

Q.1 M/s ABC & Co., Chartered Accountants have been approached by PQR Ltd., a company engaged in iron and steel manufacturing industry. The company has been facing following operational issues:

(a) Penal interest for delayed payments to the overseas vendors despite having enough cash flows; and

(b) Despite having regular production and enough inventory, delays in shipping the final goods to the customers leading to its deteriorating vendor rating.

As a partner of M/s ABC & Co., through detailed discussion with the Senior Manager of PQR Ltd., you have concluded that all these delays are because of long decision-making cycles in the company. As a consultant to the Company, would you recommend Management Audit or Operational Audit? [Study Material – ICAI]

Ans.: Selection among Management Audit & the Operational Audit:

- Management audit is concerned with the “Quality of managing”, whereas operational audit focuses on the “Quality of operations”.
- Management audit is the “Audit of management” while the operational audit is the “Audit for the management”. The focus of Management Audit is on “Quality of Decision Making” rather than the effectiveness or efficiency of operations.
- The basic difference between the two audits, then, is not in method, but in the level of appraisal. In a 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 in control and procedures and fulfillment of plans in conformity with the prescribed policies.
- Since, the delays in payments and consequent penal interest payments and the delays in shipping and the consequent deteriorating vendor ratings are happening because of the delays in decision-making process of the management. Therefore, it appears that this is not just an internal control or operational issue but an issue of management process.

Conclusion: Management audit would be recommended in this case.

Q.2 The PQR Ltd. has come across many instances where it could buy products at lesser cost than the actual procurement price it paid. The management believes that the adequate purchase policy is in place including the requirements of three quotations from registered vendors, appropriate vendor vetting and rating mechanism, however, the on-ground implementation of the purchase policy might be defective. Further, it has observed that there might be some employees involved in choosing the higher cost vendors as well. The company approaches you to advise the type of audit it should get done: Management or Operational. Please advise through a comparison between both the audits.

[Study Material – ICAI]

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- Since it is not the Management’s Decisions that are creating the operational bottlenecks. The Purchase Policy and Procedure seem to be in place, the missing part is the operational implementation by the process employees.

Conclusion: Operational Audit is recommended in this case.

Q.3

The management auditor has to analyse the nature and causes of behavioural problems in the discharge of the review function and to arrive at possible solutions to overcome these problems. As a management auditor of Real Limited, how will you demonstrate in arriving at a solution to behavioural problems and create an atmosphere of trust and friendliness, so that audit reports will be understood in their proper perspective?

[Nov. 20 – New Syllabus (5 Marks)]

Ans.: Solutions to behavioural problems in management audit:

To arrive at a solution to behavioural problems and create an atmosphere of trust and friendliness, so that audit reports will be understood in their proper perspective, there is a need to demonstrate to the extent possible that:

1. the audit is part of an overall programme mandated by higher- level authority to meet higher-level organizational needs for both protection and maximum constructive benefit.
2. the objective of the review is to provide maximum service in all feasible managerial dimensions.
3. the review will be conducted with minimum interference with regular operations of the operating personnel.
4. the responsible officers will be kept fully informed and have an opportunity to review findings and recommendations before any audit report is formally released.

In addition to the above mentioned points, management auditor also need to focus on the followings:

1. **Constructive criticism** - It is essential that the auditor should concentrate only on constructive criticism. He should also make obvious in his report the value of his comments in tangible terms.

2. **Reporting methods** - To achieve this objective, the auditor has to make a concerted effort to convey effectively his role by adopting a friendly but firm tone in his report. The reports should concentrate on areas which need improvement rather than listing inefficiencies and deficiencies in performance of the auditee.
3. **Participative approach** - It is well established that auditor's reports have better acceptability if the improvements suggested are discussed with those who have to implement them and made to feel that they have participated in the recommendations made for improvements.

Q. 4 "In reviewing any System or Procedure, the management auditor must concern himself with its purpose as well as its design." Elucidate how you as a management auditor will study system and procedural functions? [Jan. 21 – Old Syllabus (5 Marks)]

Ans.: Review of Systems and Procedures:

In reviewing any system or procedure, the management auditor must concern himself with its purpose as well as its design and then he must decide on its merits as the best serving the interests of the enterprise. A poor system or procedure may prevent the carrying out of the policy for which it was intended. A system may have outgrown its usefulness. The end result of a system or a procedure may be loose and may require improvement. In the study of the systems and procedural functions, the auditor should ask himself:

1. Is the function properly located in the organisation?
2. Do the staff personnel have the necessary training and experience to perform the work?
3. Has a definite programme been established and has been taken for its attentive accomplishment?
4. Is productivity satisfactory?

Q. 5 The Marketing Department of ISHITA Ltd. has been consistently showing a lower performance whereas the cost of the department is increasing in spurts over the years. The management believes that since the marketing department is under a regular radar of the CFO, an audit might result in the employee hostility. Also, an operational audit of Marketing Department was done two years back however, the recommendations of the previous audit were not followed by the concerned employees. Please advise the management if another audit is the solution and whether only one-time operational audit is enough? Further, advise on the ways to deal with the employee hostility. [MTP – March 21]

Ans.: Frequency of Operational Audit:

- Operational audit is not one time activity. It should be viewed as a continuous improvement cycle. All the significant operations must be subjected to the scrutiny of operational audit, at least, once in three years. Therefore, the operational audit should be done in the current scenario.

Dealing with employee hostility:

- To deal with the employee hostility the participative approach of the audit should be adopted.

- 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 a 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 the 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 does not have to force any change on the auditee.

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