

INTERNAL AUDIT, MANAGEMENT AND OPERATIONAL AUDIT

Question 1

State the important aspects to be considered by the External auditor in the evaluation of Internal Audit Function.
(4 Marks) (November 2008)

Answer

Evaluation of Internal Audit functions by external auditor.

The external auditor's general evaluation of the internal audit function will assist him in determining the extent to which he can place reliance upon the work of the internal auditor. The external auditor should document his evaluation and conclusions in this respect. The important aspects to be considered in this context are :

- (a) **Organisational Status** - Whether internal audit is undertaken by an outside agency or by an internal audit department within the entity itself, the internal auditor reports to the management. In an ideal situation his reports to the highest level of management and is free of any other operating responsibility. Any constraints or restrictions placed upon his work by management should be carefully evaluated. In particular, the internal auditor should be free to communicate fully with the external auditor.
- (b) **Scope of Function** - The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management. He should also ascertain to what extent the management considers, and where appropriate, acts upon internal audit recommendations.
- (c) **Technical Competence** - The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.

- (d) **Due Professional Care** - The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers.

Question 2

XYZ, a manufacturing unit does not accept the recommendations for improvements made by the Operational Auditor. Suggest an alternative way to tackle the hostile management.

(5 Marks) (November 2010)

Answer

Alternative way to tackle the hostile management

While conducting the operational audit the auditor has to come across many irregularities and areas where improvement can be made and therefore he gives his suggestions and recommendations.

These suggestions and recommendations for improvements may not be accepted by the hostile managers and in effect there may be cold war between the operational auditor and the managers. This would defeat the very purpose of the operational audit.

The Participative Approach comes to the help of the auditor. In this approach the auditor discusses the ideas for improvements with those managers that have to implement them and make them feel that they have participated in the recommendations made for improvements. By soliciting the views of the operating personnel, the operational audit becomes co-operative enterprise.

This participative approach encourages the auditee to develop a friendly attitude towards the auditors and look forward to their guidance in a more receptive fashion. When participative method is adopted then the resistance to change becomes minimal, feelings of hostility disappear and gives room for feelings of mutual trust. Team spirit is developed. The auditors and the auditee together try to achieve the common goal. The proposed recommendations are discussed with the auditee and modifications as may be agreed upon are incorporated in the operational audit report. With this attitude of the auditor it becomes absolutely easy to implement the proposed suggestions as the auditee themselves take initiative for implementing and the auditor do not have to force any change on the auditee.

Hence, Operational Auditor of XYZ manufacturing unit should adopt above mentioned participative approach to tackle the hostile management of XYZ.

Question 3

General objectives of an operational audit.

(4 Marks) (May 2011)

Answer

General objectives of operational audit: It include

- (i) Appraisal of Controls.
 - (ii) Evaluation of performance.
 - (iii) Appraisal of objectives and plans and
 - (iv) Appraisal of organizational structure.
- (i) **Appraisal of controls:** Operations and the results in which management is interested are largely a matter of control. If controls are effective in design and are faithfully adhered to the result that can be attained then they will be subject to the other limiting constraints in the organization.
- (ii) **Evaluation of performance:** In the task of performance evaluation, an operational auditor is heavily dependent upon availability of acceptable standards. The operational auditor cannot be expected to possess technical background in so many diverse technical fields obtaining even in one enterprise. Even when examining or appraising performance or reports of performance the operational auditor's mind is invariably fixed on control aspects.
- (iii) **Appraisal of objectives and plans:** In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but with accumulating information and evidence to measure the effectiveness, efficiency and economy with which the operations are being carried on.
- (iv) **Appraisal of organisational structure:** Organisational structure provides the line of relationships and delegation of authority and tasks. This is an important element of the internal control design. In evaluating organisational structure, the operational auditor should consider whether the structure is in conformity with the management objectives and it is drawn up on the basis of matching of responsibility and authority. He should also analyse whether line of responsibility has been fixed, whether delegation of responsibility or authority is clear and there is no overlapping area.