**Internal Check, Internal Audit And Internal Control**

**Internal Check**

Internal check is a method of organising the accounts system of a business concern or a factory where the duties of different clerks are arranged in such a way that the work of one person is automatically checked by another and thus the possibility of fraud, or error or irregularity is minimised unless there is collusion between the clerks. For example, the receipt of cash is entered by the cashier on the debit side of the cash book; this entry is carried to the ledger by another clerk; the statement of account relating to this transaction is sent to the customer by a third clerk and so on. Thus the same transaction has passed through three different hands and the work of one is checked automatically by the other. It is a kind of division of labour. This minimises the possibilities of frauds and errors unless all the three join hands in defrauding their employer.

According to the special committee on Terminology, American Institute of Accountants, 1949 "Internal check-a system under which the accounting methods and details of an establishment are so laid out that the accounts procedures are not under the absolute and independent control of any person - that, on the contrary, the work of one employee is complementary of that of another, and that a continuous audit of the business is made by the employees."

The essential elements of an internal check are :

(a) Instituting of checks on day-to-day transactions.

(b) These checks operate continuously as a part of routine system.

(c) Work of each person is made complementary to the work of another.

The objective of such allocation of the duties is that no one has an exclusive control over any transaction.

Internal check system in the various aspects of the accounting is given below :

***Internal check as regards cash***

There should be a proper system of internal ^heck in respect of all transactions because majority of the frauds arise in connection with cash. The auditor must familiarise himself with the system of internal check in operation. Duties in respect of cash should be divided in such a manner that there is automatic check on the various functionaries connected with cash section. It is necessary that employees of the cash are encouraged to go on vacation. Rotation of duties relating to cash section should also be enforced.

***Internal check as regards Cash Receipts***

1. The cashier should not have access to the incoming mail books (which do not concern him), petty cash funds and the ledgers.

2. Remittances should be opened by the cashier in the presence of a responsible person. All cheques and bank drafts received should be marked - `Not negotiable A/c Payee only.'

3. All the receipts of the day should be deposited in the bank at the end of the day or the next morning.

4. On receiving cash, it should be acknowledged by issuing a printed receipt. This receipt should have a counterfoil. These receipts should be consecutively numbered. The receipt should be kept under lock and key.

5. Cash registers should be used.

6. The cashier should prepare the paying-in-slips to be retained by the bank. However, the counter-foils of the paying-in-slips should be entered by some other clerk and not by the Cashier.

7. Cash sales should be so organised as to reduce the chances of misappropriation to the minimum.

8. As far as possible the system of collection by travellers should be discouraged. However, if they are authorised to collect debts on behalf of the business, there should be proper rules and regulations.

9. Bank reconciliation statement should be made by cashier and someone else frequently.

***Internal check as regards cash payments***

1. As far as possible, all payments should be made by cheques authorised by a responsible person and signed by responsible persons. Cheques should be marked' A/c Payee only' before they are despatched. Unused cheque books should be kept under lock and key by a responsible person.

2. Employees authorised to sign or countersign cheques should not have any other duty connected with cash. Otherwise, it will provide them with opportunity to influence entries in the ledgers.

3. Petty cash should be maintained under the imprest system.

4. There should be an efficient system of internal check as regards wages (discussed elsewhere in this chapter).

5. Vouchers should be numbered properly and filed in order. The cashier should not be asked to do this.

6. There should be a proper internal check system of cash sales (discussed in this chapter).

7. Castings of cash book should be independently checked.

***Internal check as regards wages***

In case of manufacturing concerns wage bill is of great magnitude. The system of internal check is of great importance in such concerns as regards wages. Any system of internal check as regards wages much counteract the following dangers -

(i) Inadequate time records. This may result in the workers receiving wages for time not devoted.

(ii) Inadequate piece work records. This will result in workers receiving wages for work not done.

(iii) Errors in preparation of wage-sheets or pay rolls,

(iv) Manipulation of wage sheet by inserting dummies.

The system of internal check to be suggested will vary according to each particular case.
However, to counter-act the above dangers, the following system of internal check is suggested :

1.     *Time Records :*Where the wages are to be paid according to the time basis, the times of employees entering and leaving the work should be recorded. This may be done either by a gatekeeper or time recording clock. Further, the foreman of each department should take the time of entering and leaving the department. This will not only act as a counter-check on the original records but also as a deterrent to wasting to times by the workers.

2. *Piece work records :*Where wages are paid on piece-wages basis, an efficient system of recording piece work is essential. When the work is given, it should be entered in the concerned piece worker's card. On completion, this card should be signed by the worker and foreman. Where necessary, it should be signed by the store-keeper.

3. *Preparation of wage-sheets :*Separate wage-sheets should be used for time workers and piece workers. They should be ruled to record all the essential particulars. Special columns should be provided for the gross amount payable, deductions for employees, state insurance, provident fund contribution, loans, fines etc. and the net amount payable. Columns should also be provided showing the employers' contribution under the Employees State Insurance Act.

For time workers, the gate-keepers records and departmental time records should be compared by two clerks in the wage office. Discrepancy, if any, should be enquired into. A third clerks should record on the wages sheet, the name of the employees, rate of wages and other particulars. These entries should be checked by another clerk. Net amount payable to each worker should be calculated by another clerk. Similarly, wage sheets should be prepared for the piece workers following the above procedure. It should be remembered that each wage clerk should initial for that portion of work connected with wage sheet undertaken by him. All the wage sheets should be counter signed by the Works Manager, a Director or a Partner.

4. *Payment of wages :*Wages should be paid by Cashier. The cashier should not have any hand in the preparation of wage sheets. A separate cheque should be drawn for the precise amount of the wages. The workers should attend personally to receive their wages in the presence of their foreman to avoid impersonation. Wages of the absentees should be paid to a worker only when he has brought letter of authority. The Works Manager or some responsible officer should be present at the time of payment.

***Internal check as regards purchases***

For this purpose the system of internal check to be adopted by any concern will depend on its size and resources. However, the following system of internal check for purchases is suggested -

1. All the orders for purchases should be recorded in the Purchases Order Book. They should be properly authorised. A carbon-copy of every order placed should be kept.

2. On receipt of the goods, the gate-keeper or store-keeper should make a record in the Goods Inwards Books.

3. Invoices received from the sellers should be checked with the Orders Books and Goods Inwards Books as to its quality, quantity, prices and calculations. The clerks checking them should also initial the invoices. After this invoices should be entered in the Bought Day Book and filed.

4. In case, there are a number of departments, each placing its order, the invoice should be sent to the concerned department for checking.

5. Entry for all goods purchased should be made by an independent person in the stores ledger.

6. The payment of every invoice should be authorised by a responsible official.

7. A proper system of internal check for cash purchases should be in operation. As far as possible, cash purchases should be discouraged.

***Internal check as regards sales***

Chances of errors and frauds are greater in the case of sales. Goods sent on approval being treated as actual sales or entering of fictitious sales in the sales book is possible. Further, it is possible that the next year's sales may be taken as this year's or sale of fixed assets recorded as sale of goods.  The object of internal check should be to counteract the above.

1. All orders received should be recorded properly and in writing. Orders received on telephone or verbally should be confirmed in writing.

2. All goods supplied should be recorded in the Goods Outward Book.

3. Invoice should be prepared in duplicate - one copy sent to the customer and other carbon copy should be kept. Details of every invoice should be checked before sent out. Entries in Goods Outwards Book should be compared with invoices.

4. Entries should be made in the sales Book on the basis of invoices.

5. Goods returned by the customer should be entered in the returns inwards book and a credit note be prepared.

6. In case of cash sales, cash should be received by a person other than salesman. Goods should be delivered on the basis of the receipt cash memo.

***Internal Check and Auditor***

How far an auditor can rely on the internal check system ? This is not an easy question to answer. The answer to this question will depend upon the size and nature of the business. Before he can decide upon the reliance on internal check system, he will have to take the following steps :-

1. Seek a statement from his client in this regard.

2. Examine the system taking into account the size and nature of the business.

3. Examine the system especially from its weakest point to assess the possibilities of errors and frauds.

If the auditor finds that the system of internal check is defective, he should carry on detailed checking.

An efficient system of internal check can reduce to a great extent the work of the auditor but does not reduce his liability. On the other hand, a defective system makes his work difficult.

**INTERNAL AUDIT**

Internal audit is the review of operations and records undertaken within a business by specially assigned staff on a continuous basis. Internal audit has been defined as "the independent appraisal of activity within an organization for the review of accounting, financial and other business practices as a protective and constructive arm of management. It is a type of control which functions by measuring and evaluating the effectiveness of other types of controls." Therefore it is clear that internal audit not only includes the verifications of accounting matters but also financial and other matters.

**Objects of Internal Audit**

1. To verify the correctness of the financial accounting and statistical records presented to the management.

2. To comment on the effectiveness of the internal control system and the internal check system in force and to suggest means to improve them.

3. To facilitate the early detection and prevention of frauds.

4. To ensure that the standard accounting practices to be followed by the organization are strictly followed.

5. To confirm that the liabilities have been incurred by the organization in respect of its legitimate activities.

6. To examine the protection provided to assets and the uses to which they are put.

7. To undertake special investigation for the management.

8. To identify the authorities responsible for purchasing assets and other item as well as disposal of assets.

**Distinction Between Internal Check and Internal Audit**

1. Internal check is an arrangement of as duties allocated in such a way that the work of one clerk is automatically checked by another while internal audit is an independent review of operations and records undertaken by the staff specially appointed for the purpose.

2. In Internal audit, a separate salaried staff of internal auditors is entrusted with the audit
work but in internal check, there is no separate staff appointed especially for this purpose. Different clerks are assigned with various tasks with which they proceed and carry on checking at the same time.

3. In Internal audit, the work of a clerk is checked by an internal auditor after the former has finished the work while in case of internal check, the work of one clerk is automatically and independently checked by another simultaneously.

4. In internal audit, errors and frauds which have already been committed can be discovered but the system of internal check is so devised that the possibilities of errors and frauds are reduced to the minimum.

**Internal control**

Internal control has been defined as being "not only internal check and internal audit but the whole system of controls, financial and otherwise, established by the management in order to carry on the business of the company in on orderly,manner, safeguard its assets and secure as far as possible the accuracy and reliability of its records."

Therefore internal control is a broad term with a wide coverage. Its scope extends beyond those matters which relate directly to the functions of accounting and financial records. In its modern sense, audit control includes two types of controls:

(a) *Accounting Controls :*These comprise primarily the plan of organization and the procedures and records that are concerned with and directly related to the safeguarding of assets and reliability of financial records. These include budgeting control, standard costing, control accounts, bank reconciliation, self balancing ledgers and internal auditing etc.

(b) *Administrative Controls :*These comprise the plan of organization that are concerned mainly with operational efficiency. They may include controls, such as time and motion studies, quality controls through inspection, performance reports and statistical analysis.

From the point of view of the auditor, the distinction between these two controls, is very significant. An auditor has to make a careful review of the accounting controls in order ensure the accuracy and adequacy of financial statements. He is not expected to review the administration controls because they have only a remote relationship with financial records. However he may evaluate only those administrative controls that have a bearing on the reliability of financial statements.

**Characteristics of Good Internal Control System**

1. There should be a well developed plan of organization with delegation of proper responsibilities at various levels of operational hierarchy.

2. These should be a scientifically developed system of record procedures with a view to maintain reasonable control over assets, liabilities, revenues and expenses.

3. A system of healthy practices and traditions is also necessary for the performance of duties and activities of various departments of the organization.

4. The personnel engaged in the business should be of high quality and character with a deep understanding of their responsibilities and a proper background of training and ability. This is necessary because controls are exercised by personnel engaged in the business.

5. There should be managerial supervision and reviews of the company's financial operation and positions at regular and frequent intervals by means of interim accounts and reports and operating summaries etc.

**Divisions of Internal control**

Depending upon the nature of business and the environment in which it works, the main divisions of an overall internal control system are:

1. *General Financial Control :*This control includes a proper efficient system of accounting, adequate supervision, recording and duplicating systems, good efficient staff and the maintenance of healthy relationships amongst the staff.

2. *Cash Control*: The system includes certain important aspects of control for receipts, payments and balances held. A proper system of internal check must operate at all stages. There may be specially deputed officials including the internal audit staff to exercise checks at regular and irregular intervals. Effort should be made to avoid misappropriation of cash.

3. *Employee Remuneration :*The system must cover all sections of employee remuneration and maintenance of records for remuneration, their preparation and methods of payment should be brought under tight control. So pacific instructions must be issued to the staff concerned.

4. *Trading Transactions :*These refer to the purchases, sales etc. So in respect of these transactions, effective procedure should laid down for acquisitions, handling and accounting of goods purchased or sold.

5. *Fixed Assets :*Capital expenditure on fixed assets should be kept under strict check and supervision. The authority right from sanctioning of capital expenditure to its use should be clearly defined so that any type of misappropriation by officials of the organization can be reduced to the minimum.

6. *Stock maintenance :*Stocks of raw materials, work-in-progress and finished goods should be properly maintained and accounted for. Regular stock taking procedures are quite helpful as means of independent, checks and reconciliation of records.

7. *Investments :*The procedures of control in regard to investments cover such measures as authorisation, recording and maintaining record of investments held and safeguarding the documents of title.

**Internal control and the Auditor**

An auditor is mainly concerned with the evaluation of the internal control system in force so that he may be able to know :

(i) whether mistakes, errors and frauds are likely to be located in the ordinary course of business.

(ii) Whether an effective internal auditing department exist or not.

(iii) How far and how adequately the management is discharging its function in so far as correct recording of transaction is concerned.

(iv) How extensive examination he should carry out in different areas of accounting.

(v) How far administrative control has a bearing on his work.

(vi) What should be the appropriate audit programme in existing circumstances.

(vii) To what extent reliability can be placed on the reports, records and the certificates of the management.

(viii) Whether some suggestion can be given to improve the existing control system.

Therefore we can conclude by saying that internal control is a broad term which includes internal check, internal audit, and other forms of control.