Question 1
JKT Pvt. Ltd. having ₹ 40 lacs paid up capital, ₹ 9.50 crores reserves and turnover of last three consecutive financial years, immediately preceding the financial year under audit, being ₹ 49 crores, ₹ 145 crores and ₹ 260 crores, but does not have any internal audit system. In view of the management, internal audit system is not mandatory. Comment.

Answer
Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, read with rule 13 of Companies (Audit and Auditors) Rules, 2014 every private company shall be required to appoint an internal auditor or a firm of internal auditors, having-
(i) turnover of two hundred crore rupees or more during the preceding financial year; or
(ii) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year:

In the instant case, JKT Pvt. Ltd. is having turnover of ₹ 260 crores during the preceding financial year which is more than two hundred crore rupees. Hence, the company has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit.

Question 2
Briefly explain the objectives and scope of Operational Audit.

Answer
Objectives of Operational Audit: The need for operational auditing has arisen due to the inadequacy of traditional sources of information for an effective management of the company where the management is at a distance from actual operations due to layers of delegation of responsibility, separating it from actualities in the organisation. Specifically, operational auditing arose from the need of managers responsible for areas beyond their direct observation to be fully, objectively and currently informed about conditions in the units under control. Operational audit is considered as a specialised management information tool to fill the void that conventional information sources fail to fill. Conventional sources of management information are departmental managers, routine performance report, internal audit reports, and periodic special investigation and survey. These conventional sources fail to provide information for the best direction of the departments all of whose activities do not come under direct observation of managers.
Operational auditing has filled a very significant vacuum; it has come to provide the management with inexpensive, continuous and objective appraisal of activities, operations and controls to inform the management about achievement of standards and, if otherwise, to inform the management about what has gone wrong and how it has gone wrong. Also, it enlightens the management about possible dangers, constraints and opportunities that may be of immense value to the management.

The scope and quality of operational auditing is predominantly dependent upon management attitudes. An open minded management with broad vision, can appreciate the need of operational auditing and to give it the necessary freedom and sanction to perform what it is capable of performing. Also, the qualities and the sense of perspectives of the operational auditor can mould operational audit in the right shape. Without a combination of these two, operational auditing may not be able to show its distinctively and advantages to the organisation. Therefore, there is a possibility of operational auditing having different objectives to fulfil in different organisations. Generally, operational audit objectives include:

(i) **Appraisal of controls**: Operations and the results in which management is interested are largely a matter of control. If controls are effective in design and are faithfully adhered to the result that can be attained will be subject to the other limiting constraints in the organization.

(ii) **Evaluation of performance**: In the task of performance evaluation, an operational auditor is heavily dependent upon availability of acceptable standards. The operational auditor cannot be expected to possess technical background in so many diverse technical fields obtaining even in one enterprise. Even when examining or appraising performance or reports of performance, the operational auditor’s mind is invariably fixed on control aspects.

(iii) **Appraisal of objectives and plans**: In performance appraisal, the operational auditor is basically concerned not so much with how well technically the operations are going on, but with accumulating information and evidence to measure the effectiveness, efficiency and economy with which the operations are being carried on.

(iv) **Appraisal of organisational structure**: Organisational structure provides the line of relationships and delegation of authority and tasks. This is an important element of the internal control design. In evaluating organisational structure, the operational auditor should consider whether the structure is in conformity with the management objectives and it is drawn up on the basis of matching of responsibility and authority. He should also analyse whether line of responsibility has been fixed, whether delegation of responsibility or authority is clear and there is no overlapping area.

**Question 3**

*What are the Management Audit Questionnaires? Give a sample questionnaire for Audit of Inventory.*
Answer

Management Audit Questionnaire: A management audit questionnaire is an important tool for conducting the management audit. It is through these questionnaires that the auditors make an inquiry into important facts by measuring current performance. Such questionnaires aim at a comprehensive and constructive examination of an organisation’s management and its assigned tasks. Overall it is concerned with the appraisal of management actions in accomplishing the organisation’s objectives. Its primary objective is to highlight weaknesses and deficiencies of the organisation. It includes a review of how well or badly the management functions of planning, organising, directing and controlling are being performed. The questionnaire provides a means for evaluating an organisation's ongoing operations by examining its major functional areas. There are three possible answers to the management audit questions: “Yes”, “No” and “N.A.”, (not applicable). Questionnaire comments on negative answers not only provide documentation for future reference, but, more important, provide background information for undertaking remedial action. The management audit questionnaire does not give answers, but simply asks questions. If all questions are answered with a ‘yes’, operations are proceeding as desired. On the other hand, if there are one or more ‘no’ answers, difficulties are being experienced and must be explained in writing. If the question does not apply, the N.A. (not applicable) column is checked. Thus, management audit questionnaire for this part of the audit not only serves as a management tool to analyse the current situation; more importantly, it enables the management auditors to synthesis those elements that are causing organisational difficulties and deficiencies.

Audit of Inventory

A management audit questionnaire for audit of inventory is given below:

<table>
<thead>
<tr>
<th>Questionnaire</th>
<th>Yes</th>
<th>No</th>
<th>N.A.</th>
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<tbody>
<tr>
<td><strong>INVENTORY</strong></td>
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<tr>
<td>A. Long-range plans:</td>
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<tr>
<td>1. Is inventory management sufficiently qualified to meet long-range company objectives?</td>
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<tr>
<td>2. Are long-range inventory management plans coordinated with:</td>
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<tr>
<td>a. production?</td>
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<tr>
<td>b. purchasing?</td>
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<tr>
<td>c. finance?</td>
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<tr>
<td>3. Is inventory properly and efficiently stored so as to provide a minimum of:</td>
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<tr>
<td>a. obsolescence?</td>
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<td>b. deterioration?</td>
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<td></td>
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<tr>
<td>c. pilferage?</td>
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<tr>
<td>4. Is there an adequate inventory system under</td>
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management control to plan inventory in the long run at optimum levels?

5. Is there an effective physical inventory system to obviate any surprises in loss or value?

6. Are inventory plans and procedures audited periodically by:
   a. internal auditors?
   b. external auditors?

**B. Short- or medium-range plans:**

1. Is inventory management sufficiently qualified to meet short- or medium-range company objectives?

2. Are short-range inventory management plans an integral part of:
   a. production?
   b. purchasing?

3. Are inventories under control as to:
   a. type?
   b. amount?

4. Is there an adequate inventory system to:
   a. plan current inventory at optimum levels?
   b. compare physical to perpetual inventories?
   c. detect theft?

5. Are lead times figured into inventory levels for:
   a. purchasing?
   b. manufacturing?

6. Is the concept of safety stock employed as a protection against stock-outs?

7. Are inventory levels coordinated with reorder points?

8. Are bills of materials utilized to determine inventory requirements?

9. Do short-range inventory plans include “make” versus “buy” decisions to lower costs?

10. Is receiving and inspection of inventory items adequate?

**C. Organisational structure:**

1. Is the inventory department under the direction of a capable manager?
2. Are inventories and their in-plant movements organised and reported by their basic types:
   a. raw materials?
   b. work in process?
   c. finished goods?

3. Are inventories maintained at their optimum level by their basic types:
   a. raw materials?
   b. work in process?
   c. finished goods?

4. Is there an effective system of physical inventory to disclose any irregularities or losses?

5. Is inventory organised around the ABC method of classifying materials, i.e., by high, medium, and low-value items?

6. Is inventory integrated within an information system?

7. Are modern materials-handling methods used for transportation and storage of materials?

**D. Leadership:**

1. Does inventory management exert the necessary leadership to keep inventory under control?

2. Is inventory management capable of giving the leadership necessary to minimise the investment in:
   a. raw-materials inventories?
   b. work-in-process inventories?
   c. finished-goods inventories?

3. Is inventory kept at a minimum that is consistent with efficient production planning?

4. Does inventory management have the necessary clout to store inventories properly in order to minimize losses caused by spoilage, obsolescence, or depreciation?

5. Is inventory management sufficiently progressive to employ the most modern materials-handling methods for transportation and storage of inventories?
**E. Communication:**

1. Is there an information system utilised that employs efficient management, methods and techniques to control inventories and to prepare periodic inventory reports that are of great value to management?

2. Is there an effective communication system designed to assist in, keeping the inventory turnover rate high?

3. Is there good managerial control over movement of work-in-process materials so that this inventory is kept at a minimum?

4. Is the level of work-in-process materials consistent with an efficient manufacturing cycle?

5. Is there a procedure for highlighting excess inventory quantities and bringing this condition to management’s attention in order to return them to their proper levels?

6. Is there an effective inventory system for keeping any surprises in inventory losses to minimum?

**F. Control:**

1. Are inventory management control reports, methods, and techniques integrated with:
   - a. production?
   - b. purchasing?

2. Are inventories effectively controlled as to:
   - a. type?
   - b. amount?

3. Are inventories properly stored to provide a minimum of:
   - a. obsolescence?
   - b. deterioration?
   - c. pilferage?

4. Have inventory levels been reduced by profitable disposition of obsolete or excess items?

5. Is inventory control integrated with:
   - a. economic order quantities?
   - b. reorder points?

6. Is the concept of safety stock employed to protect against stockouts?
7. Are lead times figured into inventory levels?

8. Have steps been taken to balance the cost generated by too small an inventory against the cost of carrying excessive inventories to determine an optimum inventory turnover?

9. Are bills of materials utilised to determine what items should be retrieved from inventory?

10. Is there adequate management control over the receipt of raw materials and parts from vendors?

11. Is there adequate management control over the receipt of work-in-process items for the manufacturing departments?

12. Is there adequate inspection of items received into inventory as to:
   a. type?
   b. number?

13. Are inventory items physically counted to make sure that perpetual inventory records are accurate?

14. Is inventory controlled through the use of the ABC concept (A = high-value items, B = medium-value items, C = low-value items)?

15. Is there an effective management control system for receiving materials that are not on a purchase order, i.e., products returned by customers?

16. Are materials available when needed for the start of production?

**Question 4**

“Operational auditing is not different from internal auditing.” Discuss.

**Answer**

Internal auditing is an activity carried out by the internal staff of the organisation to meet the management requirements of information. The definition of internal auditing as given by the Institute of Internal Auditors of New York, in fact, is so wide in its scope that it covers both operational and management auditing. According to the Institute of Internal Auditors, “the overall objective of internal auditing is to assist all members of management in the objective discharge of their responsibilities, by furnishing them with objective analysis, appraisals, recommendations and pertinent comments concerning the activities reviewed. The internal auditor, therefore, should be concerned with any phase of business activity wherein he can be of service to organisation”. According to the definition, the overall objective of internal auditing is to assist all members of management in the objective discharge of their responsibilities, by
furnishing them with objective analysis, appraisals, recommendations and relevant comments concerning the activities reviewed. The internal auditor, therefore, should be concerned with any phase of business activity wherein he can be of service to the organisation. Naturally, when an auditor is concerned with the appraisal of operations, he would be performing the role of an operational auditor. Another important point that this definition throws up is that operational auditing is essentially a function of internal auditing staff. Traditionally, the internal auditing was concerned with the financial transactions only. It was during early 1940’s, the concept of operational auditing came into existence. According to Cadmus “operational auditing is not different from internal auditing, it is merely an extension of internal auditing into operational areas. It is characterised in both financial and operational areas – by the auditor’s approach and state of mind”. The main objective of operational auditing is to verify the fulfillment of plans and sound business requirements as also to focus on objectives and their achievement as against the performance yardsticks evident from in the management objectives, goals and plans, budgets records of past performance, policies and procedures. Industry standards can be obtained from the statistics provided by industry, associations and government sources. It should be appreciated that the standards may be relative depending upon the situation and circumstances; the operational auditor may have to apply them with suitable adjustments. It might appear from the above that an internal auditor is not concerned with operational aspects and operational auditor is, not concerned with financial aspects which is not so. Because traditionally, internal auditors had been engaged in a sort of protective function, deriving their authority from the management. They examined internal controls in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are not there; they checked the accounting books and records to see, whether the internal checks are properly working and the resulting accounting data are reliable. They also looked into the aspect of safety of the assets and properties of the company. It should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls. A point has already been made that the special expertise acquired by the operational auditor, that enables him to view the controls and operations from the management point of view, can be carried back to his review of the financial areas. In the matter of cash transactions, the operational auditor will look into such aspects as the quantum of cash in hand (by relating it to the requirement of cash to be held) carried generally or the use of cash not immediately required. Also he will review the operational control on cash to determine whether maximum possible protection has been given to cash. Similarly, in the audit of inventories, he would have management policy. In pure administrative areas on inventory, he will see whether adequate security and insurance arrangements exist for protection of inventories.

Thus, over a period of time, the scope of internal auditing was widened to cover not only accounting and financial operations but other operations such as marketing, personnel, production, etc. As per the modern definition of internal auditing, there is no difference between the two. However, still some auditors believe that there might exist difference between the two on account of perception as far as scope of the two is concerned which in fact is not true as evident from the foregoing analysis.
Question 5

*Explain in brief the behavioural aspects encountered in the management audit and state the ways to solve them.*

**Answer**

**Behavioural Aspects Encountered in Management Audit:** Financial auditors deal mainly with figures. Management auditors deal mainly with people. There are many causes for behavioural problems arising in the review function of management audit. Particularly, when management auditors performs comprehensive audit of operations, they cannot be as well informed about such operations as a financial auditor in a financial department. Operating processes may be unfamiliar and complex. The operating people may be speaking a language and using terms that are foreign to the auditor’s experience. The nature and causes of behavioural problems that the management auditor is likely to face in the discharge of the review function that is expected of him and possible solutions to overcome these problems are discussed below:

1. **Staff / Line conflict:** Management auditors are staff people while the members of other departments are line people. Management auditors tend to discount the difficulties the line staff may face, if called on to act on the ideas of management auditors. Management auditors are specialists in their field and they may think their approach and solutions are the only answers.

2. **Control:** The management auditor is expected to evaluate the effectiveness of controls, there is an instinctive reaction from the auditee that the report of the auditor may affect them. There is a fear that the action taken based on the management audit report will affect the line people. It breeds antagonism. The causes are as under:
   - Fear of criticism stemming from adverse audit findings.
   - Fear of change in day to day working habits because of changes resulting from audit recommendations.
   - Punitive action by superior prompted by reported deficiencies.
   - Insensitive audit practices.
   - Hostile audit style.

**Solution to behavioural problems:** The following steps may be taken to overcome the aforesaid problems-

1. To demonstrate that audit is part of an overall programme of review for protective and constructive benefit.
2. To demonstrate the objective of review is to provide maximum service in all feasible managerial dimensions.
3. To demonstrate the review will be with minimum interference with regular operation.
4. The responsible officers will be involved in the process of review of the findings and recommendations before the audit report is formally released.
It is essential to create an atmosphere of trust and friendliness so that audit reports will be understood in their proper perspective.

Finally, it needs hardly any emphasis that there should be right management culture, enlightened auditees and auditors of the right calibre. May be to expect a combination at all times of all the three is asking for the impossible. But, a concerted effort by the management, auditors and auditees to achieve a more acceptable climate would go a long way to achieve the goal.

Question 6

*K Ltd. requires you to organize a Management audit program. Briefly state a plan of action.*

Answer

Organizing a Management Audit for K Ltd.: The key requirement for a successful Management audit program would be the approval and support of the top management to initiate. Accordingly, the following shall be the matters that should be considered while organizing the Management Audit of K. Ltd.

Devising the statement of policy - The management's support must be reflected clearly and categorically in the company's highest policy statement. The policy statement should be quite specific. It should spell out clearly the scope and status of the management/operational auditing within the enterprise, its authority to carry out audits, issue reports, make recommendations, and evaluate corrective action. The statement of policy should lay down in clear terms the scope of activities to be performed by the management auditor. The scope of activities is the most basic requirement for building up a successful management audit programme both for small as well as a large organisation. The statement must categorically say that the management auditor is capable of reviewing administrative and management controls over any activity within the company. However, he should not be expected to extend his activities to the evaluation of performance of professional and technical activities calling for specialised knowledge and skills and suggest remedies unaided by people competent to undertake such evaluation.

Location of audit function within the organisation - Some organisations depending upon their size and nature of have established a separate department of audit specialists where the head of the department reports directly to the top executive. In certain cases, the audit group may be a part of the activities of management services department, administrative control department or some other unit of organisation. The more important question, however, is that the function should be as entirely independent as possible of pressure from various groups in the enterprise. The greater the independence, greater is the freedom to work effectively. Therefore, it is better to place the auditing function quite high in the organisation. One of the controversies that is usually raised is whether the management auditor should report to the finance director, to whom he may be administratively responsible or to the managing director where he has no administrative responsibility. A third opinion would like the auditor to report to an audit committee, comprising of senior executives of the company who are preferably Board members. A different school of thought would like auditors to report to both the finance director and the audit committee. Though the controversy rages and no definite solution can
be arrived at, it is felt that the controversy regarding which of these persons the management auditor should report to is not much substance where independence exists. His independence is entirely dependent on the management’s attitude towards audit, the credibility the management auditor has with the management and the management’s positive will to listen to criticism for self betterment.

**Allocation of personnel** - Whatever be the size of the enterprise, it is important that all persons selected and assigned to audit possess a good understanding of auditing theory, a thorough knowledge of the fundamentals of both organisation and management, the principles and effective methods of control, and the requirements for conducting scientific appraisal. “General Guidelines on Internal Auditing” issued by the Institute also emphasise these qualifications for an auditor whose area extends beyond the review of financial controls. As the management auditor is expected to evaluate operational performance and non-monetary operational controls, he should possess basic knowledge of the technology and commercial practices of the enterprise, an enquiring, analytical, pragmatic and imaginative approach and a thorough understanding of the control system. The management auditor should also have a basic knowledge of commerce, law, taxation, cost accounting, economics, quantitative methods and EDP systems. Knowledge in these areas would be adequate for him to identify problems and to determine steps to be taken when a problem is identified. In personal characteristics individuals assigned to the job should have an inclination towards analysis, a high degree of imagination and an ability to write and express themselves clearly and logically.

**Staff training programme** - A continuous training programme is necessary to achieve quality in performing audit assignments because the management auditor must keep a breast of new ways to improve auditing standards. An effective training programme enables staff to assume additional responsibilities and advancements in the organisation. Thus the programme acts as an incentive for drawing capable people into the department and keeping them.

**Time and other aspects** - The time and cost will vary for each assignment, depending upon the nature of the assignment, the number of auditors assigned to perform the work, and whether or not more specialists in a particular field are required. An audit of a production planning and control department, for example because of its size and other factors, could require an audit staff of several persons and, in addition, a specialist in production planning and one in production control. If an assignment is one which requires technical assistance of a nature unavailable within the audit group, it might be advisable to seek a qualified outside consultant to perform the work.

**Frequency** - Having specified various approaches to management audit, including its scope and its staffing requirements the last item that should be considered before undertaking such an audit is its frequency. Prime consideration should be given to the nature of the organisation. Is the company in a fast-changing industry where there is great accent on the latest technology in the company’s products and/or services? When the organisation is subject to rapid change or the total resources utilised are expensive, the frequency of management auditing should be greater than when it does not undergo rapid changes or the resources employed are not high in value.
19.12 Advanced Auditing and Professional Ethics

To get an idea of the optimum frequency of such an audit, it might be worthwhile to look at financial audits. Customarily, financial audits are conducted annually. They are highly programmed, since an internal control questionnaire is utilised to attest to accounting methods and procedures. By contrast, a management audit should be considered from a longer time frame. For an organisation, that is subject to rapid changes or consumes a great amount of high-cost resources, a two-years basis might be adequate to protect it from managerial and operational problems becoming entrenched or too large. For those organisations in a relatively stable industry, the frequency of audit can be every three years. In no case should the interval be allowed to exceed three years.

Question 7

What are the major differences between Financial and Operational Auditing?

Answer

Differences between Financial and Operational Auditing: The major differences between financial and operational auditing can be described as follows-

(i) **Purpose** - The financial auditing is basically concerned with the opinion that whether the historical information recorded is correct or not, whereas the operational auditing emphasizes on effectiveness and efficiency of operations for future performance.

(ii) **Area** - Financial audits are restricted to the matters directly affecting the appropriateness of the presented financial statements but the operational auditing covers all the activities that are related to efficiency and effectiveness of operations directed towards accomplishment of objectives of organization.

(iii) **Reporting** - The financial audit report is sent to all stock holders, bankers and other persons having stake in the Organisation. However, the operational audit report is primarily for the management.

(iv) **End Task** - The financial audit has reporting the findings to the persons getting the report as its end objective, however, the operational auditing is not limited to reporting only but includes suggestions for improvement also.

The main objective of operational auditing is to verify the fulfillment of plans, and sound business requirements. Operational auditing is considered as specialized management information tool. Operational auditing is essentially a function of internal auditing staff. Operational auditing is a systematic process of evaluating an organisation's effectiveness, efficiency and economy of operations under management control and reporting to appropriate persons, the result of the evaluation along with recommendations for improvements. Operational audit concentrates on effectiveness, efficiency and economy of operations and therefore it is future oriented. It does not end with the reporting of the findings but also recommends the steps for improvements in future. Operational auditing is not different from internal auditing; it is merely an extension of internal auditing into operational areas.

While in financial auditing, the concentration is more in the financial and accounting areas to ensure that possibilities of loss, wastage and fraud are minimized or removed. In financial auditing, an auditor is called upon to review the financial statements of an enterprise to
ascertain whether they reflect true and fair view of its state of affairs and of its working results. He may analyse the operations of an enterprise to appraise their cost effectiveness and also he may seek evidence to review the managerial performances.

Question 8

Write a short note on - Summary Written Report.

Answer

Summary Written Reports: These are known as flash reports. They are significant highlights for immediate attention of top management. Generally suspected defalcations are reported briefly to the appropriate management official on the 'flash' basis, often ending up in referral for criminal investigation and legal action. It is common practice in number of companies of issuing a report quite frequently summarising the various individual reports issued and describing the range of their contents in a very brief and comprehensive manner where only important points are highlighted. Such reports are primarily issued for audit committees of Board of Directors and for other top level managers who do not have sufficient time to go through the elaborate reports and matters which are required to be brought to their notice for immediate action.

Question 9

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

Answer

Alternative Way to Tackle the Hostile Management: While conducting the operational audit the auditor has to come across many irregularities and areas where improvement can be made and therefore he gives his suggestions and recommendations. These suggestions and recommendations for improvements may not be accepted by the hostile managers and in effect there may be cold war between the operational auditor and the managers. This would defeat the very purpose of the operational audit.

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

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

Question 10

Write a short note on general objectives of an operational audit.

Answer

General objectives of operational audit: It includes-

(i) Appraisal of Controls.


(iii) Appraisal of objectives and plans and

(iv) Appraisal of organizational structure.

(i) Appraisal of controls: Operations and the results in which management is interested are largely a matter of control. If controls are effective in design and are faithfully adhered to the result that can be attained then they will be subject to the other limiting constraints in the organization.

(ii) Evaluation of performance: In the task of performance evaluation, an operational auditor is heavily dependent upon availability of acceptable standards. The operational auditor cannot be expected to possess technical background in so many diverse technical fields obtaining even in one enterprise. Even when examining or appraising performance or reports of performance the operational auditor's mind is invariably fixed on control aspects.

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Question 11

The Managing Director of X Ltd is concerned about high employee attrition rate in his company. As the internal auditor of the company he requests you to analyze the causes for the same. What factors would you consider in such analysis?

Answer

The factors responsible for high employee attrition rate are as under:
(i) Job Stress & work life imbalance
(ii) Wrong policies of the Management
(iii) Unbearable behaviour of Senior Staff
(iv) Safety factors
(v) Limited opportunities for promotion
(vi) Low monetary benefits
(vii) Lack of labour welfare schemes
(viii) Whether the organization has properly qualified and experienced personnel for the various levels of works?
(ix) Is the number of people employed at various work centres excessive or inadequate?
(x) Does the organization provide facilities for staff training so that employees and workers keep themselves abreast of current techniques and practices?

Question 12

Mr. ‘P’ have been appointed as operational auditor of M/s Books & Magazine Ltd. and observed a totaling error in invoice of ₹1,000. He has not taken care of the same saying that this is out of scope of his work. Comment.

Answer

Scope of Operational Audit: Operational auditing is a systematic process involving logical, structured and organized series of procedures. It concentrates on effectiveness, efficiency and economy of operations and therefore it is future oriented. It does not end with the reporting of the findings but also recommends the steps for improvement in future.

The main objective of operational auditing is to verify the fulfilment of plans and sound business requirements as also to focus on objectives and their achievement objectives; the operational auditor should not only have a proper business sense, he should also be equipped with a thorough knowledge of policies, procedures, systems and controls, he should be intimately familiar with the business, its nature and problems, and prospects and its environment. Above all, his mind should be open and active so as to be able to perceive problems and prospects, and grasp technical matters.

In carrying out his work probably at every step he will have to exercise judgement to evaluate evidence in connection with the situations and issues; he will have to get the assistance of norms and standards in every operating field to be able to objectively judge a situation. The norms and standards should be such as are generally acceptable or developed by the company itself.

To a traditional internal auditor, a loss of ₹1,000 caused by a wrong totaling of invoice is important and this is that he looks for. But for an auditor engaged in the review of operations, carrying out of a proper maintenance programme of the machines is of greater importance because considerable production loss due to machine breaks down can thus be prevented. In
both the cases, the auditor’s objective is to see that the business and its profitability do not suffer from avoidable loss, but, nevertheless, there is a distinct difference in approach. But it should not be assumed, that, since an operational auditor is concerned with the audit of operations and review of operating conditions, he is not concerned with the financial aspects of transaction and controls.

Hence, contention of operational auditor that totaling error in invoice of ₹1,000 is out of scope is not correct as operational audit is being carried out to ensure that all the management functions like planning, organizing, staffing, directing and controlling are working effectively and efficiently. Such kind of error is very much in scope because such an existence of error indicates that control system (controlling function) is not sound.

Question 13

AB Pvt. Ltd. company having outstanding loans or borrowings from banks exceeding one hundred crore rupees wants to appoint internal auditor. Please guide him who can be appointed as internal auditor and what would be reviewed by him.

Answer

Applicability of Internal Audit: Section 138 of the Companies Act, 2013 states that every private limited company is required to conduct internal audit if its outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In view of above provisions, AB Pvt. Ltd. is under compulsion to conduct internal audit as its loans or borrowings are falling under the prescribed limit.

Who can be appointed as Internal Auditor– The internal auditor shall either be a chartered accountant or a cost accountant, whether engaged in practice or not, or such other professional as may be decided by the Board to conduct internal audit of the functions and activities of the companies.

The internal auditor may or may not be an employee of the company.

Work to be reviewed by Internal Auditor– Each of the managerial functions should constantly be viewed by the internal auditor. The scope of internal auditor’s work should include a review of:

(i) internal control system and procedures.

(ii) system regarding the custodianship and safeguarding of assets - monetary and non-monetary of enterprise.

(iii) compliance by the various segments with the policies, plans and procedures of the enterprise as well as with the relevant regulations and laws.

(iv) system of collecting data both monetary and non-monetary - to ensure that the information given to management and to external agencies is relevant and reliable.

(v) organisational structure of the enterprise and its congruence with its objectives.

(vi) efficient and economical use of available resources tangible as well as intangible.
(vii) various operations.

Question 14

WWF Ltd. is a public company having ₹ 40 lacs paid up capital in previous financial year which raised to ₹ 60 lacs in current financial year under audit. The company had turnover of previous three consecutive financial years being ₹ 49 crores, ₹ 145 crores and ₹ 150 crores. During the previous year, WWF Ltd. borrowed a loan from a public financial institution of ₹ 110 crores but squared up ₹ 20 crores by the year end. The company does not have any internal audit system. In view of the management, internal audit system is not mandatory.

You are required to state the provisions related to applicability of internal audit as per the Companies Act, 2013 and comment upon the contention of the management of the company.

Answer

Applicability of Provisions of Internal Audit: As per section 138 of the Companies Act, 2013, following class of companies (prescribed in Rule 13 of Companies (Accounts) Rules, 2014) shall be required to appoint an internal auditor or a firm of internal auditors, namely:-

(A) every listed company;

(B) every unlisted public company having-
   (1) paid up share capital of fifty crore rupees or more during the preceding financial year; or
   (2) turnover of two hundred crore rupees or more during the preceding financial year; or
   (3) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year; or
   (4) outstanding deposits of twenty five crore rupees or more at any point of time during the preceding financial year; and

(C) every private company having-
   (1) turnover of two hundred crore rupees or more during the preceding financial year; or
   (2) outstanding loans or borrowings from banks or public financial institutions exceeding one hundred crore rupees or more at any point of time during the preceding financial year.

In the given case, WWF Ltd. is a public company. The company borrowed a loan from a public financial institution of ₹ 110 crores during the previous year. At the year end, the loan outstanding after being squared up is ₹ 90 crores (₹ 110 crores - ₹ 20 crores) which is less than the minimum prescribed limit of ₹ 100 crores for applicability of internal audit. Although, the outstanding loan at previous year end is ₹ 90, it was ₹ 110 crores at some point of time which is the requirement of the section (refer Rule 13(B)(3) as mentioned above).

Hence, WWF Ltd. has the statutory liability to appoint an Internal Auditor and mandatorily conduct internal audit. Consequently, the contention of the management of the company is not tenable.
Question 15

Management Audit and Operational Audit are complementary and supplementary to one another. Discuss.

Answer

Relationship between Management and Operational Audit: Operational audit is an audit for the management; it is undertaken at the instance of the management for providing it with information and appraisal of operations and activities.

Management audits are concerned with appraising management’s accomplishment of organisational objectives; the management functions of planning, organising, directing, and controlling; and the adequacy of management’s decisions and actions in moving towards its stated objectives.

The preponderant view about management audit is that it is wider in scope compared to operational audit. However, a distinction should be made between management audit and operational audit. Management audit is concerned with the quality of managing, whereas operational audit centres on the quality of operations. The basic difference between the two audits, then, is not in method, but in the level of appraisal.

The two audits are complementary and supplementary to one another. In management audit, the auditor is to make his tests to the level of top management, its formulation of objectives, plans and policies and its decision making. It is not that he just verifies the operations of control and procedures and fulfillment of plans in conformity with the prescribed policies. He is to reach the root i.e., the functions of top management which lay down objectives and policies, provide means and procedures of implementation and control and which actually engage in direction and control on a continuous basis. In addition to what would normally be covered in an operational audit, management audit would also encompass the relevance and effectiveness of the aims, duties and decisions of management at various levels.

In view of the analysis made above which recognises management audit and operational audit as two identifiable exercises having a large area of overlapping jurisdiction, it may be convenient to consider them together to avoid duplication; and for this purpose the expression “management and operational audit” may be acceptable as a management audit which includes within its scope all the elements of operational auditing.