REAL VALUE OF INTERNAL AUDIT:
By
CA. R SIVASUBRAMANIAN FCA 25991

Our main motto "ya esha supteshu jagarti" aptly brings about our role in the business environment. In today's context this quote from the "KATOPANISHAD" is more fitting to the internal audit.

Over the years, the role of the chartered accountant has been experiencing paradigm shifts with changes happening in the society that of an accountant to auditor to tax practitioner to management advisor to strategic planner. One of the oldest saying is that the auditor is "a watch dog and not a blood hound". Mostly the society places trust on the audited statements of financial affairs of an organization and this is the value we have created over the generations. With the advent of new technologies especially in the Information management, the role of the auditor is very much shrunk in the traditional areas and has taken totally different directions; the reader would be able to find out the basics even without much of a help from the professional accountant. Now, business management is one way very simple and highly complicated the other way. The entrepreneurs need organized advice on the various matters concerning the business especially the monetary ones. They require a highly competent one who shall be awake always to establish and maintain the alarms for the business. All the others, mainly the promoters would be focused on the business development, operational issues and customer management etc.

Traditionally, the chartered Accountant entrusted with the internal audit function would be expected to look into the following:

a. Proprietary of the transactions
b. Genuineness of the transactions
c. Arithmetic accuracy of the transactions
d. Legal aspects of the transactions.

Though the above responsibilities lie with the internal auditor even today, they have come comfortably under the visible range of the eagle and so the eagle is expected to fly much farther and higher with more ranges covered so that the risks
that would be challenging the business even from considerably farther future should
be focused by the Internal Auditor.

*So the scope of internal audit has widened with more meaning for the theme “ya
esha supteshu jagarti”.*

The business is more concerned with the risk management, compliance with
various Authorities and also the economic value addition to the stakeholders. It is a
tough task and definitely the business needs the Internal Audit to provide a vast range
of assistance in the form of analysis and reporting.

The result areas can be divided into two major groups:

1. Current operations that have a bearing on the top and bottom line of the
business.
   a. Cost of manufacturing / providing services
   b. Man power utilization
   c. Sales analysis with different networks
   d. Research and Development
   e. Taxation issues
   f. Transfer pricing
   g. Others
2. Strategic issues that have a bearing on both the current as well as the future.
   a. New opportunities
   b. Investments required
   c. Options of investments
   d. Benefits from the governments
   e. New markets
   f. Innovations
   g. Others.

1. Current Operations:

A traditional organization engaged in the business of textile weaving business
believes in employing staff who have been with the company for a long term and
assigns them the responsibility of marketing the products. These staff members
always have only one way of functioning that is “WAIT FOR THE BOSS’S
INSTRUCTIONS AND OBEY SINCERELY.” This system would fit in well as long as competition is at a low level.

At this juncture, the competitors start making in-roads into the company’s traditional market and they attack with new methods. How to solve this issue?

The IA shall be able to provide the options to the company:

1. Analysis of the existing market and product lines
2. Strengths available with the company
3. Methods adopted by the competition
4. Opening up the eyes of the management on:
   a. New human resources with latest knowledge on the marketing needed
   b. Shift in the attitude of the management with “DELEGATION”
   c. Make them understand whether product presentations are ok.
5. The reporting system on the financial and non-financial aspects.
6. Drive home that IA shall be the “conscious beholder” of the company.

Means experiencing the motto “ya eshaupteshu jagarti”

Strategic Issues:

Continuing with the same business,

The company has been trying to develop more products in the specialized dress wear segments and has a marketing team that is similar to the one in the weaving line. No doubt the work force is knowledgeable and shall provide the heart to do the job. By not working out alternate strategies the company would be losing the market as well as the loyal work force.

The IA should be able to support in developing the alternate strategy by

a. Identification of the present market where the company is working vis-à-vis the environment. The company shall have the inputs but the presentations make the different with the staff members presenting the case with that of a professional Chartered Accountant as the Internal Auditor of the company.

b. Understanding the capacity of the company and the needs for creating new ones to face the rejuvenated market plans. The IA should be a through Management
Accountant with sound insight into the principles and applications of management accounting.
c. The requirements of the investments in the various intangible assets like:
   1. Brand Building
   2. Trade Mark registration
   3. Strategic tie-ups
   4. Others
d. Recently, under the Intellectual Property registrations (Geographical Indication (GI) category even textiles are being registered and this would have a great benefit to the organization. For example “KANCHEEPURAM SILK SAREES” and other special marks like “HANDLOOMS, PURE SILK” etc.,
e. New age requirements in terms of the quality and trends being specified in fashion wear industry both within the country and outside with nations-specific styles and preferences.
f. Generations in terms of contributions and the product mixes
g. Long term plans

Thus in the strategic areas also the Internal Auditor would be able to play an important role with the enterprise reposing the confidence. With more and more complications the managements believe in the IA for the supports always.

*Means experiencing the motto “ya esha supteshu jagarti”*

The role of the internal auditor as mentioned above has expanded beyond the horizon and this is because the industries across the spectrum especially the SMEs’ have understood very well that to thrive and grow in the business, requires a multidimensional professional who could understand the business needs and with strong fundamental analytical skills in finance alone would be able to support them with confidence. This role has to be explained to the entrepreneurs. Normally they think that an audit means checking and reporting; that too with the legal and taxation angle only.

But once they start the discussions on various issues they would realize that more inclusive role should be offered to the Internal Auditor.
The corporate governance has been advocated towards transparency of the operations of the companies and the role of the Internal Auditor as mentioned above is the most wanted one by them. If we could walk through the decades of the existence of the corporate entities we shall be able to appreciate that the most stringent norms of governance are at the peak recently. This would very well reflect in the way the Institute of Chartered Accountants of India has enhanced the visibility of the profession by quickly adopting to changes and made the training and education to face these expectations from the Chartered Accountants by the corporate and the governance authorities.

With wide and deep knowledge in the finance, accounting, management accounting and other corporate laws the Chartered Accountant who assumes the responsibility of the Internal Auditor shall be able to deliver the best in the two major roles of the operational and strategic functions of the organization that were discussed earlier.

The internal Auditor should quickly study and understand the needs of the management and present the case and reporting requirements. Most of the time, the concerns have a blurred vision of their information needs and whatever they would have been receiving thus far would be only on trivial matters and that too with traditional methods of reporting with bias.

They have of late, been realizing and experiencing the vast difference the professional chartered accountant brings about in the success of the firms. When they meet at various forums they eagerly discuss with the successful firm in the same business and try to understand the reasons for their success against various odds. They get the feedback that apart from their own wisdom and capabilities they have the guidance and support of the services of the Chartered Accountant and they here mean that of the services of Chartered Accountant as “INTERNAL AUDITOR.” This trend is on the rise and this would be sustainable in the future as doing business is not by instinct but by intelligence.

Having said so much about internal audit and that of the motto let us have our attention on the motto itself and what it means to all. The straight meaning of this great verse from the “KATOPANISHAD” is, “that which is awake when others are asleep.”
This speaks about the sensory perceptions that are in a rhythm of working and sleeping at regular intervals and at some times getting irregular. The only thing that would be always in awakening condition is the “ATMAN” in everyone. This Upanishad is a kind of conversation between the God of Death and a youth and tries to answer to various tough questions about life and death. The sensory organs in the human being always are reacting to the external environments and are under severe stress and most of the times are controlled by the perceptions. They take very little time to look internally and it takes enormous concentration and work in succeeding in directing them internally. Whoever could achieve even a little bit shall feel the difference and are not disturbed by the turbulences of the external environments. Once realized one would like to enhance the concentration more towards the inner consciousness and have more bliss and happiness. Realizing that bliss is very much important to all and that is the inherent message of this great saying.

This kind of a very high knowledge is stored in this Upanishad words. Ultimately the Atman is awake always and not disturbed by the sensory movements, irrespective of whether they are asleep or awake. The one who is focused inside towards the Atman realizes and enjoys the real happiness and not to be concerned of the difficulties and miseries happening outside.

The great men who have chosen these words have given a great identity to the Chartered Accountant and it fits more perfectly when we discuss about the role of the Chartered Accountant as the “INTERNAL AUDITOR.”

We conclude that the internal audit is the most required professional service to a firm when it comes to the risk identification, mitigation and management. There will not be one single isolated situation and this process would exist since the birth of the business and throughout the life or transformations as the case may be. The longevity of life is extended with more and more innovations and the complexities of environment also become more with more and more innovations; this means more the risk, more the complexities, the Internal Auditor needs to innovate and have more and more solutions to tackle and overcome them. The internal auditor should remember that he is expected to be always awake and conscious of the external environment that encompasses the government regulations, exchange rate fluctuations, and competitions both domestic and
international, technology changes, cost control, legal compliances and also reporting to the stake holders. Even a small slip in this duty may mean huge set back to the organization that he is serving and the damages could be irreparable. So the Internal Auditor becomes the key resource person towards the success and survival of the organization. Always be conscious of “ya esha supteshu jagarti” and perform well.
ANNEXURE -2

Darkness to Light (ignorance to enlightenment)

"TAMASOMA JYOTIRGAMAYA" this is the motto of the Institute of Cost Accountants of India. Today we have the slogan, "Behind every successful business decision there is always a CMA".

The business environment today is highly complex and competitive. They are unable to understand and comprehend the levels of competition and in most of the cases even before they could realize the facts, the business faces huge losses in terms of market, customer base and also the competitiveness. There are instances where flourishing industries with all parameters being excellent have plunged into deep problems in no time. The main reasons for such plight are:

1. **Technology**
2. **Cost competitiveness**
3. **Market obsolescence**

Who can provide the guidance and options to prevent the organizations from the fate of reduced life span as against the wish of the promoters?

Do we have such capable people who can provide that kind of advice that would save the organization from *paralysis* and *death*?

What should be the knowledge resources that are to be possessed by such professionals?

How to go about the whole thing?

Let us for a while dwell into the Upanishad that has provided the motto to the Institute of Cost Accountants of India.
"TAMASOMA JYOTIRGAMAYA"

literally means from "darkness to light". This is meant as a prayer to the human being in enlightening himself / herself about the knowledge of the atman and also the instability of this life. The normal accounting systems and methods provide the historical inputs to the organization and are very important in recording the events and presenting them in the financial parameters. No doubt they are very vital documents; but when it comes to decision making in terms of costs, pricing and other financial issues they are very weak and insufficient in terms of helping out the organization. Management Accounting is a specialized knowledge resource to be developed and nurtured. Practice of management accounting alone would provide the required inputs for the above issues discussed. Let us examine the situations one by one.

TECHNOLOGY:

There has been a rapid growth of technology across all the fields today from agriculture to information technology. Also with the growth comes the obsolescence of the same. Especially in the Information Technology, obsolescence is happening within the eye winking time. So investments decisions become very tough having the fundamental accounting system as a tool since that provides the basic details only.

On the contrary the Management Accounting system provides far more detailed inputs and also brings out the benefits versus the cost incurred into the procurement and or development of the technology. MA looks beyond the obvious. Management Accounting, even at the stage of enquiry gets deeper into the subject and if we look at the appraisals of the Investors / Banks they inadvertently use the management accounting techniques in evaluation of the projects.

We shall look into a comparative presentation between the Normal Accounting and Management Accounting systems:
### Project: Item: Sourcing Technology and the Equipment

<table>
<thead>
<tr>
<th>No</th>
<th>Details</th>
<th>Normal Accounting</th>
<th>Management Accounting</th>
<th>Notes</th>
</tr>
</thead>
</table>
| 1  | Suppliers / Providers          | • Comparati ve Pricing and the experience                                         | • *Is the Technology being sourced the latest?*  
• *Experience of the suppliers /Providers in developing the technology?*  
• *How many users have taken so far and how many of them are staying with that still?* | While selecting the technology and equipment normal accounting practice is after the propriety of the transaction only which is absolutely essential. At the same time, this alone would not ensure the future utility of the technology and the equipment. On the other hand, Management Accounting goes deeper into the inputs and the focus is to ensure that the investment is a commercially viable proposition and also the yield / IRR would be intact and what are all the impediments that would affect the plans. The promoters would get enlightened by this process where their investments would flow into the exact channels intended to be. |
| 2  | Rate and pricing               | Comparative only.                                                                 | Comparative with technology relationship.                                              | Management Accounting is concerned with the resource utilization mainly.                                                                                                                                                                                                                       |
| 3  | Taxes                          | As per the latest Acts and Rules                                                  | As per the latest Acts and Rules. Additionally to know whether any benefits are available with specific technology. | Management Accounting is concerned with the resource utilization mainly.                                                                                                                                                                                                                       |
| 4  | Supply time involved           | Cost Escalations are viewed seriously and to that extent financial commitments are to be reviewed to suit the payments. | Yes. Financial commitments are important but with the time escalation whether there would be any obsolescence that would make these investments a secondary one? | Management Accounting is concerned with the resource utilization mainly.                                                                                                                                                                                                                       |
| 5  | Terms of payment               | To match with accounting principles and also the financial flow                   | Whether the resources required for the plan of payments would add additional burden?  | Management Accounting is concerned with the resource utilization mainly.                                                                                                                                                                                                                       |
COST COMPETITIVENESS:

Competition in business today has become global in nature. As per Peter F Drucker, “CUSTOMER IS BUSINESS; REST IS COST.” So the business decisions in most of the cases are taken by the customers and not by the management. The meaning to the above statement is that the customer should choose the product or service and the business has to follow suit. There were periods in the business history where products and services were in a condition of monopoly. But today, even in socialistic and communist environments, the respective governments are losing their holds on their businesses. This happens mainly because of the roles to be taken by the entities. Governments are socially responsible and profits and other business considerations are only secondary in the areas or concerns where Governments hold the control.

Demands have gone up in terms of consumptions and expectations and also the information availability have made the whole world upside down with the ability and availability of various methods and means to reach and have the desired products or services. With this kind of drastic and sudden developments, the so called historic costing systems would not be in a position to support the pricing solutions and also the profitability mappings.

Costing is not the arithmetic accuracy of the accounting system; it envisages the multi dimensions of the business inputs and assigns the relative values. Over the years the Management Accounting System has been improvising and sharpening the analytical skills with focus and attention towards the capability of the business to face the competitions. The method of understanding the costing information as direct and indirect has taken a paradigm shift when the Activity Based Costing (ABC) system took up the challenges. Here as far as possible the indirect costs that are invariably uncontrolable are attempted in getting converted to direct cost mapping. Also the cost drivers applied are more scientific and aid in the decision making. All the resource consumptions are under the scanner and so the final product bears the cost that has shed the unrelated fats around it; always fit, healthy and competitive. One of the main challenges here would be bringing the human resources together in working towards achieving the results.

How to keep active in this front? This is really a challenge since organizations face a key problem in the alignment of the human resources at the technical front as
well as the accounting front. Understanding the cost uniformly across the faculties generally is not up to the expectations and there always would be clashes in claims from both the sides.

First of all, the management has to work towards bridging the knowledge gap across the functions so that the product or service demand and market are kept intact. Making this clearer, the customer should feel that the products / services are supplied at the best of the prices and there is no loss to him.

Therefore, the cost information system should be made always alert and available to all the key personnel to ensure that they are very sound. Management accounting principles with the latest techniques should be applied consistently. In MSME environments this principle is generally flouted by the promoters as they shall be of the opinion that they “Know it all.”

So the owners have to hand over this responsibility to the professionals and simply they should play the role of the arbitrator between the technical and the finance team to ensure that the systems work smoothly. The purposes to be achieved are many but amongst them the foremost would be whether the products / services are cost competitive. Customers have more options in every field and so cost plays a vital role. Value Additions coupled with the cost advantage alone would be successful.

The strength of the Management Accounting is that the industry where they are totally thinking and acting on the Management Accounting principles, they shall be able to set the trend for the others. This unit need not wait for the market to tell the prices; this unit would settle scores and keep the head far ahead of the other competitors.

Management Accounting has come a long way from the normal cost and works accounting some sixty years ago to current activity based cost accounting and other tools. Management Accounting is the extended shadow of the operations and with the light being closer and above the head perfectly, the shadow represents the figure exactly. The professional Management Accountant closely watching and being the torch bearer close to operations is well fit to perform in the financial platform of the company with more perfection and result orientation.
MARKET OBsolescence:

This is the third area where the Management Accountant would be able to be

guide to the industry. It is not that MA performs any magic here but he/she is attuned
to be the torch bearer of the operations and be part and parcel of the operating areas.
When keeping so much vigilance, the market obsolescence also falls into their

scanners.

First of all, let us have a detailed discussion on the market obsolescence.

When a product is not of the latest technology, when a product is expensive than the
competitors then the product slowly gets out of sight of the customers and fades away.
This process can happen suddenly or fade away slowly over a period. All the service
products have the rate of obsolescence very high and mostly would cease to exist once
the competitive product puts the foot down.

The classic example is the typewriting machine. Initially it was coexisting

with the computer systems and the fact is that the key boards were designed as per the
type writers. Slowly, the computers entered nook and corner and commenced
eliminating the typewriters. The computer systems have proved versatile and no need
for the customers to look back to have the typewriters. The lesson out of this example
is that if one could not be aware and alert about the technology changes that may have
an impact on their business, then suddenly one day their existence will be challenged.
Automobile industry in a way is the mother of management accounting and even they
have their problems of obsolescence of their own brands. It is almost a way of life for
them to introduce new brands quite often in order to keep their head above water.

This even happens to professionals if they do not update their knowledge base

and they become unsalable in the market. The Management Accountant shall involve
actively in the market analysis and shall be able to work on the rate of obsolescence
and provide that alarm bell in advance.

Management Accounting closely observes the health parameters of the
business and keeps updating the standards. So the reporting system brings out the
shallow and erratic performances to the top managements. One cardinal principle we
have to understand is that the business results lie outside the environment of the
business and so you need to monitor that “outside” mainly the “customers”.

295
To conclude, Management Accounting provides the knowledge support to identify and avoid any crisis that may be affecting the organization both in the short term and long term.

**TAMASOMA JYOTIRGAMAYA**

Means wherever darkness is their let that be driven away with enchanting light in the form of knowledge (light). Organizations have to be on their toes to learn and lead from the front in terms of the cost of the product or service as the case may be. They no longer can afford to relax and think their positions and the berths are secure and sustainability is to be taken for granted. Precisely, they have to keep themselves enlightened always in the cost front and ensure that dark spots never occur in their knowledge systems about the markets and other related domains.

And the slogan,

**“BEHIND EVERY SUCCESSFUL BUSINESS DECISION THERE IS ALWAYS A CMA”** amplifies this in the best way.