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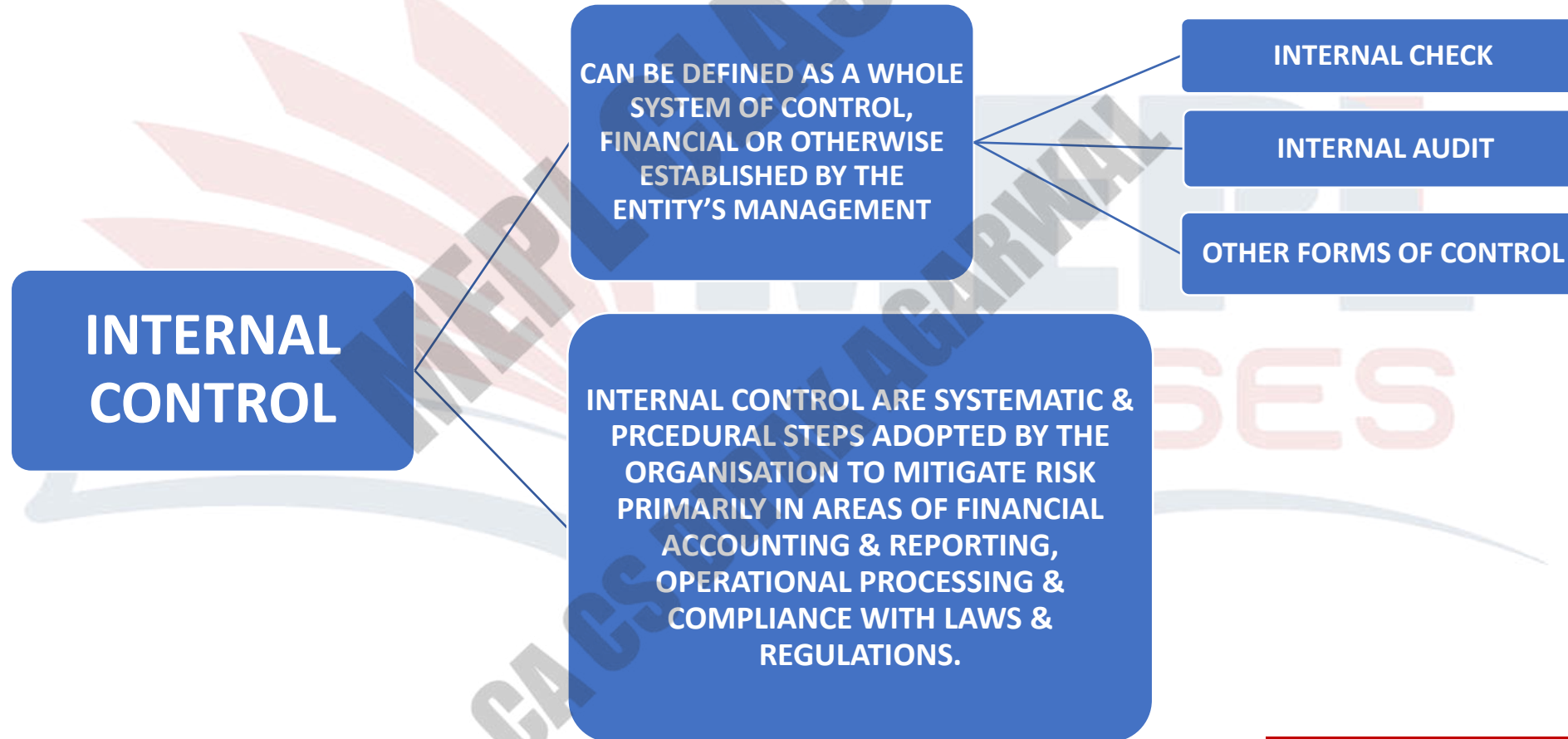
CHAPTER 14: INTERNAL AUDIT, INTERNAL CONTROL

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INTERNAL CONTROL



INTERNAL CONTROL

NOTE:

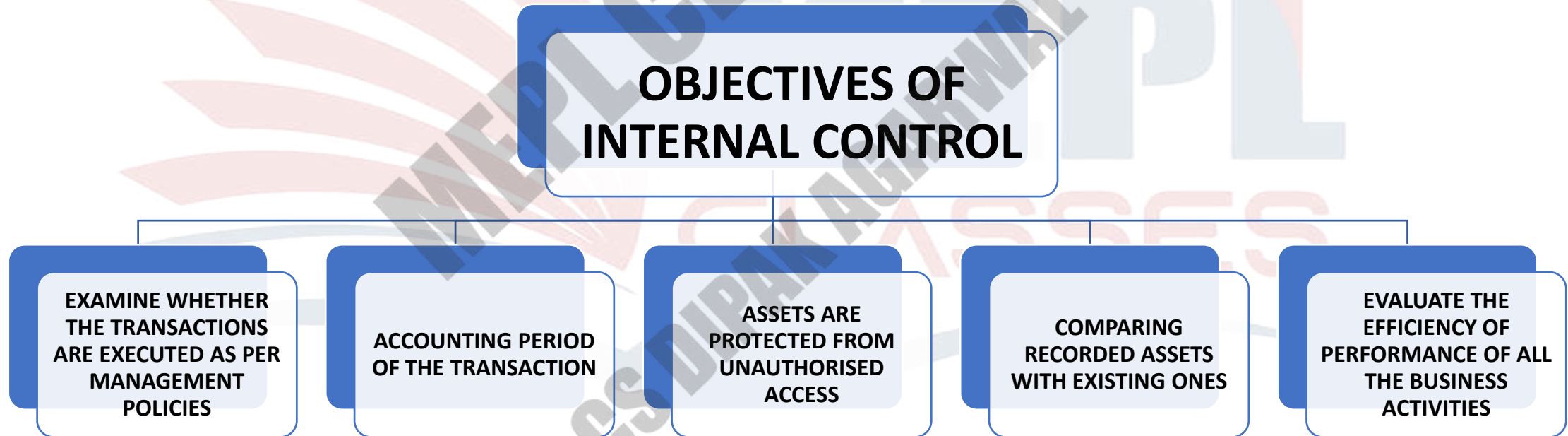
HENCE INTERNAL CONTROL MEANS THE PROCEDURES ESTABLISHED, IMPLEMENTED & MAINTAINED BY TCWG MANAGEMENT & OTHER PERSONNEL IN ORGANISATION WHICH GIVES REASONABLE ASSURANCE REGARDING ACHIEVEMENT OF ORGANISATION'S OBJECTIVES W.R.T.



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OBJECTIVES OF INTERNAL CONTROL





INTERNAL CONTROL REVIEW METHODS

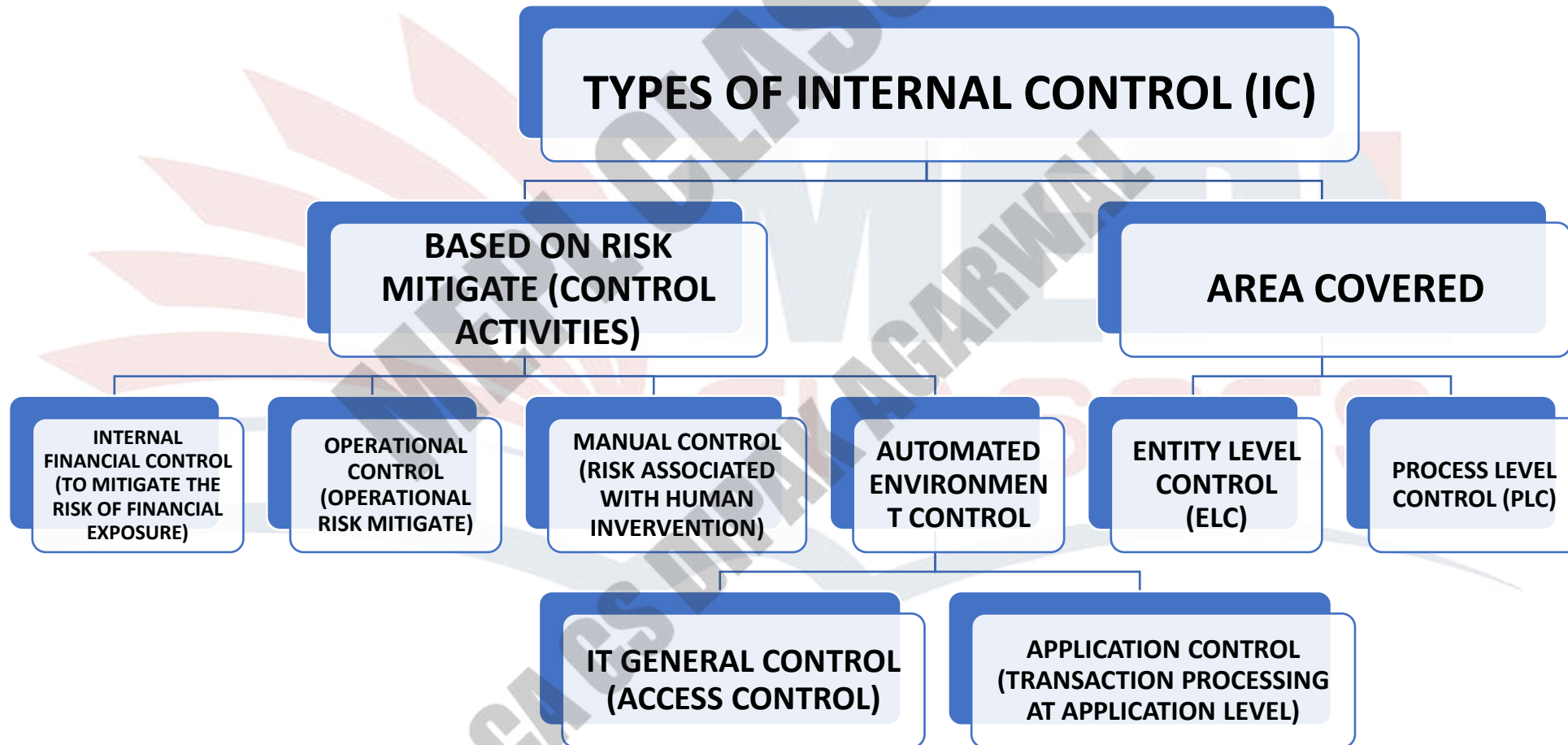
- **NARATIVE METHOD**
- **CHECKLIST**
- **QUESTIONNAIRE**
- **FLOWCHART**

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TYPES OF INTERNAL CONTROL (IC)



INTERNAL CONTROL PROCEDURES

INTERNAL CONTROL PROCEDURES

PHYSICAL CONTROL OVER ASSETS

AUTHORISATION AND APPROVAL

SEGREGATION OF DUTIES

MANAGEMENT DESIGN OF CONTROL

EFFECTIVE OPERATION CONTROLS

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INTERNAL AUDIT

INTERNAL AUDIT CARRIES OUT THE ASSESSMENT OF INTERNAL CONTROL AND PROVIDES REASONABLE ASSURANCE ON THE EFFECTIVENESS OF THE INTERNAL CONTROL AND THE RISK MANAGEMENT PROCESS

IT IS AN INDEPENDENT, OBJECTIVE ASSURANCE & CONSULTING ACTIVITY TO ADD VALUE & IMPROVE ORGANISATION'S OPERATIONS. IT HELPS THE ORGANISATION TO ACCOMPLISH ITS OBJECTIVES BY BRINGING A SYSTEMATIC, DISCIPLINED APPROACH TO EVALUATE AND IMPROVE EFFECTIVENESS OF RISK MANAGEMENT, GOVERNMENT IS GOVERNANCE PROCESS.

OBJECTIVE OF INTERNAL AUDIT

TO CHECK THE AUTHENTICITY & ACCURACY OF ACCOUNTING RECORDS

STANDARD ACCOUNTING PRACTICES FOLLOWED OR NOT

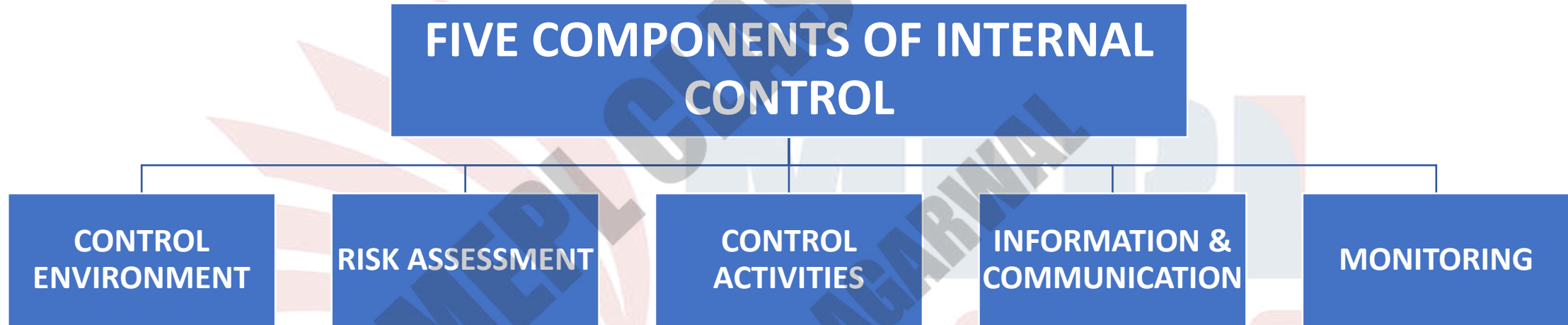
EARLY DETECTION & PREVENTION OF FRAUD & ERROR

TRANSACTIONS ARE RECORDED AFTER PRIOR APPROVAL

EXPENSES INCURRED ONLY FOR BUSINESS PURPOSES

TO REVIEW THE ACTIVITIES OF INTERNAL CONTROL

- ❖ THE COMMITTEE OF SPONSORING ORGANISATION OF THE TREADWAY COMMISSION (COSO)
→ INTERNAL CONTROL INTEGRATED FRAMEWORK

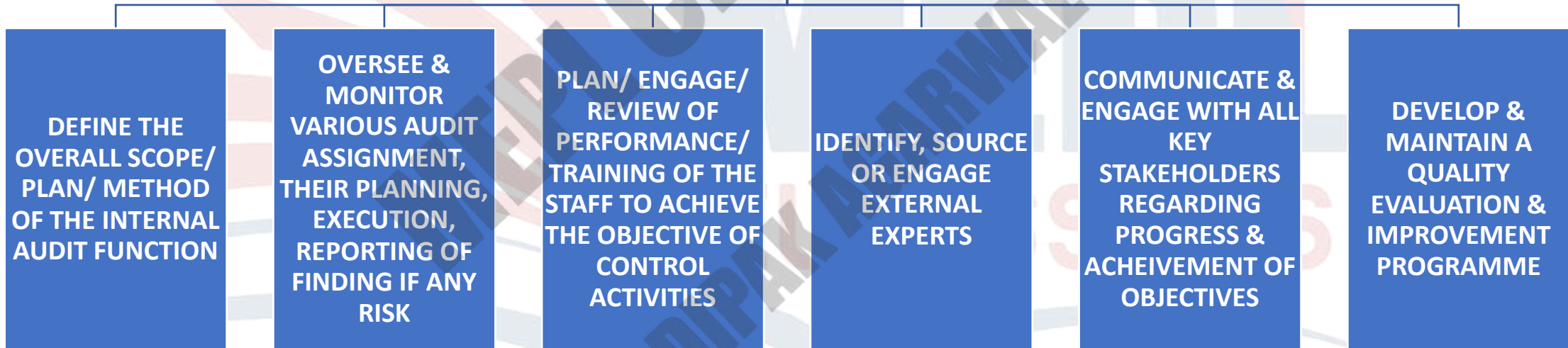


AS PER SIA (STANDARD ON INTERNAL AUDIT) 210, ISSUE BY ICAI



INTERNAL AUDIT FUNCTION IS THE RESPONSIBILITY OF THE CHIEF INTERNAL AUDITOR OR DESIGNATED PERSON

ACTIVITIES PERFORMED BY THE INTERNAL AUDITOR





INTERNAL CONTROL REVIEW OBJECTIVES

- INTERNAL CONTROL OBJECTIVES: A INTERNAL CONTROL OBJECTIVE IS A REASON A CONTROL ACTIVITY IS PUT TO ACTIONS.

CATEGORIES OF CONTROL OBJECTIVES

OPERATIONAL (EFFECTIVE & EFFICIENT BUSINESS OPERATIONS)

REPORTING [OBJECTIVES PERTAINING TO RELIABLE, TRANSPARENT & TIMELY REPORTING OF FINANCIAL (INTERNAL & EXTERNAL) AND NON-FINANCIAL TRANSACTION]

COMPLIANCE (OBJECTIVES RELATING TO FOLLOWING & ABIDING BY THE STATE & FEDERAL LAWS & INDUSTRY REGULATIONS)



OPERATIONAL (EFFECTIVE & EFFICIENT BUSINESS OPERATIONS)

BUSINESS
PERFORMANCE
REVIEW

PHYSICAL
SAFEGUARD &
SECURITY OF ASSETS

EDUCATION,
TRAINING &
COACHING

REVIEW &
APPRAISAL

SEGREGATION OF
DUTIES

**REPORTING [OBJECTIVES PERTAINING TO RELIABLE,
TRANSPARENT & TIMELY REPORTING OF FINANCIAL (INTERNAL &
EXTERNAL) AND NON-FINANCIAL TRANSACTION]**

AUTHORISATION

REVIEW &
APPROVAL

VERIFICATION

RECONCILIATION

PASSWORD
PROTECTION

SEGREGATION
OF DUTIES

PERFORMANCE
REVIEW



COMPLIANCE (OBJECTIVES RELATING TO FOLLOWING & ABIDING BY THE STATE & FEDERAL LAWS & INDUSTRY REGULATIONS)

VERIFICATION

PERFORMANCE REVIEW

EDUCATION & TRAINING

POLICIES & PROCEDURE MANUALS

INTERNAL CONTROL AUDIT OBJECTIVES

AUDIT OBJECTIVES ARE DESIGNED TO VERIFY THAT THE PREFERRED OUTCOME OF A CONTROL ACTIVITY IS ACHIEVED

JUDGING OF THE CONTROL PROCEDURE AGAINST THE SET PREDEFINED CRITERIA

OCCURRENCE/
EXISTENCE

COMPLETENESS

ACCURACY

CLASSIFICATION

CUTOFF/
TIMING

REPORTING/
SUMMARY

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- **EXAMPLE: INTERNAL CONTROL FOR A PARTICULAR EXPENSES INCURRED BY THE ORGANISATIONS.**
- **CONTROL OBJECTIVE: TO PREVENT ANY MISSTATEMENT OR FRAUD IN THE EXPENDITURE.**
- **CONTROL ACTIVITY: NO EXPENSE SHALL BE INCURRED WITHOUT APPROVAL OF THE DIRECTOR (I.E. MR. X)**
- **AUDIT OBJECTIVES:**
 - **MR. Y – EXPENSES INCURED -1 LAKH – TRAVELLING**
 - **EXISTENCE – MANAGEMENT (MR. X) APPROVE**
 - **COMPLETENESS – WRITTEN PROOF (RECORDED)**
 - **ACCURACY – ACCURATE AUTHORISATION – EXPENDITURE**
 - **CLASSIFICATION – FINANCIAL REPORTING – TRAVELLING/ CONVEYANCE/ PROMOTION/ ADVERTISEMENT**
 - **TIMING – EXPENDITURE 2/10 APPROVAL 2/11**
 - **REPORT -**

SCOPE OF INTERNAL CONTROL

ADMINISTRATIVE CONTROL

IT INCLUDES ALL THE TYPES OF MANAGERIAL CONTROL RELATED TO DECISION MAKING PROCESS. EX. MAINTAINING A REGISTER SHOWING THE DETAILS OF CUSTOMERS CONTACTED BY SALES WAY

OPERATIONAL CONTROL

IT IS EXERCISED THROUGH MANAGEMENT ACCOUNTING TECHNIQUES SUCH AS BUDGETARY CONTROL & STANDARD COSTING

FINANCIAL ACCOUNTING CONTROL

THESE CONTROL ARE THE MANAGEMENT PLAN RELATING TO SAFEGUARDING OF ASSETS, PREVENTING & DETECTION OF FRAUD/ ERROE, ACCURATE ACCOUNTING RECORDS & TIMELY PREPARATION OF FINANCIAL STATEMENT

COMPLIANCE CONTROL

IT RELATES TO TIMELY COMPLIANCE OF ALL APPLICABLE LAWS & REGULATIONS (STATE OR CENTRAL LAWS ETC.)

STRUCTURE OF INTERNAL CONTROL

INTERNAL CONTROL DIFFERS FROM ORGANISATION TO ORGANISATION & ITS STRUCTURE DEPENDS ON 4 FACTORS:

TYPE OF BUSINESS

MAGNITUDE OF BUSINESS

INFRASTRUCTURE AVAILABLE IN THE ORGANISATION

POTENTIALITY OF HUMAN RESOURCE

**FACTORS TO BE CONSIDERED
WHILE DESIGNING INTERNAL
CONTROL**

**SEGREGATION OF
DUTIES**

**COMPETENCE &
INTEGRITY OF PEOPLE**

**APPROPRIATE LEVEL
OF AUTHORITY**

ACCOUNTABILITY

ADEQUATE RESOURCES

**SUPERVISION &
PERIOD UPDATION**

**EXECUTION OF
TRANSACTION**

**AUTHORISATION OF ANY
TRANSACTION**

**MAINTAINANCE OF
RECORD & DOCUMENTS**

**PHYSICAL CUSTODY OF
RELATED ASSETS**

LIMITATION OF INTERNAL CONTROL

NO MATTER HOW STRONG IC IS BUT IT CAN ONLY PROVIDE A REASONABLE ASSURANCE WITH RESPECT TO ACHIEVEMENT OF ORGANISATIONAL OBJECTIVES & CAN NEVER GIVE ABSOLUTE ASSURANCE DUE TO LIMITATIONS OF IC –

COST & BENEFIT ANALYSIS –
MANAGEMENT MAY NOT WANT TO MAKE A STRONG IC DUE TO COST INVOLVED IN IT (COST OF CONTROL & BENEFIT)

UNUSUAL TRANSACTION –
NO CONTROL CAN BE MADE FOR UNUSUAL TRANSACTION (BREAKDOWN)

HUMAN ERRORS –
THERE IS ALWAYS A CHANCE OF ERROR BEING MADE BY EMPLOYEES HANDLING IC. (JUDGEMENT)

ABUSE OF AUTHORITY –
MANAGEMENT MAY OVERRIDE THE IC FOR ITS OWN BENEFIT. (MANAGEMENT OVERRIDE)

MANIPULATION BY MANAGEMENT –
MANAGEMENT MAY MANIPULATE THE ACCOUNTING ESTIMATES & JUDGEMENTS. (MULTIPLE CONTROLS)

COLLUSION AMONG EMPLOYEES –
EMPLOYEE MAY HAVE EGO CLASHES OR OTHER CONFLICTS WHILE MANAGING INTERNAL CONTROL. (COLLUSION)

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EVALUATION OF INTERNAL CONTROL

BASIC OBJECTIVES
WHILE EVALUATING
THE INTERNAL
CONTROL

TO SAFEGUARD THE
ASSET & CONTROL
TRANSACTIONS

TO PROVIDE
REASONABLE
ASSURANCE ON
FINANCIAL STATEMENT

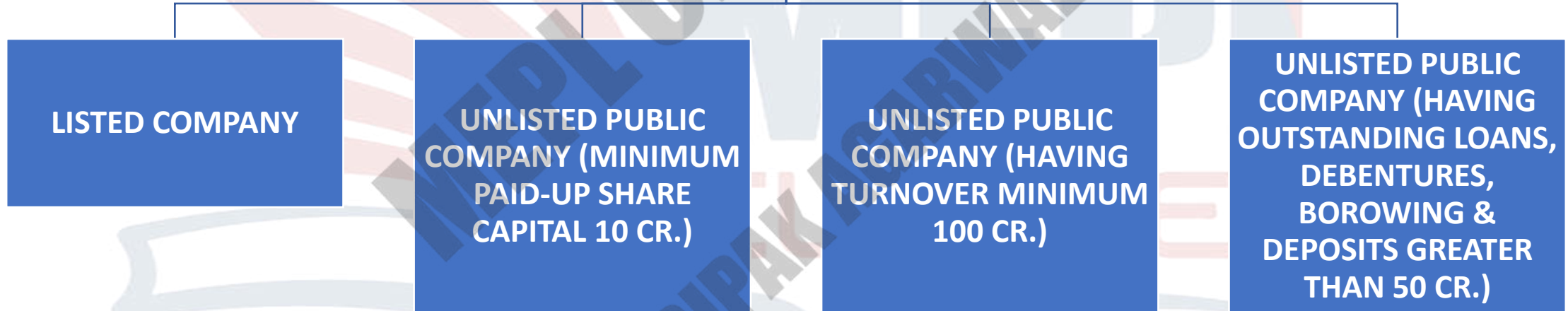
EVALUATION OF INTERNAL CONTROL

IT MEANS CHECKING THE
EFFECTIVENESS OF INTERNAL CONTROL

EVALUATION IS MAINLY DONE BY AUDIT
COMMITTEE

AUDIT COMMITTEE IS APPLICABLE ON
COMPANIES U/S 177

FOLLOWING ARE THE COMPANIES REQUIRED TO CONSTITUTE AC (AS PER SEC 177 OF COMPANIES ACT, 2013) – RULE 6 OF MEETING OF BOARD & ITS POWER RULES, 2014



❖ THESE LIMITS WILL BE CHECKED BASED ON LAST AUDITED FINANCIAL STATEMENT

**AUDIT COMMITTEE IS
NOT APPLICABLE ON
THE FOLLOWING
UNLISTED PUBLIC
COMPANY**

**WHOLY OWNED SUBSIDIARY
(WOS)**

JOINT VENTURE

DORMENT COMPANY

ROLE & FUNCTIONS OF AUDIT COMMITTEE



CLAUSE XIV OF COMPANY (AUDITOR REPORT) ORDER 2020 (CARO 2020)

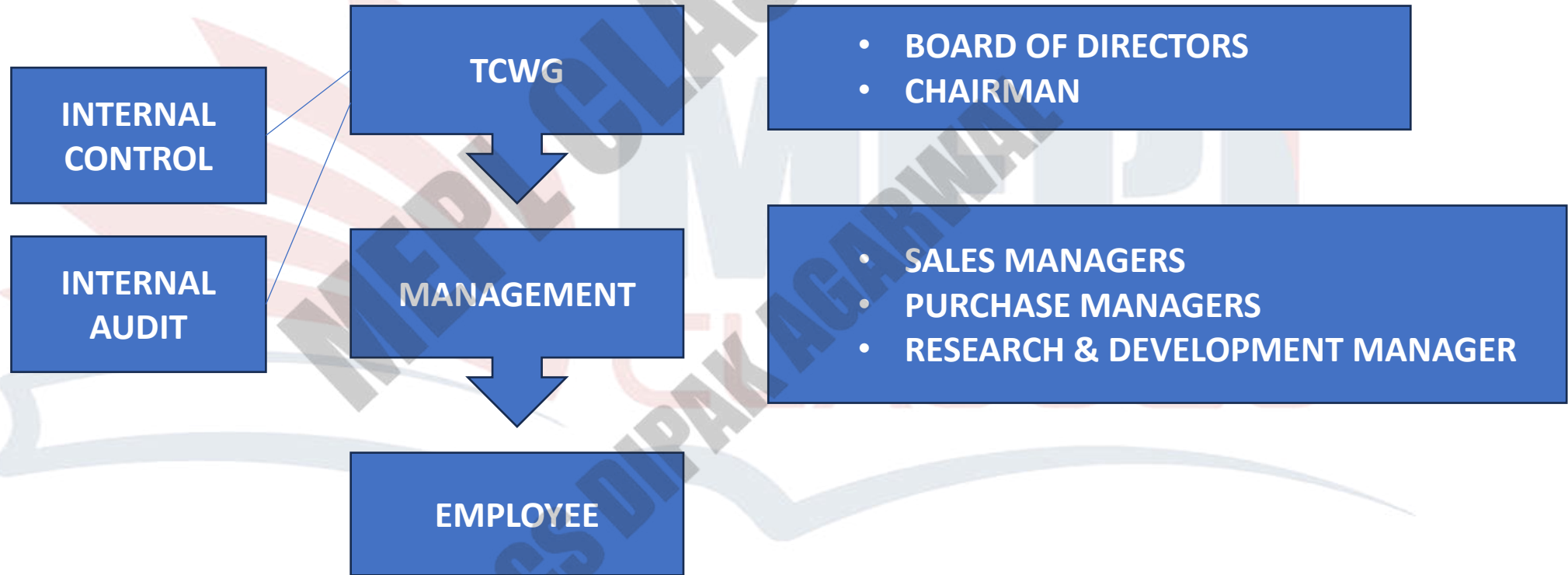
REQUIRES AN AUDITOR'S REPORT ON ACCOUNT OF THE COMPANY TO INCLUDE A STATEMENT TO WHETHER THERE IS

ADEQUATE INTERNAL CONTROL SYSTEM (CONSIDERING THE NATURE & SIZE OF THE BUSINESS)

REPORT OF INTERNAL AUDITOR SHOULD BE CONSIDERED FOR THE PERIOD FOR WHICH THE AUDIT IS CONDUCTED



INTERNAL CONTROL	INTERNAL AUDIT
METHODS & PROCEDURES IMPLEMENTED BY THE MANAGEMENT TO CONTROL THE OPERATION FOR ACHIEVEMENT OF ORGANISATIONS OBJECTIVES.	REVIEWS THE EXISTENCE & EFFECTIVENESS OF CONTROLS.
IT INCLUDES INTERNAL AUDIT & INTERNAL CHECK	INTERNAL AUDIT FRACTION ARE DESIGNED BY TCEG TO KEEP A CHECK ON OF MANAGEMENT/ ENTITY.
INTERNAL CONTROL IS CARRIED OUT WHEN THE WORK IS IN PROGRESS	INTERNAL AUDIT IS DONE AFTER THE WORK IS PERFORMED
INTERNAL CONTROL SYSTEM IS TO ENSURE COMPLIANCE WITH THE MANAGEMENT POLICIES.	INTERNAL AUDIT AIMS AT DETECTION OF FRAUD
SCOPE IS WIDER	SCOPE IS NARROW

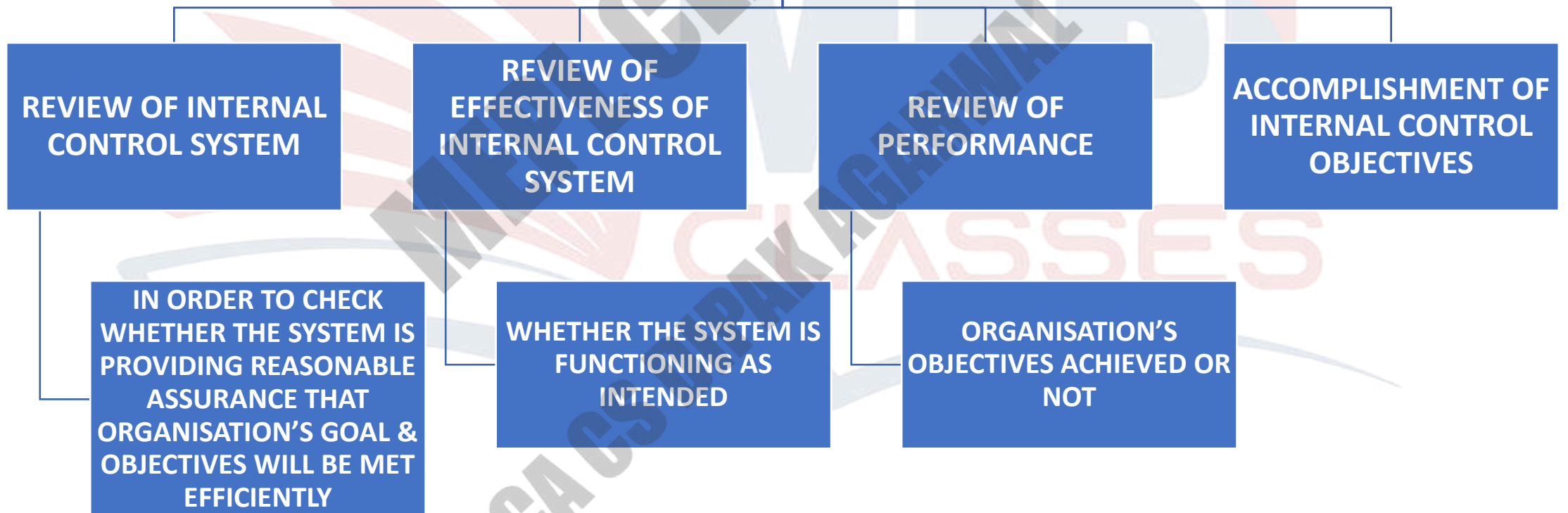


ROLE OF INTERNAL AUDITOR

The importance of role of an internal auditor in the context of internal control cannot be exaggerated.

- (a) The purpose of the review of the **systems of internal control** is to ascertain whether the system established provides reasonable assurance that the organisation's objectives and goals will be met efficiently and economically.
- (b) The purpose of the review for **effectiveness of the system of internal control** is to ascertain whether the system is functioning as intended.
- (c) The purpose of the review for **quality of performance** is to ascertain whether the organisation's objectives and goals have been achieved.
- (d) The primary objectives of internal control are to ensure:
 - i. reliability and integrity of information.
 - ii. compliance with policies, plans, procedures, laws and regulations.
 - iii. the safeguarding of assets.
 - iv. the economical and efficient use of resources.
 - v. the accomplishment of established objectives and goals.

IMPORTANT ROLE/ FUNCTION OF INTERNAL AUDITOR



INTERNAL CONTROL & AUDITOR

THE AUDITOR SHALL IDENTIFY THE DEFICIENCY IN INTERNAL CONTROL ON THE BASIS OF AUDIT WORK PERFORMED

AUDITOR SHALL ALSO FIND OUT SIGNIFICANT DEFECIENCIES IF ANY IN INTERNAL CONTROL

ALL SIGNIFICANT DEFECIENCIES SHALL BE REPORTED BY THE AUDITOR TO THE TCWG IN WRITING

AUDITOR SHALL ALSO REPORT TO THE MANAGEMENT

ALL SIGNIFICANT DEFICIENCY

OTHER DEFICIENCIES WHICH THE AUDITOR FEELS THAT THE MANAGEMENT SHOULD BE AWARE



**WHILE REPORTING THE DEFICIENCIES IN
INTERNAL CONTROL TO THE TCWG &
MANAGEMENT THE AUDITOR SHALL ALSO
COMMUNICATE**

**THE AUDITORS OBJECTIVE IS
ONLY TO FORM AN OPINION
ON THE FINANCIAL
STATEMENT**

**THE PREPARATION OF
INTERNAL CONTROL IS NOT
AUDITOR'S RESPONSIBILITY**

**DEFICIENCIES IDENTIFIED OR
REPORTED ARE LIMITED TO
ONLY THOSE WHICH HAVE
BEEN IDENTIFIED BY THE
AUDITOR**

INTERNAL AUDIT NECESSITY/ NEED

IT ASSIST THE
MANAGEMENT
TO IMPROVE
INTERNAL
CONTROL BY
IDENTIFYING THE
WEAKNESS

IT HELPS TO
DETECT FRAUD &
ERRORS

IT HELPS TO
DETECT
WASTAGE OF
RESOURCES

IMPROVES
OVERALL
ORGANISATIONS
EFFETIVENESS

IT INCREASES
MORALE OF
HONEST STAFF

HELPS IN
CHECKING
BOOKS OF
ACCOUNTS

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INTERNAL AUDITING – EVOLUTION OF THE PROFESSION

CHANAKYA (350-283 BC) WAS AN ADVISOR AND PRIME MINISTER OF FIRST MAURYA EMPEROR CHANDRAGUPTA (340 – 293 BC) IN HIS BOOK 'ARTHASASTRA' MENTIONED ABOUT MAINTENANCE OF ACCOUNTS, PERIODICITY OF ACCOUNTING, VERIFICATION, CERTIFICATION AND VARIOUS AVENUES OF FRAUD (40 TYPES OF EMBEZZLEMENT – CHANAKYA CHALISHA) OF GOVERNMENT FUND / EXCHEQUER.

IN THE MODERN ERA, RAILROAD COMPANIES IN USA ARE OFTEN CREDITED FOR BEING THE FIRST TO INTRODUCE INTERNAL AUDIT DURING THE LATTER PART OF THE NINETEENTH CENTURY. THESE RAILROAD COMPANIES HAD TRAVELING AUDITORS TO VISIT THE RAILROADS' TICKET AGENTS AND DETERMINE THAT ALL THE ACCOUNTING FOR ALL MONIES WAS PROPERLY HANDLED.

THE AUDITORS ARE TO DETERMINE WHETHER LAWS, CONTRACTS, POLICIES AND PROCEDURES HAVE BEEN PROPERLY OBSERVED AND IF ALL BUSINESS TRANSACTIONS WERE CONDUCTED IN ACCORDANCE WITH ESTABLISHED POLICIES AND WITH SUCCESS. IN THIS CONNECTION, THE AUDITORS ARE TO MAKE SUGGESTIONS FOR THE IMPROVEMENT OF EXISTING FACILITIES AND PROCEDURES, CRITICISMS OF CONTRACTS WITH SUGGESTIONS FOR IMPROVEMENT, ETC. THE GROWTH OF LARGE CORPORATE HOUSES DURING THE EARLY PART OF THE TWENTIETH CENTURY NECESSITATED THE NEED FOR EXTENDED SPAN OF CONTROL BY THE MANagements EMPLOYING THOUSANDS OF EMPLOYEES WITH MANUFACTURING PLANTS AT MANY LOCATIONS AND SALES & MARKETING ALL AROUND THE WORLD. THE TRADITIONAL FORM OF AUDIT BY THE PUBLIC ACCOUNTANT WAS NOT VERY EFFECTIVE IN THESE COMPANIES BECAUSE OF HUGE DISTANCES BETWEEN DIFFERENT LOCATIONS BESIDES BEING PROVING VERY COSTLY ALSO AS IT NECESSITATED LOT OF TRAVELING

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INTERNAL AUDITING – EVOLUTION OF THE PROFESSION

THEREFORE, A NEED WAS FELT FOR INTERNAL AUDITORS AT ALL THE LOCATIONS MAINLY FOR PROTECTION OF ASSETS. THE OBJECTIVES OF INTERNAL AUDIT DURING THIS PERIOD HAVE BEEN EXPLAINED AS UNDER:

PROTECTION OF COMPANY ASSETS AND DETECTION OF FRAUD WERE THE PRINCIPAL OBJECTIVES. CONSEQUENTLY, THE AUDITORS CONCENTRATED MOST OF THEIR ATTENTION ON EXAMINATIONS OF FINANCIAL RECORDS AND ON THE VERIFICATION OF ASSETS THAT WERE MOST EASILY MISAPPROPRIATED. A POPULAR IDEA AMONG MANAGEMENT PEOPLE A GENERATION AGO WAS THAT THE MAIN PURPOSE OF AN AUDITING PROGRAM WAS TO SERVE AS A PSYCHOLOGICAL DETERRENT AGAINST WRONGDOING BY OTHER EMPLOYEES.

HOWEVER, THIS ROLE OF INTERNAL AUDITOR HAS UNDERGONE A VAST CHANGE DURING THE SECOND HALF OF TWENTY FIRST CENTURY. EARLIER, INTERNAL AUDITING WAS ESSENTIALLY TO CHECK THE RECORDS AFTER THOSE HAD BEEN CREATED TO ENSURE ACCURACY. THESE INTERNAL AUDITORS WERE ALSO CONCERNED WITH THE POSSIBILITY OF FRAUD.



INTERNAL AUDITING – EVOLUTION OF THE PROFESSION

THE EMERGENCE OF WAR ECONOMY DURING 1940S IS ATTRIBUTED CREDIT FOR THE INITIAL EXPANSION IN SCOPE OF INTERNAL AUDIT. WITH HUGE BACK-LOG OF ORDERS, MANAGERMENTS BECAME MORE CONCERNED WITH PRODUCTION SCHEDULING, SHORTAGES OF MATERIALS AND LABOURERS, AND COMPLIANCE WITH REGULATIONS. MOST OF THESE CONTRACTS WERE ON COST PLUS BASIS. THEREFORE, COST REPORTING ALSO BECAME MORE IMPORTANT. AS A RESULT, INTERNAL AUDITORS BEGAN DIRECTING THEIR EFFORTS TOWARDS OTHER AREAS ALSO, WHICH WERE TILL THEN OUTSIDE THE PURVIEW OF INTERNAL AUDIT.

SECTION 301 (PUBLIC COMPANY AUDIT COMMITTEE) OF THE SARBANES-OXLEY ACT PASSED BY THE U.S. CONGRESS IN THE YEAR 2002 REQUIRES AN AUDIT COMMITTEE IN ALL THE LISTED COMPANIES. SECTION 404 (MANAGEMENT ASSESSMENT OF INTERNAL CONTROLS) OF THE SAID ACT REQUIRES AN ANNUAL REPORT ON MANAGEMENT OF THE INTERNAL CONTROLS AND THEIR EFFECTIVENESS. THE LAW REQUIRES ANNUAL REPORTS TO CONTAIN AN ASSESSMENT OF THE EFFECTIVENESS OF INTERNAL CONTROL OVER FINANCIAL REPORTING.

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INTERNAL AUDIT EVOLUTION

HISTORICAL PERIOD

CHANAKYA (ADVISOR OF CHANDRAGUPTA MAURYA)

ARTHASASTRYA (40 TYPES OF EMBEZZLEMENT)

IT HIGHLIGHTED BASIC PRINCIPLES OF ACCOUNTING, VERIFICATION & FRAUD DETECTION

EARLY 90'S

SCOPE OF INTERNAL AUDIT INCLUDES INSPECTION OF TRANSACTION & IT'S ACCOUNTING. FURTHER IT INCLUDED PROTECTION OF ASSETS & DETECTION OF FRAUD

LATE 90'S

SCOPE WAS EXPANDED TO INCLUDE A CHECK ON OPERATIONS SUCH AS MATERIAL MANAGEMENT, LABOUR MANAGEMENT, PERFORMANCE OF ENTITY (AUDIT OF OPERATIONS)

SARBANES-OXLEY ACT (US) 2002

SECTION 301

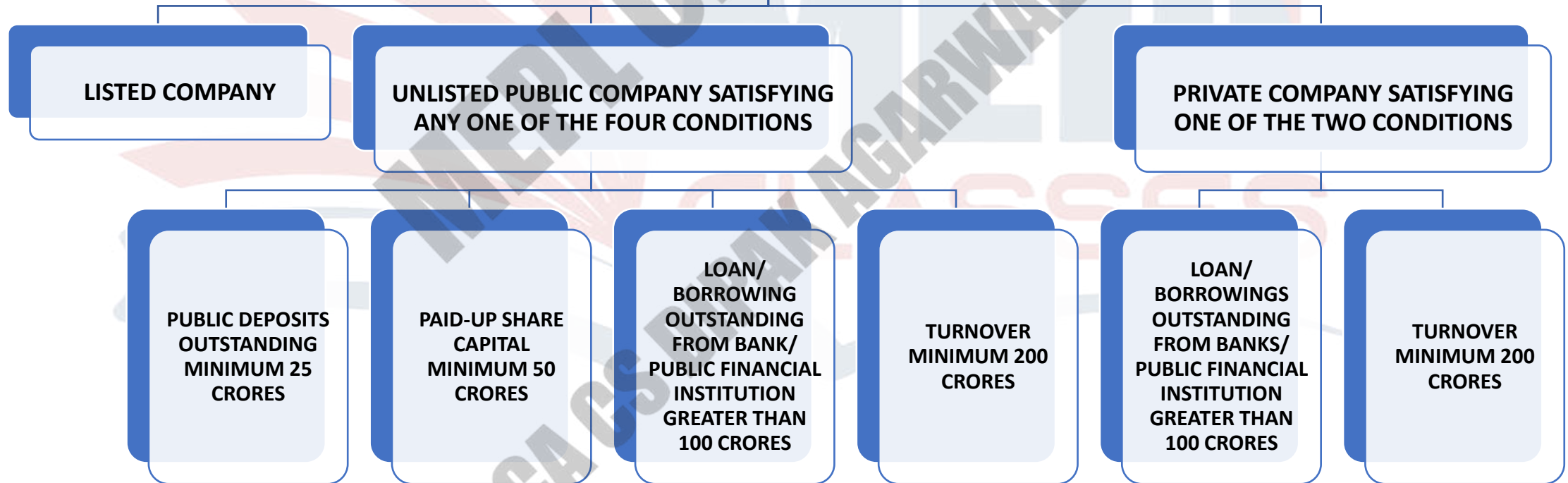
AUDIT COMMITTEE FOR ALL LISTED COMPANY

SECTION 404

ANNUAL REPORT A STATEMENT OF EFFECTIVENESS OF INTERNAL CONTROL

INTERNAL AUDIT UNDER THE COMPANY'S ACT (2013)

APPLICABILITY (SEC 138 READ WITH RULE 13 OF THE COMPANIES (ACCOUNTS) RULE, 2014)



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INTERNAL AUDIT UNDER THE COMPANY'S ACT (2013)

- LIMIT SHALL BE CONSIDERED OF IMMEDIATELY PRECEDING FINANCIAL YEAR

NOTE: IF COMPANY FAILS TO APPOINT INTERNAL AUDITOR

COMPANY

EVERY OFFICER
IN DEFAULT

UPTO 10,000
1000 PER DAY

UPTO 10,000
1000 PER DAY

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INTERNAL AUDITOR

ELIGIBILITY: CA OR CMA OR ANY OTHER PROFESSIONAL (CS) INTERNAL AUDITOR MAY OR MAY NOT BE AN EMPLOYEE (STATUTORY AUDITOR CAN NOT BE APPOINTED AS INTERNAL AUDITOR)

APPOINTING AUTHORITY: BOARD OF DIRECTOR SHALL APPOINT INTERNAL AUDITOR IN CONSULTATION WITH AUDIT COMMITTEE

FORM NO: MGT 14 HAS TO BE SUBMITTED TO INFORM ROC WITHIN 30 DAYS OF APPOINTMENT.

DUTIES & SCOPE: NOT MENTIONED IN ACT SO IT WILL BE AS PER THE TERMS OF ENGAGEMENT

PENAL PROVISION: NO SPECIFIC PROVISION EXISTS

AS PER RULE 13(2): AUDIT COMMITTEE/ BOARD OF DIRECTOR IN CONSULTATION WITH THE INTERNAL AUDITOR FORMULATE THE SCOPE, FUNCTIONING, PERIODICITY & METHODOLOGY FOR CONDUCTING INTERNAL AUDIT



Sum Up

Internal control is the process, effected by an entity's Board of Trustees, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- ❖ Reliability of financial reporting,
- ❖ Effectiveness and efficiency of operations, and
- ❖ Compliance with applicable laws and regulations.

Types of Internal Controls

Detective: Designed to detect errors or irregularities that may have occurred.

Corrective: Designed to correct errors or irregularities that have been detected.

Preventive: Designed to keep errors or irregularities from occurring in the first place.

5 ELEMENTS OF INTERNAL CONTROL

CONTROL ENVIRONMENT	RISK ASSESSMENT	CONTROL ACTIVITIES (PIPS)	INFORMATION & COMMUNICATION	MONITORING
<ul style="list-style-type: none"> • I – INTEGRITY & ETHICAL VALUES • C – COMMITMENT TO COMPETANCE • H – HUMAN RESOURCE POLICIES & PRACTICES • A – ASSIGNMENT OF AUTHORITY & RESPONSIBILITY • M – MANAGEMENT PHILOSOPHY & OPERATING STYLE • B – BOARD OF DIRECTORS OR AUDIT COMMITTEE PARTICIPATION • O – ORGANISATION'S STRUCTURE • ICHAMPBO 	<ul style="list-style-type: none"> • CHANGES IN OPERATING ENVIRONMENT • NEW PERSONNAL • NEW INFORMATION SYSTEM • RAPID GROWTH • NEW TECHNOLOGY • CORPORTE RESTRUCTURING 	<ul style="list-style-type: none"> • P – PERFORMANCE REVIEW • I – INFORMATION PROCESSING • P – PHYSICAL CONTROL • S – SEGREGATION OF DUTIES 	<ul style="list-style-type: none"> • IDENTIFY & RECORD ALL VALID TRANSACTIONS • DESCRIBE ON TIMELY BASIS • MEASURE THE VALUE PROPERLY • RECORD IN PROPER TIME PERIOD • PROPERLY PRESENT & DISCLOSE • COMMUNICATE RESPONSIBILITIES TO EMPLOYEES 	<ul style="list-style-type: none"> • ASSESSMENT OF QUALITY OF INTERNAL CONTROL PERFORMANECE OVER TIME

WHEN INTERNAL CONTROL ARE WEAK OR NOT IN EXISTENCE

COMPENSATING CONTROLS

COMPENSATING CONTROLS CAN BE IMPLEMENTED IN SITUATIONS WHERE ONE PERSON HAS TO DO ALL OF THE BUSINESS- RELATED TRANSACTIONS FOR A DEPARTMENT.

COST BENEFIT ANALYSIS OF A CONTROL SHOULD ALSO CONSIDER THE COST OF FRAUD

IF IMPLEMENTING A RECOMMENDED CONTROL SEEMS TOO EXPENSIVE, BE SURE TO CONSIDER THE COST OF A FRAUD THAT COULD OCCUR BECAUSE OF THE MISSING CONTROL. FRAUD IS ALWAYS EXPENSIVE AND THE PREVENTION OF FRAUD IS WORTH THE COST.

CONSIDER THE ISSUE OF TRUST

THE ADMINISTRATOR SHOULD REMAIN OBJECTIVE (FINALLY CONSIDER THE ISSUE OF TRUST. MOST EMPLOYEES ARE TRUSTWORTHY AND RESPONSIBLE, WHICH IS AN IMPORTANT FACTOR IN EMPLOYEE RELATIONS AND DEPARTMENTAL OPERATIONS. HOWEVER, IT IS ALSO THE RESPONSIBILITY OF ADMINISTRATORS TO REMAIN OBJECTIVE. EXPERIENCE SHOWS THAT IT IS OFTEN THE MOST TRUSTED EMPLOYEES WHO ARE INVOLVED IN COMMITTING FRAUDS.)



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CHAPTER 15: Operational Audit and Internal Audit under Companies Act, 2013

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OPERATIONAL AUDIT

“OPERATIONAL AUDIT” IS AUDITING WHICH GOES BEYOND FINANCIAL TRANSACTION AND ACCOUNTING RECORD AND EXAMINES INTO THE OPERATING, MANAGERIAL OR ADMINISTRATIVE PERFORMANCE OF THE ENTITY.

RESIDUARY APPROACH → INTERNAL AUDIT/ STATUTORY AUDIT

END OF FINANCIAL YEAR 31/03/23

FINANCIAL STATEMENT → BALANCE SHEET & PROFIT & LOSS → STATUTORY AUDITOR

INTERNAL CONTROL & INTERNAL AUDIT → INTERNAL AUDITOR

PREPARATION OF AUDIT:

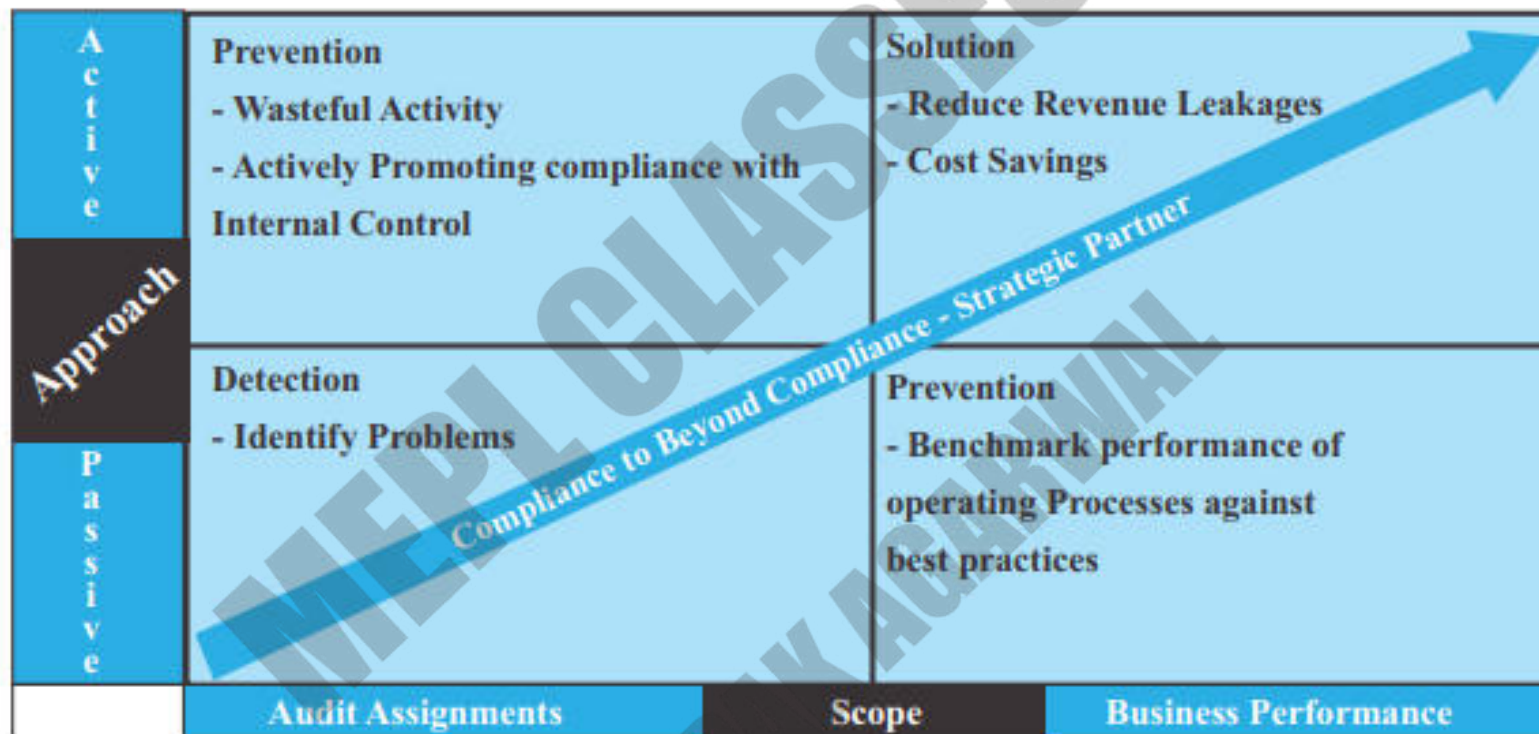
COMPLIANCE TO BEYOND
COMPLIANCE (AUDIT ASSIGNMENT)

ACTIVE
APPROACH

PASSIVE
APPROACH

PREVENTION

DETECTION



- **ACTIVE APPROACH → PREVENTION**
- **PASSIVE APPROACH → DETECTION**
- **COMPLIANCE TO BEYOND COMPLIANCE (INTERNAL CONTROL COMPLIANCE)**
- **RISK BASED APPROACH → RISK RELATED TO “OPERATION”**

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OPERATION AUDIT OBJECTIVES

TQM (TOTAL QUALITY MANAGEMENT) TERM WAS DEFINED BY W.E. DEMING

- **OPERATION AUDIT OBJECTIVES**
 - ⑩ **D – DETAILED UNDERSTANDING OF EXISTING PROCESS**
 - ⑩ **E – ELIMINATE WASTE, DUPLICATION OF WORK**
 - ⑩ **M – MERGE OPERATION TO REDUCE TURNAROUND TIME**
 - ⑩ **I – IMPROVE/ INCREASE QUALITY, VOLUME, REVENUE**
 - ⑩ **N – NEW METHODS, TECHNIQUE, DEVICES FOR BETTER EXPERIENCE**
 - ⑩ **G – GOVERN MEN, MACHINE, METHODS & MONEY**

ADVANTAGES & DISADVANTAGES OF OPERATIONAL AUDIT

ADVANTAGES	DISADVANTAGES
REDUCING TURN AROUND TIME	RESISTANCE TO EXCHANGE (THE MANAHEMENT/ ENTITY/ OWNER IS NOT ACCEPTING THE CHANGE)
PROCESS INEFFICIENCIES	
COST REDUCTION	
OPERATIONAL EXCILENCE	

STEPS OF OPERATIONAL AUDIT





AUDIT TECHNIQUES FOR EVIDENCE

ELECTRONICAL DATA
PROCESSING FOR GAP
ANALYSIS

PROCESS
FLOWCHARTING

DISCUSSION WITH
TCWS/ MANAGEMENT/
EMPLOYEE FOR CLARITY



AUDIT PROGRAMME

IT IS A DETAILED LAYOUT OF AUDIT PLAN WHICH CONTAINS EXACT AUDIT PROCEDURES TO BE APPLIED ON EXACT DETE ITEM OF FINANCIAL STATEMENT BY EXACT AUDITING STAFF.

ADVANTAGE OF AUDIT PROGRAMME

IT IS A READY CHECKLIST OF AUDIT PROCEDURES THAT HAS BEEN APPLIED.

WORK CAN BE ALLOCATED TO AUDIT TEAM EASILY

AUDIT IS TIMELY COMPLETED

AUDIT PLAN IS ACHIEVED

AUDIT EVIDENCES CAN BE EASILY COLLECTED

IT MAKES AUDIT MORE EFFECTIVE

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UNUSUAL OR NEW AREAS MIGHT
GET NEGLECTED

AUDIT BECOMES MECHANICAL

**DISADVANTAGE OF AUDIT
PROGRAMME**

AUDIT BECOMES RIGID

IT KILLS THE INITIATIVE OF
EFFICIENT STAFF



CONTINUOUS AUDIT

IT IS A TYPE OF AUDIT WHICH STARTS BEFORE THE END OF FINANCIAL YEAR

IT IS DONE THROUGHOUT THE FINANCIAL YEAR OR MAY BE MONTHLY

IT IS SUITABLE FOR ORGANISATION HAVING LARGE VOLUME OF TRANSACTIONS OR WHERE INTERNAL CONTROL IS WEAK.

FINAL AUDIT

IT IS A TYPE OF AUDIT WHICH IS DONE AFTER THE END OF FINANCIAL YEAR.

NOT DONE THROUGHOUT

SUITABLE FOR ORGANISATION HAVING LESS VOLUME OF TRANSACTIONS OR WHERE INTERNAL CONTROL IS STRONG.

AUDIT WORKING PAPER

DEFINITION	AUDIT WORKING PAPERS MEANS AUDIT FILE CONTAINING AUDIT PROCEDURES APPLIED, AUDIT EVIDENCE COLLECTED & AUDITOR'S OBSERVATIONS.
ADVANTAGES	1. IT HELPS IN AUDIT PLANNING 2. HELPS IN FUTURE REFERENCE OF ARTICLES & ASITANCES 3. ACTS AS A LEGAL EVIDENCE THAT AUDIT WAS CONDUCTED PROPERLY

FORMS OF WORKING PAPER DEPENDS UPON THE FOLLOWING FACTOR



TYPES OF WORKING PAPERS

PERMANENT AUDIT FILES

IT RECORD THOSE NON RECURRING AUDIT MATTERS WHICH DO NOT CHANGE YEAR AFTER YEAR:

CONTENTS ARE AS FOLLOWS:

- LEGAL & ORGANISATION STRUCTURE OF THE ENTITY (MEMORANDUM OF ASSOCIATION/ ARTICLES OF ASSOCIATION)
- EXTRACT OR COPIES OF LEGAL DOCUMENT, AGREEMENT AND MINUTES RELEVANT FOR AUDIT
- A RECORD OF STUDY & EVALUATION OF INTERNAL CONTROL
- SIGNIFICANT RATIOS & TREND
- COPIES OF PREVIOUS YEAR FINANCIAL STATEMENT (BALANCE SHEET/ PROFIT & LOSS ETC.)
- NOTES REGARDING SIGNIFICANT ACCOUNTING POLICIES
- SIGNIFICANT AUDIT OBSERVATIONS OF PREVIOUS YEAR

CURRENT AUDIT FILES

IT RECORD THOSE RECURRING AUDIT MATTERS WHICH GENERALLY CHANGE YEAR AFTER YEAR:

- CORRESPONDENCE RELATING TO ACCEPTANCE OF ANNUAL REAPPOINTMENT
- EXTRACTS OF MINUTES OF BOARD MEETING & GENERAL MEETING
- COPIES OF MANAGEMENT LETTER
- ANALYSIS OF TRANSACTIONS & BALANCES
- COPIES OF COMMUNICATION WITH MANAGEMENT, AUDITORS, EXPERTS, THIRD PARTY ETC.
- AUDIT PROGRAMME
- CONCLUSION OF SIGNIFICANT AUDIT ASPECT



NOTE: WHATEVER OBSERVATION IS MADE ON CURRENT YEAR BY THE AUDITOR WHICH WAS A PART OF CURRENT FILE FOR THE YEAR, WILL BE TREATED AS CONTENT OF PERMANENT AUDIT FILE IN NEXT YEAR ONWARDS

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AUDIT NOTEBOOK

MEANING	IT IS A BOUND BOOK WHICH CONTAINS LARGE VARIETY OF AUDIT MATTERS OBSERVED DURING THE COURSE OF AUDIT
CONTENT	<ul style="list-style-type: none">❖ NAME OF THE BUSINESS ENTITY❖ ORGANISATIONAL STRUCTURE❖ IMPORTANT PROVISIONS OF MEMORANDUM OF ASSOCIATION & ARTICLES OF ASSOCIATION❖ COMMUNICATION WITH PERVIOUS AUDITOR❖ MANAGEMENT REPRESENTATION & INSTRUCTION❖ LIST OF BOOKS OF ACCOUNTS MAINTAINED❖ ACCOUNTING METHODS, INTERNAL CONTROL SYSTEM, APPLICABLE LAW❖ KEY MANAGERIAL PERSONS❖ ERRORS & FRAUDS❖ MATTERS REQUIRED EXPLANATION OR CLARIFICATION❖ SPECIFIC POINTS FOR SUBSEQUENT AUDIT

Specimen of Audit Note Book

M/s. XYZ Private Limited Audit Notes for the Financial Year

Voucher/ Reference No.	Account Involved	Amount	Query/ Remarks	How disposed of
21	Machinery	2,000	Amount wrongly capitalized	Rectified after consulting with Mr. A, Chief Accountant
64	P.F.	1,750	Late deposited	Clarified with Mr. B from HR
80	Advertisement	5,000	MD sanction required	Sanction obtained
150	Colonel Securities	40,000	No TDS	TDS deducted and deposited with interest
167	Rent	2,000	Receipt required	Receipt obtained



SPECIMEN

VOUCHER/ REFERENCE NO.	AMOUNT	ACCOUNT INVOLVED	OBSERVATION	SOLUTION
10	1000	PLANT & MACHINERY	WRONGLY CAPITALISED	RECTIFIED AFTER DISCUSSION WITH MANAGEMENT



ENGAGEMENT LETTER

MEANING	IT'S A LETTER WHICH IS SENT BY THE AUDITOR TO THE CLIENT BEFORE ACCEPTING THE AUDIT. LETTER COMPANY CLIENT
CONTENT	<input type="checkbox"/> AUDITOR'S SCOPE OF AUDIT <input type="checkbox"/> AUDITOR'S RESPONSIBILITY <input type="checkbox"/> MANAGEMENT RESPONSIBILITY <input type="checkbox"/> AUDITOR'S UNRESTRICTED ACCESS TO BOOKS OF ACCOUNTS

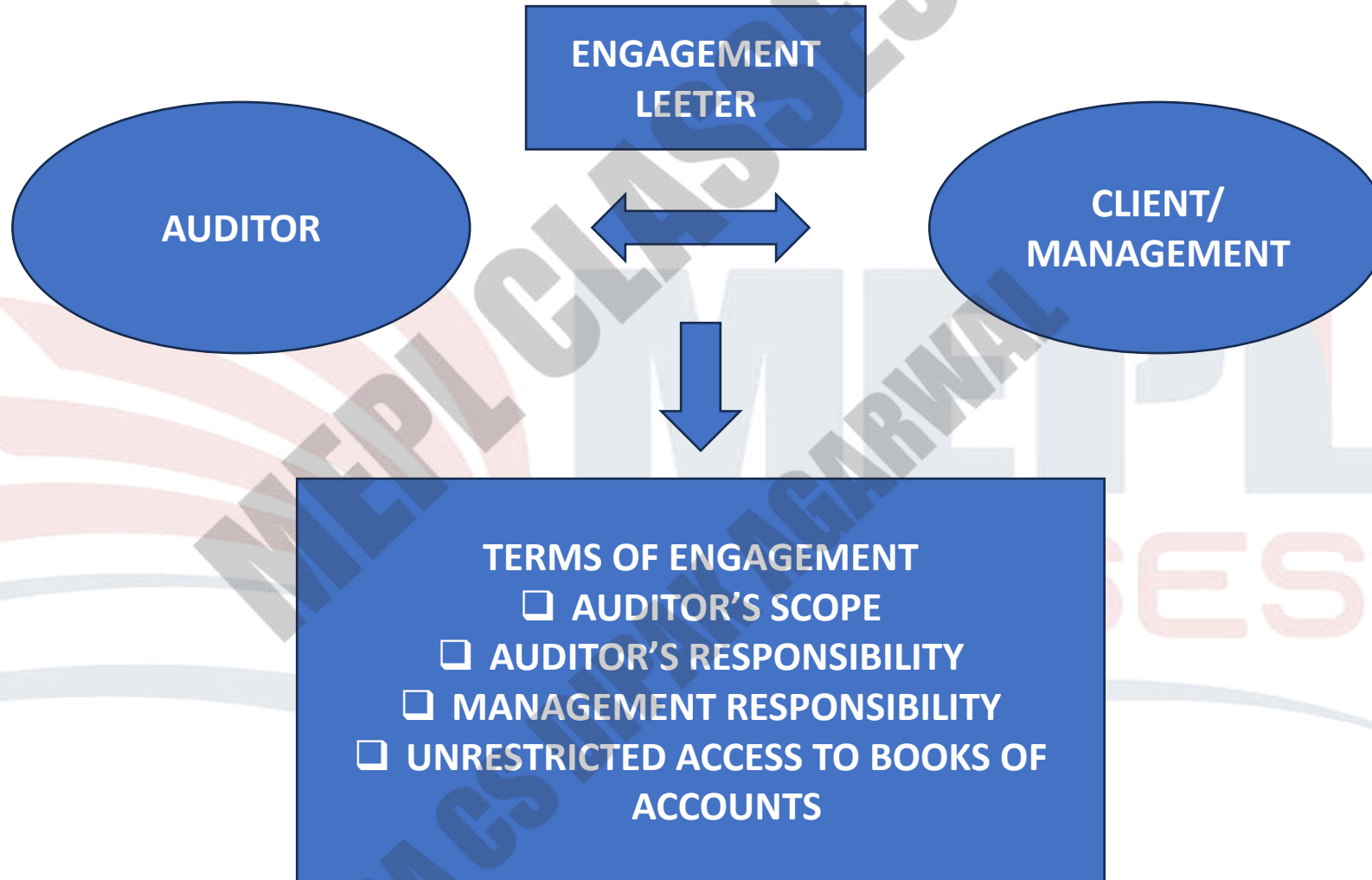


TERMS OF AUDIT ENGAGEMENT

AGREEING THE TERMS &
CONDITION OF THE
ENGAGEMENT WITH CLIENT

AUDITOR'S RESPONSES TO THE
REQUEST BY A CLIENT TO
CHANGE THE TERM OF AN
ENGAGEMENT TO ONE THAT
PROVIDES A LOWER LEVEL OF
ASSURANCE

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Specimen Internal Audit Engagement Letter

[DATE]

[NAME, TITLE] [DEPARTMENT] [ADDRESS]

[CITY, STATE PIN]

Dear [HEAD OF DEPARTMENT]

The Internal Audit Team is planning its audit for [DEPARTMENT NAME], The objectives of this audit will be: [LIST ACTUAL OBJECTIVES HERE]

For example:

- Reliability and Integrity of Financial and Operational Information,
- Compliance with Laws, Regulations, and Contracts,
- Safeguarding of Assets, and
- Effectiveness and Efficiency of Operations of the [AUDIT AREA], and
- To follow-up on recommendations included in prior audit reports. The proposed timetable for this year's audit is as follows:
 - Start date in the field: [DATE]
 - Estimated weeks to complete: [NUMBER OF WEEKS] The audit team will include the following members:

[NAME], Manager [NAME], Staff Auditor [NAME], Staff Auditor

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Specimen Internal Audit Engagement Letter

[DATE]

At the beginning of our audit, we would like the opportunity to meet with you to discuss our audit objectives and solicit your input. Our goal is to perform an effective and efficient audit. We will need your staff to provide us the following documents and schedules on:

1. [DOCUMENTS] and [DATE]
2. [DOCUMENTS] and [DATE]

At the conclusion of our audit, we will discuss audit results and potential recommendations with management of the audited area before scheduling an exit conference with you. Prior to the exit conference, you will receive a draft audit report. After the exit conference, a final audit report will be delivered to you with a request for formal management's responses to include in the audit report.

Our mission is to help you achieve [DEPARTMENTS] objectives by providing you information about the effectiveness of internal control and by recommending courses of actions which improve performance. If you have any questions about this year's audit, please do not Hesitate to call.

Yours truly,

[XYZ] [Designation]

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AUDIT SPECIMEN
LETTER HEAD OF INTERNAL AUDITOR
[DATE]

MR. X, R & D DEPARTMENT

[ADDRESS]

[CITY, STATE, PIN]

DEAR (HOD)

1. **THE INTERNAL AUDIT TEAM IS PLANNING THE AUDIT FOR R & D DEPARTMENT. THE OBJECTIVES WILL BE**
INTERNAL AUDIT OBJECTIVES

START DATE

END DATE

2. **THE AUDIT TEAM WILL BE AS FOLLOWS**

- ✓ .
- ✓ .
- ✓ .

3. **PURPOSE OF INTERNAL AUDIT**

4. **FOLLOWING BOOKS/ DOCUMENT SHOULD BE AVAILABLE AT THE TIME OF AUDIT**

- ✓ .
- ✓ .

YOUR TRULY

[Designation]

[COMPANY NAME] [STAMP] [SIGN]

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DIFFERENCE BETWEEN INTERNAL AUDIT & OPERATIONAL AUDIT

INTERNAL AUDIT	OPERATIONAL AUDIT
1. COMPLIANCE OBJECTIVE	RISK IDENTIFICATION, PROCESS IMPROVEMENT OBJECTIVE
2. FINANCIAL ACCOUNTS FOCUS	BUSINESS FOCUS
3. AUDIT FOCUS	EFFICIENCY & IMPROVEMENT FOCUS
4. TRANSACTION-BASED	PROCESS-BASED
5. POLICIES AND PROCEDURES FOCUS	RISK MANAGEMENT FOCUS
6. COST CENTRE WISE BUDGET MONITORING	ACCOUNTABILITY FOR PERFORMANCE IMPROVEMENT RESULTS
7. METHODOLOGY: FOCUS ON POLICIES, TRANSACTIONS AND COMPLIANCE	METHODOLOGY: FOCUS ON GOALS, STRATEGIES AND RISK MANAGEMENT PROCESSES

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OPERATIONAL AUDIT

THE COMMITTEE OF SPONSORING ORGANIZATIONS OF THE TREADWAY COMMISSION (COSO) HAD RECENTLY ISSUED THE “COSO REPORT”, WHICH WAS JOINTLY SPONSORED BY THE INSTITUTE OF INTERNAL AUDITORS (IIA), THE AMERICAN INSTITUTE OF CPAS, THE FINANCIAL EXECUTIVES INSTITUTE, THE AMERICAN ACCOUNTING ASSOCIATION, AND THE INSTITUTE OF MANAGEMENT TO PROVIDE A COMMON, WIDELY ACCEPTED DEFINITION OF INTERNAL CONTROL AND PROVIDE A FRAMEWORK OF INTERNAL CONTROL WHICH CAN BE USED AS A BENCHMARK FOR ASSESSING ITS EFFECTIVENESS. THE COSO REPORT DEFINES INTERNAL CONTROL AS FOLLOWS:

...A PROCESS, EFFECTED BY AN ENTITY’S BOARD OF DIRECTORS, MANAGEMENT AND OTHER PERSONNEL, WHICH IS DESIGNED TO PROVIDE REASONABLE ASSURANCE REGARDING THE ACHIEVEMENT OF OBJECTIVES IN ONE OR MORE CATEGORIES:

- ❖ EFFECTIVENESS AND EFFICIENCY OF OPERATIONS.
- ❖ RELIABILITY OF FINANCIAL INFORMATION.
- ❖ COMPLIANCE WITH APPLICABLE LAWS AND REGULATIONS.

INTERNAL AUDIT UNDER COMPANIES ACT, 2013 [U/S 138]

COMPULSORY REQUIREMENT FOR APPOINTMENT OF INTERNAL AUDITOR(S) IN LISTED AND SPECIFIED COMPANIES

SECTION 138 READ WITH RULE 13 OF THE COMPANIES (ACCOUNTS) RULES, 2014 PROVIDE THAT FOLLOWING CLASS OF COMPANIES SHALL BE REQUIRED TO APPOINT AN INTERNAL AUDITOR OR A FIRM OF INTERNAL AUDITOR; NAMELY:

- a) EVERY LISTED COMPANY
- b) EVERY UNLISTED PUBLIC COMPANY HAVING:
 - i. PAID UP SHARE CAPITAL OF 50 CRORE RUPEES OR MORE DURING THE PRECEDING FINANCIAL YEAR; OR
 - ii. TURNOVER (INCOME) OF 200 CRORE RUPEES OR MORE DURING THE PRECEDING FINANCIAL YEAR; OR
 - iii. OUTSTANDING LOANS OR BORROWINGS FROM BANKS OR PUBLIC FINANCIAL INSTITUTIONS EXCEEDING 100 CRORE RUPEES OR MORE AT ANY POINT OF TIME DURING THE PRECEDING FINANCIAL YEAR; OR
 - iv. WHICH HAS ACCEPTED DEPOSITS OF 25 CRORE RUPEES OR MORE AT ANY POINT OF TIME DURING THE LAST FINANCIAL YEAR;
- c) EVERY PRIVATE COMPANY HAVING
 - i. TURNOVER OF 200 CRORE RUPEES OR MORE DURING THE PRECEDING FINANCIAL YEAR; OR
 - ii. OUTSTANDING LOANS OR BORROWINGS FROM BANKS OR PUBLIC FINANCIAL INSTITUTIONS EXCEEDING 100 CRORE RUPEES OR MORE AT ANY POINT OF TIME DURING THE PRECEDING FINANCIAL YEAR;

PROVIDED THAT AN EXISTING COMPANY COVERED UNDER ANY OF THE ABOVE CRITERIA SHALL COMPLY WITH THE REQUIREMENTS OF SECTION 138 AND THIS RULE WITHIN SIX MONTHS OF COMMENCEMENT OF SUCH SECTION.



INTERNAL AUDIT UNDER COMPANIES ACT, 2013

ELIGIBILITY FOR APPOINTMENT AS INTERNAL AUDITOR

SUCH CLASS OR CLASSES OF COMPANIES AS MAY BE PRESCRIBED SHALL BE REQUIRED TO APPOINT AN INTERNAL AUDITOR, WHO SHALL EITHER BE A CHARTERED ACCOUNTANT OR A COST ACCOUNTANT, OR SUCH OTHER PROFESSIONAL AS MAY BE DECIDED BY THE BOARD TO CONDUCT INTERNAL AUDIT OF THE FUNCTIONS AND ACTIVITIES OF THE COMPANY.

THE CENTRAL GOVERNMENT MAY, BY RULES, PRESCRIBE THE MANNER AND THE INTERVALS IN WHICH THE INTERNAL AUDIT SHALL BE CONDUCTED AND REPORTED TO THE BOARD.

REQUIREMENT FOR FILING OF FORM MGT-14 WITH THE ROC ON APPOINTMENT OF THE INTERNAL AUDITOR

THE APPOINTMENT OF INTERNAL AUDITOR CAN BE DONE ONLY BY MEANS OF A RESOLUTION PASSED AT THE MEETING OF THE BOARD AS SPECIFIED UNDER RULE 8 OF THE COMPANIES (MEETING OF BOARD AND ITS POWERS) RULES, 2014 AND ACCORDINGLY, THE COMPANY IS ALSO REQUIRED TO FILE FORM MGT-14 WITH THE REGISTRAR WITHIN 30 DAYS FROM THE DATE OF PASSING OF RESOLUTION BY THE BOARD. HOWEVER, FILING OF RESOLUTIONS UNDER CLAUSE (G) OF SUB-SECTION (3) OF SECTION 117 HAS BEEN EXEMPTED FOR PRIVATE COMPANIES VIDE MINISTRY OF CORPORATE AFFAIRS NOTIFICATION NO.G.S.R.464(E) DATED 05.06.2015. HOWEVER, THE PRIVATE COMPANY IS STILL REQUIRED TO COMPLY THE REQUIREMENTS OF SECTION 179.

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INTERNAL AUDIT UNDER COMPANIES ACT, 2013

AUTHORITY TO APPOINT THE INTERNAL AUDITORS

RULE 13(2) OF THE COMPANIES (ACCOUNTS) RULES, 2014 SET FORTH THAT THE AUDIT COMMITTEE OF THE COMPANY OR THE BOARD SHALL, IN CONSULTATION WITH THE INTERNAL AUDITOR, FORMULATE THE SCOPE, FUNCTIONING, PERIODICITY AND METHODOLOGY FOR CONDUCTING THE INTERNAL AUDIT.

STATUTORY AUDITORS CANNOT BE APPOINTED AS INTERNAL AUDITORS

MCA CIRCULAR NO. 29 OF 1976, DATED 27-8-1976 STATES THAT THE INTERNAL AUDITOR IS APPOINTED BY THE MANAGEMENT AND HENCE IS IN THE POSITION OF AN EMPLOYEE, WHEREAS THE STATUTORY AUDITOR IS APPOINTED BY THE COMPANY IN ACCORDANCE WITH THE PROVISIONS OF SECTION 224 [SECTION 139 OF THE COMPANIES ACT, 2013] AND THE AUDITOR IS REQUIRED TO PERFORM THE DUTIES ENJOINED ON HIM UNDER SECTION 227 [SECTION 143 OF THE COMPANIES ACT, 2013] AND THE RULES/ORDERS ISSUED THERE UNDER. AS SUCH, IN THE OPINION OF THE DEPARTMENT (MCA), A STATUTORY AUDITOR OF A COMPANY CANNOT ALSO BE ITS INTERNAL AUDITOR.

FORMATION OF POLICY AND PROCEDURE FOR APPOINTMENT OF THE INTERNAL AUDITOR

THE COMPANIES (ACCOUNTS) RULES, 2014 PROVIDES THAT THE AUDIT COMMITTEE OF THE COMPANY OR THE BOARD SHALL, IN CONSULTATION WITH THE INTERNAL AUDITOR, FORMULATE THE SCOPE, FUNCTIONING, PERIODICITY AND METHODOLOGY FOR CONDUCTING THE INTERNAL AUDIT.



INTERNAL AUDIT UNDER COMPANIES ACT, 2013

EXISTING COMPANIES NEED TO APPOINT THE INTERNAL AUDITORS WITHIN A PERIOD OF SIX MONTHS, I.E. BEFORE 30TH SEPTEMBER, 2014

IN CASE OF AN EXISTING COMPANY, THIS NEEDS TO APPOINT INTERNAL AUDITORS PURSUANT TO THE PROVISIONS OF SECTION 138 OF THE COMPANIES ACT, 2013 READ WITH RULE 13 OF THE COMPANIES (ACCOUNTS) RULES, 2014, SHALL APPOINT THE INTERNAL AUDITOR WITHIN A PERIOD OF 6 MONTHS FROM THE COMMENCEMENT OF THE SECTION, I.E. NEEDS TO COMPLY WITH THE REQUIREMENT BEFORE 30TH SEPTEMBER, 2014.

SCOPE OF INTERNAL AUDIT

SUB-SECTION (2) OF SECTION 138 GIVES POWER TO CENTRAL GOVERNMENT TO MAKE RULES AND PRESCRIBE THE MANNER AND THE INTERVALS IN WHICH THE INTERNAL AUDIT SHALL BE CONDUCTED AND REPORTED TO THE BOARD. RULE 13 DOES NOT PROVIDE THE SCOPE OF INTERNAL AUDIT. HOWEVER, RULE 13 PRESCRIBED THAT THE AUDIT COMMITTEE OF THE COMPANY OR THE BOARD SHALL, IN CONSULTATION WITH THE INTERNAL AUDITOR, FORMULATE THE SCOPE, FUNCTIONING, PERIODICITY AND METHODOLOGY FOR CONDUCTING THE INTERNAL AUDIT.

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INTERNAL AUDIT UNDER COMPANIES ACT, 2013

POWERS AND DUTIES OF INTERNAL AUDITOR

THERE ARE NO POWERS AND DUTIES OF INTERNAL AUDITOR PRESCRIBED UNDER THE ACT. THE SAME MAY BE GOVERNED BY THE TERMS OF REFERENCE OF THE APPOINTMENT OF INTERNAL AUDITOR WHICH MAY BE DECIDED MUTUALLY BETWEEN THE COMPANY AND THE INTERNAL AUDITOR.

PUNISHMENT AND COMPOUND ABILITY

THERE ARE NO SPECIFIC PENAL PROVISIONS PROVIDED IN THIS SECTION 138. THEREFORE THE PENAL PROVISIONS UNDER SECTION 450 WOULD APPLY IN CASE OF ANY NON-COMPLIANCE OF THIS SECTION. ACCORDINGLY, FOR CONTRAVENTION, THE COMPANY AND EVERY OFFICER OF THE COMPANY WHO IS IN DEFAULT SHALL BE PUNISHABLE WITH A FINE UPTO RS. 10,000, IN CASE THE CONTRAVENTION IS A CONTINUING ONE THEN THE FURTHER FINE SHALL BE RS. 1,000 EVERY DAY. THE OFFENCES UNDER THIS SECTION ARE COMPOUNDABLE UNDER SECTION 441 OF THE ACT.



- **INTERNAL AUDIT & CARO**

- **U/S 227 (4A) COMPANIES ACT 1956**
 - **SEC 143(11) OF COMPANIES ACT 2013**
- **12 JUNE 2003**
 - **CARO 2020 [25/02/2020]**

INTERNAL AUDIT & CARO

CLAUSE (XIV) OF
CARO, 2020

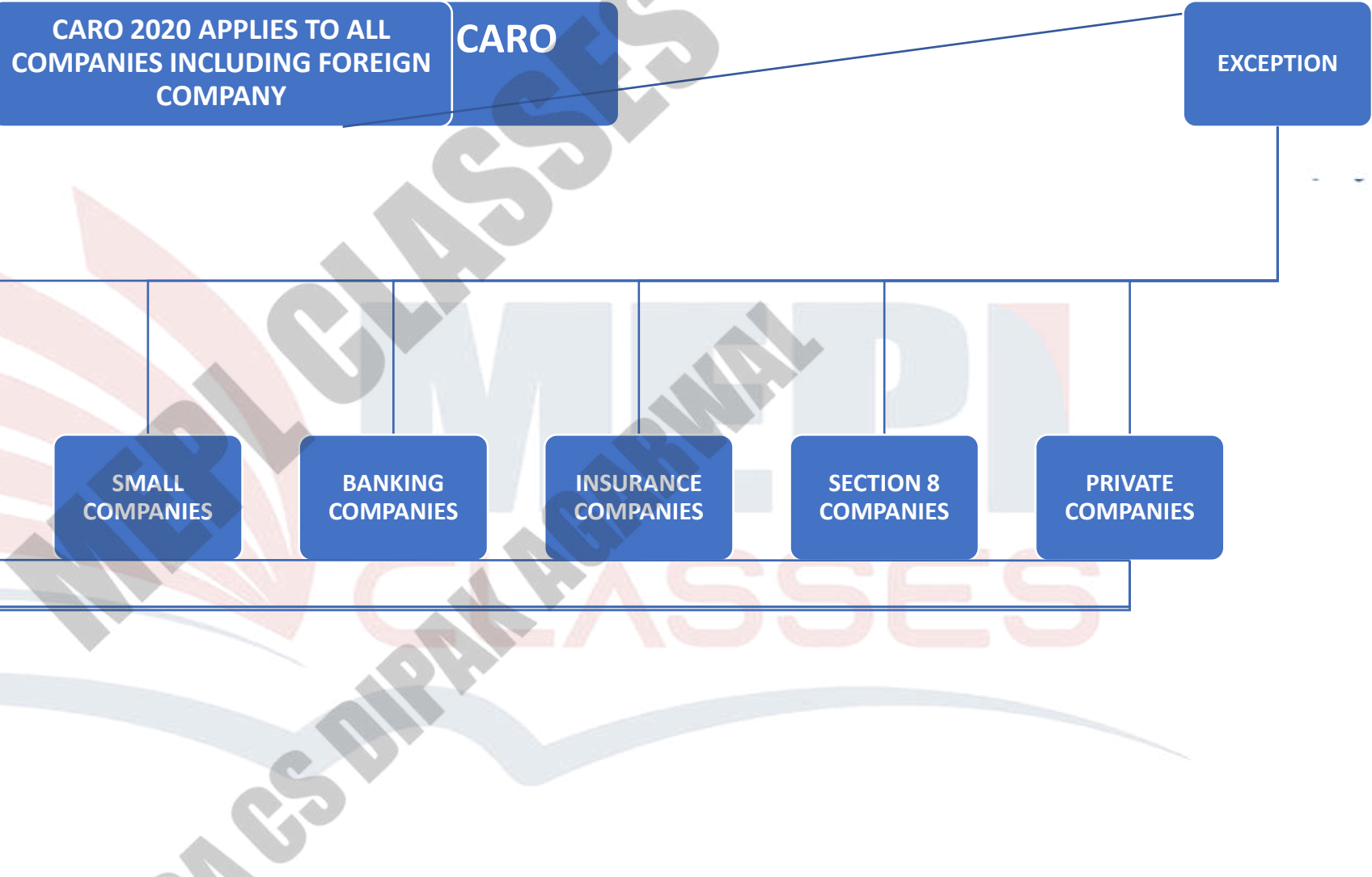
WHETHER THE COMPANY
HAS AN INTERNAL AUDIT
SYSTEM AS PER THE SIZE
AND NATURE OF ITS
BUSINESS

WHETHER THE REPORT OF
INTERNAL AUDIT SYSTEM IS
CONSIDERED BY THE
STATUTORY AUDITOR

INTERNAL AUDIT & CARO

CLAUSE (XIV) OF CARO, 2020







Internal Audit in Companies under Manufacturing Sector

Internal Audit of Manufacturing Company

Purchase, Store, Production, Sales, Marketing, Security, Lab, are important department of every Manufacturing Company, Internal audit have big role to analyze for smooth functioning of every department. Here is brief function of Internal audit of Manufacturing Company:

Annexure - I

Production

Risk	List of Controls
Production Planning	
(1) Untimely production as compared to the marketing requirements resulting in holding of inventory	Timely compilation of Production budget/plan for each of the product variety (e.g OPC, PPC, Non-Trade etc.)
(2) Excess/short production as compared to plan	Pre-defined authority level for review and modification in the production plan
(3) Loss of production due to non-consideration of sales forecast/raw materials availability	Periodic review of Production Plan vis-à-vis changes in Sales Plan or availability of raw materials & documentation thereof
	Compilation & documentation of reason-wise analysis of actual consumption vis-à-vis standard consumption
	Shift-wise production data logging in place



Consumption standard/norms & actual consumption

Excess production cost due to excess consumption of raw materials, ingredients, utilities or high process wastage

Compilation of documented consumption standards i.e BOM

Periodic comparison of actual capacity utilization

Review of periodicity of comparison of actual consumption and standard consumption and compilation of reason-wise variance analysis for deviation in consumption

Identification of controllable and non-controllable factors resulting in variation in the consumption norms and department's action plan to remedy the controllable factors

Verification of overall material reconciliation highlighting total material consumed, standard input-output norms and actual

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Capacity Utilisation

- | | |
|---|---|
| (1) Opportunity loss due to inadequate capacity utilization | Periodic comparison of actual capacity utilization with the synchronized 'sales plan' |
| (2) Excessive utilization of production capacity | |
| (3) Interruption in production process | |

Documentation & record maintenance:

- | | |
|--|---|
| (1) Inadequate documentation of production data/results, may result in incorrect decision or non availability of timely information | Compilation of Daily Production Report from DCS & its validation by the authorized personnel |
| (2) Ambiguous authority levels /access for generation of production documentation resulting in unauthenticated generation of production data | Periodic review of conformance to the ISO requirement
Pre-defined authority levels to generate, add, and modify production data in DCS/SAP |

Quality control and inspection report:

(1) Absence of standard quality control parameters resulting in sub-standard production/ high re-work cost	Standard Operating Procedures for quality control and inspection including in-built process controls
(2) Non-standardized Inspection Reports resulting in inconstancy in inspection of parameters	Review of QC norms periodically to ensure their validity
	Adherence to the pre-determined sampling techniques & exception reports for the results deviating from the QC norms
	Review of complaints received by the Production department pertaining to quality/quantity of cement sold in the market or lying at godown/s
	Customer-complaints closed in time for amicable solution
	Engagement of external agency for quality validation are approved and reports are reckoned to pre-empt possibility of quality non-conformity issues.
	The process for re-working QC failed products exists after obtaining due approval from appropriate authority against QC failed product
	All products are bagged after the same being qualified for /passed by QC
	Variations over standard Bag consumption is measured and monitored

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Review of process losses and recycling

Excessive process losses or inadequate recycling of materials due to improper monitoring of process parameters

Process loss incurred during the period are compared with the standard

System exists of analyzing the reasons for abnormal process losses, if any and documentation of remedial action plan

Identification of quantity of material non-conforming to the specification and sent for recycling.

Preparation of comparative analysis of percentage increase or decrease in the recycling materials and reasons thereof



Preventive & break-down maintenance:

Non-adherence to the preventive maintenance schedule resulting in process bottleneck / plant shut down/ loss of production.

Compilation of preventive maintenance schedule & its adherence

Compilation of report on breakdown maintenance and opportunity loss of production are measured

Ascertainment of the impact of breakdown maintenance on the production schedule

MIS Reports

- | | |
|---|---|
| <p>(1) Inadequate MIS reports resulting in unauthenticated/unreliable production details resulting in improper decision</p> <p>(2) Inconsistency in compilation of production reports due to non-standardized definition of periodicity</p> | <p>Compilation of MIS reports from the source data & their approval by the authorized personnel</p> |
|---|---|

Deployment of Workmen on Contractual basis

Risk	List of Controls
Assessment of requirement and approval	
(1) Unskilled labour engaged at the rate applicable for skilled labour;	Skill profiles of labourers are available/maintained and Job Requisitions raised against the specific skill requirement availability.
(2) Labour called without requirement for the same;	
(3) Jobs to be done not approved by appropriate authority;	Requisitions are raised with job description indicating requirement (number. of heads) for manpower.
(4) Actual engagement not in tandem with requirement	All job requisitions are approved by appropriate authority.
	Excess/short engagement in comparison to Requisition is traced, compared for deviations with reasoning.
	Purchase/Service Orders are released against approved Requisitions.

Selection of Contractors and their approval

- (1) Non-standard P.O terms;
- (2) Un-competitive rates;
- (3) High Rates;
- (4) Delay due to nonavailability of Contractor, who can handle the assignment

Standard order terms as to job nomenclature, payment terms etc. are maintained.

Contractors for a job is selected on competitive basis.

List of Contractors are maintained for jobs on offer and addition/deletions are considered on approval by appropriate authority.

Labour identification and authentication

(1) Ghost Workmen;

(2) Same workmen deployed by multiple Contractors

Each labour is traceable against identification/ employment number with photograph.

Periodical “parole” to identify dummy workmen is conducted by HR and Engaging Dept..

Change/transfer of workmen from one Contractor to another is traced and records updated accordingly.

Wage agreements and adherence

- (1) Un-competitive /high rates;
- (2) Rates applicable are higher than prevalent local rates;
- (3) Non-update of labour rates for a long time

Systematic study as to rate contract fixation is carried out periodically and rates finalized accordingly.

Benchmarking with local rates for pricing/labour contract rate is carried out.

Effectiveness of fixed rate schedule verified periodically and it's validated from time to time.

Labour rate agreements with Unions against specific skill/trade etc. are validated from time to time.

Fulfilment of safety requirements

- (1) Unsafe working environment;
- (2) No formal training to safe work mode;
- (3) Inadequate training and follow-up resulted in nonadherence to safety rules/ guidelines

Details of safety training to be imparted to Contract Workers with varied skill/ work engagement is documented.

Safety Dept. certifies the training completion of the workmen before allowing to work/job.

Adequacy of safety requirements are validated from time to time for ensuring compliance.



Engagement - Requirement vs. Actual

- (1) High rates due to dependency on single Contractor;
- (2) Un-benchmarked rates;
- (3) Dismal 'work permit' mechanism;
- (4) Uncertified jobs paid for;
- (5) Booking for labour supply and turnkey engagement for the same workmen;
- (6) Uncontrolled entry-exit mechanism

List of multiple Contractors as per engagement in different Job area is available.

Rates applicable are benchmarked and applied for rate fixation/PO.

'Work permits' are issued with predetermined strength required for the job and maintained in seriatim.

Work permits on job completion are signed-off and jobs in Contractor Bills be traced therefrom.

Actual engagement is certified by the engaging Dept.

Same contractor workforce is not allowed to work under 'turnkey' as well 'labour supply' to pre-empt possibility of multiple booking against same attendance.

Lower or higher engagement against requirements or extra time required/ booked is compared and deviation with reasoning documented.

Gate Security certifies entry/exit of workmen or "time recorder "and the same tallied with billing/hours booked/claimed.

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Bill Payment and booking

- (1) Non-deduction for drawing Co. material;
- (2) Attendance record not verified causing excess payment;
- (3) Penalty not inflicted;
- (4) Wrong passing of bills resulted in extra payment to Contractors;
- (5) Quality of jobs performed not reflected in certification as well payment;
- (6) Performance guarantee/ BG/SD not applied on Contractors for poor quality of jobs

Reconciliation of materials supplied to Contractors and passing on of appropriate impact against their billing is ensured before payment.

System as to verification of 'Attendance Record' of the labourers maintained by Contractors and reconciliation with time billed/ engaged, for actual booking and that paid by the Contractor exists.

Penalty for non-fulfilment of contractual obligation i.e. delay, quality adherence etc. are duly accounted for.

Checks are carried out before making payment of bills as to: Rates, Attendance, Job, Quality etc.

All appropriate taxes are levied / deducted and deposited in time.

System of collecting Security Deposit or 'performance guarantee' or 'bank guarantee' to bind the contractor against quality issues exists.

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Legal compliances under labour laws

- (1) Relevant licenses (by Company as well as Contractor) not obtained;
- (2) Failure in filing statutory returns;
- (3) Engagement over stipulated working hours;
- (4) Breach of statues in engagement/ payment/ Factories Act

System in place to ensure necessary Licenses under relevant laws prior to engagement is obtained by the Contractor.

All necessary returns are filed timely by the Company.

Engagement of labourers over stipulated hours are tracked.

Overtime work is regulated through adequate and timely supply of labour at the 'job area'

All Applicable statues e.g. Minimum Wages, Factories Act etc. are followed and adhered to.



Principal employer's liability

(1)Wage distribution not certified;

(2)Workforce interest not protected

by Principal Employer; Fines/
Penalties may be inflicted by
appropriate authority

Lack of proof for payment to
workmen

P.F, E.S.I (Employee State Insurance)
and other statutory dues are
monitored by HR/ Admin. to ensure
timely deposit and protection of
workforce interest.

Fixed Asset

Risk	Control
ASSETS POLICY/DOCUMENTATION/SOP	MANAGEMENT
Policy/SOP for fixed assets not available	Documented SOP's for fixed assets



CAPITAL BUDGET & APPROVALS

Capital Expenditure Policy not available	There is a Capital Expenditure Policy highlighting the procedures to be followed for estimation of Capex & pre-defined authority for sanction of the Capital Expenditure budget with value limits.
Inaccurate estimation of capital expenditures	Estimation of capital expenditures /sanction approved.
Technical & commercial feasibility studies not done	Technical & commercial feasibility studies are done before initiation of the specific Capex proposal.
Unauthorised capital expenditure.	The Capex is approved as per DOA.
Excessive delays	There is an internal mechanism to ascertain tracking of capital proposals till raising of POs to identify excessive delays

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FIXED ASSETS REGISTER

Missing Assets

A register of all fixed assets (including fully depreciated assets) is maintained and updated.

There is adequate description of all assets to identify assets physically available.

The FA Register is periodically reconciled with the financial records.

No Policy/SOP on physical verification

SOP is established and all procedures are complied with.

Physical verification of assets is carried out every year.

Company's assets physically not available

There is a set procedure for verification and confirmation of fixed assets lying with third parties.

Discrepancies observed during physical verification not adjusted.

All discrepancies are adjusted after taking approval as per DOA within time.

Title deeds not available

Physical verification of title-deeds is carried out periodically by officers not connected with assets accounting/assets administration.

Assets not being used

Periodic verification of Assets not in use is being done.

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FIXED ASSET ADDITIONS

Purchase of asset not authorised properly/ Non tracking of indent	Request for capital expenditure from user is received in standardized form. There is a separate identification number for each form. Formal documented approval as per DOA For every acquisition, Purchase order giving full details of fixed asset requirement. Every P.O. authorised as per DOA Actual transaction is as per P.O.
Lack of audit trail in ERP	Availability of audit trail in ERP/ SAP for all transactions
Unauthorised master record of asset	Master data (class, useful life, rate of depreciation) of new asset created subject to approval
Asset capitalised at WIP stage	Capitalisation only on the basis of 'put to use certificate' by proper person (technical person) only after inspection
Actual utilisation exceed the budgeted allocation	Approval as per DOA is obtained wherever actual utilisation exceed the budgeted allocation
No clear and correct distinction between capital and revenue expenditure	There is clear and correct distinction drawn between capital and revenue expenditure
Unduly delay in installation/commissioning/commencement of warranty	Reasons are documented for delay in installation/commissioning/commencement of warranty.

VALUATION OF ASSETS

Wrong valuation of assets	System to ensure that cost consist of purchase price, import duties (if any), other non-refundable taxes & direct attributable cost for bringing the asset to its working condition for its intended use.
	Self-generated asset consist of direct as well as allocable factory expenses allocated on systematic basis.
Wrong valuation of assets	Fixed assets are revalued on adequate independent evidence.

SALE OF ASSETS

Possibility of sale of performing assets	Disposal request from user.
Unauthorised sale	Approval as per DOA
Items replaced, scrapped or sold not removed/written off.	Items replaced, scrapped or sold are removed / written off from the books?
Profit or loss on sale of fixed assets	Profit or loss on sale of fixed assets is properly disclosed in the accounts

MOVEMENT/TRANSFER OF ASSETS

Loss of asset / non accountability of asset	<p>The standard form filled by user as well as sending and receiving locations.</p> <p>There is a system to track the assets transferred on a temporary basis.</p>
Unauthorised transfer	<p>Transfer of asset should be approved as per DOA.</p>
Transfer not recorded in books	<p>Transfer is properly recorded in the books</p>

IDENTIFICATION OF IDLE ASSETS

No system to identify idle assets

Documented process in place to identify the idle assets

Identification always from user documenting the reason to classify asset as idle asset.



WRITE OFF OF ASSETS

Write off approval for shortage/ missing asset is not obtained

Write off note for any shortage/missing asset is put up for approval as per DOA.



CAPITAL WIP

Delay in capitalisation leading to deferment of depreciation charge.

Under statement of F.A. / depreciation

Capitalisation of asset within two days of its ready to use certificate obtained

Ageing analysis to find out old WIP & reasons for non-capitalisation

Projects scrapped is charged off.



CAPITAL ADVANCE

Advance is given to unauthorised vendor

Request from vendor for capital advance, which should be approved as per DOA

Analysis of vendor history before granting of any advance

Non availability authentic documentary evidence

Signed agreement for purchase of fixed asset mentions all the terms including advance to be given

Analysis of unadjusted advances.

Excess payment to capital creditor

System to check any balance in advance account before making any payments.

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SECURITY OF ASSETS

Company's asset not properly Safeguarded	Controls to ensure Physical Safeguarding of Assets.
Company's asset wrongly owned by third party	All invoices/registration cards (for motor vehicle)/title deeds(for land, building etc.) clearly specifies the TCL ownership.
Encroachment of land	Adequate provisions to protect the asset from encroachment.



TRACKING OF INTERNAL RATE OF RETURN

Gaps between the projected

NPV/IRR and actual asset performance

Analysis of asset performance

against the projected NPV/IRR is being done.

Reasons for gaps between the projected NPV/IRR and actual asset performance are documented.



STATUTORY-COMPLIANCES

Non identification of Impairment to the asset

Documented & approved process in place for identification of Impairment & implementation of same

Periodical review of the assets for the impairment.

Non-compliance with Companies Act

Depreciation is charged as per provisions of the Companies Act.

No/under cover of insurance for Assets

Sum insured justifies the replacement value of Assets



Sl. No.	Functions
(1)	Plant Operation
a)	Yield-Machinery, Manpower & Material
b)	Budgeted Variance of Production
c)	Power Analysis
d)	Labour Analysis
e)	Production Delay due to unavailability of Resources (Material, Labour, Machinery & others)
f)	Capacity Utilisation of Machine & Labour
g)	Transit damaged Material
h)	Abnormal Losses, if any
i)	Quality Audit of Inward and Outward
j)	Review of Man Power Allocation Planning
k)	Review of Plant HR Policy-Labour Policy 2

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(1) Security

- (i) Security Register Abnormal Report Review (Shift Change)**
- (ii) Rotation of Security Staff**
- (iii) Insurance of Machinery Labour, Factory, Vehicle & Cash in Transit**
- (iv) Input & Output Matching with Inward/Outward/Dispatch/Tally etc.**
- (v) Audit of Security Gate Process**



Sl. No.	Functions
(2)	Purchase
a)	Review of PO Made during the Period
b)	Listing of unauthorized Purchase as per Power Limit
c)	Review of Contract Made during the period
d)	Review of Vendor Selection Process
e)	Review of Vendor Payment Policy
f)	Overdue PO
g)	Vendor Performance
h)	Review of Forward Contract

Sl. No.	Functions
(1)	Stores Audit
a)	Inward /Outward of Store Register with Gate Records
b)	Review of Inward & Issue Activity
c)	Adhoc. Audit of Bin Card Maintenance
d)	GRN Date vs. Security Date Review
e)	Review of Quality Control Of Stores items
f)	Review of Store Management
g)	Review of Action taken on Short Delivery
h)	Review of Slow/Non-Moving Stock
i)	Minimum order Quantity Review



Sl. No.	Functions
(1)	Statutory compliance
A.	Excise Register Matching with Inward & Outward
B.	Job work Register
C.	TDS Deduction Practice
D.	Review of GST
E.	Foreign Payment Review
F.	PF & PT Review
G.	Cases Pending Under Negotiable Instrument Act



Sl. No.	Functions
(1)	ROC compliance & Corporate Governance
a)	Review of Minute Books
b)	Review of Filing
c)	Review of Power Used by Company Officer
d)	CSR activities
e)	Any Non-Compliance as per Companies Act



Sl. No.	Functions
(1)	Ledger Scrutiny

Sl. No.	Functions
(1)	Cash & Bank Review
a)	BRS
b)	Physical Verification Cash
c)	LC Discounting & Charges
d)	Interest & Charges Review
e)	Stale Cheque Report
f)	Cheque Bounce Report
g)	Fund Management



Sl. No.	Functions
(1)	Corporate HR & Payroll
a)	Application of HR Policy
b)	Review of Reimbursements
c)	Review of Grievances
d)	Status of Vishakha Committee Report Implementation
e)	Surprise Head Count as per attendance Report
f)	Reconciliation of Employee Loan & Advances
g)	Review of Staff Welfare (Medical, working Environment, Staff Motivation, Training)
h)	Late Coming Report
i)	Performance Review of System, Policy & Technology



Sl. No.	Functions
(1)	Audit of Exp.
a)	Verification of Bills with ERP
b)	Approval Review of Bills
c)	Review of Bill Supporting
d)	Review of Debit Note-To be Raised
e)	Trend Analysis according to Sales/Production
f)	Forex Gain/Loss Calculation



Sl. No.	Functions
(1)	MIS Authenticity

Sl. No.	Functions
(1)	Audit of Sales
a)	Verification of Bills with ERP
b)	Review of Bill Supporting
c)	Review of Credit Note-To be Raise/Raised
d)	Review of Transport Challan Attached with Invoice
e)	Penalty & Price Variation Review
f)	Budgetary Performance
g)	C & F Form Status
h)	Utilisation of Advance Authorization Licenses



Sl. No.	Functions
(1)	Marketing
a)	Customer Complaint Addressal Review
b)	Target Performance-KAM c Debtors Performance-Ageing

Sl. No.	Functions
(1)	Business Analysis
a)	Industry Overview-Future Prospect of Business
b)	Ratio Analysis -In comparison with Industry
c)	Technology Review
d)	Costing & Pricing of Product



Sl. No.	Functions
(1)	Capex
a)	Capex Bills Review
b)	Capitalization Checking
c)	FAR Checking
d)	Barcode & Tagging Status

Sl. No.	Functions
(1)	Overview Assurance on Internal Control



Sl. No.	Functions
(1)	Transporting & Logistic
a)	Review of Transportation Contract & Rate
b)	Transportation Expense & Pooling Review
Sl. No.	Functions
(1)	Follow up of Previous Audit
Sl. No.	Functions
(1)	Stock Audit
Sl. No.	Functions
(1)	Any other area Requested by management



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CHAPTER 16: AUDIT OF DIFFERENT SERVICE ORGANISATIONS

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INTERNAL AUDIT CAN ADD VALUE

FOCUSING ON
RISK AREAS

EVALUATING &
RECOMMENDING
PROCESS
IMPROVEMENT
OPPORTUNITY

RESEARCHING
BEST PRACTICES &
HELPING IN
IMPROVEMENT

MONITORING THE
IMPLEMENTATION
OF POLICIES &
STRATEGIES

COST-EFFECTIVE
SOLUTION

AUDIT OF HOSPITALS

- AUDITOR SHALL APPLY FOLLOWING STEPS TO CONDUCT THE AUDIT OF HOSPITAL
 1. AUDITOR SHOULD CHECK THE LETTER OF APPOINTMENT TO ASCERTAIN THE SCOPE OF RESPONSIBILITIES.
 2. OWNERSHIP AND CONTROL OF THE INSTITUTION.
 3. PROCESS (E.G ADMISSION, RELEASE, OUTDOOR CHECK-UP, PATHOLOGY AND OTHER TEST FACILITIES, OPERATION THEATRE FACILITY, VACCINATION ETC.) AND RELATED CONTROLS TILL REVENUE GENERATION.

4. DONATION, SPECIAL GRANT, INTEREST AND/ OR DIVIDEND INCOME ETC. TO BE VALIDATED THROUGH NECESSARY SUPPORTING DOCUMENTS.
 - SOURCE SHOULD BE IDENTIFIED.
 - ACCOUNTING IS DONE PROPERLY
5. ENSURE PURPOSEIVE DONATIONS, GRANTS ETC. SPENT FOR THE PARTICULAR PURPOSE ONLY.
6. CLEAR DISTINCTION BETWEEN CAPITAL EXPENDITURE & REVENUE EXPENDITURE.
7. STANDARD OPERATING PROCEDURE W.R.T EXPENSES (CAPEX & OPEX)
8. VERIFY THE SYSTEM OF INTERNAL CHECK AS REGARDS TO PURCHASES & ISSUE OF STORES, MEDICINES, MEDICAL EQUIPMENT ETC.



9. EXAMINE THE APPOINTMENT OF THE STAFF, VISITING SPECIALIST DOCTORS, PAYMENT OF SALARIES ETC. FOR EXPENDITURE BOOKING VALIDATION.
10. PHYSICAL VERIFICATION OF INVESTMENTS, FIXED ASSETS & INVENTORIES.
11. CHECK CAPITAL EXPENDITURE AND DEPRECIATION RATES CHARGED IN THE BOOKS OF ACCOUNTS.
12. ACCOUNTING PRINCIPLES FOLLOWED FOR RECORDING OF TRANSACTIONS.

AUDIT OF EDUCATIONAL INSTITUTION

- i. Documents relating to formation of the institution, affiliation, Management structure, Governing Body, ownership etc. requires due attention for fund monitoring, donation, spent approval process, affiliation fees payment etc.

Examine the Trust Deed, or Regulations in the case of school or college and note all the provisions affecting accounts. In the case of a university, refer to the Act of Legislature and the Regulations framed thereunder.



- ii. Approving authority for expense, fund transfer, bank account operation etc. Read through the minutes of the meetings of the Managing Committee or Governing Body, noting resolutions affecting accounts to see that these have been duly complied with, especially the decisions as regards the operation of bank accounts and sanctioning of expenditure.
- iii. Semester/Class-wise Student Register with details of Student name, address, Aadhar No./Card, Guardian details, Contact No. etc. and fee structure (full fees, half fees, sanctioned waiver etc.) mapped for ensuring accuracy of collection. Where collection through direct Banking takes place, the Bank Statement to be equivated with 'fees receivable/recoverable' for completeness check and proper revenue /collection (advance/ arrear) recognition. Fees collected and Fees Book counterfoil reconciliation also can be carried out, for fees collected at the Counter. Collection against every student, whose names are appearing in the 'Student Register' to be validated and unpaid ones to be followed-up.



- iv. Updation of 'Student Register' w.r.t discontinued, transferred students, drop-outs etc. to be carried out on timely basis.
- v. Fees condonation by appropriate authority to be considered for reconciliation between receivable fees and received.
- vi. Admission and other collections (late fees, transfer charges etc.) need to be tracked for separately and booked under appropriate Account Heads.
- vii. Confirm that hostel dues were recovered before students' accounts were closed and their caution deposits appropriately adjusted/refunded.
- viii. Verify other sources of income (rental income from landed property with the rent rolls, bank Fixed Deposit interest from Deposit Certificates etc.)
- ix. Grants received with the relevant papers of grant.
- x. Appropriate account head for Grant receipt and spent eligible thereunder to be checked for compliance.



- xi. Review of Receipts and Payments, Income and Expenditure for completeness and accuracy of Fund balances and bank balances.**
- xii. Completeness and accuracy of income and expenditure need to be ensured.**
- xiii. All statutory deposits P.F, Municipal /Corporation Taxes, Affiliation Fees etc.), filing to be checked for compliance.**
- xiv. Vouch all capital expenditure in the usual way and verify the same with the sanction for the Committee as contained in the minute book.**
- xv. Vouch in the usual manner all establishment expenses, approvals and enquire into any high volume expenditure.**
- xvi. Verify the inventories of furniture, stationery, clothing, provision and all equipment, etc. against the spent booked for the period under review and physical existence. These should be checked by reference to Stock Register and values applied to various items should also be test checked.**
- xvii. Appropriate Fund Accounts are maintained to verify dedicated Bank balance tallies with the books maintained by the Organization.**

AUDIT OF HOTELS

1

INTERNAL CONTROL: THE HIGHEST/ BIGGEST PROBLEM IN ANY HOTEL BUSINESS IS PILFERAGE (LEAKAGE OF CASH) & SO THERE MUST EXIST A STRONG INTERNAL CONTROL SYSTEM TO MINIMISE THE PILFERAGE & LEAKAGE. STRONG INTERNAL CONTROL SHOULD INCORPORATE FOLLOWING POINTS:

EFFECTIVENESS OF ARRANGEMENT REGARDING RECEIPT & DISBURSEMENT OF CASH

PROCEDURES FOR PURCHASE & STOCKING OF VARIOUS COMMODITIES & PROVISION

PROCEDURES REGARDING BILLING OF THE CUSTOMERS IN RESPECT OF ROOM SERVICE, TELEPHONE, LAUNDRY ETC.

SYSTEM REGARDING RECORDING & PHYSICAL CUSTODY OF ASSETS SUCH AS EDIBLES, WINES, CIGARATES, CROCKERY, CUTLERY ETC.

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2

ROOM SALES & CASH COLLECTION:

IDENTIFY VARIOUS SALES POINT WHICH GENERATES REVENUE.
EG. – ROOM SALES, RESTURANT, ROOM SERVICE, MINI BAR, SPA, BANQUET INCOME

CHECK THAT TOTAL SALES MATCHES WITH SALES AT VARIOUS SALES POINTS

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THESE 3 THINGS NEEDED TO BE CHECKED SPECIFICALLY

ACCOMODATION

I. GRADE WISE ROOM TARIFF MUST BE VERIFIED WITH BILING DESK

II. OTHER SERVICES (SALES POINT) ROOM SERVICES, MINIBAR, CLUB FACILITY SHOULD BE BILLED PROPERLY

DAILY OCCUPANCY REPORT

I. CHECKIN REPORT

II. CHECKOUT REPORT

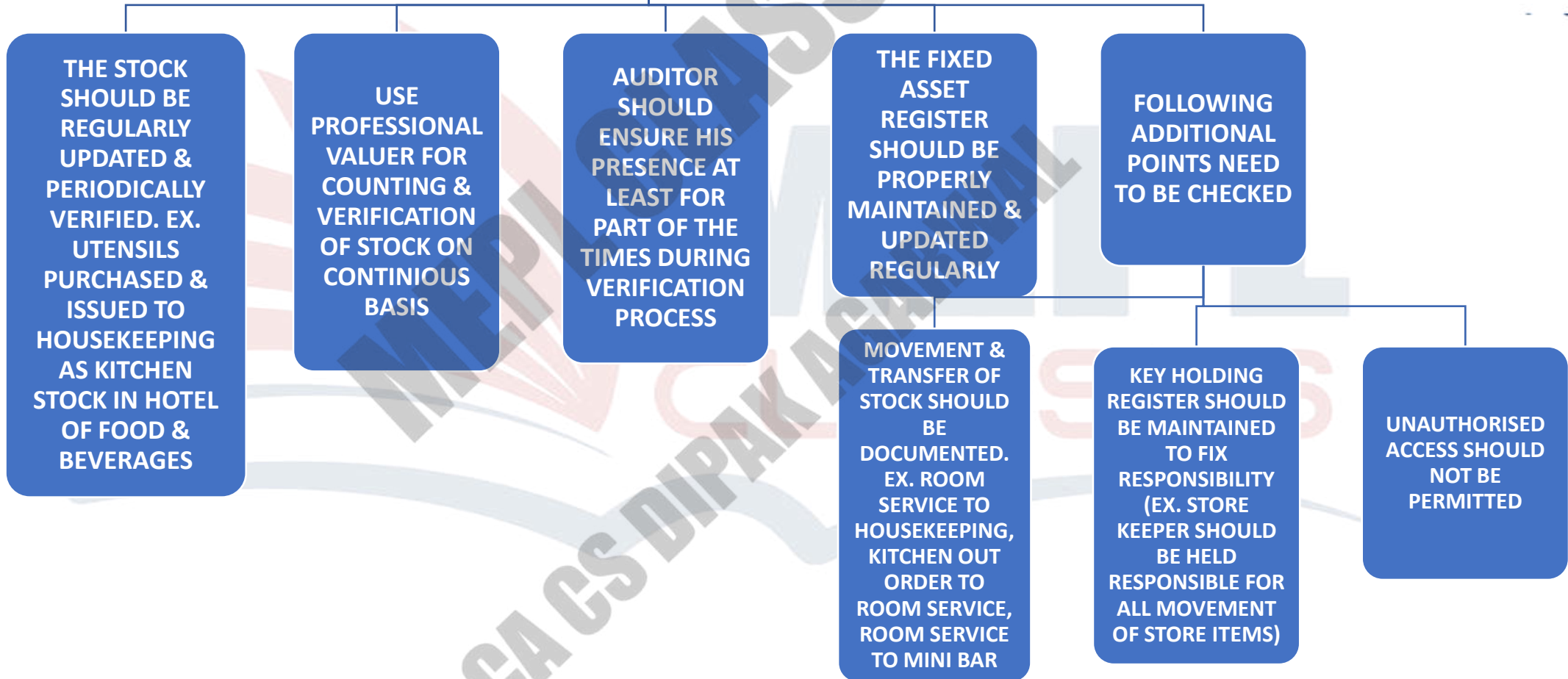
FOOD BILL WITH KOT (KITCHEN ORDER TAKEN) & SIGNED CUSTOMER COPY AS EVIDENCE OF CONSUMPTION

MATCHED WITH THE BILLING REPORT

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STOCK



4 SECTION-WISE/ COSTCENTRE-WISE DETAILS:

FOR EXAMPLE, MANPOWER DEPLOYED, MAINTENANCE EXPENSES, MANAGERIAL EXPENSES ETC. TO BE MAINTAINED ON REGULAR BASIS FOR COST ANALYSIS

CASUAL LABOUR

THE AUDITOR SHOULD CONSIDER THAT PROPER & ADEQUATE RECORD MAINTAINED FOR CASUAL LABOUR

PAYMENT OF WAGES TO CASUAL LABOUR SHOULD BE CHECKED PROPERLY.



5 **COST-REVENUE COMPARISON**

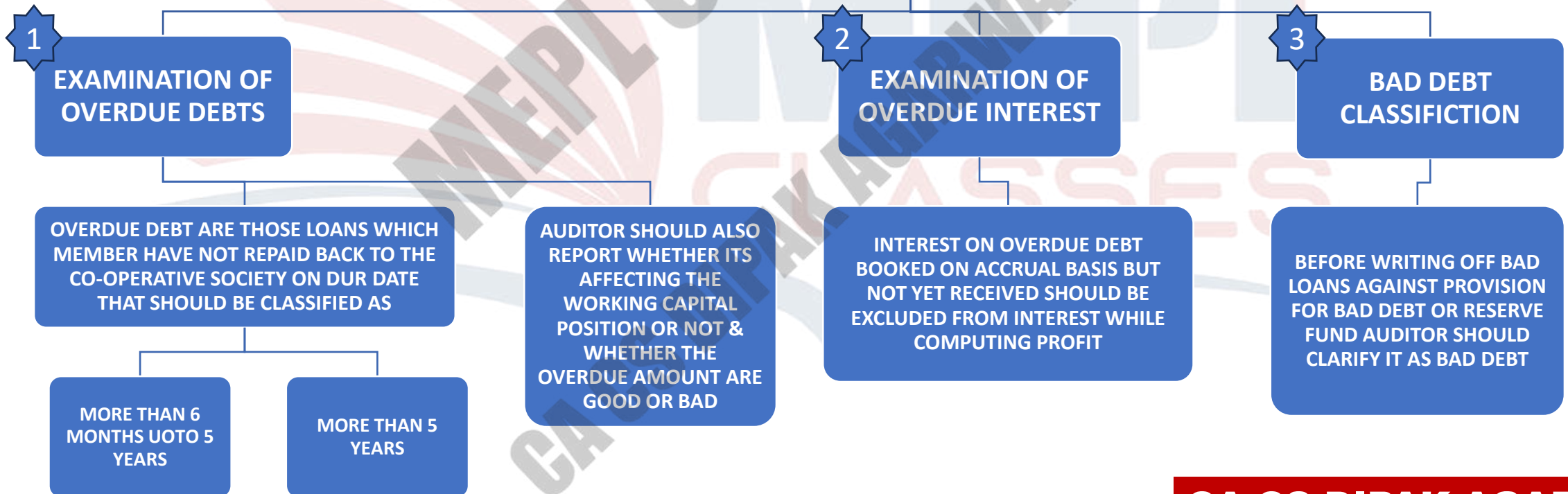
FACILITY-WISE COMPARISON (FOR EXAMPLE SWIMMING POOL, GOLF COURSE, SPA, CLUB FACILITIES ETC.) TO BE MONITORED FOR SERVICE LEVEL ASSESSMENT WITH RECOVERY RATE/ CHANGE, REQUIRED TO MONITOR SERVICE LEVEL.

6 RECEIPT & PAYMENT VERIFICATION

- A. CHECK CUSTOMER BILL COPY TO ENSURE THAT THE STOCK ISSUED TO THEM & PAYMENT IS RECEIVED.**
- B. CHECK PAYMENTS MADE TO THE FOREIGN COLLABORATOR IF ANY**
- C. CHECK EXPENSES FOR PAINTING, REPAIRS, RENOVATION ETC.**
- D. CHECK PAYMENT OF SALARIES/ WAGES ETC.**
- E. CHECK ANY INVESTMENT EXPENSES & IT'S IMCOME**
- F. CHECK WHETHER MONEY IS RECEIVED FROM THE TRAVEL AGENT AS PER THE CREDIT TERMS, ALSO THE COMMISSION PAID TO THE AGENT**
- G. VERIFY RESTURANT BILL WITH KOT ORDER**
- H. RECEIPT OF RESTURANT/ HALL BOOKING/ BANQUET HALL BOOKING SHOULD BE VERIFIED**

AUDIT OF CO-OPERATIVE SOCIETIES

CO-OPERATIVE SOCIETY'S CENTRAL ACT IS CO-OPERATIVE SOCIETY ACT, 1912 & AUDITOR SHALL APPLY THE FOLLOWING AUDIT PROCEDURES TO AUDIT CO-OPERATIVE SOCIETY



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CO-OPERATIVE SOCIETY'S CENTRAL ACT IS CO-OPERATIVE SOCIETY ACT, 1912 & AUDITOR SHALL APPLY THE FOLLOWING AUDIT PROCEDURES TO AUDIT CO-OPERATIVE SOCIETY

4

VERIFICATION OF ASSET & LIABILITY

AUDITOR SHOULD CHECK WHETHER ASSETS & LIABILITY HAVE BEEN VALUED AS PER GENERALLY ACCEPTED ACCOUNTING PRINCIPLES. HE SHALL ALSO CHECK THEIR EXISTENCE, OWNERSHIP/OBLIGATION & VALUATION. FIXED ASSETS SHOULD BE VALUED AT COST LESS PROVISION FOR DEPRECIATION. CURRENT ASSETS AT COST OR REALISATION VALUE WHICHEVER IS LOWER.

5

ADHERENCE TO CO-OPERATIVE PRINCIPLE

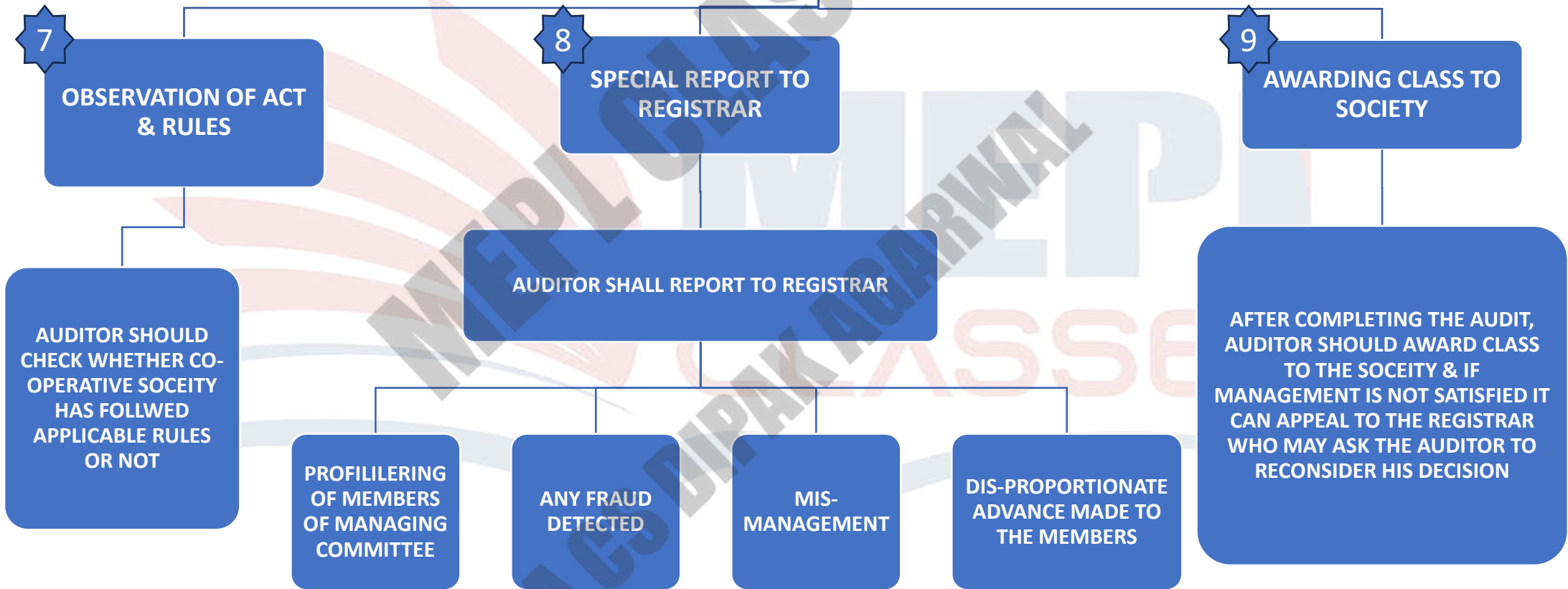
AUDITOR SHALL CHECK THAT MUTUAL ASSISTANCE PRINCIPLE FOLLOWED BY MEMBERS OR NOT

6

MEMBERS REGISTER & PASS BOOK

IF LAON GIVEN TO PERSON CHECK THAT HIS NAME WAS THERE IN REGISTER OF MEMBERS OR NOT & ALSO SEE HIS PASSBOOK TO CHECK WHETHER HE ACTUALLY RECEIVED THE LOAN OR NOT

CO-OPERATIVE SOCIETY'S CENTRAL ACT IS CO-OPERATIVE SOCIETY ACT, 1912 & AUDITOR SHALL APPLY THE FOLLOWING AUDIT PROCEDURES TO AUDIT CO-OPERATIVE SOCIETY





NOTES:

1

**10 PERSON SHOULD APPLY TO
THE REGISTRAR OF SOCIETY**

**U/S 6 OF CO-OPERATIVE
SOCEITY ACT, 1912**

- NOT PAY MORE THAN NOMINAL VALUE OF SHARES
- CANNOT HOLD GREATER THAN 20% OF THE SHARES OF CO-OPERATIVE SOCEITY

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NOTES:

2

SEC 17 (AUDIT OF CO-OPERATIVE SOCIETY)

REGISTRAR SHALL AUDIT OR CAUSE TO BE AUDITED BY ANY PERSON AUTHORISED BY HIM

THE AUDIT SHALL INCLUDE AN EXAMINATION OF OVERDUE DEBT AND VALUATION OF ASSET & LIABILITY

REGISTRAR SHALL ALL THE TIME HAVE ACCESS TO THE DOCUMENTS (ACCOUNTS, PAPER, SECURITY ETC.) OF THE SOCIETY



NOTES:

- 3 APPOINTMENT OF THE AUDITOR IS DONE BY THE REGISTRAR OF THE CO-OPERATIVE SOCIETY. THE FEES OF THE AUDITOR IS FIXED BY THE CO-OPERATIVE SOCIETY BASED ON THE SCALE FIXED BY THE REGISTRAR**
- 4 AUDITOR SHALL SUBMIT A COPY OF THE REPORT TO THE SOCIETY AND TO THE REGISTRAR DIRECTLY**



NOTES:

5

Duties of An Auditor:

- ❖ Auditor should be well-versed with the Co-operative Society Act, 1912
- ❖ Any irregularities & mis-statement should be immediately point out the same.
- ❖ Auditor should go through the agreement between the society & the borrowing (i.e. repayment schedule & rate of interest)
- ❖ Balance Sheet / P/L & auditor report should be as per the proforma fixed by the Chief Auditor of the Co-operative Society of the State.
- ❖ Audit should be in accordance to the act & rules.
- ❖ Loan given to the members are in accordance to the resolutions passed by the Managing Committee of the Society.
- ❖ Auditor should verify that the loan given is within the prescribed limit.
- ❖ The auditor should check whether the Co-operative Society is maintaining the list of ledgers as prescribed by the state u/s 43(H) of the Co-operative Society Act, 1912.
- ❖ Auditor should ascertain the number of shares held by each member of the society & within the prescribed limit

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Books, Accounts, and Other Records of the Society

Under Section 43(H) of the Co-operative Society Act, 1912, the Government of a state can frame rules prescribing the books of accounts to be kept by a Cooperative society. Following books and accounts are prescribed by the Maharashtra Government.

- ❖ Cash Book
- ❖ General Ledger
- ❖ Stock register
- ❖ Personal Ledger
- ❖ Register of Members
- ❖ Register Shares and debentures
- ❖ Minutes books of general body meetings and committee meetings
- ❖ Property Register
- ❖ Register recording loan applications
- ❖ Maintenance of register of audit objections and their rectifications

INVESTMENT OF FUNDS BY CO-OPERATIVE SOCIETY

SAVING BANK ACCOUNT OF GOVERNMENT OF INDIA (GOVERNMENT BANKS)

ANY SECURITIES SPECIFIED U/S 20 OF THE INDIAN TRUST ACT, 1882

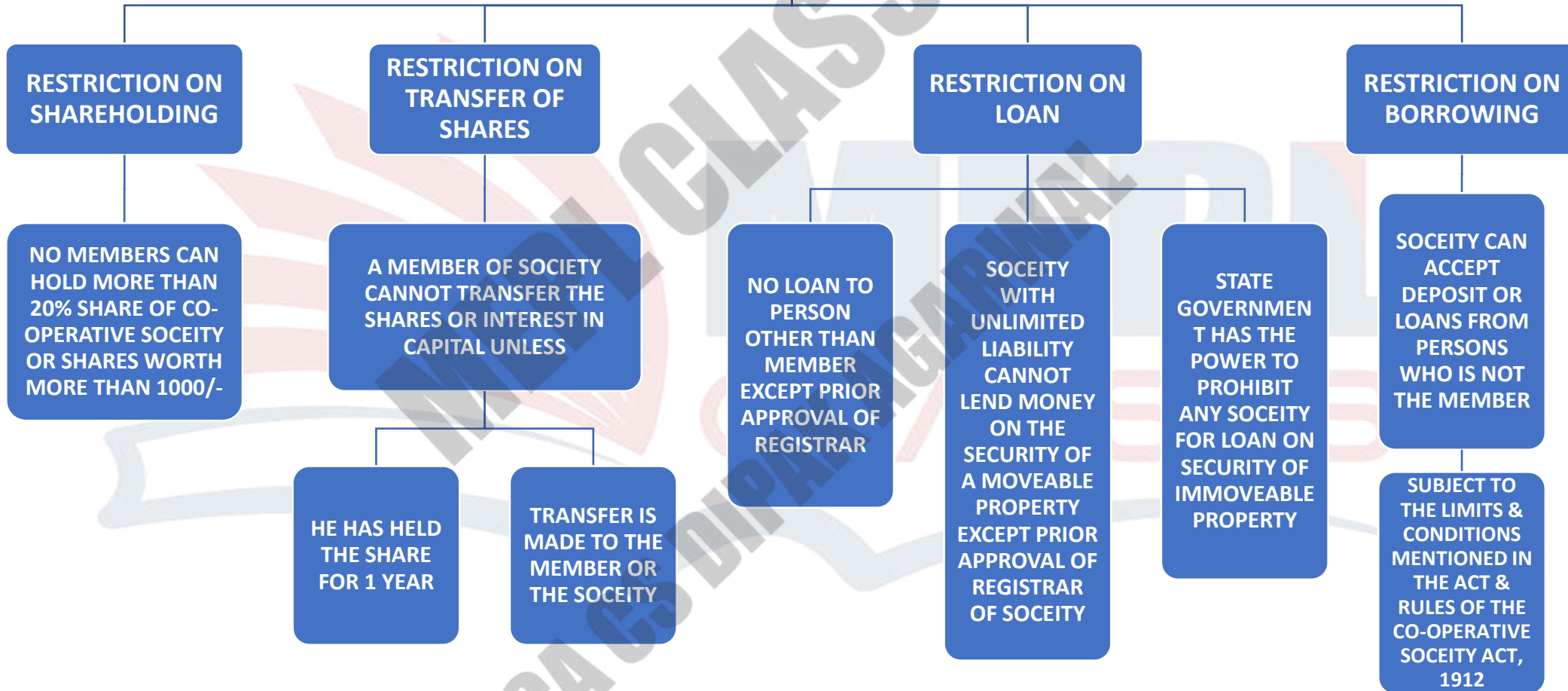
THE SHARES OR IN SECURITY OF ANY OTHE CO-OPERATIVE SOCEITY (REGISTERED)

ANY BANK OR PERSON CARRYING ON BUSINESS OF BANKING

ANY MODE PERMITTED U/S 32 OF THE ACT

APPROVED BY THE REGISTRAR

RESTRICTION ON CO-OPERATIVE SOCIETY



RESERVE FUND & DISTRIBUTION OF PROFIT

FIRST 25% OF NET
PROFIT TO BE
TRANFERED TO
RESERVE FUND

10% OF THE
BALANCE NET
PROFIT AFTER
TRANSFERING 25%
TO RESERVE FUND

BALANCE OF THE
CURRENT YEAR PROFIT &
PAST YEAR PROFIT CAN BE
DISTRIBUTED TO THE
MEMBER OF SOCEITY

DIVIDEND CAN BE
DISTRIBUTED BASED
ON RULES & BYE
LAWS SUBJECT TO
LIMIT OF 6.25%

SOCEITY CAN
CONTRIBUTE
CHARITABLE PURPOSE
WITH SANCTION OF
REGISTRAR

SUBJECT TO THE
RULES & BYE LAWS OF
THE SOCEITY



NOTE:

- UNLIMITED LIABILITY SOCIETY CANNOT DISTRIBUTE PROFIT UNLESS SPECIAL ORDER PASSED BY STATE GOVERNMENT
- EXEMPTION ARE AVAILABLE TO THE REGISTERED SOCIETY FROM INCOME TAX, STAMP DUTY OR REGISTRATION FEES.