

Internal Audit of Specific Functions

Lesson 6

KEY CONCEPTS

- Kick-off Meeting
- Process Walkthrough(s)

Learning Objectives

To understand:

- The process or activity that are critical to the various functions / department such as Purchase functions, Inventory management, production, operations, finance functions, human resource, Sales, Marketing & IT Functions etc.
- The process / steps / majors areas to be looked into by the internal auditor while conducting audit of such functions / department

Lesson Outline

- Introduction
- Internal Audit of Purchasing Activity
- Internal Audit of Inventory Management
- Internal Audit of Production and Operations
- Internal Audit of Finance and Accounts
- Internal Audit of Human Resources
- Internal Audit of Sales & Marketing
- IT System Audit
- Lesson Round-Up
- Test Yourself
- List of Further Readings

INTRODUCTION

In the previous lesson, we have studied about internal audit tools and techniques, and how they can be used effectively while conducting an internal audit. In this lesson we take the discussion forward and learn about nuances of conducting internal audit of some specific functions or processes which are usually part of most of the organisations. We will strive to understand the practical aspects as well the possible risks and controls which may be audited in such audits. We will cover below internal audits in this lesson:

- A. Internal Audit of Purchasing Activity,
- B. Internal Audit of Inventory Management,
- C. Internal Audit of Production and Operations,
- D. Internal Audit of Finance and Accounts,
- E. Internal Audit of Human Resources,
- F. Internal Audit of Sales & Marketing,
- G. IT System Audit.

Before we start discussing about specific audits as listed above, it is important to revisit the steps or stages of a typical internal audit engagement, since an understanding of these internal audit process milestones shall be helpful in better comprehension and application of the audit steps explained later on for the specific topics mentioned in this lesson.

Initiation of Internal Audit

An internal audit engagement generally starts with an audit notification being sent by the Internal Auditor to the relevant stakeholders. Generally, these stakeholders are Business Unit or Function or Vertical Heads (by whatever name called in the organisation), the senior management stakeholders including the relevant wholetime directors and other key managerial personnel identified by the company.

The objective of issuing an audit notification is to apprise the key stakeholders about the start of audit, the audit objectives and scope as approved by the audit committee or the board, as applicable and share the tentative schedule of the audit. It ensures that the senior people in the organisation are aware about the importance and schedule of the internal audit activity and can direct their subordinates to re-prioritise their tasks to enable smooth sharing of explanations, information and records to the internal audit team in a timely manner.

An audit notification generally contains a proposal to have kick-off meeting (sometimes called as information meeting), with the function owners, their immediate sub-ordinates who are the process owners of the items given in audit scope and audit co-ordinator (s) from the auditee / client side, if any.

Kick-off Meeting

After the audit notification is issued on email by the internal auditor, a kick-off meeting is generally organized by the internal auditor with the relevant function owners and their subordinates to discuss the audit objectives, audit scope (more detailed), audit schedule, audit process and methodology, audit team details, escalation routes on both sides, turn-around-time for provision of information or records, and initial data requirement is discussed and agreed. Usually, a presentation is made by the internal auditor covering all these aspects and inputs, from the auditees are invited to the same.

Exchange of views and clarifications from both sides enables better understanding of the expectations from each side and helps in avoiding debate about scope of audit and process to be followed for finalisation of the internal audit report later. Further, it helps in improving the perception of the internal audit activity since auditees can understand it better.

Process Walkthrough(s)

Process walkthroughs are step-by-step demonstrations or explanations of a process or task conducted by the process or task owner in the presence of the internal auditor. Internal auditor can use process walkthroughs to understand the process flow and identify the design of the internal controls using one or two examples chosen by the auditee for such demonstration. It helps the internal auditor in understanding how the auditees are conducting their day-to-day work, in relation to the internal audit engagement objectives, and identify the key controls or stage gates which ensure that the desired output of the process is achieved by the organisation.

While in case of mature control environments, the flow charts explaining the flow of information and key stage-gates / key controls of the process are already documented, yet there are many organisations where such documentation may not be available to a level which is detailed enough, or self-explanatory to meet the purposes of an internal auditor. In such cases, the internal auditors need to draw their own flow charts to obtain a complete understanding of the process. A flow chart provides a visual sequence of the steps in a process, illustrates the relationship between parts, and identifies what the process does or should do. Flowcharts can be created in a variety of ways by the internal auditors, from informal pencil drawings on scraps of paper to technically sophisticated computer graphics. Creation of flow charts by internal auditor based on process walkthroughs has following advantages:

- In the process of creating the flowchart, internal auditor can discover weakness in controls such as weak responsibility/accountability definitions, supervision by the wrong level of the organization, failure to segregate functions to avoid conflict of interest, and so on.
- A flowchart can provide an accurate description of process design, and later on when an internal auditor finds some exceptions to the process, it is easy to understand the risk or potential impact of that observation on the outcome of the process.

While making the flow charts, an internal auditor may need to keep revising the flow charts created by him/her as and when the understanding of the process interlocks becomes more and more clear. Reading of documented process documents, policies, authority matrix etc. are important before finalising process flow chart after process walkthroughs, since sometimes and actual process being explained by auditee and the requirement of approved policies may be different.

After a process walkthrough, internal auditor should be able to identify the process design gaps or risks which remain unaddressed if the same process continues in future also. Note that the risks to be identified should be in line with the audit objectives as well as process objectives. The quality of internal audit outcome is directly dependent on the quality of probing questions made by internal auditor during process walkthrough stage, and breadth of key risks identified.

Example:

While conducting an audit engagement of a payroll process, the client or management may have defined the audit objective to check the accuracy of payroll disbursed in the audit coverage period.

However, while conducting the process walkthroughs, an internal auditor is required to cover the entire process of managing the employee masters, payroll masters, payment controls in the bank accounts used for payroll related payments, the process for modifying these masters, and the tools used etc. and identify the key process controls mitigating the risk of erroneous or fraudulent payroll payments as well as regulatory and compliance risks applicable to the organisation. Thus, internal auditor must understand the entire process of arriving at the payroll calculations, payment controls and also include the related regulatory aspects in his walkthrough discussions to arrive the risks to be covered during the audit fieldwork stage and not limit the discussion on the payroll calculation sheets only.

After the process walkthroughs are completed, the process design gaps as well as additional data requirements are suitably discussed by the internal auditor at appropriate levels with process owners.

As per SIA 310 (Planning the Internal Audit Assignment), Section 3.3 states that a comprehensive knowledge of the Auditable Unit under review, its business and operating environment, shall be undertaken to determine the nature of audit procedures and tests to be conducted. As part of the planning process, a discussion with management and process owners shall be undertaken to understand the intricacies of each process considered for review.

Internal Audit Fieldwork

The internal audit fieldwork concentrates on determining whether the controls identified during the process walkthroughs are operating effectively and, in the manner described by the auditee. This stage concludes with a list of draft findings from which the auditor may prepare a draft audit report after a series of discussions with the auditees.

After gaining an understanding upon the process and identifying the risks to be audited in line with the audit objectives, the internal auditor needs to identify the data reports and relevant records of documents which need to be reviewed by him/her. Validation of the data reports received by internal auditors is a key step before the start of data analysis. It is also essential to analyze the outliers, if any, and understand the same through discussions and email confirmations with auditees, before proceeding with further checks. Sometimes, a discussion on the outliers in data reports may also result in finding out certain aspects of process which may have been missed to be discussed during process walkthroughs. Also, where possible a check on the integrity of data reports should also be made by reconciling the data received from related reports received from other authentic sources of information. In cases where the auditee claims some information or document is not available at all, the internal auditor must create a documented communication with the auditee to keep the same as evidence.

Documents and reports received are reviewed and corroborated with the explanations received, keeping in view the audit objectives. Various techniques such as document review, observation of process execution, interviews, data analysis, reconciliations, and benchmarking etc. are used by internal auditors to complete various checks planned by working out a detailed work program.

The work program shall have the details of risks identified, related controls understood, audit steps conducted to review the actual existence of such controls, and the results of the same. A work program is not a static document, but a work-in-progress or dynamic document which is updated by the internal auditor every day as the audit field work progresses. The work program also needs to clearly identify the sampling process and the rationale behind the same. While in some cases focused sampling after data analysis is effective, in other cases a stratified sampling approach is advisable.

SIA 310 (Planning the Internal Audit Assignment) Section 3.4 states that a risk-based planning exercise shall form the basis of the Internal Audit Assignment Plan. The Internal Auditor shall undertake an independent risk assessment exercise to prioritise and focus audit work on high-risk areas and processes, with due attention given to matters of importance, complexity and sensitivity.

Now we will discuss the specific aspects of the internal audit of various processes in detail keeping in view the discussion made so far.

INTERNAL AUDIT OF PURCHASING ACTIVITY

The term “purchase” refers to the act of acquiring or obtaining something by paying money or exchanging something of value for it. In other words, it is a transaction where a person or organization buys goods or

services in exchange for payment. The term “purchase” can be used in various contexts, such as personal shopping, business procurement, or even in the acquisition of assets or property. In the context of internal audits, we will use the term purchase with respect to business related procurement.

The purpose of a purchasing or procurement process in a company is to acquire the goods and services necessary for the business to operate efficiently and effectively. The term “procurement” refers to the process of identifying the need for goods and services, selecting vendors or suppliers, negotiating contracts, purchasing the items, and ensuring that they are delivered in a timely and cost-effective manner.

The procurement process serves several purposes in a company, including:

1. **Ensuring the availability of goods and services:** The procurement process ensures that the company has access to the goods and services it needs to operate, such as raw materials, equipment, or office supplies.
2. **Maximizing value for money:** The procurement process aims to obtain the required goods and services at the best possible price, quality, and delivery time. This can help the company to reduce costs and increase efficiency.
3. **Managing risks:** The procurement process can help the company to manage risks associated with supply chain disruptions, quality issues, or regulatory compliance.
4. **Building relationships with suppliers:** The procurement process can help the company to build and maintain good relationships with suppliers, which can lead to better pricing, more reliable delivery, and improved quality of goods and services.

Thus, the objective or purpose of conducting an internal audit of Procurement process is to provide assurance to the audit committee or board, that the procurement process is being executed effectively and efficiently, and to identify areas for improvement. Some of the specific objectives of a procurement audit may include are:

1. **Ensuring compliance with policies and regulations:** Internal audit can determine if the procurement process is following established policies and procedures, as well as regulatory requirements such as local laws and regulations, international trade regulations, and other legal requirements.
2. **Evaluating the effectiveness of the procurement process:** Internal audit can assess the effectiveness of the procurement process in meeting its goals, such as obtaining goods and services at the best possible price, quality, and delivery time.
3. **Identifying opportunities for cost savings:** Internal audit can identify areas where the procurement process can be improved to achieve cost savings or cost avoidance, such as reducing waste, optimizing inventory levels, or negotiating better prices with suppliers.
4. **Assessing supplier performance:** Internal audit can evaluate the performance of suppliers to determine if they are meeting contract requirements, delivering goods and services on time, and meeting quality standards.
5. **Improving risk management:** Internal audit can identify areas of potential risk in the procurement process, such as fraud, corruption, or conflicts of interest, and recommend ways to mitigate those risks.

Considering above audit objectives, the internal auditor usually sends the audit notification on email to the respective function owners and the other interested members of senior management. Such audit notification may generally include the following contents:

- *Audit Name or Title* (for instance, Review of Procurement Process”).
- *Audited Company:* This is more applicable in case the company is a conglomerate and the internal auditor is responsible for more than one company.

- *Audit Coverage Period:* As a general practice, last 12 months before the planned start of internal audit are taken as audit coverage period.
- *Audit Objective (s):* This is generally in line with the objectives already discussed previously in this chapter.
- *Audit Scope:*
 - a. Procurement of raw materials, consumables and finished goods.
 - b. Procurement of Services for services etc.
- *Auditee Departments:*
 - a. Purchasing department
 - b. Administration department
 - c. Finance department
 - d. Customer service department etc.
- Proposed Kick off meeting date / time slots.
- Auditor details (a firm's name or an internal audit department's employee)
- Proposed schedule of audit

After releasing the internal audit notification, (and before the kick-off meeting), the internal auditor usually works together with the function head to detail out the scope of audit as well as agree on the schedule of audit within a reasonable range of the schedule already approved by the audit committee.

A typical detailed scope of "Review of Procurement Process" may include the following:

1. Reviewing the vendor selection process in terms of following:

- Process to define the specifications/requirement (Material or Service Requisition Process).
- Approvals for going ahead to procure the requirement (Requisition Approvals).
- Process to identify the vendors who are qualified to bid for the requirement (Pre-qualification process).
- Process to define contents of Request for Proposal (RFP) / Request for Quotation (RFQ) along with the criteria to be used for their evaluation after bids are received. The criteria are defined together with RFP / RFQ to ensure that all information required for bids evaluation is asked for in the RFP / RFQ. These criteria usually include the standard terms and conditions drafted by the legal department of procuring organisation, which the bidder needs to agree and adhere to, if selected.
- Process for evaluation of bids received based on QCDM parameters.
 - Quality (Q) – while the bidders have already passed the pre-qualification stage, and thus are supposed to meet the minimum requirements of requisition, the assessment at this stage is to rank the bidders based on the bids received, as well as the discussions that may be held with the bidders to understand their alignment to requirements.
 - Cost (C) – scores or ranking is given based on the quoted amount. While the lowest bidder is given the highest score the highest bidder gets the lowest. This also includes an evaluation of other financial terms and conditions such as payment terms or credit period, advance moneys requirement, readiness to provide security deposits or bank guarantees etc.

- Delivery (D) – delivery scores are based on the schedule or delivery of materials or service as offered by the bidders. The bidder providing the delivery earlier than others shall get the maximum scores and so on. However, it must be kept in mind that the delivery committed by the bidder should not be impractical. In such case, a discussion should be held with the bidder to ensure that the requisition is understood properly by the bidder and their delivery schedule is based on correct assumptions or not.
- Management (M) – management scores are given based on the overall strength of the organisations bidding. This includes the size of the organisation, their existing customers, financial position, and experience of working in similar conditions earlier etc. Scores in this criterion help in identifying the bidder which is a better fit for the procuring organisation.
- Process to sign the contracts or issuing the purchase order with standard legal terms and conditions agreed with the bidder.
- Process to register the vendor (Vendor Registration).

In the entire process above, a review of the *Segregation of duties, documentation* created by the auditee departments and adherence to defined *approval matrix* and defined *process stage gates* are critical for an internal auditor.

2. Reviewing the Procurement Process:

Depending upon the nature of procurement the organisations may decide some procurements to be done through a Purchase Order (called as PO route), and some procurements to be made without a Purchase Order (called as non-PO route).

Following scope items are generally applicable in case of procurement by PO route:

- Review adherence to Delegation of Authority (DOA) for issuance of PO.
- Reviewing 3-way match controls (Purchase order, Goods Receipt Note (GRN) and invoice booking).
This process step involves checking whether the requirement defined in PO has been received as evidenced by GRN, and whether the supplier invoice matches with the received quantity as per GRN and price as per PO. This matching is required before any payment can be made to a vendor. While this process can be automated in an ERP environment, it may be partially automated or manual in a non-ERP environment. This checking includes the checks to ensure compliance with agreed terms and SLAs before processing the invoice and payment.
- Review PO/signed agreement terms and conditions (T&Cs).
This is to observe if any waivers on standard T&Cs have been granted to the vendors with the exception approvals being taken. While enforcing T&Cs with vendors may not be possible, an exception route definition should exist in the policy to approve for the exceptions.
- Review the process of accounting of procurement, and related segregation of duties within the accounting function including review of accounting system controls on invoice booking and payment processing.
- Review of payment process including bank payments process and cash payments process (if any) and review of appropriateness of supporting evidence.
- Review of levy of any interest, penalty or liquidated damages as per the agreed T&Cs.
- Review of segregation of duties with respect to PO creation & approval, expense approval, receipt of goods/ services, accounting and payment processing is an integral part of a Procurement Review.

Following scope items are generally applicable in case of procurement by non-PO route:

- Review to ensure that expenses are approved as per company policy or delegation of authority.
- Review of terms agreed with the vendors.
- Review of process to ensure desired receipt of goods/services and invoice accuracy.
- Review of process to ensure compliance to agreed terms and SLAs before processing the invoice and payment, and appropriateness of supporting evidence. This also includes review of levy of any interest, penalty or liquidated damages as per the agreed terms.
- Review of accounting controls with respect to the expense booking and payment processing.
- Review process of tracking due date for payments, and reconciliation of prepaid expenses (advance moneys paid).
- Review of segregation of duties with respect to the expense approval, receipt of goods/services, accounting and payment processing.

The peculiar characteristics of non-PO route procurements are given below:

Non-PO route is generally used in case of specific services such as legal services, audit services, day to day administration expenses, and utility payments. Instead of 3-way matching, only 2-way matching is applicable in non-PO route. Since there is no PO issued, the accounting for expense is done after receipt of service or goods along with the supplier invoice only. Thus, GRN and Invoice booking is done at the same time.

Vendor selection for non-PO procurements is generally done by user departments or cross functional teams. The role of centralized procurement department is minimum, leading to non-standard practices by various functions making such procurements. Thus, the internal auditor needs to review each transaction in more detail.

Procurements through non-PO route are less controllable and thus an organisation should try to route most of the procurements through PO route as far as possible.

An internal auditor needs to consider the discussion above and identify the risks applicable to the organisation process during the process walkthrough and the audit fieldwork. While each organisation may have peculiar risks applicable to their industry processes, general risks associated with a procurement process could be as follows:

1. Vendor favouritism
2. Non-transparent vendor selection without involving all stakeholders
3. Requisition specifications tweaking to benefit a specific vendor
4. Appropriate approvals not in place before effecting the transactions
5. Segregation of duties issues across the process
6. Order is placed with different content than the approved one
7. Materials not received on time resulting in delayed deliverable to end customer
8. Supply chain over-dependence on some vendors
9. Liquidity of financial risks of vendor resulting in supply chain disruption for the organisation
10. Vendors not meeting the Quality, Health and Safety norms resulting in risks for the procuring organisation

11. Vendors not providing the quality and quantity promised, especially in Just in Time procurement scenarios
12. Payment terms and other T&Cs do not meet company's payment rule
13. Use of excess or lower accruals by finance department to "manage" the financial results or keep some amounts for "rainy days"
14. Account code is not used appropriately
15. Double / multiple payment risks especially in non-PO route payments
16. Inefficient or delayed payment settlement process leading to vendors asking for higher rates due to their working capital blockage.

The risks can be more and less depending upon each organisation and an internal auditor needs to identify and audit the same using his/her professional skills while keeping in mind the process objectives and audit objectives. Once risks are identified, the internal auditor needs to look for the process controls which enable mitigation of these risks, and if any risk is not mitigated then the same shall be reported as a process design gap. Further, internal auditor needs to audit the operating effectiveness of the process by using various techniques to check whether currently designed process is working effectively to mitigate the risks identified or not. Suitable reporting is then required to be made to the auditees, and management and the audit committee or board.

INTERNAL AUDIT OF INVENTORY MANAGEMENT

The term "Inventory" refers to the stock of goods or materials that a business or organization has on hand for sale or production. It can include finished products, raw materials, work-in-progress items, and other items that are used in the production or distribution process.

The purpose of inventory management is to ensure that a company has enough stock to meet customer demand while avoiding overstocking that can lead to waste or additional costs. Proper inventory management can help a business maintain a steady supply of products, maximize efficiency, and minimize costs.

The purpose of inventory management in an organization is to ensure that there is an optimal level of inventory always maintained. Inventory management involves tracking the inventory levels, ordering new stock, and managing the flow of goods in and out of the organization. Effective inventory management has several benefits for an organization.

First, it ensures that there is enough inventory available to meet customer demand. This helps to avoid stockouts, which can result in lost sales and dissatisfied customers. Second, inventory management can help to reduce the cost of carrying inventory. By tracking inventory levels and ordering only what is needed, organizations can minimize the amount of capital tied up in inventory and reduce the cost of holding and storing inventory. Third, inventory management can help to improve cash flow. By minimizing the amount of capital tied up in inventory, organizations can free up cash to invest in other areas of the business. In a manufacturing organisation, in addition to the objective of maintaining optimum inventory, there is also an objective to ensure no line stoppages and ensure minimum wastage in the manufacturing process.

Overall, effective inventory management is essential for organizations to ensure that they have the right products available at the right time and at the right cost, which is critical for success in today's competitive business environment.

Inventory is required to be kept by an organization for any of the following purposes:

- held for sale in the ordinary course of business; or
- in the process of production for such sale; or

- in the form of materials / supplies to be consumed in the production process or in the rendering of services.

Inventory could be related to raw materials (parts, consumables), finished goods, spare parts, defective products or parts or scrap, and goods in transit. The key costs that apply to inventory management are *inventory holding cost, inventory ordering costs, investment cost, and space management costs*.

Holding cost, also known as carrying cost, is the cost that a business incurs for holding inventory in stock over a period of time. It includes various expenses related to storing and maintaining inventory such as rent, utilities, insurance, security, labor, and opportunity cost of capital. The longer the inventory is held in stock, the higher the holding cost will be. Therefore, it is important for businesses to optimize their inventory levels to minimize their holding costs. This can be achieved by implementing efficient inventory management practices such as just-in-time (JIT) inventory systems, economic order quantity (EOQ) models, and inventory turnover analysis. By minimizing the holding cost of inventory, businesses can improve their profitability and cash flow. However, it's important to strike a balance between holding costs and the risk of stockouts, which can result in lost sales and dissatisfied customers.

Inventory ordering costs, also known as setup costs or procurement costs, are the costs associated with placing and receiving orders for inventory items. These costs include expenses such as purchase order processing, supplier communication, shipping and handling, and inspection upon delivery. The ordering cost can vary depending on the quantity of items ordered and the frequency of orders placed. For instance, if an organization places fewer but larger orders, the ordering cost per unit may be lower. However, if an organization places more frequent but smaller orders, the ordering cost per unit may be higher. To optimize their inventory ordering costs, businesses can use various strategies such as batch ordering, where they order items in larger quantities to reduce the frequency of orders and hence, the ordering cost per unit. Alternatively, businesses can use supplier-managed inventory (SMI) systems, where suppliers are responsible for monitoring inventory levels and automatically replenishing stock when needed. Overall, effective management of inventory ordering costs is important for businesses to maintain an optimal level of inventory while minimizing the associated costs.

Investment costs in relation to inventory, also known as capital costs, are the costs associated with acquiring and holding inventory. These costs include expenses such as the initial purchase price of the inventory, storage costs, and the opportunity cost of capital tied up in inventory. The opportunity cost of capital is the cost of the forgone alternatives, which is the cost of the next best opportunity that could have been pursued if the capital was not tied up in inventory. For example, if an organization invests 10,000 in inventory and earns a 10% return on investment annually, the opportunity cost of capital tied up in inventory is 1,000 per year. Investment costs can have a significant impact on the profitability and cash flow of a business. Therefore, it's important for businesses to optimize their inventory levels to minimize their investment costs. This can be achieved by implementing efficient inventory management practices such as ABC analysis, safety stock calculation, and lead time management. By optimizing their inventory investment costs, businesses can improve their profitability and cash flow. However, it's important to balance inventory investment costs with the risk of stockouts, which can result in lost sales and dissatisfied customers.

Space management costs are the expenses associated with the physical space required to store inventory. These costs include rent or mortgage payments, utilities, insurance, property taxes, and maintenance expenses. Space management costs can have a significant impact on the profitability and cash flow of a business, especially if the organization stores excessive inventory. Therefore, it's important for businesses to optimize their inventory levels to minimize their space management costs. One way to minimize space management costs is to implement efficient inventory management practices such as just-in-time (JIT) inventory systems, which emphasize smaller and more frequent deliveries of inventory, and economic order quantity (EOQ) models, which calculate the optimal order quantity to minimize total inventory costs. Another way to minimize space management costs is to optimize the use of available space by using inventory management software, labeling

and organizing inventory, and using vertical storage solutions such as pallet racks and mezzanine floors. Overall, effective management of space management costs is important for businesses to maintain an optimal level of inventory while minimizing the associated costs. By optimizing their inventory space management costs, businesses can improve their profitability and cash flow.

An understanding of various costs applicable to inventory management is essential for an internal auditor to ask effective probing questions during the process walkthrough stage and identify the pertinent risks applicable to an organization that he/she is auditing.

Thus, the audit objective of “Review of Inventory Management Process” is generally to provide and assurance to the audit committee or board on the following topics:

- Adequacy of inventory control process policies and procedures and their appropriate implementation.
- Appropriateness of roles and responsibilities, including the segregation of duties in the key processes.
- Effectiveness of physical and operational controls in place for effective inventory management.
- Completeness and accuracy of reporting or recording of all inventory transactions in the financial system and adequacy of monthly and year end reporting procedures.

While conducting process walkthroughs, an internal auditor needs to understand the entire process of inventory management by meeting all stakeholders including purchase department, stores department, manufacturing department or other departments responsible for material requisitions, and accounting and finance departments. Further below given points should be specifically focused upon during these discussions:

- inventory planning process by various stakeholders
- materials receiving process
- warehousing standards and procedures including physical controls
- process for issuing the materials for production/operations
- process for assembly of any inventory items before issuing to production / operations
- shipping process for finished goods
- cyclical and periodic physical counts, and
- financial reporting and monthly and year-end procedures.

To conduct an internal audit of inventory management process, an internal auditor must understand document flow along with the physical movement of materials and goods. Thus, a physical visit to relevant locations is indispensable. Further, a clear and unambiguous understanding regarding the relevant management information systems and the reports thereof is necessary to understand how the function heads control the entire process. These discussions need to be done with a focus to identify the process used by auditees for identifying outliers, and detection of avoidable leakages. Further, the discussions should include the questions to assess the segregation of duties in entire process as well.

Additionally, an internal auditor needs to focus on process controls to detect and deal with stock losses, management of any rejected materials (including the legal recourse available against vendors as per agreed terms), and process to manage obsolete and scrap materials including the disposal process. Scrap management and its disposal process needs to be reviewed from the point of view of theft and pilferage risks.

Further, specific focus on the aspects is also generally required with regards to process controls ensuring correct accounting of inventory in books. For instance: Capital or revenue decision, inventory items used for research and development, inter unit transfers, valuation norms, proper maintenance of items master and giving

effect to results of physical count in the books. The accounting assertions given below should be kept in mind by the internal auditor while conducting this review:

Accounting Assertions:

- Existence
- Completeness
- Accuracy
- Classification
- Cut-off
- Realizable value
- Rights
- Presentation and Disclosure

An internal auditor needs to consider the discussion above and identify the risks applicable to the organisation process during the process walkthrough and the audit fieldwork. The risks can be more or less depending upon each organisation and an internal auditor needs to identify and audit the same using his/her professional skills while keeping in mind the process objectives and audit objectives. Once risks are identified, the internal auditor needs to look for the process controls which enable mitigation of these risks, and if any risk is not mitigated then the same shall be reported as a process design gap. Further, internal auditor needs to audit the operating effectiveness of the process by using various techniques to check whether currently designed process is working effectively to mitigate the risks identified or not. Suitable reporting is then required to be made to the auditees, and management and the audit committee or board.

INTERNAL AUDIT OF PRODUCTION AND OPERATIONS

Production refers to the process of creating or manufacturing goods or services that can be sold in the market. It involves transforming raw materials, components, or other inputs into finished products or services that meet the needs of customers. The production process typically involves a series of steps, such as designing the product, sourcing raw materials or components, assembling or processing the inputs, quality control, and packaging or labelling the finished product. The main goal of production is to create goods or services that can be sold in the market and generate revenue for the business. Efficient production processes can help businesses to reduce costs, increase productivity, improve quality, and meet customer demands. There are different types of production methods used by businesses, such as mass production, batch production, job production, and continuous production, each with its own advantages and disadvantages depending on the nature of the product or service being produced and the needs of the business.

The term Operations, however, refers to the activities involved in managing and controlling the processes that create goods and services within an organization. It includes all the tasks and functions required to transform inputs such as raw materials, labour, and capital into finished products or services that can be delivered to customers.

Operations management is a critical component of any business and involves various functions such as planning, organizing, controlling, and coordinating resources to achieve the objectives of the organization. The primary goal of operations management is to optimize the efficiency and effectiveness of operations while ensuring high-quality products and services. Some of the key activities involved in operations include:

- *Capacity planning* - determining the resources needed to meet customer demand.

- *Production planning and scheduling* - planning and scheduling production processes to ensure efficient use of resources.
- *Inventory management* - managing inventory levels to ensure that there is enough stock to meet customer demand while minimizing costs.
- *Quality control* - ensuring that products or services meet the required quality standards.
- *Supply chain management* - managing the flow of goods and services from suppliers to customers.

By managing operations effectively, organizations can improve their competitiveness, increase customer satisfaction, reduce costs, and ultimately achieve their strategic objectives.

By understanding the above terms in general parlance, it comes out that a “Review of Production and Operations” in internal audit shall entail covering the production planning and scheduling, quality control, inventory management and supply chain management for an organisation. However, considering the size of some organisations the same may not be possible to cover in a single audit and thus may be split into various separate audits such as Production audit, Inventory Management audit and Supply chain audit. Due to this, in this section of the lesson, we will concentrate our discussion on the production process and related controls only.

Production is a scientific process which involves transformation of raw material (input) into desired product with the help of energy, capital, manpower and machinery and is a very complex process. The key process objectives of a production process generally are:

- On time-every time,
- Zero quality issues, and
- Controlled wastages.

“On time every time” is an objective of the production process that refers to the ability to consistently deliver products or services to customers on or before the agreed-upon delivery date or time. It is a measure of reliability and consistency in meeting customer expectations and is often a critical factor in achieving customer satisfaction. It involves ensuring that all aspects of the production process are well-organized, efficient, and reliable, from raw material procurement to finished goods delivery. This includes managing the supply chain, scheduling production runs, ensuring sufficient inventory levels, and maintaining high levels of quality control. Meeting the “on time every time” objective requires a well-organized and efficient production process that can respond quickly to changes in demand or unexpected production issues. To achieve this objective, organizations need to have effective production planning and scheduling systems, robust inventory management practices, and streamlined logistics and delivery processes. By meeting the “on time every time” objective, businesses can build a reputation for reliability and trust with their customers, which can lead to increased customer loyalty, repeat business, and positive word-of-mouth recommendations.

The “zero quality issues” objective in a production process refers to the goal of achieving a production process that has no defects or errors in the finished products. It is a measure of the quality and reliability of the production process and is a critical factor in meeting customer expectations. The “zero quality issues” objective involves implementing a comprehensive quality management system that ensures that all aspects of the production process are designed, monitored, and controlled to minimize the risk of quality issues. This includes managing the supply chain to ensure that raw materials are of high quality and meet specifications, implementing robust quality control processes during production, and conducting thorough testing and inspection of finished goods. To achieve the “zero quality issues” objective, organizations need to implement a culture of continuous improvement that emphasizes the importance of quality in all aspects of the production process. This includes providing regular training and development opportunities for employees, encouraging teamwork

and collaboration, and implementing data-driven performance metrics to monitor and track progress towards the objective. By achieving the “zero quality issues” objective, businesses can build a reputation for producing high-quality products that meet customer expectations, which can lead to increased customer satisfaction, brand loyalty, and positive word-of-mouth recommendations. It can also help to reduce costs associated with quality issues such as product recalls, warranty claims, and customer returns.

The objective of “controlled wastage” in a production process is to minimize the amount of material waste generated during the manufacturing process while ensuring that the final product meets the required quality standards. It is a measure of the efficiency and sustainability of the production process. The “controlled wastage” objective involves implementing a comprehensive waste management system that aims to reduce, reuse, and recycle materials wherever possible. This includes optimizing the use of raw materials, implementing effective inventory management practices, and controlling the use of resources such as energy, water, and packaging materials. To achieve the “controlled wastage” objective, organizations need to identify and measure the amount of waste generated at each stage of the production process and implement strategies to reduce waste wherever possible. This may include reusing materials or incorporating recycled materials into the production process, implementing lean manufacturing principles to eliminate waste, and implementing best practices for managing hazardous materials. By achieving the “controlled wastage” objective, businesses can reduce costs associated with material waste, improve the sustainability of their operations, and reduce their environmental impact. It can also help to enhance the reputation of the organization as a socially responsible and environmentally conscious business.

The students may observe that all of these three objectives of a production process are intertwined with each other and also with the other sub-ordinate or feeding processes of the organization. However, while conducting an internal audit, an internal auditor cannot review all of these aspects in one go. Therefore, it is recommended to break up the entire scope into 2 to 3 separate internal audits and get approvals on the scope from the audit committee or board in accordance with the same. Further, the audit objective of a production and operation process is generally described as below:

To provide an assurance to the audit committee and board on the:

- adequacy of designing of existing control framework for production,
- process and appropriate implementation of such controls,
- appropriateness of roles and responsibilities, including the segregation of duties for key processes involved under production activity,
- optimum utilization of all the resources with minimum wastage and maximum achievement of quality of the product, and
- the procedures for ensuring accuracy of the production information in the financial system.

The risks generally covered in a production process audit are described below (this is not an exhaustive list):

- i. Materials may be delivered late or may not be delivered at all, impacting the production plan.
- ii. Associated departments may have fallen behind in their own production resulting in line stoppages.
- iii. Risk of excessive absenteeism on the part of the workers resulting in line stoppages, wastages and discontent among other workers.
- iv. The customer may insist on changing the specification or delivery date, but internal processes may not be geared up for the same.
- v. Risk of machinery or power breakdown.

- vi. Risk of errors in drawings or specification of the materials being procured or produced.
- vii. Risk of rejections due to poor material quality.
- viii. Errors in processing and inspection.
- ix. Risk of not having adequate business continuity management processes to deal with risks such as fire, earthquake, natural calamities, cyberattack, IT system failure, etc.
- x. Risk of labor unrest.
- xi. Risk of regulatory non-compliances applicable to specific process.
- xii. Risk of not meeting contractual norms with / by vendors.

An internal auditor needs to develop his interview questions for the process walkthroughs and ask probing questions to understand how things actually work. A physical visit to the production place is a must for an internal auditor to understand the situation properly. Based on the discussions in process walkthrough, an internal auditor can develop the work program and proceed with the audit.

INTERNAL AUDIT OF FINANCE AND ACCOUNTS

The term “Finance” refers to the management and allocation of money, assets, investments, and liabilities. It involves management of various financial systems, such as banking, credit, investments, and the distribution of resources. Finance encompasses a broad range of activities, including budgeting, financial planning, investing, and the evaluation of financial decisions with an objective of optimizing the allocation of resources and achieving financial goals. Thus, finance is a broad term encompassing a wide range of activities.

In the context of accounting and finance, accounts refer to the systematic record-keeping of financial transactions within an organization. These transactions are typically categorized and recorded in various accounts, such as revenue accounts, expense accounts, asset accounts, liability accounts, and equity accounts. The purpose of maintaining accounts is to track and summarize the financial activities of a business.

The term “Finance & Accounts” typically refers to a functional area or department within an organization that handles financial management, accounting, and related activities. It encompasses a range of responsibilities related to financial planning, analysis, reporting, and control. The key objectives of the Finance & Accounts department in a company typically revolve around ensuring effective financial management and supporting the overall financial health of the organization.

Some common objectives of a Finance & Accounts department include:

1. **Financial Planning and Analysis:** The Finance & Accounts department is responsible for developing financial plans, forecasts, and budgets for the company. This involves analyzing past performance, projecting future financial trends, and setting financial goals and targets.
2. **Financial Reporting:** The Finance & Accounts department prepares and presents accurate and timely financial reports to internal and external stakeholders. These reports include financial statements, such as income statements, balance sheets, and cash flow statements, which provide a comprehensive overview of the company’s financial position.
3. **Financial Control and Risk Management:** The Finance & Accounts department establishes and maintains internal controls to safeguard the company’s assets, ensure compliance with financial regulations, and mitigate financial risks.
4. **Cash Management:** Managing cash flow is a critical objective for the Finance & Accounts department. It involves optimizing the inflow and outflow of cash to ensure the company has sufficient liquidity.

to meet its operational and financial obligations. This includes monitoring cash balances, managing receivables and payables, and optimizing working capital.

- 5. Capital Budgeting and Investment Analysis:** The Finance & Accounts department evaluates investment opportunities and capital expenditure projects to determine their financial viability and potential return on investment. This involves analyzing the costs, benefits, and risks associated with various investment options and making informed investment decisions.
- 6. Financial Strategy and Decision Support:** The Finance & Accounts department provides financial insights and analysis to support strategic decision-making within the organization. This may include evaluating new business initiatives, conducting financial feasibility studies, assessing the financial impact of potential strategies, and providing financial recommendations to senior management.
- 7. Treasury Management:** The finance department manages the company's treasury function, which involves overseeing cash and liquidity management, optimizing debt and equity financing, managing foreign exchange risk, and maintaining relationships with banks and financial institutions.
- 8. Compliance and Regulatory Requirements:** The finance department ensures compliance with financial regulations, accounting standards, and tax laws. This includes preparing financial statements in accordance with applicable accounting principles, filing regulatory reports, and coordinating external audits.

These objectives can vary depending on the specific industry, size, and nature of the company. The finance department works closely with other departments to support their financial needs and contribute to the overall success of the organization.

It is obvious that while conducting an internal audit, an internal auditor cannot review all these aspects in one go. Therefore, it is recommended to break up the entire scope into separate internal audits and take approvals on the scope from the audit committee or board in accordance with the same.

While conducting an internal audit of the financial reporting controls, below aspects need to be focused upon:

- **Accounting Policies:** Whether the organization being audited is having an accounting manual documenting the accounting policies to be followed. In many cases the accounting policies are documented in the annual reports also as part of the disclosure notes to accounts. A study of these policies is required before conducting process walkthroughs of accounting procedures and identification of relevant controls to be audited.
- **Closing Checklist:** Internal auditor should obtain an understanding of monthly, quarterly, and annual financial closing procedures and assess whether they are clearly defined, communicated, and implemented properly. Closing checklists play a crucial role in a financial closing process. A closing checklist in a financial closing process is a tool or document that outlines the necessary tasks and steps to be completed to close the financial books and finalize the accounting period. It serves as a guide to ensure that all critical activities are addressed and that the financial statements are accurate and complete. The specific items included in a closing checklist may vary depending on the company, industry, and the software used for accounting, but here are some common elements:
 - a. Reconciliation of Accounts:** Perform reconciliations for bank accounts, intercompany accounts, accounts receivable, accounts payable, inventory, and other relevant accounts to ensure that balances are accurate, and discrepancies are resolved.
 - b. Revenue Recognition and Cut-off:** Review transactions and ensure that revenue is appropriately recognized, cut-off dates are observed, and any required adjustments are made.
 - c. Accruals and Deferrals:** Assess and record accruals and deferrals, such as accrued expenses,

prepaid expenses, accrued revenue, and deferred revenue, to match revenue and expenses to the correct accounting period.

- d. Fixed Assets:** Verify the accuracy of fixed asset records, review depreciation calculations, and reconcile asset registers with the general ledger.
- e. General Ledger Review:** Review the general ledger for accuracy, completeness, and proper classification of transactions. Address any misclassifications, coding errors, or other issues.
- f. Expense Analysis:** Analyze expenses to identify any unusual or significant items, review expense accounts for accuracy, and ensure appropriate categorization.
- g. Journal Entries:** Prepare and post necessary adjusting journal entries to rectify errors, account for accruals, deferrals, and other adjustments required for the period-end closing.
- h. Financial Statement Preparation:** Compile and prepare financial statements, including the income statement, balance sheet, and cash flow statement, in accordance with applicable accounting standards and organizational policies.
- i. Disclosures and Footnotes:** Review and update financial statement disclosures and footnotes to ensure compliance with regulatory requirements and provide relevant and accurate information.
- j. Compliance and Regulatory Requirements:** Ensure compliance with tax laws, financial reporting standards, and other regulatory obligations specific to the industry or jurisdiction.
- k. Review and Approval:** Obtain appropriate approvals and review the closing process with management, ensuring that all necessary sign offs are obtained.

By following a closing checklist, companies can maintain control over the financial closing process, enhance accuracy and completeness, and facilitate a smooth transition to the next accounting period. The checklist serves as a reference to ensure that all necessary tasks are completed in a timely and efficient manner. It also serves as evidence of adequate internal controls over financial reporting.

- **IT General Controls:** Although an audit of Information Technology General Controls (ITGC) is a separate audit scope, an internal auditor should review the following as a minimum while conducting an internal audit of Finance & Accounts process:
 - a. Segregation of Duties:** Assess whether appropriate segregation of duties exists within the financial reporting process, ensuring that critical tasks, such as initiation, authorization, recording, and reconciliation, are appropriately segregated to prevent fraud or errors. Further, conflicting access rights should not be provided. For instance, AP module and AR module access should not be available to one individual. Similarly, access to general ledger module should be provided only to very few people, and so on.
 - b. User Access Management:** Evaluate the adequacy of controls around periodic access reviews to ensure that authorized individuals have appropriate access and unauthorized access is prevented. For instance, separated employees' access should be removed in a timely manner. Further, employee access should be modified if there is any change in their roles and responsibilities.
- **Manual Journal Entries:** Manual journal entries are accounting entries that are recorded manually in the general ledger or accounting system to adjust or correct the financial records. Unlike automated or system-generated entries, manual journal entries are typically made outside of the regular transactional processes. They are used to reflect accounting transactions or events that cannot be captured through the normal course of business operations or to correct errors. Thus, the number of

manual journal entries passed in the accounting system should be limited and not high. Here are some common situations where manual journal entries may be necessary:

- a. **Adjusting Entries:** Manual journal entries are made to adjust accounts at the end of an accounting period to ensure accurate financial reporting. These entries account for items such as accruals, deferrals, depreciation, prepayments, and estimates.
- b. **Correction of Errors:** Manual journal entries are used to correct errors discovered in the financial records. This can include misclassifications, posting errors, transposition errors, or any other mistakes that require rectification.
- c. **Reversing Entries:** Reversing entries are often created at the beginning of an accounting period to reverse the impact of certain accruals or deferrals recorded in the previous period. They simplify the subsequent accounting process and ensure that appropriate adjustments are made.
- d. **Intercompany Transactions:** Manual journal entries may be used to record intercompany transactions between entities within the same organization. These entries facilitate the elimination of intercompany balances and ensure accurate consolidation of financial statements.
- e. **Reclassifications:** Manual journal entries are made to reclassify transactions between different accounts or categories within the general ledger. This is done to correct misclassifications or to ensure that financial information is presented in the appropriate financial statement line items.
- f. **Reserves and Provisions:** Manual journal entries may be used to establish or adjust reserves and provisions for contingencies, bad debts, warranties, or other uncertain liabilities.
- g. **Foreign Currency Adjustments:** If a company operates in multiple currencies, manual journal entries may be necessary to record currency conversions, adjust foreign currency balances, or account for foreign exchange gains or losses.

It is important to note that while manual journal entries are sometimes required, organizations should strive to minimize their use and rely on automated processes and internal controls wherever possible to enhance accuracy and efficiency in financial reporting. Proper documentation and review procedures should be in place to ensure that manual journal entries are authorized, supported by appropriate documentation, and subjected to appropriate review and approval processes.

- **Post-Close Entries:** Post-close entries, also known as post-closing entries or year-end entries, are entries made after the closing of the accounting period. These entries are made to prepare the general ledger for the subsequent accounting period and to reset the temporary accounts to zero balances. Post-close entries are necessary to ensure that the beginning balances of the new accounting period are accurate and reflect only the transactions and balances relevant to that period. The main purpose of post-close entries is to separate the income and expense accounts from the retained earnings account, so that the income statement accounts start with zero balances in the new period and only the net income or loss from the previous period is carried forward to the retained earnings account. Post-close entries typically include the following:
 - a. **Closing entries:** These entries transfer the balances of the temporary income and expense accounts to the retained earnings or owner's equity account.
 - b. **Dividend entries:** If applicable, entries are made to record the declaration and payment of dividends to shareholders or owners.
 - c. **Opening entries:** These entries establish the beginning balances for the income statement and balance sheet accounts for the new accounting period.

Post-close entries are usually made once a year, at the end of the fiscal year, to prepare for the next accounting period. They are part of the closing process and ensure the accurate presentation of financial information for the new period.

The internal auditor needs to examine the completeness, accuracy and compliance with accounting standards. Each such entry must be backed up by proper documentation as well as approval flow, and the entries should be made following the policy consistent with the prior periods. This involves assessing whether similar transactions and events have been consistently accounted for and whether there have been any significant changes in accounting policies or estimates affecting the post-close entries.

- **Management Reporting and Statutory Reporting:** It is important to reconcile the management reporting results with statutory reporting results as part of a finance and accounts audit. The reconciliation ensures consistency and accuracy between the financial information presented for management purposes and the financial statements prepared for statutory reporting and compliance purposes. There can be several reasons for differences between management reporting results and statutory reporting results. Management reporting may use different accounting standards or policies compared to statutory reporting. Differences in the recognition, measurement, and presentation of financial transactions and events under various accounting frameworks can lead to variations in reported results. Similarly, Management reporting often involves certain adjustments and reclassifications that are not required for statutory reporting purposes. These may include non-recurring items, non-operating income or expenses, or management's discretionary adjustments to reflect a particular view of the company's performance. These adjustments are typically made to provide relevant information for decision-making but may not be recognized in the statutory financial statements.

It is important for organizations to have clear and consistent processes for reconciling and addressing differences between management reporting and statutory reporting. Regular communication and coordination between the finance and accounting teams responsible for both sets of reporting can help minimize discrepancies and ensure accurate and reliable financial information.

- **Other Items:** Further, a financial reporting audit may cover off-balance sheet items, budgetary and forecasting controls as well. Note that cash management, treasury operations, financial planning and analysis etc. are separate processes and an internal auditor may conduct process walkthroughs to understand the underlying controls and review the adequacy and effectiveness of same from time to time. Generally, these processes are covered as separate audits and not as part of Finance & Accounts internal audit.

INTERNAL AUDIT OF HUMAN RESOURCES

Human resources (HR) refer to the department within an organization that is responsible for managing the human capital and workforce. It encompasses the practices, policies, and processes related to the recruitment, selection, training, development, compensation, retention, and overall management of employees.

Key areas and responsibilities within human resources include:

1. **Recruitment and Selection:** HR is involved in sourcing and selecting qualified candidates for job vacancies within the organization. This includes creating job descriptions, advertising job openings, conducting interviews, and making hiring decisions.
2. **Employee Onboarding and Orientation:** HR oversees the process of integrating new employees into the organization. This includes conducting orientation programs, providing necessary training, and ensuring a smooth transition into the workplace.

3. **Performance Management:** HR plays a role in establishing performance expectations, setting goals, and implementing performance appraisal systems. They provide guidance and support to managers in conducting performance evaluations and addressing performance issues.
4. **Training and Development:** HR is responsible for identifying training needs, designing and delivering training programs, and facilitating the development of employees' skills and competencies. This can include both technical training and professional development initiatives.
5. **Compensation and Benefits:** HR manages the organization's compensation and benefits programs, including salary administration, incentives, bonuses, employee benefits, and retirement plans. They ensure compliance with relevant labor laws and market competitiveness.
6. **Employee Relations:** HR handles employee relations matters and works to maintain a positive work environment. They address employee concerns, manage conflicts, and foster effective communication between employees and management.
7. **Employee Engagement and Retention:** HR focuses on enhancing employee engagement, job satisfaction, and retention. This involves implementing employee recognition programs, conducting employee surveys, and developing initiatives to promote a positive and inclusive workplace culture.
8. **Regulatory Compliance:** HR ensures compliance with employment laws and regulations, including equal employment opportunity, labor standards, workplace safety, and privacy laws. They stay updated on legal changes and provide guidance to the organization to maintain compliance.

A typical internal audit of Human Resource Management related processes shall thus include a review of following topics:

- a. **Hire to Retire process:** The "hire to retire" process, also known as "end-to-end employee lifecycle management," refers to the comprehensive process of managing an employee's journey within an organization, starting from their initial recruitment, or hiring to their eventual retirement or separation from the company. It encompasses all the stages and activities associated with an employee's tenure within the organization.

In the hiring process, several aspects need to be checked to ensure effective and successful recruitment. Here are some key aspects to consider when evaluating the hiring process:

- a. **Job Requirements and Description:** Review the job requirements and description to ensure they are accurate, clear, and aligned with the organization's needs. Verify that the qualifications, skills, and experience mentioned are essential for the role. Checking of manpower budgeting process is an important part of this process.
- b. **Sourcing Channels:** Assess the effectiveness of sourcing channels used to attract candidates. Consider the utilization of job boards, social media platforms, employee referrals, and professional networks. Evaluate the reach, quality, and diversity of candidates obtained through each channel.
- c. **Screening and Selection Criteria:** Evaluate the screening and selection criteria used to shortlist candidates. Ensure that the criteria are objective, relevant, and fair. Assess if the screening methods, such as resume screening and initial interviews, effectively assess candidates' suitability for the role.
- d. **Interview Process:** Evaluate the interview process to determine its effectiveness in assessing candidates' qualifications and fit for the organization. Check if structured interviews, behavioral questions, and skills assessments are used appropriately. Assess the consistency of the interview process across candidates.

- e. *Candidate Experience:* Assess the candidate's experience throughout the hiring process. Consider factors such as clear communication, prompt responses, respectful treatment, and a well-organized interview process. Evaluate if the organization provides a positive and professional impression to candidates.
- f. *Candidate Evaluation and Selection:* Review the methods used to evaluate and compare candidates. Assess if the evaluation process is consistent and objective. Verify that decisions are based on relevant criteria and align with the organization's needs.
- g. *Compliance:* Ensure compliance with relevant employment laws and regulations. Check if the hiring process adheres to equal employment opportunity guidelines, non-discrimination practices, and any other applicable legal requirements. This includes checking compliance with contracts with Registered Trade Unions etc.
- h. *Background and Reference Checks:* Assess if background checks and reference checks are conducted appropriately and consistently. Verify that the information obtained from these checks is used to make informed hiring decisions.
- i. *Timeliness and Efficiency:* Evaluate the timeliness and efficiency of the hiring process. Check if there are unnecessary delays, bottlenecks, or inefficiencies that may result in losing qualified candidates.
- j. *Feedback:* Lastly, consider whether there is a mechanism in place to gather feedback, track hiring metrics, and continuously improve the hiring process. Assess if lessons learned from previous hires are incorporated into process enhancements.

When conducting an internal audit of the separation process within an organization, several aspects should be checked to ensure compliance, efficiency, and effectiveness. Here are some key aspects to consider:

- a. *Policy and Procedures:* Review the organization's separation policies and procedures to ensure they are well-defined, documented, and up to date. Verify that the policies address various types of separations, such as resignations, retirements, terminations, and layoffs.
- b. *Compliance with Employment Laws:* Ensure that the separation process complies with applicable employment laws and regulations. Check if all legal requirements, such as notice periods, severance pay, and salary payments, are followed correctly.
- c. *Documentation and Recordkeeping:* Evaluate documentation related to separations. Check if employee separation files are maintained accurately and contain all the necessary documentation, including resignation letters, termination notices, exit interview reports, and relevant legal forms.
- d. *Exit Interviews:* Assess the effectiveness and consistency of the exit interview process. Review the questions asked during exit interviews to ensure they cover relevant topics, such as reasons for separation, feedback on the organization, and suggestions for improvement.
- e. *Benefits and Entitlements:* Verify that employees who are separating receive their entitled benefits and compensations in accordance with company policies and legal requirements. This includes benefits such as unused vacation or sick leave, retirement plans, health insurance, and any other applicable benefits.
- f. *Access Control and Data Security:* Ensure that appropriate access controls and data security measures are in place to safeguard confidential information during the separation process. Verify that employee access to systems, databases, and physical premises is promptly revoked or adjusted according to the separation status.

- g. Return of Company Property:* Evaluate the process for the return of company property, such as laptops, mobile devices, access cards, and other assets. Check if there are clear guidelines and procedures in place to ensure the timely and complete return of company property.
- h. Knowledge Transfer and Succession Planning:* Assess if the separation process includes mechanisms for knowledge transfer and succession planning. Determine if departing employees are required to share critical information and provide assistance in transitioning their responsibilities to other team members.
- i. Communication and Documentation to Relevant Stakeholders:* Review the communication process and documentation provided to relevant stakeholders, such as HR, payroll, IT, and managers. Check if clear and timely communication is maintained to ensure a smooth separation process.
- j. Process Efficiency and Continuous Improvement:* Evaluate the efficiency of the separation process, including timelines, workflow, and coordination between departments involved. Identify opportunities for process improvements and assess if feedback from previous separations is considered to enhance the process.

By assessing these aspects, an internal auditor can help identify any gaps or areas for improvement in the separation process. It protects the organization's assets and sensitive information and promotes a positive experience for both separating employees and the organization as a whole.

Payroll refers to the process of calculating and disbursing payments to employees for their work, including wages, salaries, bonuses, and deductions. It is an essential function within an organization's human resources and finance departments. Payroll involves managing and processing financial records related to employee compensation, taxes, benefits, and other deductions. The primary purpose of payroll is to ensure accurate and timely payment to employees in compliance with employment agreements, labor laws, and tax regulations. The payroll process typically includes the following key steps:

- a. Time / Attendance Tracking:* Payroll begins with tracking employees' time and/or attendance, which may be recorded through time clocks, electronic systems, or manual timesheets. This data is used to calculate the hours worked and determine employee earnings.
- b. Gross Salary Calculation:* Salary is calculated based on the employee's regular salary, taking into account factors such as overtime, shift differentials, and bonuses etc. Other elements, such as commissions or performance-based incentives, may also contribute to the salary calculation.
- c. Deductions:* Various deductions are subtracted from the gross salary to determine the net pay or take-home pay. These deductions may include income taxes, social security contributions such as provident fund, insurance premiums, and other voluntary or mandatory deductions.
- d. Tax Compliance:* Payroll departments ensure compliance with tax regulations by accurately calculating and deducting the appropriate amount of taxes from employee earnings. They also provide the necessary documentation, such as Form 16, to employees and government agencies.
- e. Funds Administration:* Payroll may be responsible for administering employee funds, such as Provident Fund Trusts, Benevolent Funds etc. These aspects must be reviewed by the internal auditor at length in compliance with the relevant regulations and bye laws.
- f. Payroll Processing:* Once all calculations and deductions are made, payroll data is processed to generate individual employee paychecks or direct deposits. Payroll departments maintain accurate records of employee earnings, deductions, and tax information. They also generate reports for internal and external purposes, such as financial statements, tax filings, and regulatory compliance.

- g. *Compliance and Audit:* Payroll processes are subject to various laws and regulations, including labor laws, tax laws, and employment regulations.

Timeliness and transparency of the payroll process are key to employee satisfaction. An internal auditor must review the process from these aspects as well. Further, *Employee Master management, Confidentiality of information, Variable pay or bonus calculations etc.* are also very important aspects to be audited by an internal auditor.

INTERNAL AUDIT OF SALES FUNCTIONS

In sales, every day is a new opportunity to contact leads, close deals, and move closer to your target. However, it's also important to step back regularly and conduct sales audits to ensure that the team is performing at a high level that meets or exceeds expectations.

A sales audit also referred to as a sales process audit is a detailed analysis of a company's sales process. This entails reviewing everything from staff, software, to strategy. Audits identify gaps and opportunities for your sales team to improve on.

The following areas need to be looked upon:

1. Auditing Sales skills of the staff:

- Assessing verbal and communicative skills (how politely, clearly and effectively salespeople speak with prospects and customers);
- Assessing problem-solving skills (how quickly and deeply salespeople can grasp a customer's problem and deliver appropriate solution);
- Assessing planning and organizational skills (how effectively salespeople spend their working time in a long- and short-term range);
- Assessing knowledge of industry and market (how well salespeople understand the latest trends, current market and industry situation, competition, etc);
- Assessing knowledge of the products and services being sold (how well the salespersons know the products or services they sell – their features, benefits, purposes, technologies used, etc);
- Assessing knowledge of current promotional and sales offers (how well the salesperson knows currently available arsenal of exclusive propositions and promotional sales offers);
- Assessing knowledge of the target prospects and customers (how well salesmen understand their customers and know their target audience);
- Assessing knowledge of the existing long-term customers and their respected contribution into the company's success;
- Assessing knowledge of the company's policies, ideology and methods applied to sell goods or services.

2. Auditing Sales documents:

- All the documents involved into your Sales process (whether electronic or paper documents) should be accurately composed, filled with sufficient information, properly filed and used, and then archived. Also this refers to a way of how well the sales data is handled in the company;

The term "well" in this section means not only common understanding of a document accuracy, but also compliance with accepted corporate/industrial procedures for managing Sales docs.

- Assessing how well the sales prospects are registered and qualified by salespeople (there needs to be a special form and procedure for registering new prospects);
- Assessing how well the existing customers are registered and qualified (their personal/corporate details and all other customer relations matters should be properly inputted into CRM software, or recorded in its paper-based analogue);
- Assessing how well the following documents are composed and registered:
 - Presales docs (Inquiries, Quotations, etc);
 - Sales Orders;
 - Outline agreements (Contracts on Quantity, Maintenance, Scheduling, etc);
 - Complaints;
- Assessing how well the Shipping data is stored, maintained and analyzed;
- Assessing how well the Billing data is stored, maintained and analyzed;
- Assessing how well the current contracts and credits are maintained and serviced.

3. Auditing Sales approaches:

- Assessing the Sales policies, procedures, methods and statistics on:
 - Customer Retention;
 - Customer Follow-Ups;
 - Customer Defections;
 - Customer Satisfaction and Dissatisfaction;
 - Efficiency of Customer Claims Addressing;
- Assessing policies and strategies.

INTERNAL AUDIT OF MARKETING FUNCTIONS

An Internal audit of marketing activities involves a comprehensive examination and analysis of marketing activities, goals and objectives. The internal audit of marketing activities / department helps to create an image of the company's mission statement, objectives, corporate culture, profitability, efficiency etc. A marketing strategy audit is vital, as it makes sure the marketing is in line with corporate goals. Under the marketing strategy audit, the auditor evaluates performance by evaluating the marketing goals and objectives, in relation to the company mission and the strategy for the organization.

An internal auditor should look at not only internal factors such as the efficiency of the marketing department and their marketing plan, but also external factors including a company's customers, competition and overall marketplace.

The components of comprehensive and systematic marketing audit are the following:

Environmental Study: The environmental study enables to focus on customers and the competition. What are customers' demographics and buying habits? What are competitors doing? What is the overall condition of company's market?

Strategic Study: It involves the examining of current marketing plan and strategies and evaluate about how well or poorly they are performing. Are the marketing objectives set the appropriate ones for business?

Organizational Study: The organizational study is an internal look at the resources available in various department such as finances, time, production, labor, equipment and more. It also involves a look at the marketing team, revenue, effectiveness of the marketing plan, products, pricing and distribution channels etc.

Key Aspects of Internal Audit of Marketing

- Formal written Business plan
- Market analyzed
- Target market segment identified
- Company strengths, weaknesses, opportunities and potential threats have been analyzed (SWOT Analysis)
- Prospects and customers profiled (Both actual and Target)
- Customer needs and wants analyzed
- Customer purchasing “influencers” identified
- Competitive information gathered and compared
- Terms and conditions & Pricing Strategy
- Delivery and after sales service policy
- Product is properly positioned in the market
- Product life cycle analyzed
- Cost and pricing objectives established
- Unit cost(s) analyzed
- Promotional tools identified (discounts, allowances, freight, etc.)
- Specific business environment and economic risks determined
- Plan and budget established for marketing communications
- Sales Promotion Strategy scrutinized
- Advertising, public relations & Brand Building
- Customer service policies/plan established
- Periodically evaluated to meet customer needs
- Sales Plan
- Sales Management strategies and objectives
- Sales goal(s) and action plan
- Sales channel(s) and distribution methods/ pricing evaluated
- Competitive comparison matrix
- Strategy for penetrating new markets.

Internal Audit Checklist for Marketing (Control Parameters)

- i. Whether the record of Sales Orders (SO) is maintained for all orders received from the customers and cross verification of the orders received vis-à-vis orders entered in the System is done.

- ii. Whether the check list of customer order is maintained properly for all customers.
- iii. Appropriate approval for dispatch of material to customers having over-due outstanding in excess of monetary credit limit.
- iv. Whether the cancelled orders and orders not processed has been document along with the reasons thereof.
- v. Time lag in receipt of order vis-à-vis actual dispatch of goods analyzed and reasons for delays identified and corrective action initiated.
- vi. The monitoring of pending order.
- vii. Access to set and modify the blacklisting option of customers for executing sales restricted to authorized persons as per segregation of duties.
- viii. Access to generated sales invoice restricted to authorized persons.
- ix. Periodic MIS for sales return prepared and analyzed and corrective action initiated.
- x. Whether the analysis of Customer meets, Customer Satisfaction Surveys (CSS) are periodically initiated to develop market intelligence and obtain customer feedback on quality, delivery and pricing issues.

IT SYSTEM AUDIT

An audit of information technology is also known as an audit of info systems. It refers to an examination of controls of management within an infrastructure of information and technology. In other words, it is the study and assessment of the IT infrastructure, strategies and activities of an enterprise.

An IT audit is a comprehensive dive into an organization's IT infrastructure and policies. While enhancing cybersecurity for greater data protection tends to be the main goal of IT audits, there are plenty of other things they can accomplish, including (but not limited to):

- Ensuring regulatory compliance
- Improving network performance
- Evaluating disaster recovery plans

Areas to be covered under IT System Audit

1) System security

- a. Antivirus software
- b. Network firewall
- c. Security policies and employee training
- d. Intrusion alerts

2) Access controls

- a. User account management
- b. Passwords
- c. Role-based access controls

3) Data backup and disaster recovery

- a. Routine testing of backups

- b. Document disposal
- c. Disaster recovery plan
- d. Recovery time objective (RTO) for key IT assets

4) Performance monitoring

- a. Network performance
- b. Outages
- c. Systems development
- d. Testing and implementation

5) Regulatory compliance

- a. Licensing
- b. Standards and regulations

Internal Audit Checklist for IT (Control Parameters)

1. Do firewalls exist on all Internet or Extranet connections?
2. Are firewalls used internally to separate networks of different security levels?
3. Is there a formal procedure for approving all external connections?
4. Is your firewall and router configured to conform with documented security standards?
5. Is your firewall's CPU utilization monitored at least every 15 minutes?
6. Are available security patches implemented within 30 days?
7. Are security patches tested before they are deployed to production systems?
8. Do all system changes go through a formal change control process?
9. Does your cryptographic solution conform to applicable international and national standards, as well as all legal and regulatory controls?
10. Are only crypto devices used that meet the approval standards and policies of your organization?
11. Are there documented processes and procedures in place for encryption keys?
12. Is access to keys restricted to the fewest number of custodians necessary?
13. Is a quarterly inventory audit performed to verify if any stored cardholder information exceeds your retention requirements?
14. Are all passwords on network devices and systems encrypted?
15. Is telnet or Rlogin used for remote system administration?
16. Is externally accessible account data transmitted in unencrypted format?
17. Is confidential account information transmitted via unencrypted email format?
18. Is strong cryptography and appropriate key controls in place to safeguard data during transmission?
19. Are modems connected to the internal systems or DMZ systems?
20. Is anti-virus software installed on all servers and workstations?

21. Have anti-virus signature files been updated to the latest signature file?
22. Is account information access on a need to know basis only?
23. Is firewall administration limited to only the network security administration staff?
24. Is at least one of the following methods used to authenticate all non-consumer users when accessing cardholder information: unique user name and password? token devices (i.e., Secure ID, certificates, or public key)? biometrics?
25. Are non-consumer users required to change their password every 60 days?
26. Are non-consumer user accounts locked within 6 invalid login attempts?
27. Are password protected screen savers or terminal locks used on all critical systems?
28. Are group passwords allowed on critical systems?
29. Are passwords required to contain both numeric and alphabetic characters?
30. Are individuals allowed to submit a new password that is the same as a previous password?
31. Are all internal and external dormant accounts removed?
32. Are applications run on default installations of operating systems?
33. Is more than one application running as the primary function of a server at any given time?
34. Are all unnecessary services disabled on a server?
35. Do you perform penetration testing on your network and applications at least once a year and after any significant modifications?
36. Is access to all audit trails logged on all critical systems?
37. Are actions related to encryption key management logged on all servers that utilize the keys?
38. Do logs include date and time stamp on all critical systems?
39. 4Are audit trails on all critical systems secured in a way that they cannot be tampered with?
40. Do you review audit logs at least once a week on critical systems?
41. Are audit logs retained for at least six months on all critical systems?
42. Are vulnerability assessments performed on the internal and external network on a monthly basis and after updates and/or upgrades to systems?
43. Is there a file integrity monitoring system in place to alert personnel of unauthorized modifications to critical systems?
44. Are security alerts from the intrusion detection sensor monitored 24 hours a day, 7 days a week?
45. Do you have Network IDS on perimeter related systems?
46. Are the latest intrusion detection system (IDS) signatures installed on all IDS sensors?
47. Is staff provided with adequate training on operational business and recovery plan execution responsibilities?
48. Are the disaster recovery plan (DRP) and the business contingency plan (BCP) tested annually?
49. Are security roles and responsibilities formally defined?

50. Are critical data backed up on a daily basis?
51. Are backup tapes stored in a location that does not require authorized access?
52. Are information security policies documented, kept current and disseminated to all employees, vendors, contractors and partners?
53. Is there a security awareness and training program in place?
54. Are pertinent security alerts monitored, analyzed and distributed to appropriate personnel?
55. Is a security incident response plan formally documented?
56. Are employees required to sign an agreement verifying they have read and understood the policies and procedures?
57. Is access to the data center restricted and closely monitored?
58. Are all paper and electronic media — e.g. computer, networking, and communications hardware, telecommunications lines, etc. — containing cardholder information located in a physically secure environment?
59. Have all discarded media been erased or destroyed using a formal procedure that ensures the complete deletion of all sensitive data?
60. Do you maintain strict control over the internal and external distribution of any paper or electronic media containing cardholder data?
61. Are visitors, including vendors, permitted to enter data centers or access sensitive systems without an escort?
62. Are visitors asked to sign out and turn in their badge or tag before leaving the building?
63. Is a visitor log retained for at least three months to retain a log of physical activity?
64. Are all media devices properly inventoried and securely stored?

CASE STUDY

A leading consumer goods industry in India, with a turnover of more than Rs.250 crores with activities spread across the country covering both the urban and rural markets, has been facing a downward trend in its sales along with rising marketing costs. Top management has been grappling with a changing consumer preference trend guided by the entry of a strong MNC competitor. Some major promoters and key marketing personnel have changed loyalties and have shifted to competition. The Board has been concerned about this disturbing trend and has been reviewing the strategies being adopted by the company to adapt to these changes and retain the earlier good performance.

Audit Committee meeting held along with this Board Meeting focussed on this important business issue. The Audit Committee members felt that although a reasonable assurance is being provided by the internal audit team on adequacy of controls, a consulting focus needs to be adopted and some suggestions on improving the marketing efforts is required from the team. If required, outside help from Company Secretaries could be taken, based on their experience in marketing area.

Methodology: The Chief Audit Executive (CAE) had been conducting marketing audits but primarily with a financial focus. He felt the need to have the knowledge expertise of an MBA —Marketing who could provide a greater insight into market performance. He, therefore, approached an internal audit organisation (Chartered Secretaries firm) who had the requisite expertise. However, he felt that the expertise should

also be built into the in-house internal audit team, so that as and when required, a reasonable internal audit project could be undertaken by the in-house team. The CAE insisted the presence of a member of the internal audit team as the co-ordinator who shall be attached to the outside team of internal auditors.

The starting point was a compilation of the sales performance data for the company which was arranged — zone wise, district-wise, distributor wise, sales-executive wise, product wise.

From secondary research — annual reports, visit to ROC, the published data on competitors was also obtained and compiled. Major variations were analysed. Salesforce composition was studied and their average age profile and experience profile in the organisation and in other organisations prior to joining the organisation, was also gathered.

The age profile of the distributor's association and their geographical spread was analysed, identifying the distances and other logistic issues. Channel management system including appointment, credit management, order management and administration was gathered and flow-charted. The earlier audit reports in this area were obtained. Market survey reports on the performance was also gathered. Channel monitoring MIS was obtained. On evaluation of all the data gathered, a detailed audit programme of dealer visits in select geographic regions, salesforce interviews, physical verifications, stock level management at the channel partners end, secondary sales analysis, analysis of visit reports, collection processes, scheme (for incentives and discounts) management was prepared.

The questionnaires for the interview were drafted and forwarded to all concerned and dates of interviews intimated. The logistics of travel and teams were arranged and communicated to all concerned. Gist of major observations are given below:

- Inadequate sales men in several regions though competitors had good market share.
- There was direct co-relation between the falling market share of the company's products in particular regions with low number of sales personnel for the same regions. There was also direct co-relation between the falling market share in particular regions and high turnover of sales personnel for the same regions.
- High turnover of field sales personnel - This was due to the falling market share and attention not being paid by company to improving communications with salesforce on a regular basis.
- Absence of proper monitoring of laid down policies by the field sales personnel. This was mainly due to improper monitoring of MIS sent by field sales personnel and absence of proper feedback on the same. This had resulted in field sales personnel getting lax and filing wrong/improper forms.
- Field sales personnel were carrying on some other part-time work rather than working full-time on company's work. This was a result of improper monitoring by Head of Marketing and decentralised Area Managers at various regions.
- Salesmen not making adequate calls - Call analysis reports were filled in more as a routine rather than accurate data being sent to the company. On studying the call reports, it was found that many of them were wrongly filled and in some of them even the totals did not tally from month to month.
- Salesmen fudging visit reports and travel reports. Visit reports were filed wrongly. This was brought out in surveys with dealers and retailers who gave in writing to the visiting internal audit team that there were no visits to them in last six months, though the same was being reported in the visit reports of sales personnel.

- Distributors not stocking adequate levels. Distributors were not giving accurate sales figures in their respective statements submitted to the company. Secondary sales were shown less which resulted in company having data that the distributors were saddled with stocks whereas, the actual situation was that distributors had sold the stocks and had also collected the amounts from wholesalers/retailers. The distributors went on pressurizing the company for more incentives/discounts, informing about their stock positions being high, though the actual situation was much different.
- Inadequate coverage of the retail market - Since in many regions there were demoralized sales staff. They did not undertake their Journey Cycle Plan (routine cycle of the market) with the distributor marketing personnel regularly and left much of the same to the distributor. Many retailers were thus not serviced regularly and retailers switched to the competitor products.
- Schemes not reaching the end users - Distributors identified. Some schemes were introduced, like free oil sachets against the products, which never reached the end customers and were pilfered by the distributors who sold these sachets in cash. This was possible as the schemes were not announced properly in every region and also the main product on which the free oil sachet slogan was written could be erased out, as it was not printed but written later by sketch pens.
- Collection in cash not registered as receipts - Sales personnel made cash collections from distributors who then did not make payments to the company. On reconciliations with distributors, they produced letters from sales personnel that they had collected the money. These sales personnel had already left the company, and it was now difficult to pursue the same with sales personnel.

Recommendations: Improve penetration — introduce stronger recruitment processes, training programmes, improving policy implementation including a very strong analysis of all information received and immediate feedback for any corrective action, monitoring visit and travel reports, introducing stock levels for distributors and stockists with proper MIS to be received from the distributors / stockists and surprise verification of the MIS with actual situation, introduction of the MIS for secondary sales monitoring, scheme audits on a regular basis by internal audit, policy of not accepting cash, Palm-tops (hand held computers) for registering orders and receipts with customer acknowledgments noted in the Palm-tops. Distributors were informed that no cash transactions were permitted by the company, and they would be giving the sales personnel money at their own risk.

LESSON ROUND-UP

- In this lesson we have discussed and learn about nuances of conducting internal audit of some specific functions or processes which are usually part of most of the organisations. Such specific function includes:
 - a. Internal Audit of Purchasing Activity,
 - b. Internal Audit of Inventory Management,
 - c. Internal Audit of Production and Operations,
 - d. Internal Audit of Finance and Accounts,
 - e. Internal Audit of Human Resources,
 - f. Internal Audit of Sales,
 - g. Internal Audit of Marketing,
 - h. IT System Audit.

- The term “purchase” refers to the act of acquiring or obtaining something by paying money or exchanging something of value for it. In other words, it is a transaction where a person or organization buys goods or services in exchange for payment. The term “purchase” can be used in various contexts, such as personal shopping, business procurement, or even in the acquisition of assets or property.
- The term “Inventory” refers to the stock of goods or materials that a business or organization has on hand for sale or production. It can include finished products, raw materials, work-in-progress items, and other items that are used in the production or distribution process.
- Production refers to the process of creating or manufacturing goods or services that can be sold in the market. It involves transforming raw materials, components, or other inputs into finished products or services that meet the needs of customers. The production process typically involves a series of steps, such as designing the product, sourcing raw materials or components, assembling or processing the inputs, quality control, and packaging or labelling the finished product.
- The term “Finance” refers to the management and allocation of money, assets, investments, and liabilities. It involves management of various financial systems, such as banking, credit, investments, and the distribution of resources. Finance encompasses a broad range of activities, including budgeting, financial planning, investing, and the evaluation of financial decisions with an objective of optimizing the allocation of resources and achieving financial goals.
- Human resources (HR) refer to the department within an organization that is responsible for managing the human capital and workforce. It encompasses the practices, policies, and processes related to the recruitment, selection, training, development, compensation, retention, and overall management of employees.
- An Internal audit of marketing activities involves a comprehensive examination and analysis of marketing activities, goals and objectives. Under the marketing strategy audit, the auditor evaluates performance by evaluating the marketing goals and objectives, in relation to the company mission and the strategy for the organization.
- An audit of information technology is also known as an audit of info systems. It refers to an examination of controls of management within an infrastructure of information and technology. In other words, it is the study and assessment of the IT infrastructure, strategies and activities of an enterprise.

TEST YOURSELF

(These are meant for recapitulation only. Answers to these questions are not to be submitted for evaluation)

1. One of the discounts offered by the store is in the form of payback cards where reward points are accumulated and the customer can redeem the same on subsequent purchase. The management are of the opinion that the points redeemed are to be treated as trade discount. The internal auditors are doubtful on the matter. What should be the next course of action of the internal auditor?
2. Comments on ‘the cash-book showed a huge cash balance on hand consistently throughout the year’.
3. Comment on the responsibilities for properly determining the quantity and value of inventories rests with the management of the entity.

4. How would an internal auditor proceed to obtain sufficient appropriate audit evidence regarding the existence and condition of inventory?
5. During the course of Internal Audit, it has been observed that No depreciation has been charged for the year in respect of spare bus purchased during the year and kept ready by the company for use as a stand-by on the ground that it was not used during the year. Comment?
6. During the course of Internal Audit, it has been observed that a sum of Rs. 1000000 is received from an insurance company in respect of claim for loss of goods in transit costing Rs. 800000. The amount is credited to the Purchases account. Comment.
7. During the course of Internal Audit, it has been observed that a loss of Rs. 200000 on account of embezzlement of cash was suffered by the company and it was debited to salary account. Comment.
8. The management of ABC Ltd., a pharmaceutical company, while valuing its finished inventory at the yearend wants to include interest on bank overdraft as an element of cost, for the reason that overdraft has been taken specifically for the purpose of financing current assets like inventory and for meeting day to day working expenses. Comment.
9. As an internal auditor, what are the major points you would see while verify / vouch the following:
 - a) Loss of inventory by theft
 - b) Inventory lying with sub-contractor for processing
 - c) Sale of Scraps
 - d) Expenditure for advertisement in newspaper.
 - e) Goods sold on Approval basis.
10. As an internal auditor, what are the major points you would see while verify / vouch the following:
 - a) Trade receivable
 - b) Advances to suppliers
 - c) Borrowing from Banks
 - d) Purchase of Fixed Assets
 - e) Goods lying with third party.

LIST OF FURTHER READINGS

- **Handbook on Internal Auditing**

Author : CA Kamal Garg

Publishers : Bharat's

- **Compendium of Standards on Internal Audit**

Author: ICAI

Year of Publication: 2022

