appointed by the management but statutory auditor is an independent [person appointed by the shareholders.

6. Scope Of Work

Internal audit is related to the examination of books of accounts and other activities of an organization but statutory audit checks the books of

accounts and related evidential documents. So, scope of internal audit is vague but scope of statutory audit is limited.

7. Removal

Internal auditor can be removed by the management but statutory auditor can be removed by the annual general meeting only.

8. Remuneration

Internal auditor is appointed by the management; so remuneration is fixed by the management but remuneration of statutory auditor is fixed by the shareholders.

9. Report

Internal auditor needs to give suggestions to improve weakness but no need to present report but statutory auditor requires to prepare report after the completion of work on the basis of facts found during the course of audit and present such report to the appointing authority.

Internal Check and its Objectives

Meaning: It is an arrangement of duties of members of staff in such a manner that the work performed by one person is automatically and independently checked by the others.

According to '**F.R.M.De PAULA**', "Internal check means practically a continuous internal audit carried on by the staff itself, by means of which the work of each individual is independently checked by other members of the staff."

Objectives of Internal Check

Following are the objectives of Internal check:

- 1.** To exercise moral pressure over staff.
- 2.** To ensure that the accounting system produces reliable and adequate information.
- 3.** To provide protection to the resources of the business against fraud, carelessness and inefficiency.
- 4.** To distribute the work in such a business transaction is left unrecorded.
- 5.** To allocate duties and responsibilities of each clerk in such a way that he may be held responsible for particular fraud or error.
- 6.** To minimize the chances of errors, frauds or irregularities in the business based on the principle of division of labour.

7. To detect errors and frauds easily if it is committed, because in an efficient internal check system, there is based on the principle of division of labour.

8. To detect errors and frauds easily if it is committed, because in an efficient internal check system, there is a provision for independent checking.

Characteristics of Good System of Internal Check

1. Responsibility: Responsibility of each individual must be properly defined and fixed. The work of the business should be allocated amongst various clerks in such a manner that their duties and responsibilities are clearly and judiciously divided.

2. Completion: The work should be divided in such a way that no single person is allowed to complete the work solely by himself from the beginning to the end. However, there should be no duplication of work.

3. Rotation of employees: A good system of internal check should not allow person having custody of assets to have access to the books of account. A system of transfer or rotation of employees from one seat of work to another must be followed by the business.

4. Automatic check: A good system of internal check must provide for an automatic checking of the work of one clerk by the other.

5. Reliance: No clerk of the business should be relied upon too much.

6. Safeguards: Safeguards should be prescribed to keep unused cheque books, files and securities etc.

7. Supervision: A strict supervision should be exercised to ensure that the prescribed internal checks and procedures are fully operative.

8. Formal sanction: No deviation should be allowed from the established procedures till it is formally sanctioned by the top official.

9. Periodical review: The system of internal check be reviewed from time to time to introduce improvements.

Internal Check Advantages and Disadvantages

Advantages of Internal Check

1. For the Business

a) Proper division of work: Internal check entails a proper and rational distribution of work among the members of staff of the enterprises keeping in view their individual qualifications, experience and area of specialization.

b) Detection of errors and frauds: since no individual worker is allowed to handle a job completely from the beginning to the end, and the work of each clerk is automatically checked by the other, this helps in the early detection and discovery of errors and frauds and the possibilities of the commission of errors and frauds can be minimized.

c) Increased efficiency coupled with economy: A good system of internal check increases the efficiency of work among the staff and leads to overall economy.

d) Moral check: knowledge of subsequent checking of each employee's work by others, acts as a great check to commission of errors and frauds.

2. For the Auditor

a) Quick preparation of final accounts: The Profit & Loss Account and the Balance Sheet are prepared without any loss of time.

b) Convenience to Auditor: Where an organization is operating system internal check, the statutory auditor may conveniently avoid detailed checking of the transactions. He may apply a few tests here and there and can relieve himself from detailed checking.

3. For the Owner

a) Accuracy of the accounts can be relied upon: if there is a system of internal check the owner of the concern may rely upon genuineness and accuracy of the accounts.

b) Increase in profits: Overall efficiency and economy in operations result in more profit - thus ensuring larger dividends for the owners or shareholders.

Disadvantages of Internal Check

Following are some of the disadvantages of a system of internal check:

- 1. Costly for small business:** A system of Internal check system quite expensive especially for small business houses.
- 2. Quality is sacrificed for Promptness:** In an internal check system quality of work declines because the clerks of the business attach greater importance to become quick and do not care if in the process their work gets substandardised.
- 3. Carelessness among high officials:** The possibility of some of the responsible and high officials being complacent, increases as they believe, though not always rightly, that under a sound system of internal check nothing can go wrong.
- 4. Disorder in the working of a business:** In the absence of a proper organized system of internal check there will be chaos and disorder in the working of business.
- 5. Risky for an auditor:** If the auditor does not apply tests and procedure his own and if he relies on the output of the system his work cannot be free from irregularities if the system itself proves to be defective.

Internal Check vs Internal Audit

- 1. Meaning:** 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.
- 2. Object:** The purpose of Internal Audit is to detect the errors and frauds which have already been committed. The purpose of Internal Check is to prevent or minimize the possibilities of errors, frauds or irregularities.

3. Need for separate staff: for carrying out Internal Audit, a separate staff of employees is engaged for the purpose.

For internal check, no new appointment is made. It, in fact represents only the arrangement of duties of the staff in a particular way.

4. Nature of work: 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 in efficiencies and suggest improvements. It is also his duty to see that the internal check system does not become static.

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.

5. Timing of work: Internal Audit starts when the accounting process of different transactions is finished.

Internal Check is an operation during the course of transaction.

6. Internal audit: It is a device for checking the work, whereas internal check is a device for doing the work.

7. In Internal Audit Errors and Frauds are detected after the completion of work, whereas in Internal Check the Errors and Frauds are discovered during the course of work.

8. Scope of work: The scope of Internal Check is very limited. The scope of Internal Audit is comparatively board.

9. Involvement: 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.

Vouching - Meaning, Objectives, Importance

Meaning:

Voucher is known as the evident for the support of a transaction in the books of account. It may be bill, receipts, requisition form, agreement, decision, bank paying slip etc.

The act of examining documentary evidence in order to ascertain the accuracy of entries in the account books is called "Vouching".

Simply stated, vouching means a careful examination of all original evidence i.e invoices, statements, receipts, correspondence, minutes and contracts etc. with a view to ascertain the accuracy of the entries in the books of accounts and also to find out, as far as possible, that no entries have been omitted in the books of accounts. Therefore, vouching is the act of testing the truth of entries appearing in the primary books of accounts. It is initial for auditing.

Voucher:

A voucher is a documentary evidence in support of a transaction in the books of account.

Objectives: Some of the major objectives of vouching are as follows:

1. To Detect Errors And Frauds

All transactions are to be supported by evidence. With the help of vouching we can detect errors and frauds by verifying each transaction. Planned fraud can be detected through vouching.

2. To Know The Truth Of Account

Each and every transaction is checked and ratified on the basis of support document. So, we can easily know the truth of account.

3. To Find The Unrecorded Transactions

Vouching helps to find out the unrecorded or missing transactions. If any voucher is found unrecorded, auditor can suggest to record such transactions.

4. To Know That Only The Business Transactions Are Recorded

Sometimes, transactions are performed for individual purpose but payment is made out of business. Such transactions should not be recorded in account of business. If such transactions are recorded, we can find it with the help of vouching. To know the real profit or loss of business, such transactions are to be separated.

Importance:

1. Vouching Is The Backbone Of Auditing

Main aim of auditing is to detect errors and frauds for proving the true and fairness of results presented by income statement and balance sheet.

Vouching is only the way of detecting all sorts of errors and planned frauds. So, it is the backbone of auditing.

2. Vouching Is The Essence Of Auditing

Auditing not only checks the accuracy of books of accounts but also checks whether the transactions are related to business or not. All the transactions are performed after the prior approval of concerned authority or not, transactions are real or not because an accountant may include fictitious transactions to commit frauds. All these facts can be found with the help of vouching. So, vouching is essential for auditing.

3. Vouching Is Important To See Whether Evidences Are Correct Or Not

An auditor checks the books of accounts to detect errors and frauds.

Frauds may be committed presenting duplicate vouchers. All the small and big amounts of frauds can be detected with the help of vouching. So, all the evidential documents and records are to be checked carefully and in detail by an auditor which is the scope of vouching.

Therefore, it can be said that vouching is the heart of auditing because without the work of vouching, the work of auditing cannot be performed.