

Quadrant II - Notes

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INTERNAL CONTROL

Internal control is the control which is exercised on the day to day operation of the company. It is a very important function of the management. It is a pre-requisite for the efficient and effective management of the company. It should be adequate, reasonable, flexible and economical. It includes internal check and internal audit. It is implemented by the organization in order to carry out the business in an orderly and efficient manner. It is useful for the company to safeguard the assets and also serve the reliability of accounting records. In other words, it is the overall control adopted by the organization.

Definition of Internal Control

According to W.W. Bigg, internal control "is best regarded as indicating the whole system of controls, financial or otherwise, established by the Management in the conduct of a business, including internal check, internal audit and other forms of control".

OBJECTIVE OF INTERNAL CONTROL

1. To detect the errors and fraud from the books of accounts as early as possible.
2. To ensure that all the transactions are properly recorded in the books of account.
3. To ensure reliability and validity of figures maintained by the company.
4. To ensure smooth functioning of day to day operation of the company.
5. To promote the operational efficiency in the company.

6. To ensure whether guidelines are properly followed by company while maintaining the records.
7. To review policies and procedures of maintaining the records.
8. To see that all the transactions are carried out only on sanctioning from authority.
9. To see that management policies and decisions are properly implemented.
10. To evaluate the efficiency of performance of the various personnel.
11. To safeguard the assets and properties of the organization.
12. To safeguard the interest of the organization.
13. To ensure reliability of accounting records.
14. To ensure the periodical verification of assets.

FEATURES OF INTERNAL CONTROL

- 1) It is the overall control adopted by the management.
- 2) It comprises of plans, methods and procedures for the efficient operations of the business.
- 3) It comprises of internal check, internal audit, accounting system and administrative control.
- 4) It is established by the management.
- 5) It intended to help the management to run the business efficiently.

TYPES OF INTERNAL CONTROLS (*SCOPE OF INTERNAL CONTROL*)

There are two types of internal control. Accounting control and administrative control. Accounting control is further classified into internal check and internal audit and administrative control is divided into promotion of the operational efficiency and coordination and implementation of managerial policies

1. ACCOUNTING CONTROL

It implies control over accounting system. It ensures that business transactions are correct and reliable and maintain as per generally accepted accounting principles. Such controls comprise primarily the plan of organisation and the procedures and records that are concerned with and directly related to the safeguarding of assets and liabilities in the financial records. Accounting controls include budgetary control, standard cost control, self balancing ledger, bank reconciliation and internal checks and internal auditing. Accounting controls deal with the process of recording of transactions, safeguarding the assets and adherence to prescribed managerial policies

OBJECTIVES OF ACCOUNTING CONTROL

- a) To ensure that accounting guidelines are properly followed while maintaining the accounting records by the company.
- b) To detect errors and frauds as early as possible in records.
- c) To review the accounting policies and procedures followed by the company.
- d) To provide accurate, complete and reliable accounting information to the management and all the stakeholders of the company.

2. ADMINISTRATIVE CONTROL

The scope of this control is very wide. They also include accounting controls. Such controls comprise of the plan of organization that are concerned mainly with operational efficiencies. In short they may include anything from plan of organisation to procedures, record keeping, of authority and the process of decision making. They include controls viz. Time and motion studies, quality control through inspection, statistical analysis and performance evaluation etc. An auditor should make a careful review of accounting controls as they have a direct bearing on the reliability of the financial statements. He is primarily concerned with the accounting controls.

OBJECTIVES OF ADMINISTRATIVE CONTROL

- a) To promote operational efficiency of the company.
- b) To co-ordinate and implement the managerial policies.
- c) To reduce the time require for completion of work.
- d) To reduce paper work and duplication of the work.
- e) To ensure co-operation, co-ordination and smooth functioning of the organization.

INTERNAL AUDIT

Internal audit is described as the verification of the operations within the business by a specially assigned staff. It is an important tool of management to evaluate the correctness of records on a continuous basis in an organisation.

The term internal audit has been defined as "an independent appraisal of activity" within an organisation for review of operations as a basis of service to management. It is a managerial control which functions by measuring and evaluating the effectiveness of other control

OBJECTIVES OF INTERNAL AUDIT

1. To verify the correctness and authenticity of the financial records and statistical records presented to the management.
2. To ensure that the standard accounting practices are strictly followed in the organisation.
3. To facilitate early detection of errors and frauds.
4. To ensure that all the transactions have been carried out under a proper authority and by persons authorised for the same in the business.
5. To review the system of internal check from time to time to advice the management on improvement of the system and to undertake special investigation for the management.
6. To confirm that the liabilities have been incurred by the organization for legitimate activities.

ADVANTAGES OF INTERNAL AUDIT

1. Internal audit helps the statutory audit to a large extent. Both the internal auditor and the statutory auditor have a common interest as far as authenticities of the accounts are concerned. However soundness of internal audit relieves the statutory auditor from detailed checking.
2. The internal auditor reviews the operations and performs such functions as evaluation, compliance, verification and ensures that policies, procedures, rules and other type of controls of the business are carried out efficiently.
3. It is helpful to statutory auditor in the matter of examination of books of accounts. Generally, the statutory auditor accepts some of the detailed checking made by the internal auditor.
4. Internal auditor is responsible only to the management.
5. Internal audit is not in accordance with standard accounting and auditing practices and provisions of law which govern the organisation.

INTERNAL CHECK

It is an arrangement of accounting work under which the work of one person comes under the scrutiny of another person. So, that there is no scope for any frauds. In other words, it is an arrangement of accounting system under which no individual person can carry out entire work by himself. The work of one staff is automatically checked by another staff to locate errors and frauds.

OBJECTIVES OF INTERNAL CHECK

1. To detect the errors and frauds as early as possible.
2. To ensure complete accurate and reliable information
3. To make review of work done by one staff member by another staff member.
4. To exercise moral pressure and ethical responsibilities on staff.
5. To identify the responsible person for any fraud in the company
6. To distribute the work in such a way that no business transaction is left unrecorded.

ADVANTAGES OF INTERNAL CHECK

1. FOR THE BUSINESS

a. Proper division of work

Internal check entails a proper and rational distribution of work among the members of staff of the enterprises keeping in view their individual qualifications, experience and area of specialization.

b. Detection of errors and frauds

Since no individual worker can handle a job completely from the beginning to the end, and the work of each clerk is automatically checked by the other, this helps in the early detection and discovery of errors and frauds and the possibilities of the commission of errors and frauds can be minimized.

c. Increased efficiency coupled with economy

A good system of internal check increases the efficiency of work among the staff and leads to overall economy.

d. Moral check

Knowledge of subsequent checking of each employees work by others, acts as a great check to commission of errors and frauds.

2. FOR THE AUDITOR

a. Quick preparation of audit report

Cost Auditor will prepare his report quickly without wasting any time.

b. Convenience to Auditor

When internal check is in operation, Cost Auditor may avoid detail checking of all the transactions. He may apply a test check and complete the audit work.

INTERNAL CHECK: DISADVANTAGES

1. Costly for small business

An internal check system is quite expensive especially for small business houses.

2. Quality is sacrificed for Promptness

In an internal check system quality of work declines because the clerks of the business attach greater importance to become quick and do not care if in the process their work gets substandardised.

3. Carelessness among high officials

The possibility of some of the responsible and high officials being self-satisfied increases as they believe, though not always rightly, that under a sound system of internal check nothing can go wrong

4. Disorder in the working of a business

In the absence of a proper organized system of internal check there will be chaos and disorder in the working of business.

5. Risky for an auditor

If the auditor does not apply tests and procedure his own and if he relies on the output of the system, his work cannot be free from irregularities if the system itself proves to be defective.

INTERNAL CHECK Vs INTERNAL AUDIT

a) Meaning

Internal Check is an arrangement of duties allocated in such a way that the work of one person is automatically checked by another. Internal Audit is an independent appraisal of the operations and records of the company.

b) Object

The purpose of Internal Audit is to detect the errors and frauds which have already been committed. The purpose of Internal Check is to prevent or minimize the possibilities of errors, frauds or irregularities.

c) Need for separate staff

For carrying out Internal Audit, a separate internal staff is engaged. For internal check, no new appointment is made; in fact represents only the arrangement of duties of the staff in a particular way.

d) Nature of work

The work involved in the Internal Audit is just like that of a watch man. Internal auditor has to report, from time to time, to the management about the various in efficiencies and suggest improvements. It is also his duty to see that the internal check system does not become static. Internal Check, on the other hand, represents a process under which the work goes on uninterruptedly and the checking too is more or less automatic.

e. Timing of work

Internal Audit starts when the accounting process of different transactions is finished. Internal Check is an operation during the course of transaction.

f. Internal audit

It is a device for checking the work, whereas internal check is a device for doing the work.

g. In Internal Audit Errors and Frauds are detected after the completion of work, whereas in Internal Check the Errors and Frauds are discovered during the course of work.

h. Scope of work

The scope of Internal Check is very limited. The scope of Internal Audit is comparatively broad.

i) Involvement

A large number of employees are needed for the implementation of Internal Check System, whereas, a much smaller number of persons are needed for implementing Internal Audit.

DISTINGUISH BETWEEN INTERNAL CONTROL, INTERNAL CHECK, AND INTERNAL AUDIT

INTERNAL CONTROL	INTERNAL CHECK	INTERNAL AUDIT
It is the whole system of control established by management.	It is the arrangement of accounting work under which the work of one person comes under another.	Continuous review of records by staff appointed for the purpose.
Scope of internal control is very wide. it includes internal check and internal audit.	Scope of internal check is less.	Scope of internal audit is less than that of internal control wider than internal check.
The objective is to safeguard the asset of enterprise.	Objective is to locate errors and frauds.	The object of internal audit is to assure the management that the system of internal control and internal checks in operation are in effective in design and operation.
There is no separate staff.	There is no separate staff	It is conducted by the staff specially appointed for the purpose called as internal auditor.
Internal control is exercised when the work of employees in progress.	Internal check is exercised when the work of employee is in progress.	It is undertaken by the auditor after the work has been completed.
Any organization can adopt internal control.	Any organization can adopt internal check.	Internal audit is adopted only those concerns which really need it