# INTERNAL CONTROL

## Internal Control - Meaning

The system of Internal Control may be defined **as the organizational plan and all the methods and procedures adopted by the management** of an entity to assist in achieving.

- Orderly and efficient conduct of its business.
- Adherence to management policies
- Safeguard of assets
- Prevention and detection of frauds and errors
- Accuracy and completeness of accounting records.

## Objectives of Internal Control

- To ensure that transactions are executed in accordance with management's general or specific authorization.
- To ensure that all transactions are promptly recorded in the correct amount in the appropriate accounts.
- To ensure that assets are safeguarded from unauthorized access, use, disposition.
- Prevention and detection of frauds and errors.
- Elimination of conflicting responsibilities.
- Preparation of periodical accounting and financial report.
- Minimizing loss and wastage
- Encouraging employees to do good work with full involvement.
- Securing documentation at each stage.

## Inherent Limitations of Internal Controls

- Benefits expected from a control may not commensurate with cost of implementation.
- Manipulations by the management.
- Possibility that a person responsible could abuse the authority.
- Possibility that procedures may become inadequate due to changed in conditions and compliance with procedures may become inadequate due to changes in conditions and compliance with procedures may deteriorate.

- Most internal controls do not tend to be directed at transactions of unusual nature.
- The potential for human error such as due to carelessness, misunderstanding of instructions.

**Role of Management with regard to Internal Control**

- The Management is responsible for maintaining an adequate accounting system incorporating various internal controls to the extent appropriate to the size and nature of the business.
- The system installed should be reviewed by the management.
- Management should also install an internal Audit system as an independent function to check, amongst other things, the actual operation of the Internal control System and should report any deviations.

**Accounting System**

The auditor should obtain an understanding of the accounting system sufficient to identify and understand:-

- Major classes of transactions
- Initiation of the transactions
- Relevant accounting records, supporting documents etc.
- The accounting and financial reporting process.



**Review of Internal Control by the Auditor**

To facilitate the accumulation of the information necessary for the proper review and evaluation of the internal auditor should use any one of the following:-

- Narrative record: - Actual testing and observation is necessary before a narrative record can be developed. Narrative record is a complete description of the system as found by the auditor in operation.
- Check list: - A check list is a series of instructions and questions which the auditor should follow and answer.
- Questionnaire: - Internal control questionnaire is a set of questions designed to provide a thorough view of the state of the internal control in an organization. This is most widely used for collecting information about the existence, operation and efficiency of internal control in an organization.

- Flow Chart
  - It is a graphic presentation of each part of the Company's system of Internal Control.
  - A flow chart is considered to be most concise way of recording the auditor's review of the system.
  - It gives bird's eye view of the system and the flow of transactions and integration and in documentation, can be easily stopped and improvements can be suggested.

**Assessment of Detection Risk**

Detection Risk relates directly to the effectiveness of audit procedures. For the purpose of restricting detection risk to an acceptable level, the auditor should consider:

- Assessed level of inherent risk and control risk: - Inherent and Control risk are related to detection risk inversely. Higher the level of assessed Inherent and Control risk, less Detection risk auditor will accept.
- NTE of substantive procedures: - The NTE of substantive testing would depend upon the assessed level of Detection risk. Even in the cases when where inherent and control risk are very low, the auditor should perform some substantive procedures.



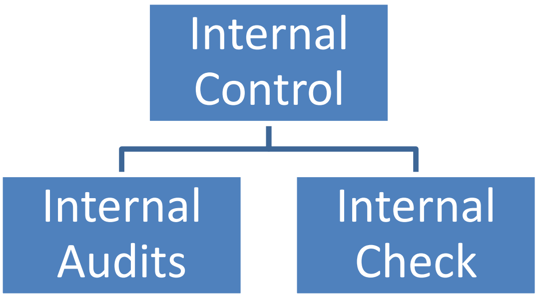
**Control Risk**

The preliminary assessment of Control Risk is the process of evaluating the likely effectiveness of an entity's accounting and internal control system's in preventing or detecting and correcting material misstatements.

**Communication of weakness in Internal Control**

The auditor should make management aware at appropriate level of responsibility of material weakness in the design or operation of accounting and internal control system, which has come to his attention. This communication should be in writing through a letter of weakness or management letter.

Internal Control has two aspects:




**Internal Audit**

From being a mere cross check over the accounts of the entity, internal audit has, over the years, moved a long way forward to being a indispensable control tool in the hands of the management for effectively and efficiently running the affairs of the entity. Internal audit is playing a significant and critical role in evaluating the adequacy of internal controls and assessing the extent of compliance with the applicable laws and regulations, policies and procedures and suggesting ways to reduce the costs and promote efficiency.

Internal audit is an independent management function, which involves a continuous and critical appraisal of the functioning of an entity with a view to suggest improvements thereto and add value to and strengthen the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system.

Internal Audit is an Independent appraisal activity within an organisation, for the review of operations as a service to the organisation. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls.

**Evolution of Internal Audit**

Internal audit is **a management function**, thus, it has the high-level objective of serving management's needs *through constructive recommendations* in areas such as, internal control, risk, utilisation of resources, compliance with laws, management information system, etc.

Internal audit's role should be a *dynamic one*, continually changing to meet the needs of the organisation. There is often a need to change audit plans as circumstances warrant. These changes may include coverage of new areas, assistance to management in solving problems, and the development of new internal audit techniques.

***Scope***

*(i) Review of accounting system and related internal controls*

*(ii) Examination for management of financial and operating information*

*(iii) Examination of the economy, efficiency and effectiveness of operations including non-financial controls of an organisation*

*(iv) Physical examination and verification*

**Internal Audit - Basic Principles**

Like any other profession, the profession of internal audit also is based on certain fundamental principles, which constitutes the life and blood of this profession.

**Integrity, Objectivity and Independence**

The internal auditor should be straightforward, honest and sincere in his approach to his professional work. He must be fair and must not allow prejudice or bias to override his objectivity.

**Confidentiality**

The internal auditor, in the course of his work, invariably comes across information that is confidential and/ or critical to the working of the entity. The internal auditor should respect the confidentiality of such information and should not disclose the same to a third party without the specific authority or unless there is a legal or professional duty to do so.

**Due Professional Care, Skills and Competence**

The internal auditor should exercise due professional care, competence and diligence expected of him while carrying out the internal audit. Due professional care signifies that the internal auditor exercises reasonable care in carrying out the work, relative complexity and materiality of the matters subject to internal audit, assessment of risk management, control and governance processes and cost benefit analysis.

A member of the ICAI, carrying out an internal audit activity, would apart from other requirements, additionally be governed by:

(i) the requirements of the Chartered Accountants Act, 1949;

(ii) the Code of Ethics issued by the Institute of Chartered Accountants of India; and

(iii) other relevant pronouncements of the ICAI.

**Internal Check**

Internal check has been defined by the Institute of Chartered Accountants in England and Wales,

- as the checks on day-to-day transactions;
- which operate continuously as part of the routine system;
- whereby the work of one person is proved independently or complimentary to the work of another,
- the object being the prevention or earlier detection of error or fraud".

*General considerations in framing a system of Internal Check*:

(i) No single person should have an independent control over any important aspect.

(ii) The duties of members of the staff should be changed from time to time.

(iii) Persons having physical custody of assets must not be permitted to have access to the books.

(iv) Budgetary control would enable the management to review from time to time the progress of trading activities.

(v) The financial and administrative powers should be distributed very judiciously.

(vi) Procedures should be laid down for periodical verification and testing of different sections of accounting records to ensure that they are accurate.

Regards,

CA Jatin Bansal
Professional Careers Academy
# 1639, First Floor, Sector 40 B,
Chandigarh – 160036
pcaclasses@gmail.com
Mobile: 9814622848, 9814098480

## About PCA

*Professional Careers Academy (popularly known as CA Jatin Bansal Classes) is best among the various CA/ CS Coaching institutes in the Country. We are the only coaching institute in the Tricity (Chandigarh-Panchkula-Mohali) to have classes for all the subjects of CA/ CS* ***all levels*** *under one roof by a team of highly professionally qualified and experienced faculties. Our aim is to provide quality education and guidance to the students.*

*We have established a distinctive Teaching Framework and Evaluative Technique. That inter-alia includes evaluation of students by regular tests. This makes our classroom products very efficient as we know forward of time the level of input required for unique scholars. We are privileged to inform that our students are among the highest scorer of the Institute of Chartered Accountants of India and the Institute of Company Secretaries of India. We proudly say that we have taught more than 10,000 students at various levels (CA, CS, CMA, M.B.A).*

Our motto " ***Results speak louder than words***".

**Visit PCA at:** [http://www.facebook.com/pages/Professional-Careers-Academy/455495514488643](http://www.facebook.com/pages/Professional-Careers-Academy/455495514488643)

# Courses offered by Professional Careers Academy

| | | |
|---|---|---|
| CA | CPT | All subjects |
| | IPCC<br>Group I | 1. Accounts<br>2. Cost & Financial Management<br>3. Taxation<br>4. Law, Ethics & Communication |
| | IPCC<br>Group II | 1. Advanced Accounts<br>2. Auditing & Assurance<br>3. Information Technology & Strategic Management |
| | CA Final | 1. Advanced Auditing & Professional Ethics<br>2. Corporate & Allied Laws<br>3. Information System Control & Audit (ISCA) |
| CS | Foundation | All subjects |
| | Executive<br>Group – I | 1. Company Law<br>2. Cost & Management Accounting<br>3. Economic & Commercial Laws<br>4. Tax Laws & Practice |
| | Executive<br>Group – II | 1. Company Accounts & Auditing Practices<br>2. Capital markets & Securities Laws<br>3. Industrial, Labour & General Laws. |
| | Professional<br>Module – I | 1. Advanced Company Law & Practice<br>2. Secretarial Audit, Compliance, Management & Due Diligence.<br>3. Corporate Restructuring, Valuation & Insolvency. |
| | Professional<br>Module – II | 1. Information Technology & Systems Audit<br>2. Financial, Treasury & Forex Management<br>3. Ethics, Governance & Sustainability. |
| | Professional<br>Module – III | 1. Advanced Tax Laws & Practice<br>2. Drafting, Appearances & Pleadings |
| B.Com | B.Com. – I, II, III | 1. Financial Accounting<br>2. Business Math & Statistics<br>3. Indirect Tax Laws<br>4. Direct Tax Laws<br>5. Operations Research |



**Professional Careers Academy®**
**# 1639, 1st Floor, Sector 40 B, CHANDIGARH**
**Mobile: 9814622848, 9814098480, pcaclasses@gmail.com**