

Internal Control, Internal Check and Internal Audit

Explain Internal Control

Ans: Internal control refers to a process that is designed for helping the organization to accomplish goals and objectives through people of the organization and IT systems, whereas internal check is a part of internal control. It refers to the accounting procedure that acts as a safeguard against frauds and losses. On the other hand, internal auditing is an activity that devises ways for organizations for better achievement of objectives.

Essentials of Internal Control

Ans: An efficient internal control system should provide:

1. For proper division of functional responsibilities.
2. For proper authorization and assignment of duties to perform and record the transactions.
3. For adoption of proper practices for adherence with management policies.
4. For proper review and authorization of all transactions before they are recorded in the books and safeguard all business assets.
5. Proper internal checks
6. Proper internal audit system.

Objectives of Internal Control

Ans: This system plays a very important role in any organization. The main objectives of internal control are as follows:

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|------------------|---------------------------|--|-------------------------------------|
| 1. Compliance: | 5. Increased efficiency: | 9. Delegation: | 12. Resource utilization: |
| 2. Reliance: | 6. Evaluation: | 10. Accurate planning: | 13. Safeguarding of resource: |
| 3. Safeguarding: | 7. Review and correction: | 11. Conformity with accounting principles: | 14. Setting future Corporate Goals: |
| 4. Security: | 8. Authorization: | | |

Advantages of Internal Control

Ans:

1. Efficiency, effectiveness and economy: A good internal control system ensures that the resources are utilized only for their intended purposes and helps to overcome the risk associated with the misuse of organization's funds and other resources.
2. Prevention of errors and irregularities: It prevents errors and irregularities by detecting them in a timely manner, thereby promoting reliable and accurate accounting records.
3. Safeguarding: Safeguard from irregularities or misappropriations.
4. Employees' satisfaction: It protects the interests of employees by segregation of duties and delegation of responsibilities.

Types of Internal Control

Ans: Generally, there are two types of Internal Control in an Organisation: preventive and detective controls.

A) **Preventive Controls** are designed to discourage errors or irregularities from occurring. They are proactive controls that help to ensure departmental objectives are being met. Examples of preventive controls are:

1. **Segregation of Duties**: Duties are segregated among different people to reduce the risk of error or inappropriate action. Normally, responsibilities for authorizing transactions (approval), recording transactions (accounting) and handling the related asset (custody) are divided.
2. **Approvals, Authorizations, and Verifications**: Management authorizes employees to perform certain activities and to execute certain transactions within limited parameters. In addition, management specifies those activities or transactions that need supervisory approval before they are performed or executed by employees. A supervisor's approval (manual or electronic) implies that he or she has verified and validated that the activity or transaction conforms to established policies and procedures.
3. **Security of Assets (Preventive and Detective)**: Access to equipment, inventories, securities, cash and other assets is restricted; assets are periodically counted and compared to amounts shown on control records.

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B) **Detective Controls** are designed to find errors or irregularities after they have occurred. Examples of detective controls are:

1. **Reviews of Performance:** Management compares information about current performance to budgets, forecasts, prior periods, or other benchmarks to measure the extent to which goals and objectives are being achieved and to identify unexpected results or unusual conditions that require follow-up.
2. **Reconciliations:** An employee relates different sets of data to one another, identifies and investigates differences, and takes corrective action, when necessary.
3. **Physical Inventories:**
4. **Audits:**

C) **Corrective Controls** target at the correction of errors and irregularities as soon as they are detected.

Steps in Internal Control

Ans: An effective internal control system consists of certain important steps:

1. **Control Environment:** Establish Integrity & ethical value.
2. **Assessment of Risk:** Establishment of plan to prevent risks.
3. **Control Activities:** Formulating policies & procedures.
4. **Information & communication:** Evaluation of employee performance.
5. **Monitoring:** Assessing overall performance of the Organisation.

Nature & Scope Internal Control

Ans:

1. **Nature:** Internal control is an essential prerequisite for efficient and effective management of any organization. It is, thus a primary responsibility of every management to establish and maintain an adequate system of internal control appropriate to the size and nature of the business of the entity.

SA 265 defines the **system of internal control** as “all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management’s objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information”.

2. **Scope:** **SA 265** defines ‘**accounting system**’ as “series of tasks and records of an entity by which transactions are processed as a means of maintaining financial records”. The system of internal control “extends beyond those matters which relate directly to the functions of the accounting system” and comprises control environment and control procedures.

‘**Control**’ represents the overall attitude, awareness and actions of directors and management regarding the internal control system of the entity. For example, in a strong control environment, there would be tight budgetary controls and an effective internal audit function. The control environment in an enterprise depends largely on the following factors:

- i. The entity’s organizational structure and methods of assigning authority and responsibility (including segregation of duties and supervisory functions).
- ii. The function of the board of directors or the corresponding governing body and its committees, e.g. how strong is the audit committee of the board of directors.
- iii. Management’s philosophy and operating style. Does the management believe in having a strong control environment (which implies that the management itself would also be subjected to the discipline of controls)?
- iv. Management’s control system including the internal audit function, personnel policies and procedures.

‘**Control procedures**’ are the policies and procedures that the management has established to achieve the entity’s specific objectives, e.g. physical verification of assets, periodical review and reconciliation of accounts, specific controls on computer generated data.

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Basic Elements of Internal Control

Ans: An effective system of internal control should have the following basic elements:

1. **Financial and other Organizational Plans:** This may take the form of manual suitably classified by flow charts. It should specify the various duties and responsibilities of both management and staff, stating the powers of authorisation that reside with various members. This is important as in the event of staff absence or otherwise the correct flow of work and the internal control system could be vitiated by any wrong implementation of procedures by staff either unintentionally or willfully.
2. **Competent Personnel:** In any internal control system, personnel are the most important element. When the employees are competent and efficient in their assigned work, the internal control system can be worked and operated efficiently and effectively even if some of the other elements of the internal control system are absent.
3. **Division of Work:** this refers to the procedure of division of work properly among the employees of the organization. Each and every work of the organization. Each and every work of the organization should be divided in different stages and should be allocated to the employees in accordance with quality and skill.
4. **Separation of operational responsibility from record keeping:** If each department of an organization is being assigned to prepare its own records and reports, there may be a tendency to manipulate results for showing better performance. So in order to ensure reliable records and information, record-keeping function is separated from the operational responsibility of the concerned department.
5. **Separation of the custody of assets from accounting:** To protect against misuse of assets and their misappropriation, it is required that the custody of assets and their accounting should be done by separate persons. When a particular person performs both the functions, there is a chance of utilizing the organisation's assets for his personal interest and adjusting the records to relieve himself from the responsibility of the assets.
6. **Authorization:** In a internal control system, all the activities must be authorized by a proper authority. The individual or group which can grant either specific or general authority for transaction s should hold a position commensurate with the nature and significance of the transactions and the policy for such authority should be established by the top management.
7. **Managerial supervision and review:** The internal control system should be implemented and maintained in conformity with the environmental and elemental changes of the concern. By adapting any specific control system permanently, the extent to which the procedures of flexible controls have been followed in real practice should be observed and re-examined.

Limitations of Internal Control

Ans:

1. **Organizational Structure:** Deficiencies in organizational structure make internal control ineffective.
2. **Size of the Organization:** Small organizations have very low levels of internal control, which are almost negligible due to more interference by owners and management.
3. **Unusual Transactions:** The internal control procedures normally fail to keep a check on unusual transactions.
4. **Costly:** The implementation of internal control procedures and processes involves incurring costs in terms of time, effort and resources.
5. **Abuse of Power:** Members at the top-level management may override/interfere with control.
6. **Collusion of two or more People:** It may lead to internal controls being over- ridden.
7. **Obsolescence:** Control system may become redundant with passage of time if not updated with change in the size and nature of business.
8. **Mistakes:** Potential for human error.
9. **Frequent follow-up measures:** Follow-up procedures need to be frequent to ensure its effectiveness, which is extremely time-consuming.

Responsibilities of Management Vis-A-Vis Auditors

Ans:

1. **Primary Responsibility of Management:** The prime responsibility for maintaining an adequate accounting system and incorporating various internal controls rests with the management. The responsibility of closely monitoring the system to ensure that it is in place, so as to facilitate the basic objectives of installing it, also rests with the management.

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2. **Auditor's Responsibility:** To safeguard his own interests, the auditor might resort to examination and evaluation of the internal controls that exist in the organization. He formulates an audit programme only after satisfying himself that such internal control systems are adequate and in consonance with the requirements of the business. The auditor should bring the weaknesses of the internal control system, if any, to the management's notice through a "letter of weakness" or "management letter".

Evaluation of Internal Control By The Auditor

Ans:

A) Understanding the System

This can be done in the following ways:

1. Discussions with personnel at various levels of the organization.
2. Reference to organization charts, procedure manuals, information flow channels, etc.
3. Inquiries using a brief, but complete questionnaire

B) Testing of internal control

This can be done in the following ways:

1. Procedural tests:

These tests deal with checking the compliance of the procedures laid down by the management in respect of transactional flow at each stage. They provide reasonable assurance about the proper implementation and effectiveness of internal controls.

2. Examination in depth:

This involves examination of a few selected transactions from the beginning till the end. Recording of transactions at various stages, documentation of the same, and authenticity of authorizations is checked in detail.

The Auditor forms a conclusion, based on his examination of the internal control system, which incorporates the following points:

- a) The degree and nature of weaknesses in the system.
- b) The extent to which audit reliance may be placed.
- c) The nature, timing and extent of substantive procedures that need to be applied.

Techniques For Evaluation of Internal Control System

Ans:

1. **Narrative Record:** It is a complete and exhaustive description of the system. It is appropriate in circumstances where a formal control system is lacking, like in the case of small businesses. Gaps in the control system are difficult to identify using a narrative record.
2. **Check List:** It is a series of instructions that a member of the audit staff is required to follow. They have to be signed/ initialed by the audit assistant as proof for having followed the instructions given. A specific statement is required for every weakness area.
3. **Flow Chart:** It is a pictorial representation of the internal control system depicting its various elements such as operations, processes and controls, which help in giving a concise and comprehensive view of the organization's working to the auditor. A complete flow chart would depict the process of raising documents, personnel involved in doing so, the flow of documents through various departments, maintenance of records, flow of goods and consideration, and dealing with results. The internal control evaluation process becomes easier through a flow chart as a broad picture of all the controls involved can be gauged in a glimpse.
4. **Internal Control Questionnaire:** This is the most widely used method for collecting information regarding the internal control system and involves asking questions to various people at different levels in the organization. The questionnaire is in a pre-designed format to ensure collection of complete and all relevant information. The questions are formed in a manner that would facilitate obtaining full information through answers in "Yes" or "No".

Internal Check

Ans: Internal check has been defined by the Institute of Chartered Accountants of 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 is complementary to the work of another, the object being the prevention or early detection of errors or fraud".

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• Auditor's Duty In Regard to Internal Check System

In the case of a big concern where there is a good internal check system the auditor may, to a great extent, presume the accuracy of the accounting. But he must not be negligent. He should apply a few test checks, i.e. he should check a few transactions here and there at random or check fully the accounts for a few months, and carry out a through check of the whole of a certain class of transactions taking place during that particular period, e.g. cash sales, or cash received or credit purchases during that period. In selecting certain transactions are representative and true specimens the auditor should see that such sample transactions are representative and true specimens of such entries throughout the year.

If he finds that there is no mistake and there is nothing to arouse his suspicion, he may presume that the accounts are correct. It must be remembered that in such a case, the auditor is not relieved of his responsibility. Therefore, it would be better for him to probe the matter thoroughly if there is the slightest suspicion. If later on, it is found that a fraud had been committed which the auditor failed to detect as he had not checked all the transactions, he would be held liable. The existence of a good internal check system reduces to a great extent the work of the auditor but does not reduce his liability. To what extent an auditor should depend upon the internal check system will depend upon his tact, skill, experience and judgement.

The internal check is said to have the following fundamental aims:

1. To pin down to definite persons responsibility for particular acts, default or omission, by the segregation of tasks.
2. To obtain confirmation of facts and entries, physical and financial, by the creation and preservation of necessary records.
3. To facilitate the "breakdown" of routine procedures so as to avoid bottlenecks and to establish an even flow of work.
4. To reduce to a minimum the possibility of fraud and error.

Check list is usually a questionnaire set, designed to draw attention to important aspects of the system of internal check. The question should be phrased in such a way that an affirmative answer would normally reveal a satisfactory position. If the answer is negative, enquiry should be made to see if there is a satisfactory substitute for the procedure referred to in the questionnaire. A negative answer always merits further examination. All the items on the questionnaire cannot be of the same importance and an unhealthy position might be revealed either by a single negative answer or by a number of such answers.

No questionnaire for the appraisal of a system of internal check can ever be considered to be complete. Although every effort should be made to make such a questionnaire as comprehensive as possible, it is primarily a stimulation to thinking along recognized channels.

• Internal Control Questionnaires

1. The evaluation of internal check system in an organization is of great concern both to the statutory auditor as well as to the internal auditor. The guiding factor for audit operation by the statutory auditor depends to a great extent on the soundness or otherwise of the internal controls in business. Due to the limitation of time a statutory auditor can spend on a company's audit, he has to decide the extent of in-depth audit of many areas, particularly the checking and verification of routine aspects of financial transactions.
2. The evaluation of the internal check system including internal accounting control gives an opportunity to the statutory auditor to have a clearer insight into the operational systems and an overall view of the organization Workings to spot weakness in the systems and procedure both in respect of financial and operational areas of the business The internal check system questionnaire is a list of systematically and logically prepared questions designed to find out and evaluate the effectiveness of the internal check system regarding various aspects and accounting transactions of an organization. The questionnaire are to be as comprehensive as possible in nature to make sure that all aspects and accounting transactions are covered which are to be replied by the official of the department or division concerned.
3. During the course of the audit statutory auditor will submit to the organization a complete questionnaire for reply by concerned official which will help the former to form an opinion as to the adequacy and reasonableness of the internal check system.
4. The statutory auditor during the course of his audit may make test checks or in-depth checking depending on the circumstances to make sure that the replies to the questionnaire are accurate and complete. In respect of many of the replies, the statutory auditor may have to make sure that the internal check system are really in operation through proper verification. In respect of negative replies, he may have to qualify his audit report depending on the seriousness of the situation.
5. The internal auditor in their pre-audit i.e. before taking up real internal audit operations may require the officials concerned to reply to the questionnaire. This will help the internal auditor in shaping his programming.
6. The department or divisional heads should also make use of such questionnaire, solely on their own initiative, by directing the personnel to prepare replies to such a questionnaire for the benefit of the department itself. This procedure will enable the department head to evaluate the existing internal control system and thereby to suggest management to review the said systems to further strengthen the organizational controls.

- a) Internal Control Questionnaire For Cash And Bank Receipts
- b) Internal Control Questionnaire for Purchase And Creditors
- c) Internal Control Questionnaire for Sales And Debtors Section

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Difference between a checklist and Internal control questionnaire

Ans:

<u>Basis</u>	<u>Check List</u>	<u>Internal Control Questionnaire</u>
1. Point of Time:	It is issued at the commencement of audit and reported back after completion of audit.	It can be issued at any point of time and reported back immediately.
2. Issued To:	It is issued to the audit staff to be followed by them during audit and reported back at completion.	It is issued to various people at different levels in the organization.
3. Contents:	It contains instructions to be followed by audit assistants.	It contains questions to be answered by the employees of the organization.
4. Objective:	It works as a guideline for audit staff so that no area remains unchecked.	This is used to collect the information to know about the internal control system and evaluate the weaknesses therein.

Difference between a Internal check, Internal Audit and Internal control

Ans:

<u>Basis</u>	<u>Internal Check</u>	<u>Internal Audit</u>	<u>Internal Control</u>
1. Definition:	“checks on day-to-day transactions which operates continuously as part of the routine system whereby the work of one person is proved independently or complementary to the work of another, the object being the prevention or earlier detection of error or fraud.”	“independent, objective assurance and consulting activity designed to add value and improve an organisations, operations. It helps an organisation accomplish its objectives by bringing a systematic disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process.”	“Internal control refers to a process that is designed for helping the organization to accomplish goals and objectives through people of the organization and IT systems”
2. Meaning:	It is a continuous critical review of financial and operating activities by a staff member of the auditor.	It consists of all the methods and procedures adopted to assist in achieving the objective of efficient conduct of business. It Includes internal checks and internal audit.	A system of allocation of responsibility, division of work, and methods of recording transactions, whereby the work of an employee is checked continuously by another.
3. Objective:	Its objective is to evaluate the internal control system and to detect frauds and errors.	Its objective is to ensure adherence to management policies, safeguarding of assets, prevention and detection of frauds and errors, accuracy and completeness of accounting records.	Its objective is to ensure that no one employee has exclusive control over any transaction or group of transactions and their recording in the books.
4. Way of Checking:	In an internal audit system, each component of work is checked.	In internal controls systems, work of one person is automatically checked by another.	It operates in routine to doubly check every part of a transaction at the time of occurrence and recording of the same.

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5. Point of Time:	In an internal audit system, work is checked after it is done.	In an internal control system, checking is done simultaneously with the conduct of work. Every transaction is checked as soon as it is entered.	Methods of recording transactions are devised where work of an employee is checked continuously by correlating it with the work of others.
6. Thrust of system:	The thrust of internal system is to detect errors and frauds.	The thrust of internal check system is to prevent errors.	The thrust of internal control lies in fixing of responsibility and division of work to avoid duplication.
7. Cost Involvement:	In an internal audit system, work is checked specially; therefore cost is involved in addition to accounting.	The system proves to be costly in case of small businesses because more number of employees are engaged	It is a part of internal control and a method of division of work, therefore does not add to the cost.
8. Report	The internal auditor submits his report to the management.	Internal Controls provide for built in MIS reports.	The summary of day to day transactions work as report for the senior.

Surprise Check

Ans: All the audit procedures which are applied as not in the general routine of conducting an audit but are spontaneous in nature for surprise checks. They are performed without giving a prior notice to the client.

• Features of Surprise Check:

1. It is spontaneous in nature i.e. unplanned.
2. Random selection of items to be checked.
3. Helps in assuring maintenance of up-to-date accounts.
4. Performed in situations facing weak internal controls.
5. Helps in testing effectiveness of internal controls.
6. The frequency of occurrence depends on the auditor's professional judgment.
7. Ensures communication of weaknesses in the controls to the management.

Cut off Procedures

Ans:

1. **Definition:** Periods usually coincide with calendar months, which lead to the need for specific demarcation between transactions forming the part of one period from those included in the following period. Thus, cut-off procedures are adopted to allocate revenues and costs to the proper accounting period.
2. **Areas of concern:** Close attention should be paid to the accounts payable and accounts receivable functions. These two functions are the most susceptible to recording of transactions in the wrong accounting period.
3. **Cut-of points:** Serially numbered documents like invoice for sales or purchase bills are allocated to the respective accounting periods by establishing cut-off points based on the serial numbers.
4. **Importance:** Cut-off procedures require detailed testing by the auditor so as to ensure proper accounting of assets and liabilities, which may arise without the corresponding physical delivery of goods taking place.

Examination in debth

Ans:

1. Fixation of the maximum tolerable error limit/desired confidence level.
2. Selecting a few transactions in each area of audit to be checked.

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3. Verification of those selected transactions- 100% by verifying the accounting aspects, internal control aspects, documentation and audit trail.
4. Audit trail refers to the documents, records, books and files, which enable an auditor to trace a transaction from its source till it is summed up, recorded and presented in an accounting report.
5. Analysis of the results with the maximum tolerable error limit.

Difference between Test checking and Statistical Sampling

Ans:

<u>Basis</u>	<u>Test Checking</u>	<u>Statistical Sampling</u>
1. Selection	Selective transactions are verified.	Drawing a sample from a large number of transactions.
2. Technique	No specific technique is used.	Statistical technique used is: selection on random basis.
3. Subjective	It is subjective and depends upon the choice of the auditor.	It depends upon the statistical technique applied.
4. Risk & Method	It involves more risk as there are no specific methods for test check.	It carries lesser risk and various statistical methods can be used at different times.

Internal Audit

Ans: According to the Institute of Internal Auditors New York, “Internal audit is an independent appraisal activity within the organization for the review of financial, accounting and other operations done as a basis of service to the management. It is a managerial control which functions by measuring and evaluating the effectiveness of other controls”.

• Internal Audit under section 138 of Companies Act, 2013:

Internal Audit is required by –

1. Such class or classes of companies as may be prescribed shall be required to appoint an internal auditor, who shall either be a chartered accountant or a cost accountant, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the company.
2. The Central Government may, by rules, prescribe the manner and the intervals in which the internal audit shall be conducted and reported to the Board.

• Internal audit involves five areas of operations:

- | | | | | |
|---|--|---------------------------|--|---|
| 1. Reliability and integrity of financial and operating information | 2. Compliance with laws, policies, plans, procedures and regulations | 3. Safeguarding of Assets | 4. Economic and efficient use of resources | 5. Accomplishing of established objectives and goals for operations |
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Features of Internal Audit

Ans:

1. It is an independent appraisal activity within the organization.
2. It can be conducted by the staff of the entity or by an independent professional appointed for that purpose.
3. It is conducted for review of accounting, financial and other operations and controls established within an organization.
4. It is conducted as a service to the organization and is not a part of the organization.
5. It intends to furnish the analysis, appraisals, suggestions and information concerning the activities reviewed to the management.
6. Internal auditing functions as a continuous effort for promoting effective control at cost reasonable cost.

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• Functions of Internal Audit

1. **An appraisal function:** The internal auditor's job is to appraise the activity of others, not to perform a specific part of data processing. For example, a person who spends his time checking employee expense claims is not performing an internal audit function. But an employee who spends some times reviewing the system of checking employee expense claims may be performing an internal audit function.
2. **As a service to the organization:** the management requires that the auditor ensures the following:
 - ➔ That its policies are fulfilled.
 - ➔ That the information it requires to manage effectively is reliable and complete; this information is not only that which is provided by the accounting system.
 - ➔ That the organisation's assets are safeguarded.
 - ➔ That the internal control system is well designed.
 - ➔ That the internal control system works in practice.The internal auditor's activities will be directed to ensure that these requirements are met. The internal auditor can be seen as the notice of the board within the enterprise.
3. **Other duties:** other duties may include the following events:
 - ➔ Being concerned with the implementation of social responsibility policies adopted by top management.
 - ➔ Being concerned with the response of the internal control system to errors and required changes to prevent errors.
 - ➔ Being concerned with the response of the internal control system to external stimuli. The internal control system must continually upgrade itself to deal with change.
 - ➔ Acting as a training officer in internal control matters.
 - ➔ Auditing the information given to management particularly interim accounts and management accounting reports.
 - ➔ Taking a share of the external auditor's responsibility in relation to the figures in the annual accounts and
 - ➔ Being concerned with the compliance with external regulations such as those on the environment, financial services, related parties etc.

Need of Internal Audit

Ans:

1. Increased size and complexity of businesses.
 2. Enhanced compliance requirements.
 3. Focus on risk management and internal controls to manage them.
 4. Unconventional business models.
 5. Intensive use of information technology.
 6. Stringent norms mandated by regulators to protect investors.
 7. An increasingly competitive environment.
- **Internal audit is an important management tool for the following reasons:**
 1. Internal audit ensures compliance of Companies (Auditors Report) Order, 2015.
 2. It ensures compliance of accounting standards and policies.
 3. It ensures reliability of MIS through internal audit's independent appraisal and review.
 4. It looks into the standard of efficiency of business operation.
 5. It can evaluate various problems independently and suggest improvement.
 6. This system makes the internal control system effective.
 7. It ensures the adequacy, reliability, accuracy and understandability of financial and operational data.
 8. It performs as an integral part of 'Management by system'.
 9. It can add valuable assistance to management in acquiring new business, promoting new products and expansion or diversification of business etc.

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Advantages of Internal Audit

Ans:

A) To the management in specific:

1. It gives a review of overall internal control system established by the management.
2. It furnishes the deviations in following the procedures adopted for safeguarding assets.
3. It appraises the organizational structure and management information system.
4. It establishes that the policies, plans and strategies implemented are well in place and gives suggestions on management information systems reports for promoting effective control at reasonable cost.

B) To the statutory auditor in specific

1. It evaluates the internal control system, so the statutory auditor can reduce the number of tests that he may have had to conduct in case there was no internal audit
2. It carries out physical stock taking procedures, so reliance on stock valuation is increased.
3. It helps in timely completion of accounts and accuracy of records.
4. It evaluates the contingent liability existing at the year end.
5. It ensures correctness of financial statements through a system of pre-audit or continuous audit.

C) To the organization as a whole and other stakeholders in general

1. The regular audit and checks result in accurate and efficient accounting system.
2. It is a critical review of the business' performance and management.
3. It provides strict supervision and direction to have effective controls.
4. It provides safeguard to the business assets and prevents misuse and misappropriation of all business assets.
5. The auditor can suggest ways and means to improve performance of the business.
6. It prevents occurrence of errors and frauds.
7. It enhances the performance of the business by division of duties and responsibilities as per the capability of the employees.
8. It keeps a check on proper utilization of resources, which leads to reduction in costs.

Distinction between Internal Audit & External Audit

Ans:

<u>Basis</u>	<u>Internal Audit</u>	<u>External Audit</u>
1. Appointment:	The internal auditor is appointed by the management, generally the Directors and is responsible to them.	The external or the statutory auditor is appointed according to the concerned statute. Generally, in case of company form of organization, the auditors are appointed by the shareholders in the annual general meeting.
2. Scope:	The extent of the work undertaken by the internal auditor is determined the management.	The extent of the work undertaken by the internal auditor is determined by the governing statute.
3. Approach:	The internal auditor's approach is with a view to ensure that the accounting system is efficient, so that the accounting information presented to management throughout the period is accurate and discloses material facts.	The external auditor's approach is governed by his responsibility to satisfy himself that the accounts to be presented to the shareholders show a true and fair view of the profit or loss for the financial period and of the company's state of affairs at the end of that period.
4. Responsibility:	The responsibility is to the management. It follows that the internal auditors, being a servant of the company, does not have independence of status.	however, he is responsible directly to the shareholders. Unlike the internal auditors, he is a representative of the shareholders and has independence of status.

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5. Objectives:	The main objective of internal audit is to ensure that the laid down policies, procedures and other internal control functions are functioning as designed.	Whereas the objective of the external auditor is to express opinion and view to on financial statements whether those statements are showing true and fair view of the organisation.
6. Independence:	External auditor is less independent than internal auditor in the field of reporting.	External auditor is more independent than internal auditor in the field of reporting.

Relying Upon the Work of an Internal Auditor

Ans:

1. **Not mandatory:** It is not mandatory for the statutory auditor to compulsorily rely on work of internal audit.
2. **Not protected from liability:** Even if he relies on the work of internal audit, he is still not protected from his liability.
3. **Required to comment on internal audit:**

In the case of companies having Share Capital + Reserves at a minimum level of ` 50 lacs, or having minimum Average Annual Turnover of ` 5 crores for last 3 financial years, CARO 2003 requires a statutory auditor to mention in his report whether the internal audit system is commensurate with the size and nature of the business.

Importance of Internal Audit Function to Statutory Auditor

Ans: The internal auditor, depending on the size and structure of the enterprise and as per the requirements of its management, performs the following functions:

1. Reviews the accounting systems and internal controls prevailing in the organization.
2. Examination of management information system reports on financial and operational performance of the organization, to check the efficiency and effectiveness of the operations and the management policies laid down for the purpose.
3. Collection of third party evidences and physical verification of stocks and other assets at the year end.
4. Collection of evidence and estimation of contingent liabilities.

<u>S. No.</u>	<u>Points of Consideration</u>
i.	Independence Who is responsible for reporting and to whom? Is there interference by other managers in the internal audit department? What is the position of an internal auditor in the organization?
ii.	Skill and Competence What are the qualifications and experience of the internal auditor? Is a trained team from the staff conducting the internal audit? Is the internal audit staff updated with changes in law?
iii.	Audit Planning What is the composition of qualified and unqualified staff in the internal audit team? How long has the experience of the internal audit staff been in the same organization? How is the internal audit staff trained?
iv.	Use of Documentation

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	Is the internal control system evaluated by the use of questionnaires, flow charts and checklists? Are such questionnaires and checklists considered?
v.	Audit Procedure Is there an internal audit manual in existence? Is the internal audit work done as per an audit programme and whether the audit programme is frequently amended? Is there a consultation with the statutory auditor regarding the audit programme? Is there a system of rotating the functions among internal audit staff? Is there a system of maintaining working papers by internal audit staff? Is the work of internal auditor subjected to supervision by managers?
vi.	Audit Scope & purview Does the internal auditor cover only financial areas or also operational areas? Does the defined scope of internal audit cover investigations, statutory compliance and year end stock taking procedures?
Vii.	Audit Report To whom is the internal audit report submitted? Does it contain recommendations in addition to observations? Is there a follow up of earlier recommendations? What is the management's attitude towards internal audit recommendations? What is the periodicity of audit report?



Difference between Internal Audit and Operational Audit

Ans:

S. No	Internal Audit	Operational Audit
i.	Compliance objective	Risk identification, process improvement objective
ii.	Financial accounts focus	Business focus
iii.	Audit focus	Efficiency & improvement focus
iv.	Transaction-based	Process-based
v.	Policies and procedures focus	Risk management focus
vi.	Cost Centre wise budget monitoring	Accountability for performance improvement Results
vii.	Focus on policies, transactions and compliance	Focus on goals, strategies and risk management Processes

Internal Control, Internal Check and Internal Audit

• Standards on Internal Audit (SIA)

Ans:

• SIA 1: Planning an Internal Audit

1. Planning involves developing an overall plan for the expected scope and conduct of audit and developing an audit programme showing the nature, timing and extent of audit procedures.
2. Develop and document a plan in consultation with those charged with governance, including the audit committee for each internal audit engagement.
3. Objectives of internal audit engagement as well as time and resources required for conducting the engagement be considered. Internal audit plan should also reflect risk management strategy of the entity.
4. Internal audit plan should cover areas such as obtaining knowledge of legal and regulatory framework within which the entity operates, obtaining knowledge of the entity's accounting and internal control systems and policies, determining the effectiveness of internal control procedures adopted by the entity, determining the nature, timing and extent of procedures to be performed, identifying activities warranting special focus based on materiality and criticality of such activities, and their overall effect on operations of the entity, identifying and allocating staff to different activities to be undertaken.
5. Planning process includes obtaining knowledge of business, establishing the audit universe, establishing the objectives of engagement, establishing scope of the engagement, deciding resource allocation, preparation of audit programme.
6. Plan to be finalised in consultation with the appropriate authority before commencement of the work

• SIA 2: Basic Principles Governing Internal audit

1. Internal auditor should adhere to the basic principles governing an internal audit.
2. These principles are integrity, objectivity and independence, confidentiality, skills and competence, work performed by others, documentation, planning, internal audit evidence, accounting system and internal control, and internal audit conclusions and reporting.

• SIA 3: Internal Audit Documentation

1. Internal audit documentation should be designed and properly organized to meet the requirements and circumstances of each audit. To formulate policies for standardization of internal audit documentation.
2. It should be sufficiently complete and detailed for an internal auditor to obtain an overall understanding of the audit.
3. All significant matters which require exercise of judgment, together with internal auditor's conclusion thereon should be included in the internal audit documentation.

Documentation prepared by internal auditor should enable reviewer to understand:

- the nature, timing and extent of audit procedures performed to comply with SIAs and applicable legal and regulatory requirements;
 - the results of audit procedures and audit evidence obtained;
 - significant matters arising during the audit and conclusions reached thereon; and
 - terms and conditions of an internal audit engagement/requirements of internal audit charter, scope of work, reporting requirements, any other special conditions, affecting the internal audit.
4. It should cover all the important aspects of an engagement viz., engagement acceptance, engagement planning, risk assessment and assessment of internal controls, evidence obtained and examination/evaluation carried out, review of the findings, communication and reporting and follow up.
 5. The internal audit file should be assembled within sixty days after the signing of the internal audit report.
 6. To formulate policies as to the custody and retention of the internal audit documentation within the framework of the overall policy of the entity in relation to the retention of documents.

• SIA 4: Reporting

1. To review and assess the analysis drawn from internal audit evidence obtained as the basis for his conclusion on the efficiency and effectiveness of systems, processes and controls including items of financial statements.
2. Report clearly expressing significant observations, suggestions/recommendations based on the policies, processes, risks, controls and transaction processing taken as a whole and managements' responses.
3. Report includes basic elements such as title, addressee, report distribution list, period of coverage of the report, opening or introductory paragraph, objectives paragraph, scope paragraph (describing the nature of an internal audit), executive summary (highlighting key material issues, observations, control weaknesses and exceptions), observations, findings and recommendations made by the internal auditor, comments from the local management, action taken report – action taken/not taken pursuant to the observations made in the previous internal audit reports, date of the report, place of signature and Internal auditor's signature with membership number.
4. To facilitate communication and ensure that recommendations presented in final report are practical from the point of view of implementation, the internal auditor should discuss the draft with the entity's management prior to issuing the final report. The different stages of communication and

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discussion should be discussion of draft, Exit meeting, formal draft, submission of final report.

5. When there is a limitation on the scope of internal auditor's work, the internal auditor's report should describe the limitation.
6. To state in the report that the same is to be used for the intended purpose only as agreed upon and the circulation of the report should be limited to the recipients mentioned in the report distribution list.

• SIA 5: Sampling

1. Design and select an audit sample, perform audit procedures thereon, and evaluate sample results so as to provide sufficient appropriate audit evidence to meet the objectives of internal audit engagement unless otherwise specified by the client.
2. When designing an audit sample, internal auditor should consider specific audit objectives, the population from which internal auditor wishes to sample, and the sample size.
3. When determining the sample size, internal auditor should consider sampling risk, tolerable error and the expected error.
4. To select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items or sampling units in the population have an opportunity of being selected.
5. Having carried out, on each sample item, those audit procedures that are appropriate to the particular audit objective, the internal auditor should:
 - analyse the nature and cause of any errors detected in the sample;
 - project the errors found in the sample to the population;
 - reassess the sampling risk; and
 - consider their possible effect on the particular internal audit objective and on other areas of internal audit engagement
6. To evaluate the sample results to determine whether the assessment of relevant characteristics of the population is confirmed or whether it needs to be revised.

• SIA 6: Analytical Procedure

1. To apply analytical procedures as the risk assessment procedures at the planning and overall review stages of internal audit.
2. Analytical procedures are analysis of significant ratios and trends including resulting investigation of fluctuations and relationships that are inconsistent with other relevant information or which deviate from predicted amounts.
3. Factors to be considered for analytical procedures are significance of the area being examined, adequacy of the system of internal control, availability and reliability of financial and non-financial information, the precision with which results of analytical procedures can be predicted, availability and comparability of information regarding the industry in which the organization operates, the extent to which other auditing procedures provide support for audit results. After evaluating the aforementioned factors, internal auditor should consider and use additional auditing procedures, as necessary, to achieve the audit objective.
4. To apply analytical procedures at or near the end of internal audit when forming an overall conclusion as to whether the systems, processes and controls as a whole are robust, operating effectively and are consistent with the internal auditor's knowledge of the business.
5. When analytical procedures identify significant fluctuations or relationships that are inconsistent with other relevant information or that deviate from predicted amounts, the auditor should investigate and obtain adequate explanations and appropriate corroborative evidence.

• SIA 7: Quality Assurance in Internal Audit

1. A system for assuring quality in internal audit should provide reasonable assurance that the internal auditors comply with professional Standards, regulatory and legal requirements, so that the reports issued by them are appropriate in the circumstance. In order to ensure compliance with the professional standards, regulatory and legal requirements, and to achieve the desired objective of internal audit, a person within the organization should be entrusted with the responsibility for the quality in the internal audit, whether done in-house or by an external agency.
2. In case of in-house internal audit or a firm carrying out internal audit, the person entrusted with the responsibility for the quality in internal audit should ensure that the system of quality assurance includes policies and procedures addressing leadership responsibilities for quality in internal audit, ethical requirements, acceptance and continuance of client relationship and specific engagement, as may be applicable, human resources, engagement performance, monitoring. The quality assurance framework should cover all the elements of internal audit activity.
3. The internal quality review framework should be designed with a view to provide reasonable assurance that the internal audit is able to efficiently and effectively achieve its objectives of adding value and strengthening the overall governance mechanism of the entity, including the entity's strategic risk management and internal control system.
4. The internal quality reviews should be undertaken on an ongoing basis. The person entrusted with the responsibility for quality in internal audit should ensure that recommendations resulting from the quality reviews for improvements in the internal audit activity are promptly implemented.
5. Internal quality reviews are also communicated to appropriate levels of management and those charged with governance on a timely basis along with the proposed plan of action to address issues and concerns raised in the review report.
6. External quality review is a critical factor in ensuring and enhancing the quality of internal audit

• SIA 8: Terms of Internal Audit Engagement

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1. Internal auditor and the auditee should agree on the terms of engagement before commencement. Terms should be approved by the Board of Directors or a relevant Committee thereof such as the Audit Committee or such other person(s) as may be authorised by the Board in this regard.
2. It should contain a statement in respect of the scope of internal audit engagement.
3. It should clearly mention that internal auditor would not be involved in the preparation of auditee's financial statements. It should also be made clear that the internal audit would not result in the expression of an opinion or any other form of assurance on the auditee's financial statements or any part thereof.
4. The terms of engagement should clearly mention the responsibility of the auditee vis-a-vis the internal auditor.
5. It should provide the internal auditor with requisite authority, including unrestricted access to all departments, records, property and personnel and authority to call for information from concerned personnel in the organization.
6. The internal auditor should have full authority on his technologies and other properties like hardware and audit tools he may use in course of performing internal audit.
7. It should be clear that the ownership of working papers rests with internal auditor and not the auditee.
8. The engagement letter should contain a condition that the report of internal auditor should not be distributed or circulated by the auditee or the internal auditor to any party other than that mutually agreed between the internal auditor and auditee unless there is a statutory or a regulatory requirement to do so.
9. There should be a clear understanding among internal auditor and auditee as to the basis on which the internal auditor would be compensated, including any out of pocket expense, taxes etc, for the services performed by him.
10. It should contain a statement that the internal audit engagement would be carried out in accordance with the professional Standards applicable to such engagement as on the date of audit.

• SIA 9: Communication with Management

1. Internal auditor while performing audit should communicate clearly the responsibilities of internal auditor and an overview of the planned scope and timing of audit with the management.
2. Communication regarding the planned scope and timing of internal audit may assist the management to understand better the objectives of internal auditor's work, to discuss issues of risk and materiality with internal auditor and to identify any areas in which they may request the internal auditor to undertake additional procedures, assist the internal auditor to understand the entity and its environment better.
3. Different stages of communication and discussion should be: discussion of draft; exit meeting; formal draft; and final report.
4. Clear communication of internal auditor's responsibilities, planned scope and timing of internal audit and expected general content of communications helps establishing the basis for effective two-way communication.
5. Appropriate timing for communications will vary with the circumstances of the engagement. Relevant circumstances include significance and nature of the matter, and the action expected to be taken by management.
6. Where matters required by this SIA to be communicated, are orally communicated, internal auditor shall document them and when and to whom they were communicated. Where matters have been communicated in writing, the auditor shall retain a copy of the communication as part of internal audit documentation.

• SIA 10: Internal Audit Evidence

1. To obtain sufficient appropriate evidence to enable him to draw reasonable conclusions therefrom on which to base his opinion or findings.
2. Scope of an internal audit is much broader in comparison to that of statutory audit. The depth of coverage of internal audit, being a management function, would also be much wider. An internal audit function normally is spread beyond checking of financial transactions and is expected to cover comments on internal control systems, risk management, propriety aspect of transactions.
3. To evaluate sufficiency of appropriate audit evidence before conclusions therefrom. The internal audit evidence should enable internal auditor to form a opinion on the scope of the terms of engagement.
4. The reliability of internal audit evidence depends on its source – internal or external and on its type.
5. When internal audit evidence obtained from one source is inconsistent with that obtained from another, or the internal auditor has doubts over the reliability of information to be used as internal audit evidence, the internal auditor shall determine what modifications to or additional audit procedures are necessary to resolve the matter.
6. Various methods for obtaining audit evidence include inspection, observation, inquiry and confirmation, computation and analytical review.

• SIA 11: Consideration of Fraud in an Internal Audit

1. An internal auditor is not expected to possess skills and knowledge of a person expert in detecting and investigating frauds, he should, however, have reasonable knowledge of factors that might increase the risk of opportunities for frauds in an entity and exercise reasonable care and professional skepticism while carrying out internal audit.

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2. A system of internal control comprise of following five elements namely control environment, entity's risk assessment process, information system and communication, control activities and monitoring of controls. It is essential for internal auditor to gain an understanding of the components of system of internal control.
3. The primary responsibility for prevention and detection of frauds is that of the management of the entity. The internal auditor should, however, help the management fulfill its responsibilities relating to fraud prevention and detection.
4. To obtain an understanding of the various aspects of control environment and evaluate the same as to the operating effectiveness.
5. To evaluate the mechanism in place for supervision and assessment of internal controls to identify instances of any actual or possible breaches therein and to take corrective action on a timely basis.
6. To carefully review and assess conclusions drawn from audit evidence obtained. Actual or suspected fraud or any other misappropriation of assets should be immediately reported to management.
7. To document fraud risk factors identified as being present during internal auditor's assessment process and document internal auditor's response to any other factors.

• SIA 12: Internal Control Evaluation

1. The system of internal control must be under continuous supervision by management to determine that it is functioning as prescribed and is modified, as appropriate, for changes in environment. Internal control system extends beyond those matters which relate directly to the functions of accounting system and comprises of control environment and control activities.
2. To examine the continued effectiveness of internal control system through evaluation and make recommendations, if any, for improving that effectiveness. To focus towards improving internal control structure and promoting better corporate governance.
3. To obtain an understanding of significant processes and internal control systems sufficient to plan the internal audit engagement and develop an effective audit approach, assess and evaluate the maturity of entity's internal control, assess management's attitudes, awareness and actions regarding internal controls and their importance in the entity.
4. To evaluate internal control system in an entity, based on various criteria To ensure segregation of duties between various functions.
5. Tests of control are performed to obtain audit evidence about the effectiveness of design of internal control systems.
6. Based on the results of tests of control, internal auditor should evaluate whether the internal controls are designed and operating as contemplated in the preliminary assessment of control risk. To consider whether internal controls were in use throughout the period.
7. To identify internal control weaknesses that has not been corrected and make recommendations to correct those weaknesses.
8. When internal controls are found to contain continuing weaknesses, internal auditor should consider whether management has increased supervision and monitoring, additional or compensating controls have been instituted and/or management accepts the risk inherent with control weakness
9. To evaluate identified control deficiencies and then determine whether those deficiencies, individually or in combination, are significant deficiencies or material weaknesses
10. Report to the management should provide a description of significant deficiency or material weakness in internal control. His opinion on possible effect of such weakness on entity's control environment

• SIA 13: Enterprise Risk Management

1. Risk is an event which can prevent, hinder, fail to further or otherwise obstruct the enterprise in achieving its objectives. Risk may be broadly classified into Strategic, Operational, Financial and Knowledge.
2. ERM is a structured, consistent and continuous process of measuring or assessing risk and developing strategies to manage risk within the risk appetite. It involves identification, assessment, mitigation, planning and implementation of risk and developing an appropriate risk response policy. Management is responsible for establishing and operating the risk management framework.
3. ERM process consists of Risk identification, prioritization and reporting, Risk mitigation, Risk monitoring and assurance. The corporate risk function establishes the policies and procedures, and the assurance phase is accomplished by internal audit. The role of internal auditor is to provide assurance to management on the effectiveness of risk management.
4. Nature of internal auditor's responsibilities should be adequately documented and approved by those charged with governance.
5. To review the maturity of an ERM structure by considering whether the framework so developed, inter alia protects the enterprise against surprises, stabilizes overall performance with less volatile earnings, operates within established risk appetite, protects ability of the enterprise to attend to its core business and creates a system to proactively manage risks.
6. To review whether the ERM coordinators in the entity report on the results of assessment of key risks at appropriate levels, which are, inter alia risk Management Committee, Enterprise Business and Unit Heads, Audit Committee.
7. To submit his report to the Board or its relevant Committee, delineating the following information Assurance rating (segregated into High, Medium or Low) as a result of the review, Tests conducted, Samples covered and Observations and recommendations.

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• SIA 14: Internal Audit in an Information Technology Environment

1. The overall objective and scope of an internal audit does not change in an IT environment. However, the use of a computer changes the processing, storage, retrieval and communication of financial information and the interplay of processes, systems and control procedures. This may affect the internal control systems employed by the entity. Accordingly, an IT environment may affect the procedures followed by the internal auditor in obtaining a sufficient understanding of the processes, systems and internal control system and the auditor's review of the entity's risk management and continuity systems.
2. To consider the effect of an IT environment on internal audit engagement, inter alia the extent to which IT environment is used to record, compile, process and analyse information and the system of internal control in existence in the entity with regard to flow of authorised, correct and complete data to the processing centre, the processing, analysis and reporting tasks undertaken in the installation and the impact of computer-based accounting system on the audit trail that could otherwise be expected to exist in an entirely manual system.
3. To have sufficient knowledge of information technology systems to plan, direct, supervise, control and review the work performed. The sufficiency of knowledge would depend on the nature and extent of the IT environment. The internal auditor should consider whether any specialised IT skills are needed in the conduct of audit, for example, the operating knowledge of a specialised ERP system.
4. If specialized skills are needed, the internal auditor should seek the assistance of a technical expert possessing such skills, who may either be the internal auditor's staff or an outside professional. If the use of such a professional is planned, the internal auditor should obtain sufficient appropriate evidence that the work performed by the expert is adequate for the purposes of the internal audit.
5. To obtain an understanding of the systems, processes, control environment, risk– response activities and internal control systems sufficient to plan the internal audit and to determine the nature, timing and extent of the audit procedures.
6. When the information technology systems are significant, the internal auditor should also obtain an understanding of IT environment and whether it influences the assessment of inherent and control risks. The nature of risks and internal control characteristics in IT environments include the Lack of transaction trails, Uniform processing of transactions, Lack of segregation of functions, Potential for errors and irregularities, Initiation or execution of transactions, Dependence of other controls over computer processing, Potential for increased management supervision, Potential for the use of computer-assisted audit techniques.
7. To review whether the information technology system in the entity considers the confidentiality, effectiveness, integrity, availability, compliance and validity of data and information processed. To review the effectiveness and safeguarding of IT resources, including – people, applications, facilities and data.

• SIA 15: Knowledge of the Entity and its Environment

1. To obtain knowledge of the economy, entity's business and its operating environment, including its regulatory environment and the industry in which it operates, sufficient to enable him to review the key risks and entity-wide processes, systems, procedures and controls. To identify sufficient, appropriate, reliable and useful information to achieve the objectives of the engagement.
2. Prior to accepting an engagement, the internal auditor should obtain a preliminary knowledge of the industry and of the nature of ownership, management, regulatory environment and operations of the entity subjected to internal audit, and should consider whether a level of knowledge of the entity's business adequate to perform the internal audit can be obtained.
3. Following the acceptance of the engagement, further and more detailed information should be obtained. To the extent practicable, the internal auditor should obtain the required knowledge at the commencement of the engagement. As the internal audit progresses, that information should be assessed, enhanced, updated, refined and validated as the internal auditor and the engagement team obtain more knowledge about the entity's business.
4. In case of continuing engagements, internal auditor should update and re– evaluate information gathered previously, including information in the prior year's working papers. The internal auditor should also perform procedures designed to identify significant changes that have taken place in the operations, control environment, technology and strategic processes since the last internal audit.
5. To obtain sufficient, appropriate information about the entity. An understanding of business risks facing the entity increases the likelihood of identifying risks of material misstatement in the information subject to internal audit.
6. Knowledge of the entity's business is a frame of reference within which the internal auditor exercises professional judgment in reviewing the processes, controls and risk management procedures of the entity.
7. To ensure that the internal audit engagement team assigned to an internal audit engagement obtains sufficient knowledge of the business to enable them to carry out internal audit work delegated to them. The internal auditor should also ensure that the audit team appreciates and understands the need to be alert for additional information and the need to share that information with the internal auditor and other members of internal audit team.
8. To make effective use of knowledge about the business, internal auditor should consider how this knowledge acquired, affects his review of internal controls and systems taken as a whole and whether his overall entity-wide assessment of systems, procedures, controls and risk management principles are consistent with his knowledge of the entity's business.
9. The information and knowledge obtained by the internal auditor on the entity and its environment should be adequately documented in the engagement working papers.

• SIA 16: Using the Work of an Expert

1. To obtain technical advice and assistance from competent experts if the internal audit team does not possess necessary knowledge, skills, expertise or experience needed to perform all or part of the internal audit engagement.
2. When the internal auditor uses the work of an expert, he should satisfy himself about the competence, objectivity and independence of such expert

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and consider the impact of such assistance or advice on the overall result of internal audit engagement, specially in cases where the outside expert is engaged by senior management or those charged with governance.

3. When determining whether to use the work of an expert or not, internal auditor should consider the materiality of the item being examined, the nature and complexity of the item including the risk of error therein, the other internal audit evidence available with respect to the item.
4. When the internal auditor plans to use the expert's work, he should satisfy himself as to the expert's skills and competence. To consider the objectivity of the expert. To satisfy himself that the expert has no personal, financial or organizational interests that will prevent him from rendering unbiased and impartial judgments and opinion.
5. When the internal auditor intends to use the work of an expert, he should gain knowledge regarding the terms of the expert's engagement. To seek reasonable assurance that the expert's work constitutes appropriate evidence in support of the overall conclusions formed during the internal audit engagement. To consider whether the expert has used source data which are appropriate in the circumstances.
6. In exceptional cases where the work of an expert does not support related representations in the overall systems, procedures and controls of the entity, the internal auditor should attempt to resolve the inconsistency by discussions with the auditee and the expert.
7. The internal auditor should not, normally, refer to the work of an expert in the internal audit report.

• SIA 17: Consideration of Laws and Regulations in an Internal Audit

1. It is the primary responsibility of management, with the oversight of those charged with governance, to ensure that the entity's operations are conducted in accordance with the provisions of laws and regulations, including compliance with the provisions of laws and regulations that determine the reported amounts and disclosures in an entity's financial statements.
2. The objectives of the internal auditor are to obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial statements, to perform specified audit procedures to help identify instances of noncompliance with other laws and regulations that may have a significant impact on the functioning of the entity and to respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the internal audit.
3. Since the role of an internal auditor is to carry out a continuous and critical appraisal of the functioning of an entity and suggest improvements thereto, the identification of non-compliance with laws and regulations is also an inherent part of his responsibilities.
4. Internal auditor should obtain an Understanding of the Legal and Regulatory Framework. The internal auditor shall inquire from the management and, where appropriate, those charged with governance, as to whether the entity is in compliance with such laws and regulations; and Inspecting correspondence, if any, with the relevant licensing or regulatory authorities to help identify instances of non-compliance with other laws and regulations that may have a significant impact on the entity's functioning.
5. The internal auditor shall request management and, where appropriate, those charged with governance to provide written representations that all known instances of non-compliance or suspected non-compliance with laws and regulations which impact the functioning of the entity, including the reporting framework, have been disclosed to the internal auditor.
6. If the internal auditor becomes aware of information concerning an instance of non-compliance or suspected non-compliance with laws and regulations, the internal auditor shall obtain an understanding of the nature of the act and circumstances in which it has occurred and further information to evaluate the possible effect on the functioning of the entity. The internal auditor may discuss the findings with those charged with governance where they may be able to provide additional audit evidence.
7. The internal auditor shall evaluate implications of non-compliance in relation to other aspects of internal audit, including the internal auditor's risk assessment and the reliability of written representations, and take appropriate action.
8. If the internal auditor concludes that non-compliance has a significant impact on the functioning of an entity and has not been adequately dealt with by the management, the internal auditor shall report the same in accordance with SIA 4, "Reporting". If the internal auditor is precluded by management or those charged with governance from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be significant to the functioning of the entity has, or is likely to have, occurred, the internal auditor should report the same.