

2.3-2 Internal audit -

- *Definition* - Internal audit has been defined by the Preface to the Standards and Guidance Notes on Internal Audit issued by the ICAI as, "an independent management function which involves a continuous and critical appraisal of the function of the entity. The objective of internal audit is to suggest improvement to the function of the entity and add value to and strengthen the overall governance mechanism of the entity including strategic risk management and internal control system."
- *Statutory status* - Under section 138 of the Companies Act, 2013 internal audit has been made mandatory for the class of limited companies required by the Central Government to do so.

Independent audit v. Internal audit

2.3-3 The differences between independent audit and internal audit have been listed below :

- (i) **Object** - The object of independent financial audit is to *ascertain the truthfulness and fairness of state of affairs* of an entity while the object of internal audit is to *review financial and non-financial operations* as a service to management.
- (ii) **Appointment of auditor** - Independent audit is conducted by a qualified auditor appointed by the *owners or shareholders* of the entity. On the other hand, an internal auditor, who is generally an employee of the organisation, is appointed by the *management*. It may be noted that though an employee, an internal auditor should approach his work independently.
- (iii) **Submission of report** - Independent financial auditor submits his report to the *owners or shareholders*. But an internal auditor submits his report to *management*.
- (iv) **Duties** - Duties of an independent financial auditor are fixed by *statute* or by *engagement letter* whereas *management* decides the duties of an internal auditor.
- (v) **Responsibility for detection and prevention of frauds and errors** - In case of independent audit, auditor is *incidentally concerned* with the detection and prevention of those frauds and errors which affect financial statements materially. On the other hand, internal auditor is *directly concerned* with the detection and prevention of frauds and errors.
- (vi) **Periodicity** - Independent audit may be conducted on an *annual* or on a *continuous basis*. But internal auditor reviews the operations of a company *continuously i.e., throughout the year*.