



THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA
(SET UP BY AN ACT OF PARLIAMENT)
THRISSUR BRANCH (SIRC)



02 October

GANDHI
Jayanti

*Strength does not come from physical capacity,
it comes from an indomitable will.*

-Mahatma Gandhi

2024 OCTOBER E-NEWSLETTER



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EDITOR'S NOTE

Dear Professional Colleagues,

September has been a tumultuous month filled with extended work hours, endless client discussions, intense auditing procedures, and the need for seamless teamwork. It's understandable if you're feeling exasperated and worn out. As we close this tax audit period and shift our focus to upcoming due dates and tax filings, I encourage you to carve out time for your family amidst the busy schedule.

As we celebrate Gandhi Jayanti on October 2nd, we take a moment to reflect on the profound teachings of Mahatma Gandhi, a symbol of peace and non-violence. This day not only commemorates the birth of a visionary leader but also reminds us of our duty to foster harmony and integrity in our personal and professional lives. At the ICAI Thrissur Branch, we urge all members to embody Gandhi's values of truth and simplicity, promoting ethical practices in our work. Let us honor his legacy by committing to the principles of transparency and service, which are vital to our journey as Chartered Accountants.

In this edition of the newsletter, we are pleased to feature a thought-provoking article by CA Rahul Sharma, titled "Internal Management and Operational Audit."

Happy Reading!

Jai Hind, Jai ICAI.

Warm regards,

CA. Jeen Paul

Newsletter In Charge

CHAIRPERSON'S MESSAGE

Dear Professional colleagues,

I extend warm greetings to you all.

As we embark on the journey through the final quarter of the year, I want to take a moment to reflect on our commitment to continuous professional development and the importance of staying updated in our ever-evolving field. Our recent lineup of CPE seminars exemplifies this commitment, addressing critical topics that impact our profession and the industries we serve.

On September 4th, CA. Roopa Nayak addressed "Issues in Input Tax Credit in GST and the Real Estate Sector," providing valuable insights. This was followed by CA. Soman N. L. on September 7th, who analyzed the "53rd GST Council Decisions and Finance Act 2024," essential for navigating indirect taxation.

On September 9th, CA. Ravinath R. Pai and CA. Adv. Santhosh Sagar focused on Tax Audit and recent amendments, while on September 10th, CA. Ramnath V conducted a detailed analysis of the Finance Act 2024 in direct taxation. Each session has been instrumental in enhancing our professional capabilities.

As we approach Gandhi Jayanti on October 2nd, let us reflect on the values of truth and integrity that Mahatma Gandhi championed. These principles are vital in our profession, guiding us toward ethical conduct and social responsibility.

I encourage all members to engage with these learning opportunities and to embody these values in our work. Your participation strengthens our community as we navigate the challenges ahead.

Thank you for your commitment to excellence.

Warm regards,

Jai ICAI Jai Hind

CA. ANOOP V FRANCIS
CHAIRPERSON

INTERNAL AUDITING TO MANAGEMENT AUDIT: A JOURNEY OF PROFESSION FROM EVOLUTION TO GROWTH AND SURVIVAL

Contribution of Internal Auditing in the Evolution of Auditing Profession:

Internal Auditing was developed as an “audit on behalf of the management”, In older times when normally owners who used to be the top management as well, placed their reliance on some of their close employees, these owners or managers used to assign task of checking of affairs of the organization to those employees. Gradually this practice became popular and a new branch in the auditing i.e. Internal Audit got evolved. Thus, the traditional concept of internal auditing was primarily concerned with questions like whether the assets of the organization were adequately safeguarded and properly accounted for, whether the accounting and other allied records were reliable, and whether the organizational policies and procedures were complied with. There was a great emphasis on detection of frauds and accuracy of financial records, the internal auditor was perceived as status Quo oriented auditor of financial records.

In later time need for Internal Audit increased primarily due to the fact that in the recent past business organizations have grown enormously in size and operations. Many of them employed thousands of persons and conducted operations from various locations. It therefore became necessary for the management of such organizations to have a team of specialists to review the procedures and operations of various units and report cases of non compliances, inefficiency and lack of control so that necessary action can be taken. This task cannot be handed over to statutory auditors whose main job is to give opinion on true and fairness of the financial statements

Traditional Approach: Internal Auditing was developed as a checking of records on behalf of management to ensure a. That laid Internal Controls are adequate and Effective, b. Financial and other records & reports show the actual operations accurately and promptly and c. Each unit of the organization follows the policies and

procedures as laid down by the Management. All these efforts are aimed at minimization of chances of fraud and errors.

How Internal Audit Contributed in Growth and Survival of Profession in competitive environment:

As the time changed Modern Approach developed, whereby in addition to above three objectives Internal Auditing has been entrusted with the task to d. Assist members of Organization in discharge their duties and e. Outcome of Audit is also to furnish Analysis, Appraisal, Recommendations, Counsel and provide Information in Respect of activities under review.

Thus Internal Auditing has gained importance in an organization because it has constructively provided solutions to the problems encountered by the business. Further It has also secured attention because most of the times Internal Auditing remained futuristic and suggested areas of weaknesses to the business before damage actually occurs. The suggestive and recommendatory report may add value to the organization.

The term ‘Management Audit’, ‘Operational Audit’ and the modern concept of the term Internal Audit often convey more or less the same meaning. There is no clear-cut demarcation of the audit activities and the areas which they may fall in the ambit of these three terms. In an audit assignment to review operations and performances, it is difficult as to say as to which portion of the audit program relates to internal audit, which to operational audit and which to management audit. If we compare the definition of the internal audit given as above with the following definition of ‘Operational Audit’ as given by the Federal Financial Officers Institute of Canada, our observation get confirm:

“A systematic independent appraisal activity within an organization for a review of the entire departmental operations as a service to management. The overall objective of operational auditing is to assist all levels of management in the effective discharge of their responsibilities by furnishing them with objective

analysis, appraisal, recommendations and pertinent comments concerning the activities reviewed”

Afterwards some authors attempted to distinguish between ‘Operational Audit’ and ‘Management Audit’. Accordingly, operational audit is said to be confined to various operations and activities in the functional area, where as the management audit said to be dealing with various aspects of management process. In any case one can say that the management audit, as its name signifies, attempts to evaluate the performance of various management processes and functions. It is an audit to examine, review and appraise the various policies and actions of the management on the basis of certain standards. It may be comprehensive and critical review of all aspects of management performance.

Management Audit is needed for all Economic Activities in today’s world:

Initially many accountants regard management audit as a vague concept and argued that it serve no material purpose. The critics of management audit do not realize that it is not really a detailed audit of the kind that is conducted under and protection of statute rather it is value for money. They must also appreciate the fact that organizations opts to pay for management audit because this audit adds value to organization. Management Audit is essentially a review of the performance of various managers. It does not emphasize whether procedures have been followed or not or whether all formalities have been complied or not. It evaluates the actual performances and compares them with the predetermined targets. It concentrates on the results and not on the files and papers. It concerns primarily with the results and with ratios of input and output. It measures in quantitative terms various inputs that a manager uses in terms of wages, material, overheads, or capital resources. The outputs are measured in terms of quantity, rate of return or performance targets. The performances are evaluated by relating inputs with outputs. Thus management audit is highly result oriented.

Examples of some Agenda for Management/Operational Audit:

- 1.Evaluation of credit policy with a view to cost benefit associated with credit period and target sales volume.
- 2.Suggestions as to receivable management tools with cost benefit analysis like factoring, discounting etc.

- 3.Cost of capital analysis along with cost benefit analysis for deciding as to swapping of funds, fresh fund raising, proportion as to indigenous and foreign funds.
- 4.Cash and bank management to reduce holding costs - evaluation of different investment propositions, current account maintenance with FDR sweep facility at different locations, cash credit account management with suggestions as to size nature and location of limit (including cost benefit analysis in report).
- 5.Production process analysis with a view to identify areas of efficiency improvement like review of production losses, wastage management, input output ratio evaluation etc.
- 6.Critical analysis of Production capacity and technology involved in production process. Cost benefit analysis for increase/decrease or substitution thereof.
- 7.Raw material holding and storage evaluation along with cost benefit analysis so as to arrive at optimum level where funds are not blocked and production is not interrupted - especially beneficial where raw material supply is seasonal.
- 8.Evaluation of leasing and owning propositions with the help of cost and revenue data.
- 9.Critical cost and benefits analysis of each and every activity of production process so as to find out activities eligible for job work lending and procurement.
10. Cost benefit analysis before establishment of control systems.
11. Cost benefit analysis for in-house employment vs outsourcing.
12. In house training vs sending outside for training - cost benefit analysis.
13. Manpower substitution with mechanical systems - cost benefit analysis.
14. Development and periodic performance appraisal of profit and responsibility center. With an aim to eliminate non profitable activities.
15. Export and domestic order wise profit/loss analysis. With an aim to reduce non profitable orders.
16. Loss due to cancellation of orders. To quantify loss due to delay, quality issues etc.
17. Profit/loss analysis and Product lifecycle analysis for suggesting elimination of non profitable products and products needing modifications.
18. Cost benefit analysis of minimum level of inventories. To recommend or otherwise suggest maintenance of minimum level of inventories.

19. Calculation of EOQ for various items of inventories. Cost of non observance of EOQ.
20. Cost benefit analysis of holding stores department and purchasing of items available in local market.
21. Identification of slow moving items in stores department. To release additional funds involved.
22. Cost analysis of interruption in production due to shortage of items. Identification of key production factor and measures to overcome its shortage.
23. Profit/ loss analysis of purchasing from domestic supplier and importing from outside country.
24. Market analysis of various items to be purchased and suggestions for cost reduction

Though as far as workability is concerned Management/Operational and Modern Approach of Internal Audit are one and the same, Still We should differentiate between Management and Operational Audit for conceptual understanding of different term used:

Management Audit focus on evaluating an organization's management practices, including its planning, organizing, directing, and controlling functions. This provides insights into the effectiveness of the organization's management practices, its ability to achieve its strategic objectives, and its alignment with its mission and vision.

Operational Audit, on the other hand, focuses on evaluating an organization's operational processes and procedures. The service provides insights into the efficiency and effectiveness of the organization's operations, its ability to identify and mitigate risks, and its compliance with laws and regulations.

A management audit assesses the overall effectiveness of an organization's management and its strategic direction. It evaluates the leadership, decision-making processes, organizational structure, and corporate governance. The primary goal is to ensure that the management is leading the organization in the right direction and making sound decisions for its long-term success. An operational audit focuses on the efficiency and effectiveness of an organization's operations and processes. It examines specific operational areas such as production, marketing, finance, and human resources to identify areas for improvement. The main objective is to optimize processes, reduce costs, and enhance overall operational performance.

In real world Efficiency of Management is not different from efficiency of Operations undertaken by the Organization. Normally what a Management Auditor does is almost identical to the process followed by the Operational Auditor.

Conducting Management Audit : Management Audit requires an interdisciplinary approach since it involves review of all aspects of the management functions. It should normally be conducted by a team of experts of different fields because the variety of skills required cannot be mastered by one individual. Due to this help of Engineers, Marketing Specialist, HR Specialists can be necessary for a meaningful Management Auditing. It is necessary that each member of the team posses analytical mind and an ability to look at a management function from the point of view of the organization as a whole. The information collected through the various techniques has to be correlated so that proper conclusions can be arrived at. The management auditor has to compare the actual performances with the standards laid down or with the performance in the previous years. A good deal of skill is required in correlating the relevant information so as to reach meaningful conclusion.

In the process of conducting a review of the various activities in an organization, in an organization, a management auditor can adopt and use a number of techniques of verifactory audit. However, a management auditor may not be concerned with techniques like re-computations, retracing book keeping procedures, external confirmation of balances, and comparison of records with supporting documents. This is because the objectives of a management audit are much different from objective of verifactory audit. The management auditor is primarily concerned with the appraisal of performances in the various areas of management. Hence he does not look for evidence to support definite accounting figures. Instead, he attempts to evaluate the processes and functions of management.

Scope of Modern day Internal Auditing/Operational Auditing/Management Auditing: “ The examination and Evaluation of the adequacy and effectiveness of the organization’s system of Internal Control and the Quality of performance in carrying out assigned responsibilities.”
– The Institute of Internal Auditors

A. Reliability and Integrity of Information: The Internal Audit should review the Reliability and Integrity of Financial and Operating Information.

B. Compliance with Policies, Plans, Procedure, Laws and Regulations : Review and report has to be done of Policies, Plans, Procedure, Laws and Regulations which could have a significant impact on operations. This include compliance relating to GST, Income Tax, Labor Laws, Environmental Laws, FEMA, Factories Act. Provident Fund Act & Employee State Insurance Act etc. Report should also be on compliance of management plans and procedures.

C. Safeguarding of Assets : Internal Audit review the safeguarding of assets and as appropriate verify the existence of such assets. System of safeguarding should be evaluated to assess the risk of losses from theft, fire, misappropriation and natural calamities.

D. Economical and Efficient use of Resources : Internal Audit Appraise the economy and efficiency with which resources are employed. It is normally misunderstood by “Responsibility to comment on individual Managerial Action and Decision”. Rather it actually means :

a.To check whether operating standards have been established by the management for measuring economy and efficiency (To set standards is not the responsibility of Internal Auditors)

b.Established Standards are understood properly by the executing staff and are being met periodically

c.Deviation from standards are Identified, Analyzed and Communicated to those responsible for Corrective Action

d.To see finally corrective actions have actually been taken.

E. Accomplishment of Established Objectives and Goals for Operations/Program : Internal Auditors should review the operations or program to ascertain whether results are consistent with established objectives & Goals and whether the operations / program are being carried out as they are planned.

Independence of Internal/Operation/Management Auditors : How Important : The nature and scope of operations and the status of An Internal Control System differ from one organization to another organization.

A. Organizational Status : Place of Internal Audit Department in Organizational Chart ensure it’s relative independence so that it can carry out it’s work freely & objectively and render impartial and unbiased judgments.

“The organizational status of the Internal Audit Department should be sufficient to permit the accomplishment of it’s Audit Responsibilities”. Steps which are initiated to ensure effective Internal Audit are :

a.Chief Internal Auditor should be made responsible to Higher Management. This ensure Comprehensive coverage and sufficient/prompt action on audit report.

b.Functions, Responsibilities and Authority of the Internal Audit Department should be clearly & specifically laid in a written and Formal document approved by top management.

c.Chief Internal Auditor should have a direct communication with higher management.

B. Objectivity: To ensure that Internal Auditors are objective in performing audits, i.e. they do not subordinate their judgment on auditing matters to that of others and they should not be asked to assume operating responsibilities. This is because having assumed authority or responsibility responsibility for any function he himself cannot review the performance in that area objectively. The Institute of Internal Auditors have opined that “Even designing, installing and operating the system are not audit functions and they are likely to impair audit objectivity..

However Internal Auditor can review the procedures before they are implemented and suggest improvement therein.

CA Rahul Sharma



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