

# **AUDITING**

**5th SEMESTER**

**TOPIC:**

**AUDIT AND CONTROL**

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# **INTERNAL CHECK**

## **Meaning of internal check:**

Internal Check is a valuable part of internal control. it is an arrangement of duties of the staff is such a manner that the work performed by one individual is automatically checked by another person is a run time course. Some definitive of internal Checks are given below-

According to Spiear and Peglar:

A system of internal check is an arrangement of staff duties, whereby no one person is allowed to carry through and to record every aspect of a transaction, so that without collusion between the two or more persons a fraud is prevented and at the same time the possibilities of errors are reduced to a minimum.

## Objective of Internal Check

**(1) To prevent frauds and errors:** The main objective of internal check is to establish a system which makes fraud impossible or very difficult to commit and hence employees are dissuaded against committing frauds. In the same manner the prevention of errors is also one of its objectives since in this technique there is provision for compulsory examination of work done by one employee by another.

**2) Determination of responsibility:** The determination of responsibilities of employees is also one of the objectives of internal check. In this system work is divided in such a manner so that in case of frauds and errors the related officers can be held responsible.

**(3) To prevent omissions in accounting:** The aim of this system is to bring about discipline in accounting so that no transaction is omitted from being recorded in the books of accounts.

**(4) To increase the efficiency of employees:** The aim of the internal check system is to divide the work into various parts and assigning it to those employees who are efficient in doing such work. In this manner, this system is also adopted in order to increase the efficiency of employees.

**(5) Quick preparation of final accounts:** The aim of this technique to prepare an organization structure of the accounting department in such a way that the accounting work can be done in an efficient and error free manner, and at the end of the financial year the final accounts can be prepared as quickly as possible.

**(6) To ease the audit work:** The internal check system is also adopted in order to make the audit work easier. In organizations where this system is implemented the auditor can resort to test checking in his examination.

## **Principles of Internal Check**

Let us now understand the principles of Internal Check –

**Responsibility** – Allocation of business work amongst the various staff members should be done in such a way that their duties and responsibilities should be judiciously and clearly divided.

**Automatic check** – Automatic checking of work of one employee by another forms part of a good Internal Check system.

**Rotation** – Transfer or rotation of employees from one seat to another must be followed under good system of internal control.

**Supervision** – Prescribed procedures and Internal Check should be strictly supervised.

**Safeguard** – To safeguard files, securities, cheque books is also recommended in Internal Check.

**Formal Sanction** – Without formal sanction, no deviation should be allowed from the established procedures.

**Reliance** – Under good system, too much reliability on one employee should not be there.

**Review** – From time to time, system of Internal Check should be reviewed to introduce improvement

# Advantages of Internal Check

Following are the advantages of a good system of Internal Check –

From the Owner's Point of View

Good system of Internal Check provides accurate, reliable and genuine accounting record and data to the owner of the business on which he can rely upon.

Economy in operations and overall efficiency in system due to good Internal Check may result in more profits.

## From the Auditors Point of View

Due to efficient system of Internal Check, the statutory Auditor can avoid deep and detailed checking of transactions. He may rely on test checks, hence Internal Check provides convenience to Auditor.

Since the Balance Sheet and the Profit and the Loss account is prepared without wasting of time, hence quick preparation of final accounts is possible.

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For the Business

**Moral Check** – Great check to commission of errors and frauds is possible with knowledge of subsequent checking of work of each employee by others.

**Detection of Errors and Frauds** – This helps in early detection of errors and frauds because work of each clerk is checked by another automatically and no one is allowed to do complete work from the beginning to the end.

**Proper Division of Work** – According to qualification, experience and area of specialization of work, proper and rational distribution of work among the members of staff is done.

**Increases Efficiency** – A good internal control system provides increased efficiency of work coupled with overall economy.

## Disadvantages of Internal Check

Let us now discuss the disadvantages of Internal Check –

- ✓ It is *costly* for small business units.
- ✓ If Internal Check system is not properly organized, there are chances of disorder in the working of business.
- ✓ There might be instances where the quality of the product and the work is compromised with by the staff members due to greater importance to faster results.
- ✓ An Auditor cannot be relied on if he does not conduct tests with procedures of his own.

# Features Or Elements of Internal Check

- This technique is an integrate part of the complete system of internal control.
- This technique is related to the division of work among the people maintaining the accounts.
- In this technique, no single employee records any transaction from the beginning to the end.
- In this technique, the work done by every employee is examined independently by another employee.

- In this technique, the work done by one employee is complementary to the work done by another employee.
- The aim of this technique is to develop an automatic system for detection of frauds and errors.
- In this technique, the work of book-keeping and accountancy is mechanised to the maximum possible extent.

## Auditor's Duties in relation to internal check.

- It is no part of an Auditor's duty to prescribe the system of internal check for any business, but in case a system of internal check is in operation, he must check its efficiency and find out its weak points. In a large business concern it becomes difficult for an auditor to carry out a detailed checking.
- He would prefer to have test checking but he can do this only when he is satisfied about the efficiency and reliability of the system of internal check in force in the business.

- Thus, internal check largely determines the nature and extent of the scope of an auditor's work. It determines to a great extent the examination of details which the auditor may consider necessary to undertake and the extent to which reliance can be placed upon test checking.
- A good and effective system Of internal check may relieve him of a large part of detailed checking and he may give his attention to more important matters. Wherever the system is found to be unreliable because of its fundamental weaknesses, the auditor should take up the checking of the whole of the transactions of the business

- An auditor must satisfy himself that the internal check is properly conceived and is being satisfactorily carried out before deciding to accept the checking that has already been done by the internal staff of the concern, as adequate, warranting curtailment of the area of checking that he should carry out.
- If on examination of the system of internal check, the Auditor finds that there are certain weaknesses, and as a result of those, it would be necessary for him to extend the scope of detailed examination, he must point out this fact to his client so that internal check in that regard maybe strengthened in future.

## Internal Control

**Definition:** Internal Control can be defined as a system designed, introduced and maintained by the company's management and top-level executives, to provide a substantial degree of assurance in achieving business objective, while complying with the policies and laws, safeguarding the assets, maintaining efficiency and effectiveness in regular operations and reliability of financial statements.

## Objectives of Internal Control System

- To ensure that the **business transactions take place as per the general and specific authorization** of the management.
- To make sure that there is a **sequential and systematic recording** of every transaction, with the accurate amount in their respective account and in the accounting period in which they take place. It confirms that the financial statement fulfils the relevant statutory requirements.

- To provide **security to the company's assets from unauthorized use**. For this purpose, physical security systems are used to provide protection such as security guards, anti-theft devices, surveillance cameras, etc.
- To **compare the assets in the record with that of the existing ones** at regular intervals and report to the those charged with governance (TCWG), in case any difference is found.

- To evaluate the **system of accounting for complete authorization** of the transactions.
- To review the **working of the organization and the loopholes in the operations** and take necessary steps for its correction.
- To ensure there is the **optimum utilization of the firm's resources**, i.e. men, material, machine and money.
- To find out **whether the financial statements are in alignment with the accounting concepts and principles**.

An ideal internal control system of an organization is one that ensures best possible utilization of the resources, and that too for the intended use and helps to mitigate the risk involved in it concerning the wastage of organization's funds and other resources.

THANK YOU