

Technical Guide on Internal Audit of Textile Industry

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Internal Audit Standards Board
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
New Delhi

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First Edition	:	September, 2012
Second Edition	:	February, 2023
Committee/Department	:	Internal Audit Standards Board
E-mail	:	cia@icai.in
Website	:	www.icai.org
Price	:	₹ 200/-
ISBN	:	978-81-8441-625-1
Published by	:	The Publication & CDS Directorate on behalf of The Institute of Chartered Accountants of India ICAI Bhawan, Post Box No. 7100, Indraprastha Marg, New Delhi - 110 002 (India)
Printed by	:	SAP Print Solutions Pvt. Ltd. 28A, Lakshmi Industrial Estate, S. N. Path, Lower Parel, Mumbai - 400 013 August 2023 P3426 (Revised)

Foreword

The Internal Audit Standards Board (IASB) has been constituted by the Institute of Chartered Accountants of India (ICAI) to prepare qualitative technical literature in the area of Internal Audit in the form of Standards on Internal Audit and Technical Guides/ Studies/ Manuals, which constitute an important tool in helping internal auditors to provide effective and efficient internal audit services. The Standards on Internal Audit are performance benchmarks as they represent the best practices in internal auditing and other assurance services performed by the members.

I am happy to note that the Board has published the revised edition of *Technical Guide on Internal Audit of Textile Industry*. This Technical Guide would help the members not only to understand the concept of risk based internal audit but also learn the techniques and methodology of the same.

I congratulate CA. Charanjot Singh Nanda, Chairman of Internal Audit Standards Board, ICAI, CA. Gyan Chandra Misra, Vice-Chairman and all members of the Board for issuance of this Technical Guide.

I am sure that this Technical Guide will assist the members in discharging their responsibilities efficiently.

February 3, 2023
New Delhi

CA. (Dr.) Debashis Mitra
President, ICAI

Preface

India is second largest textile producer in the world. The global textile industry is facing paradigm shift due to globalization, heavy competition, shifts in sourcing, impact of climate change, digitalization, dominance of man-made fibres. The industry needs to effectively address the risk factors, the distinctive peculiarities of the sector and the integration of the textile value chain for steady growth. Internal Auditor helps management to assess the effectiveness of system, address the risks factors, policies, and procedures. Internal auditor also helps to find system flaws exist, as well as actions required to make the system more efficient and effective.

Considering this, the Internal Audit Standards Board is issuing this publication “Technical Guide on Internal Audit of Textile Industry” to provide guidance to members regarding procedure to be followed while conducting internal audit of Textile Industry. This Guide has been divided into various chapters that covers basic framework for internal audit, structure, history, regulatory framework, SWOT analysis and functioning of the industry. This Guide also provide guidance on risks management and internal control with textiles industry. This Guide also contains illustrative checklist for internal audit of major areas of textile industry and guidance for conducting risk based internal audit.

At this juncture, I am grateful to CA. Harsha Ramnani for sharing her experience and knowledge with us and preparing the draft of the Technical Guide.

I would like to thank CA. (Dr.) Debashis Mitra, President, ICAI and CA. Aniket S. Talati, Vice President, ICAI and CA. Gyan Chandra Misra, Vice Chairman, IASB for their continuous support and encouragement to the initiatives of the Board.

I must also thank my colleagues from the Council at the Internal Audit Standards Board, viz., CA. Chandrashekhar V. Chitale, CA. Vishal Doshi, CA. Durgesh Kumar Kabra, CA. Piyush Sohanraji Chhajed, CA. Purushottam Khandelwal, CA. Priti Salva, CA. Sridhar Muppala, CA. Prasanna Kumar D., CA. Cotha S. Srinivas, CA. Ranjeet Kumar Agarwal, CA. Rohit Ruwatia, CA. Abhay Chhajed, CA. Anuj Goyal, CA. Prakash Sharma, CA. Sanjay Kumar Agarwal, CA. (Dr.) Raj Chawla, CA. Hans Raj Chugh, CA. Pramod Jain, CA. (Dr.) Sanjeev Kumar Singhal, Shri Deepak Kapoor and Shri Chandra Wadhwa

and co-opted Members, viz., CA. Anil Kumar Jain, CA. Sapna Govindalal, Gandhi, CA. Viswanath K., CA. Vivek Choudhary, CA. Nagesh Pinge, CA. Venugopala Rao P., CA. Satish Patel, CA. Sunil Kumar Mehta, and Special Invitee, CA. Pradeep Tyagi for their vision and support and their invaluable guidance and also their dedication and support to the various initiatives of the Board. I also wish to express my sincere appreciation for CA. Arti Bansal, Secretary, Internal Audit Standards Board, ICAI and her team for their efforts in giving final shape to the publication.

I am sure that the readers would find this Technical Guide really useful.

February 3, 2023
New Delhi

CA. Charanjot Singh Nanda
Chairman, Internal Audit Standards Board, ICAI

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Overview of Technical Guide

About the Technical Guide

This Guide helps members who are handling internal audit function in textile industry and helps in management of the audit function, from planning to execution, reporting, documentation and quality assurance of audit engagements. The Technical Guide also helps to establish a minimum guidelines for the smooth conduct of audit by the internal auditor. This Technical Guide is a strong conceptual foundation of the principles of Internal Audit and emphasises the need to link the strategic planning at the headquarters level with the planning process at the field audit level.

This Technical Guide also recommends that Risk Based Internal Audit (RBIA) methodology should be used and constantly reviewed throughout the period of audit. While outlining the methods of reporting and making recommendations, it focuses on the need for continuous interaction with the audit entities to ensure accurate and balanced reporting.

Purpose of the Technical Guide: The purpose of this Guide is to help the auditor to perform their roles and responsibilities in achieving objectives of the internal audit. This Guide contains detailed guidelines, methodology, techniques and procedures for the auditors to carry out the audit in accordance with modern audit techniques. There have been many significant changes in applicable regulations and rules considering growth in economies at global, national and states levels in the recent times. These changes in regulatory regime, rules and governance landscape must be factored in the functioning of textile Industry to make it robust efficient, effective, and relevant.

Structure of the Guide: The Guide is divided into following five parts

Part I: Internal Audit Function – a Theoretical Framework

An internal auditor, to effectively discharge his function, must have a sound understanding of internal controls framework audit risk, materiality. While audit may be performed based on checklist and internal control questionnaires, a good understanding of underlying concepts helps the auditor to perform a qualitatively better job. This part of Technical Guide would give those additional inputs to internal auditor that would make him aware of the theoretical underpinnings to what he is doing.

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Part II- Introduction to Textile Industry

The textile industry includes agriculture (cotton), Cloth, garments, merchandising, etc. If macro level of the industry, it includes spinning mills, weaving mills, process house, garment factories, etc.

This Part of Technical Guide provides guidance on structure of the Textile Industry in depth and its regulatory framework and cover the following :

- Overview and Structure of Textile Industry in India
- Governing Acts and Rules
- SWOT Analysis
- Spinning Process
- Process
- Making Apparels Process

Part III - Practice Guide to Internal Audit

This part is divided into two sections viz. Internal Audit Process and Execution, which are briefly discussed below:

Internal Audit Process

- This section deals with various steps involved in planning from the annual audit program to specific audit assignments.
- It also involves gaining:
 - ✓ *Understanding of the organization and its operations,*
 - ✓ *Controls and management assertions,*
 - ✓ *Desk review including analytical review,*
 - ✓ *Identification of legal compliances to be made*
 - ✓ *Assessment of inherent risks and controls risks,*
 - ✓ *Documentation.*
- At the end of this phase, auditor determines the nature, timing and extent of audit procedures to be applied.

Execution

In this phase, the auditor apply audit procedures i.e., gathers evidence applying different techniques including sampling. A well-documented audit program helps auditor to delegate and supervise audit efficiently.

Part IV: Enterprises Risk Management and Internal Audit Function

Value of any enterprises is maximized when management sets strategy and objectives to strike an optimal balance between growth and return goals and related risks, and efficiently and effectively deploys resources in pursuit of the entity's objectives.

Encompasses Internal Control

Internal control is an integral part of enterprise risk management. Enterprise risk management framework encompasses internal control, forming a more robust conceptualization and tool for management.

Standard of Internal Audit (SIA) 120, "Internal Controls" as issued by the ICAI guides the members classifies the responsibilities of management and auditors over Internal Controls, and how certain requirements need to be met to assess, evaluate, report and provide an independent assurance over Internal Controls.

This section also covers:

- Enterprises Risk Management & Internal Audit (SIA) 130, Risk Management
- Identification of 12 anticipated Risks areas in Textile Industry
- Standardized/ Checklist for Internal Audit of Textile Industry.

Part V: Closing & Reporting Phase

Closing Phase: At closing phase of internal audit, an internal auditor must:

- Ensure that all areas of audit programme have been completed
- Review field work done by the audit staff
- Review analytical tests conducted by the audit staff
- Evaluate audit evidence gathered
- Drafting preliminary audit observation

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- Discuss with Head of Audit Department

Reporting Phase

Final deliverable of audit process is the Audit Report. This section deals with *contents, documentation and quality of audit report*.

In today's environment, role of internal auditor do not end after submission of his report of findings and suggestions for improvement but also include follow-up of its compliance/ action taken and report the progress during next review.

Part I
Introduction to Textile Industry

Chapter 1

Overview & Structure of Textile Industry in India

Objective: This chapter will give overview and structure of textile industry in India and will help readers to know more about textile industry history.

Meaning of Textile

1.1. The term 'textile' is a Latin word originating from the word 'texere' which means 'to weave'. Textile refers to a flexible material comprising of a network of natural or artificial fibers, known as yarn. Textiles are formed by weaving, knitting, crocheting, knotting and pressing fibers together. Textile Museum is that specialized category of museum which primarily preserves different types of textile and textile products.

History of textile industry in India

1.2. India is well known for textile industry since ancient times. The traditional textile industry of India is virtually decayed during the colonial regime. However, the modern textile industry took birth in India in the early nineteenth century when the first textile mill in the country was established at Fort Gloster near Calcutta in 1818.

The cotton textile industry, however, made its real beginning in Bombay, in 1850s. The first cotton textile mill of Bombay was established in 1854 by a Parsi cotton merchant then engaged in overseas and internal trade. Indeed, the vast majority of the early mills were the handiwork of Parsi merchants engaged in yarn and cloth trade at home and Chinese and African markets.

The first cotton mill in Ahmadabad, which was eventually to emerge as a rival centre to Bombay, was established in 1861. The spread of the textile industry to Ahmadabad was largely due to the Gujarati trading class.

The cotton textile industry made rapid progress in the second half of the nineteenth century and by the end of the century there were 178 cotton textile mills; but during the year 1900 the cotton textile industry was in bad state due to the great famine and a number of mills of Bombay and Ahmadabad were to be closed down for long periods.

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The two World War and the Swadeshi movement provided great stimulus to the Indian cotton textile industry. However, during the period 1922 to 1937 the industry was in doldrums and during this period a number of the Bombay mills changed hands. The second World War, during which textile import from Japan completely stopped, however, brought about an unprecedented growth of this industry. The number of mills increased from 178 with 4.05 lakh looms in 1901 to 249 mills with 13.35 lakh looms in 1921 and further to 396 mills with over 20 lakh looms in 1941. By 1945 there were 417 mills employing 5.10 lakh workers.

The cotton textile industry is rightly described as a Swadeshi industry because it was developed with indigenous entrepreneurship and capital and in the pre-independence era the Swadeshi movement stimulated demand for Indian textile in the country.

The partition of the country at the time of independence affected the cotton textile industry also. The Indian Union got 409 out of the 423 textiles mills of the undivided India. 14 mills and 22 per cent of the land under cotton cultivation went to Pakistan. Some mills were closed down for some time. For a number of years since independence, Indian mills had to import cotton from Pakistan and other countries.

After independence, the cotton textile industry made rapid strides under the Five Year Plans. India is the **second-largest textile producer** in the world, with an installed capacity of more than 50 million spindles.

Role of Indian textile industry in the economy:

1.3. The Indian textile industry has a significant presence in the economy as well as in the international textile economy. Its contribution to the Indian economy is manifested in terms of its contribution to the industrial production, employment generation and foreign exchange earnings. Currently, India holds a 4% share of the global trade, accounting for 5% of Gross Domestic Product (GDP), and 13% of its export earnings. Textile is the core business of the country, and given its contribution to the economy, it is also the second most employment generating sector after agriculture. Government data suggest that the industry employs about 4.5 crore people directly and another 6 crores through allied sectors.

India is the world's second largest producer of textiles after China. It is the world's third largest producer of cotton – after China and the USA – and the

Overview & Structure of Textile Industry in India

second largest cotton consumer after China. The textile industry in India is one of the oldest manufacturing sectors in the country and is currently its largest.

The textile sector also has a direct link with the rural economy and performance of major fibre crops and crafts such as cotton, wool, silk, handicrafts and handlooms, which employ millions of farmers and crafts persons in rural and semi-urban areas. It has been estimated that one out of every six households in the country depends directly or indirectly on this sector.

India has several advantages in the textile sector, including abundant availability of raw material and labour. It is the second largest player in the world cotton trade. It has the largest cotton acreage, of about nine million hectares and is the third largest producer of cotton fibre in the world. It ranks fourth in terms of staple fibre production and fourth in polyester yarn production. The textile industry is also labour intensive, thus India has an advantage.

1.4. The key advantages of the Indian industry are as follows:

- India is the third largest producer of cotton with the largest area under cotton cultivation in the world. It has an edge in low cost cotton sourcing compared to other countries.
- Average wage rates in India are 50-60 per cent lower than that in developed countries, thus enabling India to benefit from global outsourcing trends in labour intensive businesses such as garments and home textiles.
- Design and fashion capabilities are key strengths that will enable Indian players to strengthen their relationships with global retailers and score over their Chinese competitors.
- Production facilities are available across the textile value chain, from spinning to garments manufacturing. The industry is investing in technology and increasing its capacities which should prove a major asset in the years to come.
- India has gathered experience in terms of working with global brands and this should benefit Indian vendors.

Size of Textile Industry in India

1.5. The textile industry in India covers a wide gamut of activities ranging from production of raw material like cotton, jute, silk and wool to providing high value-added products such as fabrics and garments to consumers. The industry uses a wide variety of fibres ranging from natural fibres like cotton, jute, silk and wool to man-made fibres like polyester, viscose, acrylic and multiple blends of such fibres and filament yarn. The textile industry plays a significant role in Indian economy by providing direct employment to an estimated 35 million people, by contributing 4% of GDP and accounting for 35 per cent of gross export earnings. The textile sector contributes 14% of the value-addition in the manufacturing sector.

Estimates say that the textile sector might achieve about 15 to 18% growth this year following dismantling of MFA.

1.6. With the growing awareness in the industry of its strengths and weakness and the need for exploiting the opportunities and averting threats, the Government has initiated many policy measures such as follows:

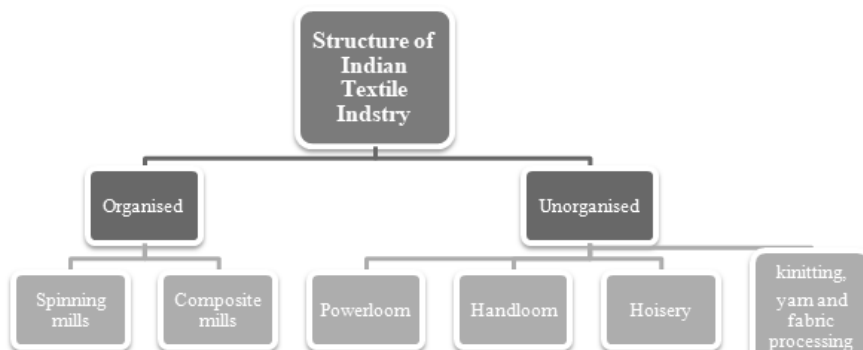
- The Government has launched an Emergency Credit Line Guarantee Scheme. The aim of this scheme is to provide funds to micro and small textile business owners. This will help them to invest in increasing their production and minimize the effect of the pandemic. This scheme will be available till March 2023, with a huge guarantee cover.
- The Indian Government has allowed 100% Foreign Direct Investment (FDI) in the textile industry.
- The rates of incentives for the exports of readymade garments and dress materials are increased from 2% to 4% by the Directorate General of Foreign Trade.
- The allocation for RoSCTL scheme has been increased from ₹7,641 crore for 2022-23 to ₹ 8,405 crore for 2023-24.
- The outlay for Amended Technology Upgradation Fund Scheme (ATUFS) has been increased from ₹650 crore in 2022-23 to ₹900 crore in 2023-24.

Segment Analysis

1.7. India's textile industry comprises of predominantly two sectors: Organized & Unorganized sector.

The organized sector consists of spinning mills and composite mills. Composite mills are those where all the activities, i.e., spinning, weaving and processing are performed in the same building.

Weaving is done in unorganised decentralized sector and consists of powerloom, handloom and hosiery units which mainly perform weaving. Apart from this, knitting, yarn and fabric processing units are also included in the decentralized sector.



Structure of Indian Textile Industry

1.8. The textile sector in India is one of the worlds largest sector and is divided into three segments:

- I. Cotton Textiles
- II. Synthetic Textiles
- III. Others like Wool, Jute, Silk, Denim, etc.

All segments have their own place but even today cotton textiles continue to dominate with 73% share. The structure of cotton textile industry is very complex with co-existence of oldest technologies of hand spinning and hand weaving with the most sophisticated automatic spindles and loom. The structure of the textile industry is extremely complex with the modern, sophisticated and highly mechanized mill sector on the one hand and hand spinning and hand weaving (handloom sector) on the other in between falls the decentralized small scale power loom sector.

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Unlike other major textile-producing countries, India's textile industry is comprised mostly of small-scale, nonintegrated spinning, weaving, finishing, and apparel-making enterprises. This unique industry structure is primarily a legacy of government policies that have promoted labor-intensive, small-scale operations and discriminated against larger scale firms.

Composite Mills

Relatively large-scale mills that integrate spinning, weaving and, sometimes, fabric finishing are common in other major textile-producing countries. In India, however, these types of mills now account for about only 3 percent of output in the textile sector. About 276 composite mills are now operating in India, most owned by the public sector and many deemed financially sick.

Spinning

Spinning is the process of converting cotton or manmade fiber into yarn to be used for weaving and knitting. This mills chiefly located in North India. Spinning sector is technology intensive and productivity is affected by the quality of cotton and the cleaning process used during ginning. Largely due to deregulation beginning in the mid-1980s, spinning is the most consolidated and technically efficient sector in India's textile industry. Average plant size remains small, however, and technology outdated, relative to other major producers.

Weaving and Knitting

The weaving and knits sector lies at the heart of the industry. Three distinctive technologies which are used in the sector are handlooms, power looms and knitting machines. Weaving and knitting converts cotton, manmade, or blended yarns into woven or knitted fabrics. India's weaving and knitting sector remains highly fragmented, small-scale, and labour-intensive.

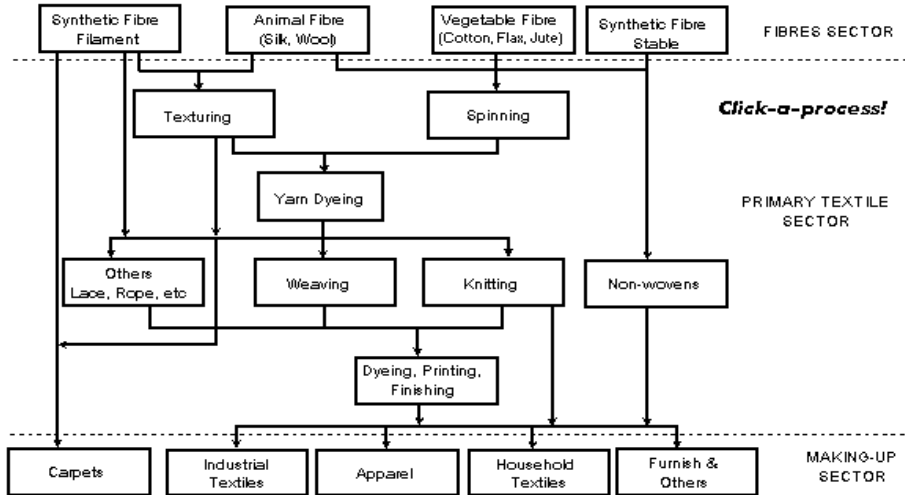
Fabric Finishing

Fabric finishing (also referred to as processing), which includes dyeing, printing, and other cloth preparation prior to the manufacture of clothing, is also dominated by a large number of independent, small-scale enterprises. Overall, about 2,300 processors are operating in India, including about 2,100 independent units and 200 units that are integrated with spinning, weaving, or knitting units.

Overview & Structure of Textile Industry in India

Clothing

Apparel is produced by about 77,000 small-scale units classified as domestic manufacturers, manufacturer exporters, and fabricators (subcontractors).



Chapter 2

Governing Policies and Regulations

2.1 The Indian textile industry is one of the largest industries in the world. Being one of the most significant sectors in the Indian economy, it has been a key focus area for the Government of India. The Ministry of Textiles in India has formulated numerous policies and schemes for the development of the textile industry in India. In this Chapter major rules and regulation regarding textile industry are explained in brief.

The Ministry of Textiles

2.2 The Ministry of Textiles is responsible for policy formulation, planning, and development export promotion and trade regulation in respect of the textile sector. This included all natural and manmade cellulosic fibres that go into the making of textiles, clothing and handicrafts.

The Multi-Fibre Agreement (MFA)

2.3 The Multi-Fibre Agreement (MFA), that had governed the extent of textile trade between nations since 1962, expired on 1 January 2005. It is expected that, post-MFA, most tariff distortions would gradually disappear and firms with robust capabilities will gain in the global trade of textiles and apparels.

National Textile Policy, 2000

2.4 Faced with new challenges and opportunities in a changing global trade environment, the GOI unveiled its National Textile Policy 2000 (NTP 2000) on November 2, 2000. The NTP 2000 aims to improve the competitiveness of the Indian textile industry. The NTP 2000 opens the country's apparel sector to large firms and allows up to 100 percent FDI in the sector without any export obligation. The National Textile Policy was formulated keeping in mind the following objectives:

- Development of the textile sector in India in order to nurture and maintain its position in the global arena as the leading manufacturer and exporter of clothing.

Governing Policies and Regulations

- Maintenance of a leading position in the domestic market by doing away with import penetration.
- Injecting competitive spirit by the liberalisation of stringent controls.
- Encouraging Foreign Direct Investment as well as research and development in this sector.
- Stressing on the diversification of production and its upgradation taking into consideration the environmental concerns.
- Development of a firm multi-fibre base along with the skill of the weavers and the craftsmen.

New Textile Policy

2.5 According to the press release dated Feb 12, 2021, Government is considering promotion of MMF and Technical Textile under Production Linked Incentive (PLI) scheme. The formulation of Focus Product Incentive Scheme (FPIS) under the ambit of Production Linked Incentive (PLI) Scheme is in process. The objective of the FPIS would be creating global champions in MMF apparel and Technical Textiles and capturing substantial share in global trade in these segments. The scheme will provide incentive from 3% to 15% on stipulated incremental turnover for a period of five years after one year gestation period for brownfield investment and two years gestation period for greenfield investment.

The Ministry of Textiles is contemplating a New Textile Policy. At present, New Textile Policy has not been finalized and it is at draft stage. The New Textile Policy inter alia, will give thrust on enhancing export performance and creating better employment opportunities. The New Textile Policy is being formulated by holding widespread consultations with various associations, industry bodies, State Governments and other stakeholders representing subsectors viz. Cotton, Silk, Jute Wool, Handloom, Handicrafts, Powerloom, etc.

In the budget 2021-22, it has been announced that a Mega Integrated Textile Regions and Parks scheme (MITRA) will be launched, with an aim to attract large investment and employment generation in the sector to further boost domestic manufacturing and to create world class infrastructure at one place with plug & play facilities. It will enable textile industry to achieve size and scale so as to become globally competitive and also create global champions

in exports. Under the scheme, 7 Mega Textile Parks will be established over 3 years.

Export Promotion Capital Goods (EPCG) Scheme

2.6 To promote modernization of Indian industry, the Government of India set up the Export Promotion Capital Goods (EPCG) scheme, which permits a firm importing new or Secondhand capital goods for production of articles for export to enter the capital goods at preferential tariffs, provided that the firm exports at least six times the C.I.F. value of the imported capital goods within 6 years. Any textile firm planning to modernize its operations had to import at least \$4.6 million worth of equipment to qualify for duty-free treatment under the EPCG scheme.

Export-Import Policy

2.7 The GOIs EXIM policy provides for a variety of largely export-related assistance to firms engaged in the manufacture and trade of textile products. This policy includes fiscal and other trade and investment incentives contained in various programs.

Duty Drawback Scheme (DDBK)

2.8 Expansion of Duty Drawback Scheme from 2835 items to approximately 4000 items, adding 1100 from the DEPB schedule, will make duty drawback all encompassing without leaving any product from the existing DEPB Rates.

The Agreement on Textiles and Clothing (ATC)

2.9 The Agreement on Textiles and Clothing (ATC) promised for abolition of all quota restrictions in international trade in textiles and clothing by the year 2005. This provides tremendous scope for export expansion from developing countries.

Guidelines on revised Textile Centers Infrastructure Development Scheme (TCUDS)

2.10 TCIDS Scheme is a part of the drive to improve infrastructure facilities at potential Textile growth centres and therefore, aims at removing bottlenecks in exports.

Under the Scheme funds can be given to Central/ State Government Departments/ Public Sector Undertakings/ Other Central /State Governments agencies/recognized industrial association or entrepreneur bodies for development of infrastructure directly benefiting the textile units. The fund would not be available for individual production units.

Technology Up-gradation Fund Scheme (TUFs)

2.11 Recognizing that technology is the key to being competitive in the global market, the Government of India established the Technology Upgradation Fund Scheme (TUFs) to enable entities to access low-interest loans for technology upgradation. Under this scheme, the Government reimburses 5 per cent of the interest rates charged by the banks and financial institutions, thereby ensuring credit availability for upgradation of the technology at global rates. Under the TUF Scheme, launched on April 1, 1999, loans amounting to Rs. 149 billion have been disbursed to 6,739 applicants.

At present, this is the only scheme through which Government can assist the industry which provides for reimbursing 5% interest on the loans/finance raised from designated financial institutions for bench marked projects of modernization. IDBI, SIDBI, IFCI have been designed as nodal agencies for large and medium small scale industry and jute industry, respectively. They have co-opted 148 leading commercial banks/cooperative banks and financial institutions like State Finance Corporations and State Industrial Development Corporation, etc. Handlooms will now be covered under the TUF scheme.

Scheme for Integrated Textile Parks (SITP)

2.12 Manufacturing is a thrust area for the Government, as Indian industry and the Government see foreign companies more as partners in building domestic manufacturing capabilities rather than a threat to Indian businesses. Following this through, the Central Government as well as various States has executed Schemes, such as, Schemes for Integrated Textile and Apparel Parks.

To provide the industry with world-class infrastructure facilities for setting up their textile units, Government has launched the Scheme for Integrated Textile Parks (SITP) by merging the Scheme for Apparel Parks for Exports

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(APE) and Textile Centre Infrastructure Development Scheme (TCIDS). This scheme is based on Public-Private Partnership (PPP) and envisages engaging of a professional agency for project execution. The Ministry of Textiles (MOT) would implement the Scheme through Special Purpose Vehicles (SPVs).

Under the Scheme for Integrated Textiles Parks (SITP), 26 parks have been approved so far out of 30 sanctioned.

National Textile Corporation Ltd. (NTC)

2.13 National Textile Corporation Ltd. (NTC) is the single largest Textile Central Public Sector Enterprise under Ministry of Textiles managing 52 Textile Mills through its 9 Subsidiary Companies spread all over India. The headquarters of the Holding Company is at New Delhi. The employer strength of the group is around 22000 employees.

Cotton Corporation of India Ltd. (CCI)

2.14 The Cotton Corporation of India Ltd (CCI), Mumbai, is a profit-making Public Sector Undertaking under the Ministry of Textiles engaged in commercial trading of cotton. The CCI also undertakes Minimum Support Price Operation (MSP) on behalf of the Government of India.

Power loom development and export promotion council

2.15 Power loom development and export promotion council has been set up by the Ministry of Textiles, government of India. PDEXCIL provide the following assistance:

- Exploration of overseas market.
- Identification of items with export potential.
- Market survey and up-to-date market intelligence.
- Contact with protective buyers to interest them in your products.
- Providing company's profile to overseas buyers and vice-versa.
- Advice on international marketing.
- Display of selected product groups.

Cotton Textile Export Promotion Council (TEXPROCIL)

2.16 The Council looks after the export promotion of cotton fabrics, cotton yarn and cotton made-ups. Its activities include market studies for individual products, circulation of trade enquiries, participation in exhibitions, fairs and seminars at home and abroad, in order to boost exports.

Hank Yarn Obligation

2.17 The Hank Yarn Obligation is a mechanism to ensure adequate availability of hank yarn to handloom weavers at reasonable prices. The existing hank Yarn Packing Notification dated 17.04.2003 promulgated under Essential Commodities Act, 1955 prescribes that every producer of yarn, who packs yarn for civil consumption, shall pack at least 40% of yarn packed for civil consumption in hank form on quarterly basis and not less than 80% of the hank yarn packed shall be of counts 80s and below. The Government of India is implementing the following schemes all over the country for overall development of handloom sector:

Integrated Handlooms Development Scheme (IHDS)

2.18 The Integrated Handlooms Development Scheme (IHDS) aims to focus on formation of Weavers Group as an entity, develop the Handlooms Weavers Groups to become self-sustainable, inclusive approach to cover weavers both within and outside the cooperative fold, skill up gradation of handlooms weavers/workers to produce diversified product etc.

Under the IHDS scheme, financial assistance is inter-alia provided for a group of weavers, who are in the clusters, having 300-500 handlooms per cluster and also, for a group of weavers who are outside the cluster under Group Approach Project having 10-100 weavers per Group.

Under the cluster development programme, financial assistance is provided on need basis towards design development, formation of consortium, skill up gradation, basic inputs, construction of work sheds, corpus for yarn depot, setting up of Common Facility Centre/ Dye House, publicity & marketing etc.

Diversified Handloom Development Scheme

2.19 Under the Scheme Design Exhibition –cum Dyeing Workshops are being organized through existing 25 Weavers' Service Centres in the States concerned all over the country including Karnataka to improve the productivity and earnings of the handloom weavers.

Quality Improvement

2.20 The Textile Commission, under the Ministry of Textiles, facilitates firms in the industry to improve their quality levels and also get recognized quality certifications. Out of 250 textile companies that have been taken up by the Commission, 136 are certified ISO 9001. The other two certifications that have been targeted by the Textile Commission are ISO 14000 Environmental Management Standards and SA 8000 Code of Conduct Management Standards.

Foreign Direct Investment (FDI) Policy

2.21 100% FDI is allowed in the textile sector under the automatic route. FDI in sectors to the extent permitted under automatic route does not require any prior approval either by the Government of India or Reserve Bank of India (RBI). The investors are only required to notify the concerned Regional Office of RBI within 30 days of receipt of inward remittance. Ministry of Textiles has set up FDI Cell to attract FDI in the textile sector in the country. The FDI cell will operate with the following objectives:

- To provide assistance and advisory support (including liaison with other organizations and State Governments)
- Assist foreign companies in finding out joint venture partners.
- To sort out operational problems
- Maintenance and monitoring of data pertaining to domestic textile production and foreign investment

Other legislations regarding the Textile sector

2.22 Ministry of Finance has added 165 new textile products under duty drawback schedule. The new products included wool tops, cotton yarn, acrylic yarn, viscose yarn, various blended yarn/fabrics, fishing nets etc.

Governing Policies and Regulations

Further, the existing entries in the drawback schedule relating to garments have been expanded to create separate entries of garments made up of (1) cotton; (2) man made fibre blend and (3) MMF. Separate rates have been prescribed for these categories of garments on the basis of composition of textiles.

A Five-pronged strategy aiming to attract FDI by making reforms in local market, replacement of existing indirect taxes with a single nationwide VAT (now replaced by GST), liberalization of contract norms for textile and garments units, elimination of restrictions that cause poor operational and organizational performance of manufacturers, was suggested.

Proposals for modernization of NTC mills have been made to the consultative committee members, including formation of a Committee of Experts to improve management of these mills. Even the present status of jute industry was under the scanner of the consultative committee.

The Government had announced change from the value-based drawback rate hitherto followed to a weight-based structure for textile exports that will discourage raw material exports and also curtail the scope for misusing the drawback claims by boosting invoice value of exports.

NCDEX has launched its silk contract (raw silk and cocoon). With this launch, the total number of products offered by NCDEX goes up to 27. The launch of the silk contract will offer the entire suite of fibres to the entire value chain ranging from farmers to textile mills.

With the objective of protecting the interests of those affected by the WTO agreements and globalisation process, Government of India jointly with NCDEX has adopted a policy of encouraging future contracts of silk.

Governing Acts and Rules

2.23 The guides provided in this Guide are governed by the applicable act, rules & regulations and laid down procedure issued by government and other regulatory authorities from time to time. Some of the major acts relating to textile industry are as follows:

- Central Silk Board Act, 1948
- The Textile Committee Act, 1963
- The Handlooms (Reservation of Articles of Production) Act, 1985

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- Cotton Control Order, 1986
- The Textiles Undertakings (Nationalisation) Act, 1995
- National Institute of Fashion Technology Act, 2006;
- National Jute Board Act, 2008.

Besides the above, there are also Act related to Jute manufacturing, packaging, nationalization of Jute companies, etc.

Chapter 3

SWOT Analysis of Indian Textile Industry

3.1 **SWOT** is an acronym for Strengths, Weaknesses, Opportunities and Threats. By definition, Strengths (S) and Weaknesses (W) are considered to be internal factors over which you have some measure of control. Also, by definition, Opportunities (O) and Threats (T) are considered to be external factors over which you have essentially no control.

3.2 SWOT Analysis is the most renowned tool for audit and analysis of the overall strategic position of the business and its environment. Its key purpose is to identify the strategies that will create a firm specific business model that will best align an organization's resources and capabilities to the requirements of the environment in which the firm operates. In other words, it is the foundation for evaluating the internal potential and limitations and the probable/likely opportunities and threats from the external environment. It views all positive and negative factors inside and outside the firm that affect the success. A consistent study of the environment in which the firm operates helps in forecasting/predicting the changing trends and also helps in including them in the decision-making process of the organization.

SWOT Analysis

3.3 Brief about SWOT analysis of Textile Industry is as follows:

(i) Strengths

- (a) India has rich resources of raw materials of textile industry. It is one of the largest producers of cotton in the world and is also rich in fibre resources like polyester, silk, viscose, etc.
- (b) India is rich in highly trained manpower. The country has a huge advantage due to lower wage rates. Because of low wages the manufacturing cost in textile automatically comes down to very reasonable rates.
- (c) India is highly competitive in spinning sector and has presence in almost all processes of the value chain.

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- (d) Indian garment industry is very diverse in size, manufacturing facility, type of apparel produced, quantity and quality of output, cost, and requirement for fabric etc. It comprises suppliers of ready-made garments for both, domestic or exports markets.
- (e) Manufacturing capacity present across the entire product range, enabling textile companies and garment manufactures to source their material locally and reduce lead-time.

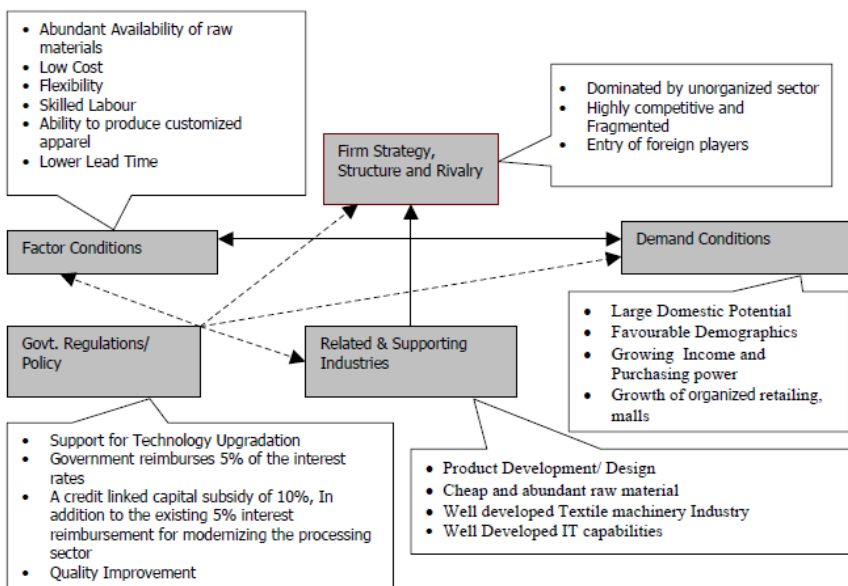
(ii) Weaknesses

- (a) **Fragmented industry:** Fragmented industry leading to lower ability to expand and emerge as world-class players. Huge unorganized and decentralized sector.
- (b) **Effect of Historical Government Policies:** Historical regulations thought relaxed continue to be an impediment to global competitiveness.
- (c) **Lower Productivity and Cost Competitiveness:**
 - (i) Labour force in India has a much lower productivity as compared to competing countries like China, Sri-Lanka etc.
 - (ii) The Indian industry lacks adequate economies of scale and is therefore unable to compete with China, and other countries etc.
 - (iii) Cost like indirect taxes, power and interest are relatively high.
- (d) **Technological Obsolescence**
 - (i) Large portion of the processing capacity is obsolete
 - (ii) While state of the art integrated textile mills exists majority of the capacity lies currently with the power loom sector.
 - (iii) This has also resulted in low value addition in the industry.
- (e) Increased global competition in the post 2005 trade regime under WTO
- (f) Inadequate capacity of the domestic textile machinery manufacturing sector.
- (g) Big demand and supply gap in the training facilities in textile sector.

(iii) Opportunities

India's strong performance and growth in the textiles sector is aided by several key advantages that the country enjoys, in terms of easy availability of labour and material, buoyant and large market demand, presence of supporting industries and supporting policy initiatives from the government. These advantages can be exhibited within the framework given in the figure below, and are further discussed in the subsequent sections.

Indian Textile Industry – Porter's Diamond Analysis



(a) **Covid 19 – Boost in the demand for textile industry following factors drove demand for the textile products and specifically yarn :**

- (i) With operations nearly shut for 3-4 months, the inventory pipeline was completely dry. Weavers across the world and in India were looking at filling this pipeline. Also, the world was preparing for the Autumn-Winter Season for which required yarn.
- (ii) There was pent up demand in urban India. People wanted to buy clothes for changing their wardrobe, for the forthcoming festive season, and more because it was therapeutic (it signaled the return to normal days).

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- (iii) The rural markets were flush with funds. India experienced three good agricultural cycles. Moreover, the Covid package announced by the Government also added to their liquidity. Hence, demand from the rural markets was robust.

(b) Research and Development and Product Development

- (i) Indian companies needs to increase focus on product development.
- (ii) Newer specialized fabric- smart Fabrics, specialized treatment, etc.
- (iii) Faster turnaround times for design samples
- (iv) Investing in design centers and sampling labs.
- (v) Increased use of CAD to develop designing capability in the Organization and developing greater options.
- (vi) Investing in trend forecasting to enable growth of the industry in India.

(iv) Threats

- (i) Possibility of a global recession triggered by a weakening dollar.
- (ii) Non-availability of indigenous textile machinery.
- (iii) Lack of domestic capital and absence of appetite of domestic industries to invest in the quantities envisaged for 12 percent growth target.
- (iv) Higher competition specially after 2008 when China could not be restrained under WTO.
- (v) Sickness is widespread in the cotton textile industry. After the engineering industry, the cotton textile industry has the highest incidence of sickness. As many as 125 sick units have been taken over by the Central Government.

Miscellaneous

3.4 The industry faces a number of other problems like power cuts, infrastructural problems, lack of finance, exorbitant rise in raw material prices and production costs, etc.

SWOT Analysis of Indian Textile Industry

The Indian textile industry is currently one of the largest and most important sector in the economy in terms of output foreign exchange earnings and employment in India. The textile industry has the potential to scale new height in the globalized economy. The textile industry in India has gone through significant changes in anticipation of increased international competition. The industry is facing numerous problems and among them the most important once are those of liquidity for many organized sector units, demand recession and insufficient price realization. The long-term problems include the need for sufficient modernization and restructuring of the entire industry to cater more effectively to the demands of the domestic and foreign markets for textiles as per the needs of today and tomorrow.

Chapter 4

Spinning

4.1 Spinning is the process of creating yarn (or thread, rope, cable) from various raw fiber materials. Several fibers are twisted together to bind them into a strong, long yarn. Characteristics of the yarn vary based on the material used, fiber length and alignment, quantity of fiber used and degree of twist.

The process of spinning yarn falls into two distinct parts- Spinning Preparatory and Spinning Finishing. Preparatory processes involve mixing of raw material, cleaning and removal of waste, parallelization of sliver whereas finishing involves uni-formation of yarn and insertion of twist.

Technical information and guidelines are given below based on the learning's from personal experience and discussions with technologists. This could be used as a guideline and can be implemented based on the trials taken at site. Some of this information can be disproved in some other applications, because many of the parameters are affected by so many variables. The same machine or raw material cannot perform in the same way in two different factories. This is because of the fact that no two factories can be identical. The individual processes are explained below:

Blow Room - Removal of impurities and mixing

4.2 Basic operations in the Blow-room are as follows:

- Opening
- Cleaning
- Mixing or blending
- Micro-dust removal
- Uniform feed to the carding machine
- Recycling the waste

Fibre is drawn from the godown and in the given proportion fed into the bale breaker alongwith usable wastes if applicable. The raw material mix is passed through the beating points of the bale breaker which thrashes the cotton and waste and removes impurities such as sand leaves and seeds; to

be collected through a duct.. The mixing then is taken to a separate room and fed into scutchers. The deliveries obtained from the scutcher are in the form of laps which look like cotton sheets, these are weighed and dispatched to the card room.

Carding - Sliver formation in rope form

4.3 "Card is the heart of the spinning mill" and "Well carded is half spun"

This indicates significance of carding in the spinning process. **High production** in carding to economise the process leads to reduction in yarn quality. Higher the **production**, the more sensitive becomes the **carding** operation and the greater danger of a negative influence on quality.

4.4 The purpose of carding are as follows:

- to open the flocks into individual fibres
- cleaning or elimination of impurities
- reduction of neps
- elimination of dust
- elimination of short fibres
- fibre blending
- fibre orientation or alignment
- sliver formation

In this process the laps are opened up to a stage where every fibre becomes individualized and the cotton is no more in an entangled state. The laps are processed by the card engines and the output obtained is in the form of a silver which is like a cotton rope.

At this stage, three types of wastes known as

- (i) flat strips
- (ii) cylinder and doffer strips and
- (iii) card fly are produced.

Draw Frame -Uni-formation of Yarn

4.5 In this process, the fibres are straightened out and parallelized. A group of slivers are fed into draw frames twice and the delivery obtained at the second operation is ready to go to simplex frames. If combed yarn is to be spun the carded slivers go to combers and the output of the combers is fed into the draw frames twice.

4.6 Combing is an extra process introduced after carding and designed to parallelize the fibres and to remove the short fibres that are present in cotton so as to produce yarn which is more even, smoother, and freer from imperfection than carded yarn. Fine varieties are subjected to combing. The drawing operation is performed after this.

4.7 Drawframe is a very critical machine in the spinning process. Its influence on quality, especially on evenness is very big. If drawframe is not set properly, it will also result in drop in *yarn strength* and yarn elongation at break. The faults in the sliver that come out of drawframe **cannot** be corrected. It will pass into the yarn.

The factors that affect the **yarn quality** are as follows :

- the total draft
- no of drawframe passages
- break draft
- no of doublings
- grams/meter of sliver fed to the drawframe
- fibre length
- fibre fineness
- delivery speed
- type of drafting
- type of auto leveller
- auto leveller settings

The total draft depends upon following :

- material processed

- short fibre content
- fibre length

4.8 Following are some facts derived from trials:

- Wider back roller setting will result in lower yarn strength
- Wider back roller setting will affect yarn evenness
- Wider back roller setting will increase imperfections
- Higher back top roller loading will reduce yarn strength
- Higher back top roller loading will reduce end breakage rate
- Wider front roller setting will improve yarn strength

4.9 **Drafting wave** is caused primarily not by mechanical defects as such but by the uncontrolled fibre movement of a periodic type resulting from the defects. As the fibre-accelerating point moves towards the front rollers, the draft increases(and vice versa), so that a periodic variation in linear density inevitably results. With variable fibre-length distribution (with more short fibre content), the drafting irregularity will be high.

More the number of doublings , lower the irregularity caused due to random variations. Doublings does not normally eliminate periodic faults. But it reduces the effects of random pulses. Doubling does not have any effect on Index of Irregularity also, since both the irregularities are reduced by square root of the number of doublings.

Fibre hooks influences the effective fibre length or fibre extent. This will affect the drafting performance. For carded material normally a draft 7.5 in both breaker and finisher drawframe is recommended. Seven of a draft can be tried in breaker, since it is a carded material.

For combed material, if single passage is used, it is better to employ draft of 7.5 to 8. If combers with four doublings are used, it is better to use two drawframe passages after combing. This will reudce long thick places in the yarn.

In case of two drawframe passage, first drawframe passage will reduce the periodic variation due to piecing. Therefore the life of servomotor and servo amplifier will be more , if two drawframe passage is used. Quality of sliver will also be good, because of less and stable feed variation.

Speed Frame

4.10 This forms the final stage in the spinning preparatory sequence of operations. The main object of this process is to reduce the silver bulkiness i.e. to attenuate it so as to be suitable for the is in the form of an attenuated strand of cotton with a little twist known as 'roving and is wound on bobbins'

Roving machine is complicated, liable to faults, causes defects, adds to production costs and delivers a product that is sensitive in both winding and unwinding. The following parameters are very important in **SPEED FRAME**:

- Feed hank
- Delivery hank
- Roving tension
- break draft
- Drafting system
- Bottom roller setting
- Top roller setting
- condensers and spacers
- Twist in the roving
- Bobbin content
- flyer speed
- Creel and creel draft
- Drawframe sliver and cane
- Bobbin height
- Breakage rate
- Piecings

Since modern Ringframes are capable of handling higher drafts in ringframe without quality deterioration it is better to have coarser hanks in the speed frame. This helps to increase the production in speed frame.

Ring Frame - Ultimate Production

4.11 Spinning is the process of (i) continuing the drawings out of the roving so as to attain the desired degree of fitness; (ii) imparting sufficient twist to the emerging strands of fibres and forming continuous yarn; (iii) winding up the spun yarn into some convenient package form, usually on bobbins. The machine used for spinning yarn is known as ring frames. When the yarn has to be doubled either for weaving purpose or for sale, the requisite number of ply is first wound parallel and thereafter twisted on the doubling frame. The double yarn is obtained on bobbins and it is wound on cones.

4.12 **Ringframe Technology** is a simple and old technology, but the **production** and quality requirements at the present scenario puts in a lot of pressure on the Technologist to select the optimum process parameters and machine parameters, so that a good quality yarn can be produced at a lower **manufacturing cost**.

Following are the points to be considered in a **ringframe**:

- Draft distribution and settings
- Ring and travellers
- Spindle speed
- Twist
- Lift of the machine
- Creel type
- Feed material
- Length of the machine
- Type of drive, above all

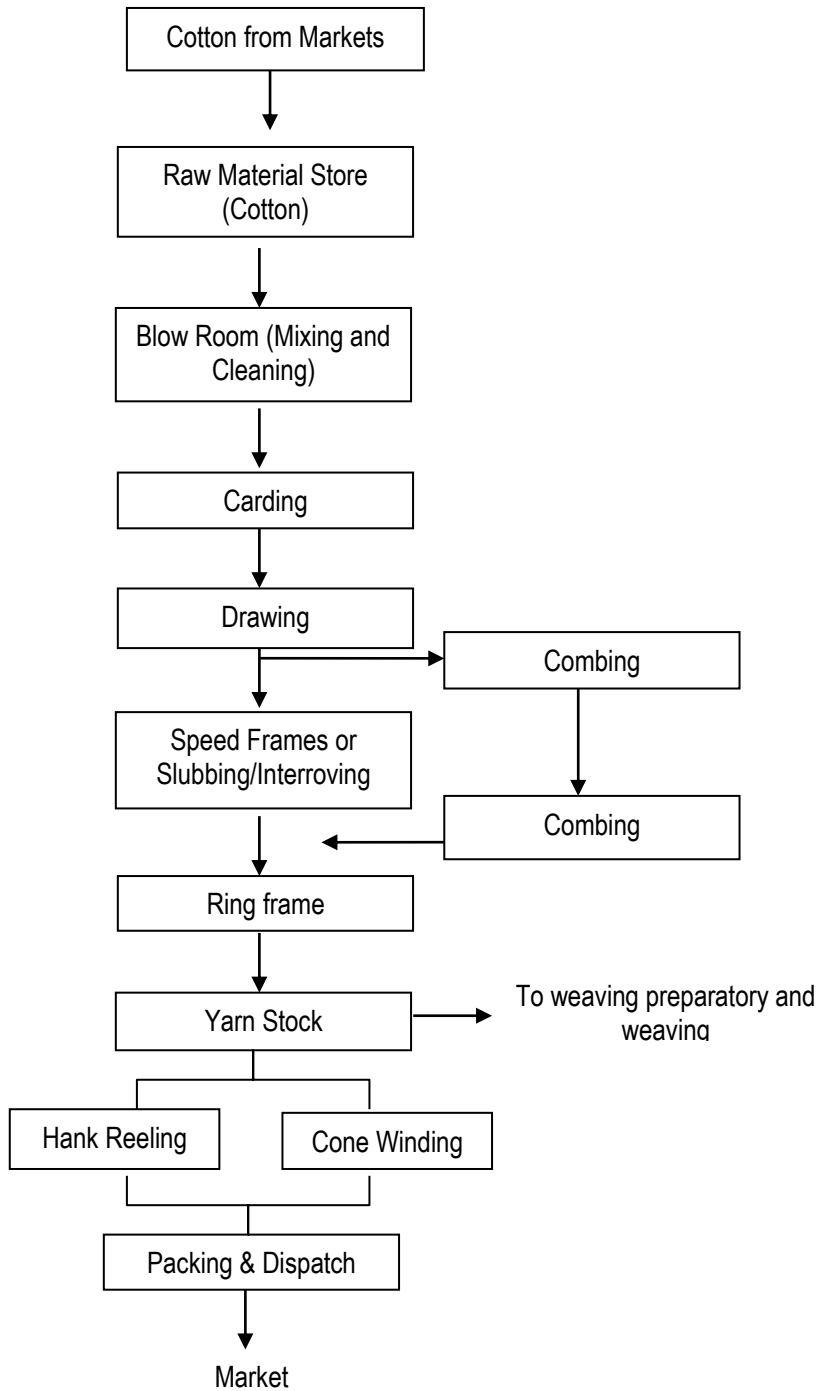
Cone Winding

4.13 The single or double yarn, as the case may be, intended for sale in hanks is reeled, bundled and baled. The yarn to be sold on cones is packed in bags or boxes after being wound on cones. The hard waste resulting from winding, doubling and reeling processes is collected and sent to the waste stores.

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4.14 The yarn is measured in kilograms. The fitness of the yarn is determined on the basis of the counts i.e. if 840 yards of the yards of yarn weigh 1lb it is 1s (s=count) if 2 x 840 yards weigh 1 lb, it is 2s and so on. Thus, under the count system, higher the number, finer is the yarn.

A flow chart giving the aforesaid processes is as follows:



Chapter 5

Weaving

Weaving

5.1 Weaving is an ancient textile art and craft that involves placing two threads or yarn made of fibre onto a warp and weft of a loom and turning them into cloth. The yarn for weaving is of two kinds namely, (i) warp yarn and (ii) weft yarn. Warp yarn means the yarn running length-wise in the cloth, and the transverse threads in the cloth are called weft. The warp yarn should be stronger than weft yarn so as to withstand the stress and strain of shuttle movement at the time of weaving. This cloth can be plain (in one color or a simple pattern), or it can be woven in decorative or artistic designs, including tapestries.

Warping

5.2 The yarn is taken from number of cones, which are placed in a rack known as creel, and is drawn out in parallel on beams. This operation is called warping.

Sizing

5.3 In this process, sizing solution consisting of materials like starch, maize, tallow, gums, etc. are applied to give strength to the yarn and a bigger beam of more number of ends (threads) is made.

Drawing

5.4 The ends of the sized warp have to be drawn. The process of drawing-in-divides the warp into two sets of threads which are alternately moved up and down on the loom with each passage of the shuttle so as to result in the inter-lacing of the weft thread with the warp.

Loom

5.5 The section where the fabrics are woven is termed as 'loomshed'. Weaving is the process of interlacing of warp and weft threads on a loom. The weaving process consists of impelling a pirn of weft thread contained in a shuttle across the warp yarns from one side of the loom to another side. The

weft yarn laid down after each passage of the shuttle is beaten up against those previously laid down to form the fabric.

Looms may be either automatic or manually operated. Plain cloth is woven on plain looms whereas drop-box looms are used for check weave, dobby looms for fancy cloth of limited choice and jacquard looms for patterns as in the case of furnishing fabrics.

In addition to warp and weft the construction of the cloth can also be expressed by specifying 'picks' and 'piece length'. 'Picks' refers to number of thread per inch in the weft yarn. 'Piece length' is the standard measure of cloth in metres.

Finishing/ Processing

5.6 Fabric coming from the weaving department are seldom in a condition to be offered directly to the consumers. They may contain imperfections which give them a harsh lusterless and dis-coloured character; they may also be soiled and may have strains. The grey fabric is subjected to wet processing in order to make it acceptable to the consumers. The successive stages in wet processing are briefly described below:

(i) Batching

The fabric is first sewn so that continuous processing of large quantity of cloth can be carried out.

(ii) Cropping and Shearing

This process is employed to remove lint, dust, loose yarn, loops, hanging ends etc.

(iii) Singeing

The fabric is passed through a singeing machine with the object of burning off the fuzz or hairiness on the fabric to obtain a smooth surface. After singeing, the fabric is led through a water trough to quench sparks which may have fallen on it.

(iv) De-sizing/Sourcing/Bleaching

The impurities in the fabrics such as the sizing materials, fatty and oily substances, gums and mineral impurities are removed by employing the

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desizing process. Mineral impurities which are inherent in fibre are removed by scouring. Bleaching helps to impart a white colour to the fabric.

The bleached cloth may be sold as it is or after one or more of the followings processes:

- Mercerizing

This process gives fabrics a high lustre more or less of permanent nature. The fabric is treated in a caustic soda solution of specific strength and temperature.

- Dyeing

The dyeing process imparts colour to the whole of the fabric.

- Printing

There are two methods of obtaining a coloured design or pattern on a piece of cloth –either by weaving coloured yarns or by printing. The latter method is more economical, faster and more versatile. Commonly employed methods for printings are roller printing and screen printings. In roller printing, the design is engraved on copper rollers. More than one colour printings is possible at a time by using as many as six copper rollers. The copper rollers are capable of being re-engraved a number of times. When the re-engraving becomes impossible, copper rollers are usually sold. Under the screen printings, screen or frames containing the design are manually pressed over the fabric repeatedly.

- Finishing

After the process fabric become distorted as it is stretched either in length or width, their surface may be rough and unattractive to the customers. Further, it may be necessary or desirable to give the fabrics some special characteristics such as added resistance to shrinkage, high luster, etc. Such treatments are carried out in the finishing department.

- Folding, Packing and Bailing

The finished cloth is sent to the folding department where it is thoroughly inspected. It is then folded by a folding machine and stamped with specifications as required by the stamping regulations

issued by the textile controller, and with brand name, trademark etc. Finally, the cloth is packed in bales or cases which are then ready for dispatch to buyers.

5.7 In the course of packing grey or processed cloth cut piece of small length arise and these are grouped as under: -

Fents: measuring a length of more than about 65 c.m. but less than about 135 c.m

Rags: measuring a length of more than about 23 c.m and less than about 65 c.m

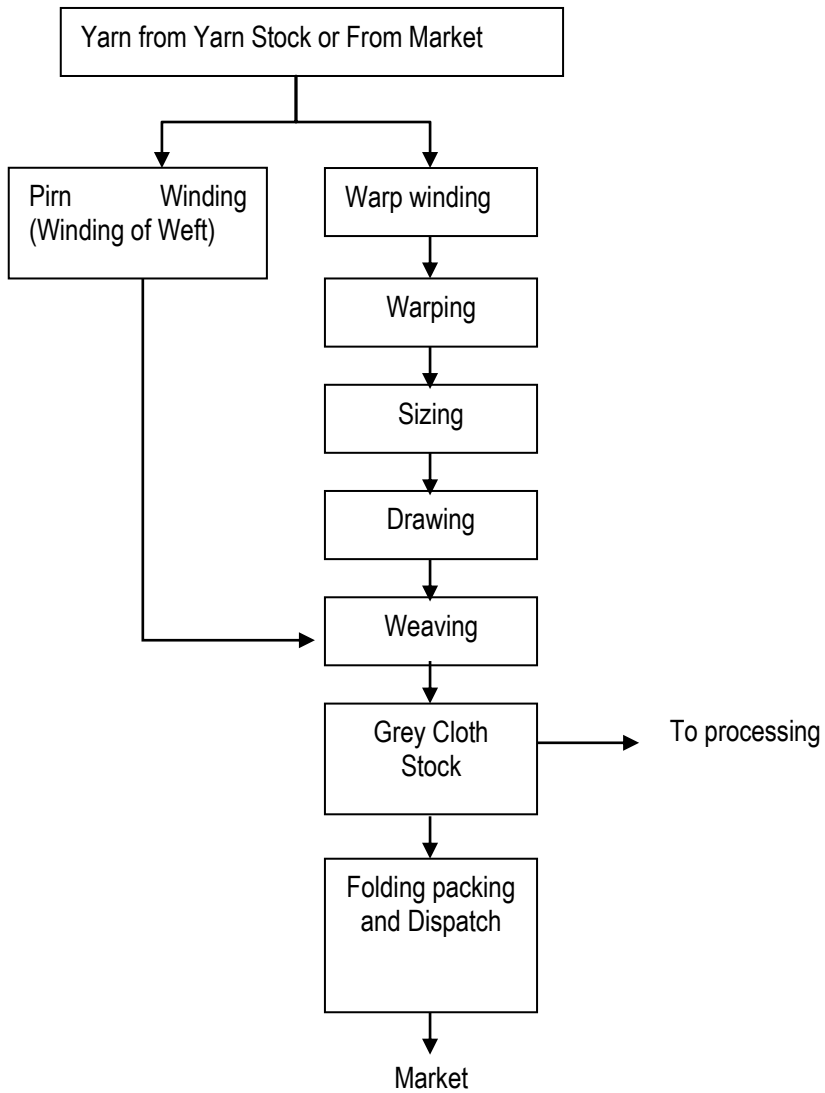
Chindies: small cut pieces measuring less than 23 c.m in length

This classification, however may vary according to the width of the cloth, these materials are sold by weight.

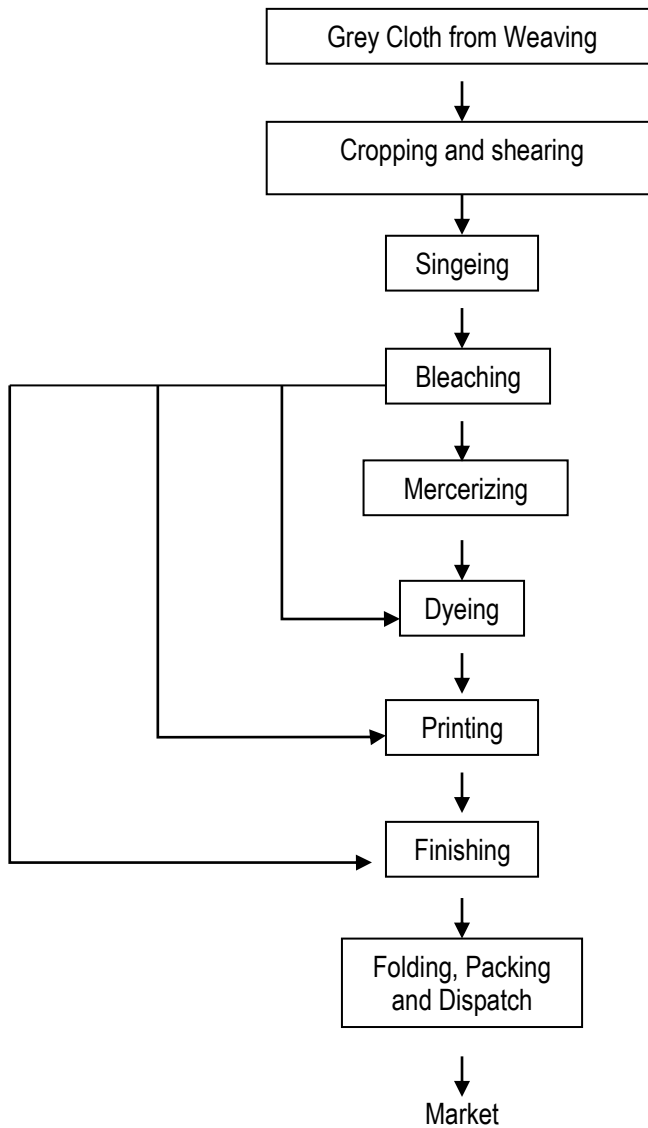
Weaving Process

5.8 The following chart shows the steps in weaving process:

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Processing



Textile Dyeing

Methods of Dyeing

5.9 In selecting the method of textile dyeing the type of process used depends on several factors that include type of material like fiber, yarn,

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fabric, fabric construction, garment. Generic type of fibers, quality standards used in the dyed fabric, sizes of the dye lots etc.

5.10 Batch Dyeing Process is the most popular and common method used for dyeing of textile materials. Batch dyeing is also referred to as Exhaust dyeing. This is because in this process, the dye gets slowly transferred from a comparatively large volume dye bath to the substrate or material that is to be dyed. The time taken is also longer. The dye is meant to 'exhaust' from dye bath to the substrate. In batch processes, textile substrates can be easily dyed at any stage of their assembly into the desired textile product. This includes fiber, yarn, fabric or garment. Some type of batch dyeing machines can function at only temperatures up to 1000°C. For example cotton, rayon, nylon, wool etc. can be dyed at 1000°C or lower temperatures. While polyester and some other synthetic fibers are dyed at 1000°C or even higher temperatures.

5.11 There are three general types of batch dyeing machines.

- where there is circulation of fabric.
- where the dye bath gets circulated while the material that is being dyed remains stationary,
- where both the bath and material to be dyed get circulated. Examples of dyeing machines that utilizes batch dyeing process are Beck, Jet, Jigs, Beam Package dyeing machines etc.

Materials used in the Textile Dyeing Process

5.12 The materials that are used as inputs in textile dyeing and finishing process may include water, fibre, yarn or cloth. Examples are wool, cotton, polyester, and a host of process chemicals that includes:

- Acids, e.g. acetic, formic.
- Alkalis- NaOH, potassium hydroxide, sodium carbonate.
- Bleaches- Hydrogen peroxide, sodium hypochlorite, sodium chlorite etc.
- Dyes, for example direct, disperse, pigment, vat.
- Salts, e.g. NaCl.
- Size, e.g. PVA, starch.

- Stabilisers from sodium silicate, sodium nitrate and also organic stabilizers.
- Surfactants
- Auxiliary finishes, like fire retardant, softeners.

Dyeing Process

5.13 Dyeing is the process in which a dye molecule gets thoroughly dissolved and dispersed in the carrier. It can be in water or some other carrier also, but it must be able to penetrate and colour the textile materials in the process. In the textile dyeing process the dyeing is carried out at different stages like polymer, yarn, fabric and garment or even at the product stage.

Optimizing the Batch Dyeing Process

5.14 For any dyers the ultimate dream is to get the maximum out of the process of dyeing, at minimal cost. For a batch dyeing process the following techniques can prove to be effective for optimum utilization:

- Use machinery that are fitted with latest state-of-the-art automatic controllers of fill volume, temperature and other dyeing cycle parameters, indirect system of cooling and heating, innovative hoods and doors that lessens vapor losses.
- Choosing the machinery that is exactly sized for the batch that needs to be processed. Also confirmation that it is operated exactly within the specified range of nominal liquor ratios for which it is designed. It has been seen that machines that are operated with a consistent liquor ratio while being loaded at 60 percent level of their nominal capacity gives optimum results. With yarn dyeing machines this level can stretch to even 30% of the nominal capacity.
- Opting new machineries that adheres to the following requirements:
 - Liquor ratio that is low-or-ultra-low.
 - Complete in process separation of bath from substrate.
 - Mechanism that involves smooth internal separation of process liquor from the washing liquor.

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- Mechanical liquor extraction that brings the carry-over to minimum and improves washing efficiency.
- Reduced cycle duration.
- Replacement of conventional overflow-flood rinsing method, like, drain and fill or other methods (for example smart rinsing for fabric).
- Proper re-use of rinsed water for the next dyeing session.
- Re-use of the dye bath if technical considerations allows.

Chapter 6

Knitting Process (Apparels)

Garment Manufacturing

6.1 Garment manufacturers are primarily engaged in the design, cutting and sewing of garments from fabric. Some manufacturers are contractors or subcontractors, who generally manufacture apparel from materials owned by other firms. Some manufacturers are vertically integrated, producing textiles from which they make garments, or operating retail outlets too.

History of Garment Industry

6.2 Sewing machine was invented in the Victorian era, after the development of machine elite class used to have a seamstress who stitched clothes for them on sewing machine. Before sewing machines everything was done by hand. The seamstresses went to the home of the woman who wanted to stitch the clothes. As industrial revolution started in the 19th century, garment trade too began to evolve but it was in its infancy and had no developed system for garment manufacturing. Seamstresses observed that they can develop standard patterns which can fit more than one woman. They developed a mathematical sizing system to accommodate most women with very few patterns. As businessmen, interested in lowering costs, they continued developing these patterns to become paper “information systems” engineered to control quantities of exact reproductions in cutting and stitching cloths in mass production systems.

6.3 The apparel industry grew from these tailors/businessmen, as they built manufacturing factories for production, which pattern engineering accommodated. Pattern engineering grew as great industry in the early and mid-20th century. Pattern making was first taught to “apprentices” who were called “designers”. Creative designers of styles didn’t exist during early 20th century. Paris was the center of the developments in style and creation in garments at that time and many other countries copied from there. Later designers created booklets for teaching the pattern making systems mathematically – that came to be called “pattern drafting”. One disadvantage of mass production was that designers put little effort in bringing new designs and patterns but they either copied or else made very little changes. Even today the readymade garment industry does not bring too

many new ideas in the products rather it is creating mass garments to reduce cost. Garment industry has developed many new and time saving techniques, processes and machinery for the effective production today. The most important is the CAD/CAM which enables the designer, pattern maker, marker and grader to do their jobs precisely and effectively.

Organizational Areas in Garment Manufacturing

6.4 On industrial basis there are certain areas or through the computer systems. Process through which garments are manufactured. These process are as follows:

Design / Sketch

6.5 In the garment manufacturing the first step is designing the sketch for the dresses that have to be prepared. For this purpose the designer first draw several rough sketches in the sketch book. The designer does not go for details at this moment but he rather let his creativity flow on the paper and he draws many sketches. Later these sketches are analyzed by a panel of designers. They finally select few of them. These few sketches are rendered in detail separately or in the form of a single collection. The designer also draws working drawings along with the sketch. Working drawings are flat drawing of the sketch and it help maker in understanding the patterns involved in the construction.

Pattern Design

6.6 The pattern maker now develop first pattern for the designs in any one standard size. This is made by pattern drafting method and the purpose of making this pattern is to create the sample garment for test fit.

Sample Making

6.7 The first patterns are sent to the sewing unit for assembling them into garment. This is usually stitched on calico or muslin which is an inferior quality fabric and it reduces cost. This sample is constructed to analyze the pattern fit and design too. After the sample garment is stitched it is reviewed by a panel of designers, pattern makers and sewing specialists. If any changes have to be made they are made at this time.

Production Pattern

6.8 The pattern design is now taken for creating the production patterns. The production pattern is one which will be used for huge production of garments. The pattern maker makes the patterns on standard pattern making paper. These papers are made-up of various grades. The most important component, the tissue paper pattern, is made from the lightest and thinnest paper commercially available (it is not made at the pattern companies). It is called 7.5 lb (3.4 kg) basis paper, meaning that a ream of it (500 sheets) only weighs 7.5 lb (3.4 kg).

6.9 Garment patterns can be constructed by two means: manual method, CAD/CAM method. Today many companies have developed CAD/CAM because of the ease of designing patterns, fluency and precision involved which cannot be guaranteed with the manual method. Investing once into the CAD/CAM unit is worth in itself. Many buyers around the world prefer manufacturers who are using CAD/CAM methods. The production patterns created in CAD/CAM can be stored easily and they can be modified at any point of time.

6.10 A garment sewing pattern or garment fabric and patterns draft is developed by calculation, taking account of the following measurements:

- (i) Direct Sample.
- (ii) Specification Sheet/ Measurement Chart.
- (iii) Actual body size measurements
- (iv) Ease Allowances
- (v) Sewing Allowance.

These allowances are different for different types of fabrics and patterns.

Grading

6.11 The purpose of grading is to create patterns in different standard sizes. Grading a pattern is really scaling a pattern up or down in order to adjust it for multiple sizes. Pattern sizes can be large, medium and small or else there are standard patterns of size 10, 12, 14, 16 and so on for different figures and statures sizes. This is, generally, how we get S M L XL XXL sizing. Pattern grading by manual method is a cumbersome task because the

grader has to alter the pattern on each and every point from armhole, to neckline, sleeve cap and wrist etc. by using CAD it is much easier and faster.

Marker Making

6.12 The measuring department determines the fabric yardage needed for each style and size of garment. Computer software helps the technicians to create the optimum fabric layout that fabric can be used efficiently. Markers, made in accordance to the patterns are attached to the fabric with the help of adhesive stripping or staples. Markers are laid in such a way so that minimum possible fabric gets wasted during cutting operation. After marking the garment manufacturer will get the idea as to how much fabric he has to order in advance for the making of garments. Therefore careful execution is important in this step.

Computer marking is done on specialized software. In computerized marking there is no need of large paper sheets for calculating the yardage, in fact, mathematical calculations are made instead to know how much fabric is required.

Spreading

6.13 With the help of spreading machines, fabric is stacked on one another in reaches or lays that may go over 100 ft (30.5 m) long and hundreds of plies (fabric pieces) thick.

Cutting

6.14 The fabric is then cut with the help of cloth cutting machines suitable for the type of the cloth. These can be band cutters having similar work method like that of band saws; cutters having rotary blades; machines having reciprocal blades which saw up and down; die clickers similar to die or punch press; or computerized machines that use either blades or laser beams to cut the fabric in desired shapes.

Sorting/Bundling

6.15 The sorter sorts the patterns according to size and design and makes bundles of them. This step requires much precision because making bundles of mismatched patterns can create severe problems. On each bundle there are specifications of the style size and the marker too is attached with it.

Sewing/ Assembling

6.16 The sorted bundles of fabrics are now ready to be stitched. Large garment manufacturers have their own sewing units, others used to give the fabrics on job work contract to other contractors. Stitching in-house is preferable because one can maintain quality control during the processing. On the other hand if contractors are hired keeping an eye on quality is difficult unless the contractor is one who precisely controls the process.

There are what is called sewing stations for sewing different parts of the cut pieces. In this workplace, there are many operators who perform a single operation. One operator may make only straight seams, while another may make sleeve insets. One or two other operators can sew the waist seams, and make buttonholes. Various industrial sewing machines too have different types of stitches that they can make. These machines also have different configuration of the frame. Some machines work sequentially and feed their finished step directly into the next machine, while the gang machines in multiples perform the same operation supervised by a single operator. All these factors decide what parts of a garment can be sewn at that station. Finally, the sewn parts of the garment, such as sleeves or pant legs, are assembled together to give the final form to the clothing.

Inspection

6.17 Open seams, wrong stitching techniques, non- matching threads, and missing stitches, improper creasing of the garment, erroneous thread tension and raw edges are some of the sewing defects which can affect the garment quality adversely. During processing the quality control section needs to check each prepared article against these defects.

Pressing/ Finishing

6.18 The next operations are finishing and/or decorating. Molding may be done to change the finished surface of the garment by applying pressure, heat, moisture, or these in certain combinations. Pressing, pleating and creasing are the basic molding processes. Creasing is mostly done before other finishing processes like stitching a cuff. Creasing is also done before decorating the garment with something like a pocket, appliqués, embroidered emblems etc.

Vertical form presses are automated machines which perform simple

pressing operations, such as touching up wrinkles in knit shirts, around embroidery and snaps, and at difficult-to-reach places on garments.

Final Inspection

6.19 For the textile and apparel industry, product quality is calculated in terms of quality and standard of fibers, yarns, fabric construction, color fastness, designs and the final finished garments. Quality control in terms of garment manufacturing, pre-sales and posts sales service, delivery, pricing, etc. are essential for any garment manufacturer, trader or exporter. Certain quality related problems, often seen in garment manufacturing like sewing, color, sizing, or garment defects should never be over looked.

(i) Sewing Defects

Open seams, wrong stitching techniques, non- matching threads, missing stitches, improper creasing of the garment, erroneous thread tension and raw edges are some of the sewing defects which can affect the garment quality adversely.

(ii) Color Defects

Variation of color between the sample and the final garment, wrong color combinations and mismatching dyes should always be avoided.

(iii) Sizing Defects

Wrong gradation of sizes, difference in measurement of various parts of a garment like sleeves of XL size for body of L size garment can deteriorate the garments beyond repair.

(iv) Garment defects

Broken or defective buttons, snaps, stitches, different shades within the same garment, dropped stitches, exposed notches and raw edges, fabric defects, holes, faulty zippers, loose or hanging sewing threads, non-aligned buttons and holes, missing buttons, needle cuts or chews, pulled or loose yarn, stains, unfinished buttonhole, short zippers, inappropriate trimmings etc. all can irreparably damage brand name even before its establishment.

Packing

6.20 The finished garments are finally sorted on the basis of design and size and packed to send for distribution to the retail outlets.

Recent Developments in Garment Manufacturing

6.21 CAD and CAM are two technologies that have made prominent changes in the way garment manufacturing was done in previous eras. Today all large garment manufacturing companies have developed CAD/CAM system to do the process of garment manufacturing. CAD is an abbreviation for computer-aided design and CAM for computer-aided machine. CAD/CAM is computer software that controls the production of garments. In CAD the designer designs the garments by using any suitable software like Adobe Photoshop, Adobe Illustrator, Corel Draw etc and in CAM the cutters, sewers, graders and markers control the process of development.

The designer creates 2-D or 3-D model of design in CAD and CAM as a software numerically controls the machines that generates the production.

There are several advantages of CAD/CAM over manual method of designing and production of garments:

- The expense and time is reduced in a considerable manner when compared to the laborious manual work of designing.
- Designing can be done from anywhere as the designers are able to control the process from remote locations as well.
- The data can be easily stored, transmitted, and transported through computer files.
- Digital swatches can be saved on floppy disks, zip disks, CD-ROM or hard drive thus saving space. Moreover they can be easily organized for fast and easy retrieval.
- The designs can be easily customized and personalized as corrections and editing can be done at any time without significant delays or cost increases.
- The designers don't need to produce swatches all the time as they can now see how a particular fabric or garment looks in different colors and shapes on computer screen itself.

**Part II:
Internal Audit Function –
A Theoretical Framework**

Chapter 7

Internal Controls

Internal Control

7.1 Standard on Internal Audit 120 “Internal Controls” as issued by the ICAI states that Internal Controls are systemic and procedural steps adopted by an organization to mitigate risks, primarily in the areas of financial accounting and reporting, operational processing and compliance with laws and regulations.

7.2 Internal Controls (ICs) are essentially risk mitigation steps taken to strengthen the organization’s systems and processes, as well as help to prevent and detect errors and irregularities.

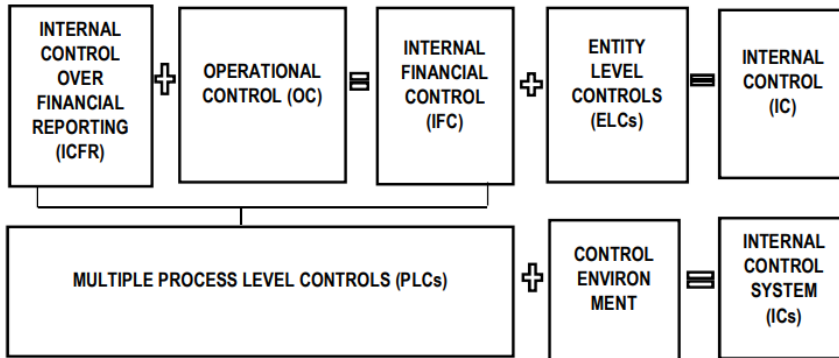
7.3 The actual steps of mitigation (e.g., review, approval, physical count, segregation of duty, etc.) are referred to as “Control Activities”. When ICs mitigate the risk of financial exposure, they are also referred to as Internal Financial Controls (IFCs) and when they mitigate operational risks, they are also referred to as Operational Controls (OCs). ICs generally operate with human intervention (Manual Controls), but in an automated environment, computer controls are deployed to secure the systems and called IT General Controls (e.g., access controls) or check transaction processing at an application level and called Application Controls (e.g., sequential numbering of invoices, etc.).

7.4 The term “Internal Controls System” is an all-encompassing term generally used to refer all types of controls put together, covering ELCs, IFCs and OCs. The Control Environment (ELCs) includes the overall culture, attitude, awareness and actions of Board of Directors and management regarding the internal controls and their importance to the organization. The control environment has an influence on the effectiveness of the overall Internal Control System since it provides the basis for establishing and operating process level controls (such as IFC and OCs) in the organization.

7.5 The internal auditor may obtain an understanding of the significant processes and internal control systems sufficient to plan the internal audit engagement and develop an effective audit approach. The internal auditor should use professional judgment to assess and evaluate the maturity of the entity’s internal control. The auditor should obtain an understanding of the control environment sufficient to assess management’s attitudes, awareness and actions regarding internal controls and their importance in the entity

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7.6 Below is a pictorial depiction of Internal control and Internal control systems:



7.7 Standard on Internal Audit (SIA) 120, Internal Controls issued by ICAI defines Internal Controls as follows:

Risk Management

7.8 Standard on Internal Audit (SIA) 130, Risk Management as issued by ICAI provides guidance on Risk Management.

7.9 “Risk Management is a process with a series of steps, taken on a continuous basis to identify the threats and vulnerabilities, assess them for severity and likelihood, monitor risks, prioritize them for action and to minimize their possible negative impact through mitigation actions. The process also encompasses the monitoring and reporting of the status of these risks.

7.10 Risk Management Framework is the combination of structure, systems and processes put in place to organise the various risk management activities and to integrate them seamlessly into the organisation. Risk management activities, forming part of the framework, are designed to enhance the organisation’s ability to, amongst others:

- (a) Provide strategy, leadership and direction on risk management;
- (b) Establish a culture of risk management throughout the organisation;
- (c) Provide an organisation structure for assigning risk management resources and defining their responsibilities;
- (d) Capture and maintain a comprehensive database of all risks;

- (e) Ensure expertise and competence in the area of risk management;
- (f) Exercise continuous monitoring and oversight on risk management; and
- (g) Periodic communication of risk management matters and formal reporting of risk status to management and those charged with governance.”

Responsibility of the Board and Management

7.11 The responsibility of the Board of Directors in the areas of Risk Management is, generally, established by the prevailing laws of the nation. The responsibility of the management is established by both the prevailing laws and the oversight of the Board of Directors.

Responsibility of Internal Auditor

7.12 Unless specially excluded from the audit approach, the Internal Auditor shall plan and conduct risk based internal audits. This requires the application of risk management concepts to ensure that the audits are prioritised in areas of importance, appropriate resources are allocated effectively where needed most, audit procedures are designed to give due attention to important matters and issues identified and reported are significant in nature.

7.13 The Internal Auditor shall not assume any responsibility to manage the risks or to execute risk management decisions. It is not responsibility of the Internal Auditor to mitigate or resolve the risks.”

Chapter 8

Internal Audit

8.1 Internal Audit provides an effective tool to ease out all complexities, ensures that systems and processes are adequate to support the growth and are adapted to the changes in various regulations, thereby ensuring sustained growth and development.

As defined in Framework Governing Internal Audits, "Internal Audit provides independent assurance on the effectiveness of internal controls and risk management processes to enhance governance and achieve organizational objectives."

Brief explanation of the key terms used above is as follows:

- (i) Independence: Internal audit shall be an independent function, achieved through the position, organization structure and reporting of the internal auditor.

At times, in addition to providing assurance, the internal auditor may adopt an advisory role to help an organization achieve its objectives, provided this does not compromise the independence of the internal auditor.

- (ii) Internal controls and risk management are integral parts of management function and business operations. An internal auditor is expected to evaluate the design and operating effectiveness of internal controls and risk management processes (including reporting processes) as designed and implemented by the management.
- (iii) Governance is a set of relationships between the company and its various stakeholders and provides the structure through which the company's objectives are achieved. It includes compliance with internal policies and procedures and laws and regulation.
- (iv) Organizational objectives incorporate the interests of all stakeholders and include the short- and medium-term goals that an organization seeks to accomplish.

8.2 This definition forms the underlying foundation of all the Standards on Internal Audit (SIA) issued by the Board. Internal audit activities shall be conducted in line with the Definition of Internal Audit.

Basic Principles of Internal Audit

8.3 The Basic Principles as mentioned in Basic Principles of Internal Audit as issued by the Internal Audit Standards Board, ICAI are a set of core principles fundamental to the function and activity of internal audit. The Basic Principles are critical to achieve the desired objectives as set out in the Definition of the Internal Audit, and therefore, apply to all internal audits.

Basic Principles can be summarized as follows:

1. Independence
2. Integrity and Objectivity
3. Due Professional Care
4. Confidentiality
5. Skills and Competence
6. Risk Based Audit
7. System and Process Focus
8. Participation in Decision Making
9. Sensitive to Multiple Stakeholder Interests
10. Quality and Continuous Improvement

Key Concepts

8.4 As per the Framework Governing the Internal Audit as issued by ICAI, there are certain concepts which form an integral part of Internal Audit activity and therefore apply to most internal audit. Key Concepts are in the nature of:

- Internal Controls
- Risk Management
- Governance Processes
- Compliance with Laws and regulations
- Nature of Assurance

Standards on Internal Audit (SIAs)

8.5 Standards on Internal Audit are classified and re-numbered by ICAI in a series format as follows:

- (i) 100 Series: Standards on Key Concepts
 - SIA 110, Nature of Assurance
 - SIA 120, Internal Controls
 - SIA 130, Risk Management
 - SIA 140, Governance
 - SIA 150, Compliance with Laws and Regulations
- (ii) 200 Series: Standards on Internal Audit Management
 - SIA 210, Managing the Internal Audit Function
 - SIA 220, Conducting Overall Internal Audit Planning
 - SIA 230, Objectives of Internal Audit
 - SIA 240, Using the Work of an Expert
 - SIA 250, Communication with Those Charged with Governance
- (iii) 300–400 Series: Standards on the Conduct of Audit Assignments
 - SIA 310, Planning the Internal Audit Assignment
 - SIA 320, Internal Audit Evidence
 - SIA 330, Internal Audit Documentation
 - SIA 350, Review and Supervision of Audit Assignments
 - SIA 360, Communication with Management
 - SIA 370, Reporting Results
 - SIA 390, Monitoring and Reporting of Prior Audit Issues
- (iv) 500 Series: Standards on Specialized Areas
 - SIA 520, Internal Auditing in an Information Technology Environment
 - SIA 530, Third Party Service Provider

- (v) 600 Series: Standard on Quality Control
- (vi) 700 Series: Other/ Miscellaneous Matters
- (vii) Standards issued up to July 1 2013
 - SIA 5, Sampling
 - SIA 6, Analytical Procedures
 - SIA 7, Quality Assurance in Internal Audit
 - SIA 11, Consideration of Fraud in an Internal Audit
 - SIA 18, Related Parties

8.6 Standards on Internal Audit (SIAs) are important for carrying out an internal audit of Retail Industry. The internal auditor and the audit team are expected to be updated on the latest pronouncements issued by the Institute in order to conduct an effective internal audit.

Objective of Internal Audit

8.7 The purpose of defining objectives of Internal Audit as mentioned in SIA 230, Objective of Internal Audit, issued by ICAI are to :

- (a) Document the formation and functioning of the Internal Audit activity and the terms of the out-sourced internal audit arrangement;
- (b) Provide clarity to the Internal Auditor and its stakeholders regarding the nature of the internal audit set-up and its working;
- (c) Ensure linkage between what is expected of the Internal Auditor and how those expectation can be met within the Framework governing Internal Audits; and
- (d) Promote better understanding on key operational areas, such as, accountability and authority, roles and responsibility, and such other functional matters.

Once the objectives of internal audit are defined, they help to establish the operating parameters within the overall internal audit agenda. These objectives and operating parameters are formally recorded in one of these two documents:

- (a) An Internal Audit Charter, primarily designed for the in-house team of internal auditors and its stakeholders; and

- (b) An Engagement Letter is a formal agreement signed with the out-sourced internal audit service provider.

Internal Audit Planning

8.8 As per SIA 220, Conducting Overall Internal Audit Planning as issued by ICAI:

“Knowledge of the entity, its business and operating environment shall be undertaken to determine the types of audit assignment which could be conducted. As part of the planning process, a discussion with management and other stakeholders shall be undertaken to understand the intricacies of each auditable unit subject to audit.

The Internal Auditor shall gather all the information required to fully understand the entity's business environment, the risks it faces and its operational challenges.

The extent of information required shall be sufficient to enable the Internal Auditor to identify matters which have a significant effect on the organisation's financials. Hence, there is a need to connect the financial aspects of the business with other business elements, such as industry dynamics, company's business model, operational intricacies, legal and regulatory environment, and the system and processes in place to run its operations.

Audit Planning, Materiality and Sampling

8.9 SIA 220, Conducting Overall Internal Audit Planning, as issued by the ICAI involves the following key elements:

- (a) It is undertaken prior to the beginning of the plan period (generally, the financial year).
- (b) It is comprehensive in nature covering the entire entity.
- (c) It is directional in nature and considers all the Auditable Units (i.e., locations, functions, business units and legal entities including third parties, where relevant), along with the periodicity of the assignments to be undertaken during the plan period.
- (d) It is normally prepared by the Chief Internal Auditor (or the Engagement Partner, where an external service provider is appointed to conduct internal audits).

- (e) The outcome of this exercise is an “Overall Internal Audit Plan” (or the “Audit Engagement Plan,” if outsourced).

8.10 SIA 220 “Conducting Overall Internal Audit Planning” and SIA 310 “Planning the Internal Audit Assignment” as issued by ICAI provides guidance in respect of planning an internal audit for the whole entity and particular part of entity respectively. The Internal Auditor may consider referring these standards before commencement of the Internal Audit

8.11 While designing an audit sample, the internal auditor may consider the specific audit objectives, materiality, population from which the internal auditor wishes to select the sample, area of audit significance and the sample size. Standard on Internal Audit (SIA) 5, “Sampling” provides that when using either statistical or non-statistical sampling methods, the internal auditor may consider designing and select an audit sample, perform audit procedures thereon, and evaluate sample results so as to provide sufficient and appropriate audit evidence to meet the objective of internal audit engagement unless otherwise specified by the client.

Chapter 9

Risk Based Internal Audit

Introduction

9.1 "Begin with the end in mind" is a famous advice given by Stephen R. Covey. Risk based Internal Audit (RBIA) frameworks is the best example of this which helps auditors to determine the end results to be achieved and use that information to direct audit efforts, IT efforts, and business efforts.

Internal auditors are expected to provide assurance on the adequacy and effectiveness of internal controls with a clear objective whether risks are being managed within acceptable limits. As internal auditor, we cannot assure that there is no risk at all, but assurance can be given that risk exists within the acceptable limits as laid down by the management of the enterprise and such tolerances of risk depend on nature of the business and size of the organization.

Globalization, rapidly changing business and regulatory environment requires a new thinking about risk. Business managements are more risk focused and the expectation from internal auditors has shifted from traditional internal audit to risk based internal audit. Now a days audit is no more a post-mortem exercise rather it a proactive exercise. Taking an innovative approach to manage and improve governance, risk and compliance (GRC) activities can help internal auditor to seize opportunities, stay a step ahead of uncertainty, and meet stakeholder expectations.

9.2 Internal audit's function evaluates a company's internal controls including its corporate governance, risk, regulatory compliances and accounting processes. These audits ensure compliance with laws and regulations and help organisation to maintain uninterrupted business activities with accurate and timely financial reporting and data collection. Internal audits provide management with the necessary tools to attain operational efficiency by identifying problems and correcting lapses. The objectives of audit program vary across entities and organizations and specifying objectives for each entity allows the audit program to align with business requirements and add tangible value in final results.

9.3 The purpose of Standard on Internal Audit (SIA) 130 "Risk Management as issued by the ICAI" is to:

- (a) Provide a common terminology by defining various risk management terms to prevent ambiguity or confusion on the subject matter;
- (b) Explain the responsibilities of the Board of Directors and management with regard to risk management, as mandated by law and regulations; and
- (c) State the responsibilities of the internal auditor, especially when providing assurance on the risk management framework.

9.4 The ICAI has issued Standard as Internal Audit (SIA) 130, Risk Management. The Internal auditor may refer this Standard in detail to understand the important terms, various responsibilities of Management and Internal Auditor and how this standard to be used in context of mitigating and management risk.

Risk Based Internal Audit

9.5 Risk-based internal audit (RBIA) is a methodology which is mainly focused on the inherent risk involved in the organisation's activities or in process and provide assurance that risk is being managed within the defined risk appetite level. It is primarily the risk management framework and seeks at every stage to reinforce the responsibility of management/BOD (Board of Directors) for managing risks.

Risk based Internal Audit allows internal auditor to provide assurance to the management/board that risk management processes are managing risks effectively, in relation to the risk appetite.

9.6 Traditional audit plans tend to focus on the controls organisation already have in place and whether or not same functioning correctly. Risk-based internal audit starts with examining the inherent risks organisation faces and then seek to correct and reframe internal controls according to what risks are the most urgent and have the most potential for causing loss. This technique is more related in keeping with an enterprise risk management (ERM) approach as it examines the organization as a whole rather than by department or process, as in a traditional audit methodology.

RBIA's give auditors a larger role in an organisation's risk reduction program. Beyond simply diagnosing the problems, it gives opportunity to internal auditor to be a part of the creation of effective controls and maintaining risk management efforts over time. An RBIA approach can require more frequent

updates than a traditional audit, but the results will be more nuanced and specific to organisation's exact risk universe at any given time.

Difference between Traditional Internal Audit Approach and Risk Based Internal Audit Approach

9.7 Difference between Traditional Internal Audit and Risk based Internal Audit is as follows:

S.No.	Traditional Internal Audit Approach	Risk Based Internal Audit Approach
1.	It is based on the audit cycle.	It is based on the results of the business risk evaluation. Risky areas are covered first and more frequently.
2.	Important risks might not be covered during the audit plan.	Provides assurance that key risks are being managed properly.
3.	Focuses on deficiencies in controls and cases of non-compliance with policies and procedures.	Focuses on risks that are not properly controlled or overly controlled.
4.	IA resources are spread over all business activities.	More efficient use of IA resources by concentrating on risk areas.
5.	Business risks are not being mapped.	The importance of risks is established during the risk assessment phase and in agreement with Internal Audit.
6.	Disagreement with the business management over the action plans leading to delays in implementation.	Facilitates consensus with line management on the needed action plans thus improving timely implementation of corrective measures.

Benefits of Risk-Based Internal Auditing

9.8 Risk-based internal audit has more benefits over traditional audit approach as follows:

S.No	Benefit	Particular	Type of Benefit
1.	Consistency	Developing a consistent and comprehensive approach to risk management makes it easier for an organization to adapt to changing conditions. Adjusting organisation's audit schedule to their risk management framework will also help them to switch tactics quickly when their business objectives need to change.	Strategic Benefits: <ol style="list-style-type: none"> 1. Easier adaptation to changing conditions by developing a consistent and comprehensive approach for risk management 2. Provides a better understanding and management of the risks
2.	Transparency	A risk-based approach to audits enables the internal auditors to identify risks correctly and allows management to put in place internal controls for the best performance. This provides organisation with a better understanding of the risks and enables them for better management.	Performance-Related Benefits <ol style="list-style-type: none"> 1. Increases the risks of opportunity by reducing negative risks 2. Provides the risks to be identified timely and correctly to ensure the best performance
3.	Specificity	Ranking and mapping risks with RBIA will allow organisation to allocate	Management of Unexpected Events <ol style="list-style-type: none"> 1. Creates the ability

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	<p>activity and funds to the areas that need the most attention.</p> <p>While compliance frameworks are necessary for many industries, RBIA also helps organisation to create a unique risk management program for every potential risk they could face.</p>	<p>to give the correct answer to unexpected demands and challenges in the face of deviations from targets</p> <p>2. Easier to understand the risks waiting for the business and their actual effects</p>
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Conducting an Effective Risk based Internal Auditing

9.9 According to David Griffiths is “Risk-Based Internal Auditing: Three views on compliance,” in order to conduct an effective RBIA, we need to ensure that the risk management framework includes the following:

- Directors have identified and evaluated the risks that threaten the objectives of the organization and have developed an internal control system to reduce this threat to a level below the risk appetite, or report to the Board where this is not possible.
- The inherent risks are recorded and assessed in some way allowing them to be classified in order of threat.
- The Board has approved a risk appetite for the organization on such a basis that risks can be easily identified as being above, or below, the risk appetite.
- The responsibility for providing assurance on the risk management framework is defined. This will include defining the responsibilities of management, external audit, internal audit and any other functions that provide assurance, such as HR, Finance, Loss Prevention and the department of Health and Safety.

- The way to score risks is to attribute a level (e.g., high, medium and low) to the consequence and likelihood of the risk.

Setting Goal for Risk Based Internal Audit Assessment:

9.10 Now organisations are increasingly recognizing the cost-benefit value of risk-based audit approach. Auditors have realized that in today's dynamic risk environment, an efficient audit risk assessment activity holds the key to an organization's success. Risk-based audit assessment helps organisation to ensure that audit program and specific tests to be performed are appropriate and tied to areas of identified risk exposure. An effective internal auditor determines goals through a process-driven effort that focuses on results as under:

- Define Objective, Criteria and Risk Appetite
- Understanding The Business Environment and Process
- Prepare Audit Population
- Identify Risk Areas
- Filter Risks (Acceptable Risks, Tolerable Risks)
- Categorise Risks and Link to Audit Areas
- Prioritize Risk and Rate the Same
- Summarise Risk for Each Audit Areas
- Assess Control Environment
- Derive Residual Risk Rating
- Decide Audit Frequency
- Develop Audit Plan and Get Approved
- Assign Resources, And Schedule Execution
- Re-Assess Risk and Control Environment
- Update Or Revise the Plan

Risk-Based Internal Audits Process

9.11 One of the benefits of a risk-based audit is that it can be altered and adjusted to match company's risk management process and particular needs. Here are some steps auditors can consider to create and execute a successful risk-based audit:

(i) Understand The Risk Universe

A risk-based internal audit requires that internal auditors to understand the company's strategies, goals and objectives very clearly. While conducting risk-based audit, auditor should have deep knowledge of the business including its strengths, weaknesses, and challenges, so that auditors can focus on the most critical risk areas. Defining and classifying organization's risk universe will help auditor to schedule RBIA's appropriately and give an idea of what key risks require the most attention.

After the risk identification process, auditors will need to assess likelihood of occurrence of risks, the impact on the organization and the risk mitigation efforts that are already in place, if any. This information should be compiled in company's risk register so it can be easily shared and distributed.

(ii) Get Management Involved

Management involvement is one of the factors that sets risk-based auditing apart from traditional approach. No one knows company's business risk better than management and using their knowledge can help auditors to develop an effective auditing system that works for organisation proactively.

Therefore, internal auditors should work closely with top management to align business strategy and risks with auditing and monitoring program. This enables top management to assist the internal auditors to conduct an accurate risk assessment of various business areas. It also helps the internal auditors to understand the company's risk tolerance and thresholds.

(iii) Determine Your Risk Maturity

Risk appetite is the amount of risk exposure that an organisation is willing to accept and risk tolerance is the degree to which an entity is able to deviate from its established risk appetite. Company's risk maturity is defined by its comprehension of these two aspects of company's business. Stakeholders must understand both of these concepts and set risk thresholds so that can identify when and where they need to implement internal controls.

Internal auditors have to identify and understand the risk management policies that are in place, along with the risk appetite at the organizational process levels. The internal auditors then need to determine the risk tolerance of the management/Board to establish a starting point for independent risk assessments.

RBIA Stages

9.12 The implementation of an RBIA is generally done in three stages, as mentioned below:

Stage 1: Assessing risk maturity

In this stage, an overview is obtained from administration and Board regarding the assessment, management and risk monitoring. This procedure is a key indicator of the reliability of the identified risk for audit planning purposes.

Stage 2: Periodic audit planning

An audit is planned for a specific period where all areas on which the management requires objective assurance are identified and prioritized including the management of key risks and the recording and reporting of risks (audit results).

Stage 3: Individual audit assignments

In this stage, individual risk-based assignments to provide assurance on part of the identified risk management framework are executed.

Processes to Sustain the Efficiency of Risk based audit program

9.13 A risk based internal audit plan contributes to sustainable success. To support the continuous improvement of the risk based internal audit program, a well-defined audit function will include reviews that help to monitor the progress and effectiveness of the program. Two of the most widely known practices are:

- Post-audit Project Review
- Quality Assurance and Improvement Program (QAIP)

Post-audit Project Review

There are five steps to be considered when completing the post-audit review:

- (i) Declare the intent of the review
- (ii) Select participants from the internal audit team to be a part of the post-audit review
- (iii) Conduct the review - Identify the top five success processes and opportunities for improvement
- (iv) Report findings to the senior management
- (v) Prepare reports, develop and adopt recommendations, and formally incorporate the recommendations into the quality, improvement, and standard operating practices of the internal audit department

Quality Assurance and Improvement Program (QAIP)

9.14 The QAIP is a means to systematically improve internal audit practices and results. It enables an evaluation of the risk-based audit activity's conformance to the "Definition of Internal Audit as issued by the ICAI." The QAIP also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement to add value to the audit activity and improve organizational operations.

Economic and social life have expanded in unexpected ways recently and the volume of business has also expanded greatly to match them. This means more and greater risks. Controlling each process in terms of both time and resources has been an arduous task and for this reason, organizations should consider implementing RBIA processes to protect their assets from unnecessary risks, as it provides a 360° vision of the business. The key for business success is also related to the first analysis performed, typically by internal auditors that analyse business goals, business objectives and their associated risks in order to conduct the risk based internal audit in the best way.

Chapter 10

Internal Financial & Operational Controls

10.1 The Council of the Institute of Chartered Accountants of India (ICAI) has introduced SIA 120, “Internal Controls” to address the issue and guide the members during the engagements, having the overall objective of clarifying the increasing responsibilities of management and auditors over Internal Controls, and how certain requirements need to be fulfilled to assess, evaluate, report and provide assurance over Internal Controls.

The purpose of this Standard is to:

- (a) Provide a common terminology on Internal Controls to prevent ambiguity or confusion on the subject matter amongst stakeholders;
- (b) Define Internal Controls, how they mitigate risk, and also how they are viewed from a legal perspective;
- (c) Explain the responsibilities of management and auditors with regard to Internal Controls, as mandated by law and regulations; and
- (d) Specify certain requirements which need to be satisfied to be able to provide assurance on Internal Controls.

10.2 Internal financial and operational controls are the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to the company’s policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. Moreover, the reporting on internal financial controls is significantly broader than the reporting on internal controls.

10.3 As indicated in SIA 230, Objectives of Internal Audit, the Internal Auditor derives his mandate from those charged with governance, which in the case of listed entities, is generally the Audit Committee. In line with the definition of internal audit, and as per the objectives defined for internal audit, the Internal Auditor is expected to include Internal Controls as a key part of his scope and approach.

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10.4 Unless specifically excluded, the Internal Auditor, and the work he performs, shall be directed to ensure that the entity has designed, implemented and maintains effective and efficient Internal Controls. The audit procedures shall be sufficient to allow the Internal Auditor to check the design, proper implementation and operating effectiveness of the Internal Controls. Any shortcoming shall result in recommendations for improvement and suggestions on how to make the Internal Controls more efficient and effective in line with their objectives.

10.5 Internal Auditor shall review the risk assessment exercise undertaken at time of planning the audit assignment to establish a basis of evaluating whether adequate and appropriate Internal Controls are in place to address the risks identified. Audit procedures to be conducted would primarily be directed over high and medium risk Internal Controls, and adequate documentation (e.g., a Risk Control Matrix) should be in place to confirm the linkage of the audit procedure with the respective risks.

10.6 Where the Internal Auditor is required to provide an independent opinion over the design, implementation or operating effectiveness over Internal Controls, this shall be undertaken in line with the requirements of SIA 110, "Nature of Assurance", especially with regard to the need to have a clear understanding of the Internal Controls Framework which shall form the basis of the assurance. Also, in such situations where a written assurance report is being issued, the Internal Auditor shall consider the following (as a basis for his opinion):

- (a) An evaluation of the system of Control Self-Assessment by owners of Internal Controls to support the CEO/CFO certification process.
- (b) Availability of Compliance Certificates from owners of Key Controls to support a continuous system of compliance.

10.7 In situations where the Statutory Auditor is expected to rely on the work of the Internal Auditor as per Standard on Auditing (SA) 610, Using the Work of the Internal Auditors, issued by ICAI, regarding their audit of Internal Financial Controls Over Financial Reporting, the Internal Auditor shall document the objectives and agreed scope and approach of the internal audit, over which reliance is to be placed by the Statutory Auditor.

Internal financial controls (IFC) applicability

Relevant provisions	Applicability	Statutory requirement
Section 134 of Companies Act	All listed entities	The Directors Responsibility Statement shall state the directors had laid down internal financial controls to be followed by the company and that such internal financial controls are adequate and operating effectively.
Section 143 of Companies Act	All entities (listed/unlisted)	The auditor's report shall state whether the company has adequate internal financial controls with reference to financial statements in place and the operating effectiveness of such IFC.
Section 177 of Companies Act	All entities having an audit committee	<p>The audit committee shall evaluate internal financial controls and risk management systems.</p> <p>The audit committee may call for comments of auditors about internal control systems before their submission to the Board.</p>

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Schedule IV	All entities having independent directors	The independent directors should satisfy themselves on the integrity of financial information and ensure that financial controls and systems of risk management are robust and defensible.
Rule 8 (5) of Companies Accounts Rules	All entities (listed /unlisted)	The board report shall state the details in respect of adequacy of internal financial controls with reference to the financial statements.

10.8 An Internal Finance Control (IFC) audit checklist is an invaluable tool for comparing a business's practices and processes to the requirements set out by ISO standards. Internal Finance Control (IFC) audit is an independent assessment of how effective an organization's risk management, processes, and general governance is. The Internal Finance Control (IFC) audit checklist contains everything needed to complete an Internal Finance Control (IFC) audit accurately and efficiently.

10.9 Internal Finance Control (IFC) audits can be scheduled as frequently as your organization determines is needed in order to improve processes. Some businesses schedule audits once a year, every quarter, or even once a month, at most.

The Internal Finance Control (IFC) audits will review a few areas of your organization, including::

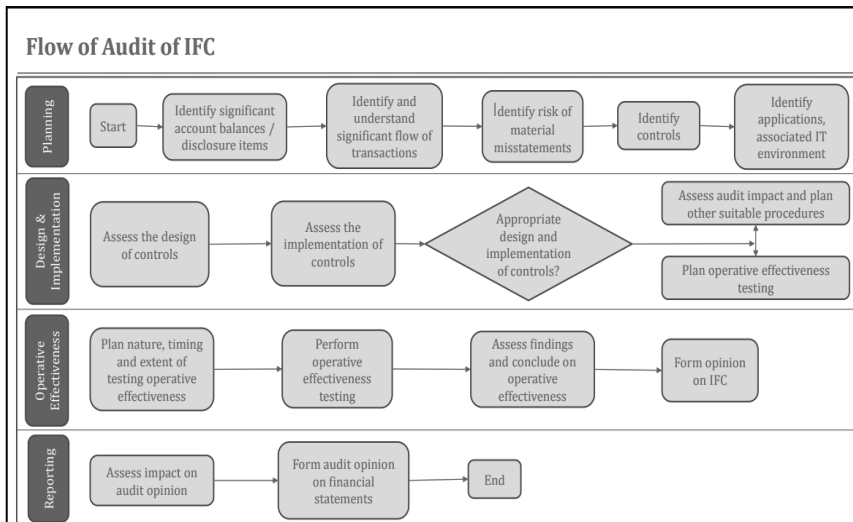
- Standards
- Areas subject to improvement
- Effectiveness of the system

Benefits of Internal Financial Control System

- Enhance Senior Management Accountability & Responsibility

Internal Financial & Operational Controls

- Improved stockholder confidence in company's financial reporting progression
- Trickle back on operational management accountability
- Developments in the financial reporting and financial controls of the Board
- More accurate, reliable financial statements Making audits more comprehensive



Components of Internal Control

- Entity Level Control
- IT Controls
- Process Level Control

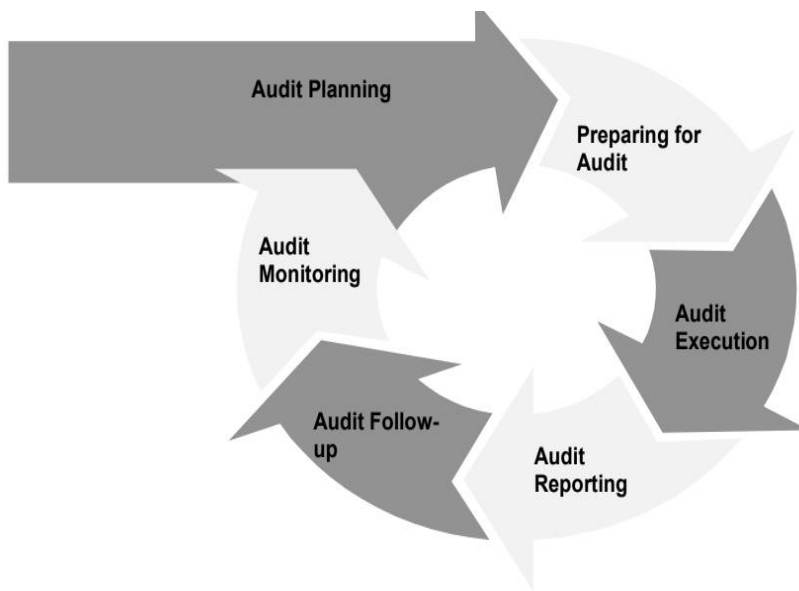
10.10 To sum up Internal financial and operational controls are important for any organization for ensuring the orderly and efficient conduct of its business, including adherence to the company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. Therefore, internal auditor should focus more on this and make themselves more equipped to perform this exercise.

Part III:
Practice Guide for Internal Audit

Chapter 11

Audit Life Cycle

11.1 The audit life cycle starts with audit planning and continues till the follow-up and closure of audit observation mentioned in the audit report. Following flow chart depicts the components of audit life cycle from the perspective of the internal audit:



Audit Life Cycle

11.2 The above flow chart illustrates the components of audit life cycle:

Audit Planning

As per Standard on Internal Audit (SIA) 220, "Conducting Overall Internal Audit Planning," issued Audit planning includes the selection of areas to be audited based on risk assessment of audit units, resource allocation to individual audits, assigning man-days for each audit, preparation of an annual audit calendar and communication of the audit plan to audit parties and audit units. Preparing for audit includes conducting internal team meeting and carrying out various audit preparation activities (Understand the

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audit unit, its operation, financial and regulatory framework, calculation of audit materiality and audit sampling).

Audit Execution

It includes field visit for conducting the audit. This includes calling for an entry conference with audit unit, revising the scope of work (if required), allocating work among audit team members, maintaining daily diary to keep an account of the work done, interaction with the client and collecting audit evidence.

Audit Reporting

It includes preparation of draft audit report and consequently discussion on draft audit report and getting management remarks, holding exit conference, review and approval of the report and submission of the audit report.

Audit Follow-up

It includes receiving first compliance, reminders to ensure response to audit observations are received in time, procedure for non-compliance, steps to improve compliances with audit reports and marking audit observations on compliances.

Post Audit procedures

It includes supervision by management of company, surprise checks of audit team by flying squad and audit committee meetings. In addition to the above, internal and external reporting in the form of monthly progress report, administrative report and annual audit report is included in the component of audit life cycle. Finally, quality control procedures monthly knowledge sharing and review of audit reports at RO/HO level are also included in this component.

Chapter 12

Internal Audit Processes-Audit Planning & Preparation

12.1 To improve the quality of audit, a detailed and well-defined planning is essential. In this stage each audit unit will be planned in a manner to ensure that audit are carried out in an efficient and timely manner. The planning establishes and documents the overall audit approach, audit objectives, scope of audit program and cover as all the audit procedure to be performed.

9.1 As per the Standard on Internal Audit (SIA) 220, Conducting Overall Internal Audit Planning issued by the Institute.

“1.4 Conducting the Overall Internal Audit Planning involves the following key elements:

- (a) It is undertaken prior to the beginning of the plan period (generally, the financial year).
- (b) It is comprehensive in nature covering the entire entity.
- (c) It is directional in nature and considers all the Auditable Units (i.e., locations, functions, business units and legal entities including third parties, where relevant), along with the periodicity of the assignments to be undertaken during the plan period.
- (d) It is normally prepared by the Chief Internal Auditor (or the Engagement Partner, where an external service provider is appointed to conduct internal audits).
- (e) The outcome of this exercise is an “Overall Internal Audit Plan” (or the “Audit Engagement Plan,” if outsourced).

2.1 The objectives of an Overall Internal Audit (Engagement) Plan are to:

- (a) ensure that the planned internal audits are in line with the objectives of the internal audit function, as per the internal audit charter of the entity (and terms of engagement, where it is an outsourced engagement) and also in line with the overall objectives of the organisation.
- (b) align the organisation’s risk assessment with the effectiveness of the risk mitigation implemented through internal controls.

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- (c) confirm and agree with those charged with governance the broad scope, methodology and depth of coverage of the internal audit work to be undertaken in the defined time-period.
- (d) ensure that overall resources are adequate, skilled and deployed with focus in areas of importance, complexity and sensitivity.
- (e) Ensure that the audits undertaken conform at all times with the applicable pronouncements of the “Institute of Chartered Accountants of India.”

In case of textile industry specific care should be taken to design the internal audit plan. Audit planning should be divided into annual audit planning and individual audit planning.

Annual Audit Programme

12.2 As it would not be possible for Internal Auditor to audit all departments of the organization within one audit cycle, it should develop a framework for identification of departments and functional areas that would be taken up for audit of 4 to 5 departments in a quarter of the year so that one department could be covered once in a year. Such prioritization can be done based on risk analysis and materiality of the potential risk.

Important objectives of the annual audit plan are to:

- Ensure coverage of all key departments each year;
- Review periodicity of coverage at regular intervals;
- Resource planning; and
- Control redundancy in audits.

Internal auditor should prepare the annual audit programme sufficiently in advance, at least two to three months in advance i.e. by January so that the auditee units can be informed accordingly. Also, the annual audit programme should be broken down into quarterly programmes and it should be so arranged that travel of audit teams should be optimized and there is a good mix of audits at state capital and districts in every quarter.

The first six steps illustrate the various activities to be conducted at the annual audit planning stage to prepare the annual audit calendar of any company. Further, seventh step explains the concept of audit planning at

Internal Audit Processes-Audit Planning & Preparation

individual audit life cycle.

1. Selection of units/process to be audited using risk based audit approach
2. Resource allocation
3. Man-days to be allotted for audit of unit
4. Preparing the annual audit calendar
5. Preparation of unit specific required list of documents
6. Communication of calendar to audit units and audit teams
7. Preparation for individual audits

The first and important step in audit planning stage is to identify the units/processes to be audited each year. An effective mechanism for selection of units is the classification of units into “high”, “medium” and “low” risk based on certain pre-defined parameters i.e. risk-based approach. The risk-based approach will provide required information to the audit teams to guide their focus and resources in conducting audit of more risky units and operations by planning the nature and extent of the audit in accordance with the risk profiling. A risk-based approach for preparation of the Annual Audit Plan facilitates strategic use of scarce audit resources, aligns audit efforts with its objectives, facilitates institutional development, and reduces risk exposure by focusing attention on areas of weakness. Such an approach makes it possible to select those units for audit which are likely to be more vulnerable due to either their budgets being large (thus probability of irregularities being a little more because of more expenditure), or which have not been audited for more than a year, or which have a past record of having large number of adverse audit observations against them. This approach enables directing audit efforts on such units and ensure more effective utilization of the limited manpower.

Planning Individual Audits

12.3 The auditor should plan the audit in such a manner, which ensures that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner.

As per Standard on Internal Audit (SIA) 310, Planning the Internal Audit assignment.

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“1.1 Internal Audit Planning is conducted at two levels:

- (a) An overall internal audit plan for the entire entity is prepared for a given period of time (usually a year) and presented to the highest governing body responsible for internal audits, normally, the Board of Directors, or the Audit Committee.
- (b) A number of specific internal audit plans are prepared for individual assignments to be undertaken covering some part of the entity and presented to the Chief Internal Auditor.

1.2 Standard on Internal Audit (SIA) covers the second level, the “Planning the Internal Audit Assignment” for a particular part of the entity. SIA 220 covers the first level, “conducting overall Internal Audit Planning” of the entity at a whole.

Planning the Internal Audit Assignment involves the following key elements:

- (a) It is a sub-set of the Overall Internal Audit Plan.
- (b) It is undertaken prior to the beginning of a particular assignment during the plan period.
- (c) Assignments are specific to a part of the entity, covering a particular Auditable Unit (location, function, business unit or a legal entity, including third parties, where relevant).
- (d) It is specific in nature, covers the manner in which a particular audit assignment will be conducted with details of the Auditable Unit, such as, the business activities or processes to be audited.
- (e) Assignments are, generally, completed during a short period of time;
- (f) It is prepared by the Internal Auditor responsible for the assignment (or the Engagement Staff where an external service provider is appointed to conduct internal audits).
- (g) The outcome of this exercise is, generally, in the form of an “Internal Audit Assignment Plan”

While planning individual audit, due considerations should be given to the information available in permanent audit files. In case of first audit, sufficient time should be given to the audit team to gain understanding of the departments. Plan shall consider availability of resources and skill levels and prior experience in conducting the audit of the said department. Preliminary planning involves

Internal Audit Processes-Audit Planning & Preparation

- gathering basic understanding about the department, its operations and controls;
- identifying areas of audit focus through study of past audit reports, analytical review and assessing inherent risks;
- Identifying of legal compliance requirements.

Ideally about 40 percent of time should be devoted for planning.

Knowledge of the Entity and its Environment

12.4 Since internal audit is a key assurance function regarding organization's achievement of its objectives, auditor should have fairly good knowledge of the organization and its operations. This includes understanding the rationale of *establishing* the department, structure of the department, functions of the department, relation between secretariat office, head office and plant level offices.

A comprehensive knowledge of the Auditable Unit under review, its business and operating environment, shall be undertaken to determine the nature of audit procedures and tests to be conducted

As per Standard on Internal Audit (SIA) 310 issued by the ICAI. The Internal Auditor shall gather all the information required to fully understand the Auditable Unit's business environment, the risks it faces, the legal and regulatory requirements, the activities conducted and its day to day operational challenges.

The extent of information required should be sufficient to enable the internal auditor to identify matters which have a significant effect on the Auditable Unit's financials and operations. Hence, there is a need to connect the financial aspects of the Auditable Unit's business with the entity's business elements, as well as external elements such as industry dynamics, business model, operational intricacies, legal and regulatory framework and the system and processes in place to run its operations.

12.5 Also, the internal auditor should obtain knowledge of the economy, the entity's business and its operating environment, including its regulatory environment and the industry in which it operates, sufficient to be able to review the key risks and entity- wide processes, systems, procedures and controls. The internal auditor should identify sufficient, appropriate, reliable and useful information to achieve the objectives of the engagement. Such

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knowledge is used by the internal auditor in reviewing the key operational, strategic and control risks and in determining the nature, timing and extent of internal audit procedures.

Since internal audit is a continuing engagement, the auditor should re-evaluate the knowledge gained in previous audits and keep updating the changes. Primary source of information about the department can be obtained through the following documents:

- Internal policies
- Budget estimates, revised estimates and actual expenditure
- Audited financial statements
- Standard operating procedure manuals, departmental manuals, etc.
- Organization charts and flow charts of processes
- Annual reports
- MIS reports.

The Internal Auditor should use flowcharts, questionnaire or interview methods to obtain necessary information. Audit manager should ensure that members of audit team inculcate habit of gaining functional knowledge of the department throughout the course of audit and share information among themselves. Knowledge so gained should be used to interpret and correlate the contents of various financial and MIS reports prepared by the department.

Gathering knowledge about various departments is a continuous process that would help the auditor in:

- Identifying inherent risk
- Determining materiality
- Develop audit plan and program
- Evaluating audit evidence
- Identification of areas of special consideration
- Identification of unusual transactions and fraud indicators
- Appropriateness of accounting principles applied

Understanding Controls

12.6 The auditor, in determining the extent and scope of the audit, should study and evaluate the reliability of internal control.

After gaining understanding the organization, auditor identifies key controls in conducting operations. Internal auditor should examines and evaluates the compliance to the controls specified in the various codes, manuals to assure effectiveness of controls in fulfilling the objectives of the organization.

As per standard on Internal Audit (SIA) 120, Internal Controls

“5.4 Where the Internal Auditor is required to provide an independent opinion over the presence, design, implementation and/or operating effectiveness over Internal Controls, this shall be consistent with the requirements of SIA 110, “Nature of Assurance”, especially with regard to the need to have a clear understanding of the Internal Controls Framework which shall form the basis of the assurance. Also, in such situations where a written assurance report is being issued, the Internal Auditor shall consider the following (as a basis for the opinion):

- (a) An evaluation of the system of Control Self-Assessment by owners of Internal Controls to support the CEO/CFO certification process.
- (b) Availability of Compliance Certificates from owners of Key Controls to support a continuous system of compliance.”

“5.2 The Internal Auditor shall ensure that the entity has designed, implemented and maintains effective and efficient Internal Controls. The audit procedures shall be sufficient to allow the Internal Auditor to check the design, proper implementation and operating effectiveness of the Internal Controls. Any shortcoming shall result in recommendations for improvement and suggestions on how to make the Internal Controls more efficient and effective in line with the objectives.”

Identification of Inherent Risk

12.7 Risks in operations of an organization due to lack of controls are as ‘Inherent Risk’.

Auditor should also try find the reasons for existence of adverse conditions or highly favorable conditions such as sudden increase in the budget of department or acquisition of high value capital items. Assessment of inherent

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risk depends on auditor's professional judgment and may be judged at two levels i.e., macro level (environmental factors) and micro (account balance) level.

Environmental factors that substantiate the inherent risks are:

- Integrity of the management (lower the integrity levels, higher the risk)
- Management's experience and understanding of the operations (inexperience of the management can lead to potential misuse by the staff)
- Unusual pressures to perform (unrealistic deadlines may cause management to take short cuts, make false claims, etc.)
- Economic conditions (lower economic activity can have impact on functioning of some of the departments like commercial taxes)

Accounting factors that underpin the inherent risk would involve:

- Quality of accounting system (poor quality accounting is prone to more misstatements);
- Complexity of the transactions (huge engineering project may have more complexity in accounting than simple accounting of petty cash expenses);
- Susceptibility of assets (assets like cash are more susceptible to theft than say, building);
- Pressure to complete unusual and complex projects (routine transactions may be accounted with ease by the staff than unusual transactions);

Identify Legal Compliances

12.8 Compliance is a key concept in Internal Audit.

All organisations should adhere to all legal requirements. For example, Income Tax Act requires an organisation to deduct tax at source while paying salaries to employees, or payments made to suppliers etc. The details of such deductions need to be furnished to the tax authorities periodically. Similarly, Provident Fund Act requires deduction of employee's contribution from salary and payment to PF authorities. In case of textile unit permissions under Water (Prevention and Control of Pollution) Act, 1974 and Air

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(Prevention and Control of Pollution) Act 1981, Explosives license for FO & Diesel , Boiler License, Factory License, etc. is important for which auditor should acquaint himself with the applicable legal provisions as one of the audit objectives is to assure adherence to legal provisions.

Standard on Internal Audit (SIA) 150 Compliance with Laws and Regulations as issued by ICAI clarifies the responsibility of management and auditing over CLR and the retirements which need to be met to asset, evaluate, report and providing independence assurance over the compliance framework.

As per SIA 150,

“5 Responsibility of the Internal Auditor

5.1 The nature and extent of internal audit procedures to be conducted in the area of compliance is dependent on the framework in place and the maturity of the processes. Where management has implemented a formal compliance framework, and unless specifically excluded from the audit scope (or technically not feasible), the Internal Auditor shall plan and perform internal audit procedures to evaluate the design, implementation and operating effectiveness of such framework so as to provide independent assurance to management and to those charged with governance (refer Para 6.1).

5.2 Where no formal compliance framework exists, the Internal Auditor shall design and conduct audit procedures with a view to highlight any exposures arising from weak or absent compliance activities and processes, make recommendations to implement and strengthen those processes and thereby, improve compliance (refer Para 6.2).

5.3 Where the independent assurance requires the issuance of an audit opinion over the design, implementation and operating effectiveness over compliance, this shall be undertaken in line with the requirements of SIA 110, Nature of Assurance, especially with regard to the need to have a formal compliance framework in place, which shall form the basis of such an assurance (refer Para 6.3).

5.4 While the primary objective of an internal audit is to strengthen the system and process of compliance, there may be instances where the Internal Auditor is asked to undertake compliance audit assignments with the primary objective of identifying any instances of noncompliances. In such situations, and where no formal compliance framework is in place, the Internal Auditor may not be able to provide a written opinion in line with requirements of SIA 110 “Nature of

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Assurance”. Never-the-less a Summary of Findings may be possible, listing any instances of non-compliance identified as a result of the internal audit procedures undertaken. These findings shall be reported along with the following:

- the scope, listing all the specific laws and regulations tested;
- audit procedures performed, sample selected, and population covered;
- summary of the work performed; and
- limitations, if any, on the responsibilities assumed by the internal Auditor, such as, inherent limitations in sample selection, or that a court of law is the ultimate authority in establishing legal interpretation of non-compliance, etc.

5.5 The Internal Auditor shall not assume any responsibility to manage or operate the compliance framework (e.g., to act in the capacity of a chief compliance officer, to take ownership of the compliance tracking system, etc.) or to take compliance related decisions (e.g., to accept the risk of non-compliance). It is not responsibility of the Internal Auditor to execute or resolve compliance related risks (e.g., engaging directly with regulators, etc.).”

Perform Analytical procedures

12.9 Analytical procedures are tests like trend analysis, ratio analysis, changes in account balances, etc. done to study plausible relationship between two sets of data to judge the reasonableness. For example, while auditing finance department, auditor may compute ratio of interest paid by company over total outstanding loans taken by the company. This relationship may show that average interest paid at around 8%. However, if it showed that interest amount was abnormally high as a proportion of total loans, the internal auditor would flag this for detailed check during the audit. Significant deviation from expected results may prompt auditor to enquire and plan audit procedures accordingly.

Standard on Internal Audit (SIA) 6, Analytical Procedure as issued by ICAI provides that:

“7. In determining the extent to which the analytical procedures should be used, the internal auditor should consider the following factors, including:

- The significance of the area being examined.
- The adequacy of the system of internal control.

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- The availability and reliability of financial and non-financial information.
- The precision with which the results of analytical procedures can be predicted.
- The availability and comparability of information regarding the industry in which the organization operates.
- The extent to which other auditing procedures provide support for audit results.

After evaluating the aforementioned factors, the internal auditor should consider and use additional auditing procedures, as necessary, to achieve the audit objective.

12.10 The following are the some of the established analytical procedures applied by the auditors while auditing in the textile company:

- Comparison of Target V/s actual Production and sales
- Comparison of power consumption
- Comparison of Labour cost per Kg/per meter per month

Working papers

12.11 Standard on Internal Audit (SIA) 330 Internal Audit Documentation state that:

“1.2 The Internal Auditor is expected to record and collate all the evidence obtained in the form of complete and sufficient audit documentation. This Standard explains certain key requirements in the process of collection, preparation, retention and subsequent review of internal audit documentation.”

Good practices suggest that the auditor should document all important matters that provide evidence that audit has been carried out in accordance with the generally accepted auditing standards. The working papers aid internal auditors in planning, performing, and supervising and reviewing audit work. Working papers are also a good source of evaluation of the internal auditor's work by external auditors and for peer review also helps internal auditor to in following ways:

The objectives of preparing complete and sufficient audit documentation is to:

- (a) validate the audit findings and support the basis on which audit observations are made and conclusions reached from those findings;

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- (b) aid in the supervision and review of the internal audit work; and
- (c) establish that work performed is in conformance with the applicable pronouncements of the Institute of Chartered Accountants of India.

Nature of Documentation (refer Para. 3.1): Documentation includes written records (electronic or otherwise) of various audit activities and procedures conducted, including evidence gathered, information collected, notes taken and meetings held. It includes, for example, internal memoranda, letters of confirmation and representation, Internal Audit Documentation 3 checklists, external reports and correspondence (including e-mail) concerning significant matters. Abstracts or copies of the entity's records, significant and specific contracts and agreements, may be included as part of internal audit documentation, if and when appropriate.

These documents need not necessarily be printed on paper and soft/ electronic/ digital version may be used and filed. However, where alternate method of recording and storage is used, it must be reproducible in print form if required, similar in nature to the original documents.

Chapter 13

Conducting Effective Audit

13.1 Internal Audit commences with an **entry conference**, which is a meeting between the key personnel of the auditee unit (including the head of the office) and the internal auditors to create a conducive environment for the audit. The scope and flow of activities of the audit are communicated so that auditee department makes necessary arrangements for effective conduct of audit. The plan and the methodology of the audit may be discussed for better understanding and entitling the support of the auditee. However, audits with an element of surprise do not have any entry conferences. During the opening conference, internal auditors should:

- Introduce the team members and explain the scope and methodology of the audit;
- Describe the process of raising the audit queries and their finalization including the time line for replies to be received from auditee;
- Request for the support (production of records, arrangements for seating the audit team, prompt response to audit queries, etc.) that is needed from the auditee;
- Identify the information / records that would be needed and the contact points in the auditee's organization;
- Elicit concerns, questions and suggestions of the auditee (particularly, the head of office);

The entry conference sets the tone for effective audit by establishing effective communication lines with the auditee organization. It also helps the internal auditor to validate the information he had gathered during the planning stage and assess the attitude and perception of the key personnel towards controls.

Immediately after the entry conference, the internal auditors should submit a list of records that they would like the auditee to submit. Simultaneously, the internal auditors should collect additional information that would enhance their understanding of the organization.

Identification of audit areas

13.2 Internal Auditor should develop individual worksheet for evaluation of control activities and procedures in internal controls. He should list down all components of an audit area. For example, in audit of commercial taxes department, cash receipt could be on account of the following:

- Collection of taxes
- Collection of penalties
- Sale of an asset
- Recovery of advance given to an employee

Internal Auditor would then identify assertions in each audit area. For example, in case of collection of tax, assertions would include occurrence (no collection is accounted without actually being received), completeness (all tax collections have been accounted for and no transaction is left out unaccounted), and accuracy/valuation (amount is credited with actual value of money received – neither understated nor overstated and accounted under correct head of account) and compliance with law.

For each of the assertions, internal auditor should identify possible misstatement. These can be identified from the controls incorporated by the organization (through various codes and manuals). The internal auditor would then comment on the effectiveness of each of the controls.

Note: *Preparation of control evaluation sheet for individual area of audit may not be required in case of repetitive audit assignments. Standardized questionnaire may be used subject to periodical review of changes in the processes or legal requirements. However, disadvantage with questionnaire is loss of creativity. In questionnaire-based audit, auditors tend to lose skills of identification of controls, constructing relation between assertions and audit objectives. In long run loss of importance of evidence, documentation etc. leads to fall in standards of audit. It is, thus, a good practice to identify assertions and controls and verify their effectiveness.*

Review of audit plan

13.3 After entry conference, collection of additional information regarding the auditee, internal control evaluation, the internal auditors can review the audit plan that was prepared prior to commencement of the audit.

Monitoring quality of audit work

13.4 The work of the audit staff at each level and audit phase should be properly supervised during the audit, and a senior member of the audit staff should review documented work.

Monitoring quality of audit is an important task of team leader. On completing each task, audit staff shall submit individual work sheet for manager's review. Key responsibilities of audit manager include:

- Coordinating staff assignments – with specific reference to capabilities
- Monitoring progress
- Level of understanding of the audit staff
- Review of documentation
- Review of evidence gathered (i.e., sufficiency, objectivity, relevance and appropriateness)
- Resolving issues
- Review of preliminary risk assessment and change in audit program and procedures needed in light of audit finding

In each audit area, the internal audit or would first check compliance with the established internal control. If the compliance is poor, the auditor should conduct a larger substantive testing. To illustrate, it is expected that every item of store is issued against a valid indent (issue voucher). Compliance testing would involve checking a sample of issues to assess the extent of compliance with the above requirement, where as substantive testing goes beyond compliance and sees whether the outcomes are as they should be i.e. whether actual physical balance tally with bin card or stores ledger in a sample of items. If the compliance is poor, the auditor would be required to conduct higher substantive testing to rule out errors or mischief.

The Internal Auditors would also decide at each stage how they would select the transactions for audit. As 100 percent of transactions cannot be verified, a sample of transactions needs to be selected. As far as possible, the auditors should try to apply a scientific sampling technique. The internal audit should also include surprise check on some sections like cash and stores.

13.5 While the items that need to be reviewed during audit of a government

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department may vary slightly from organization to organization due to difference in the nature of activities and functioning, some items that are common to all departments are:

- Custody of cash
- Fixed assets and stores
- Cash Receipts
- Cash disbursements
- Establishment expenditure
 - Pay & allowances
 - Claims
 - Pension
- Contingent bills
- Grants-in-aid
- Procurement & contracts
- Budgetary controls
- Assessment of computerized systems
- Assessment of risk of fraud

The Internal Audit Standards Board of the Institute of Chartered Accountants of India (ICAI) has issued Standard on Internal Audit (SIA) 530, Third Party Service Provider.

“1.1 This standard deals with the responsibility of the Internal Auditor and management with regards to risks from situations where some part of the entity’s business operations, processes and information resides with Third-Party Service Providers (TPSPs).

2.1 The primary objective of this Standard is to Prescribe the key requirements for providing an independent assurance over business operations at third party service providers. These requirements are in the nature of:

- (a) Assessment of risks associated with outsourcing, especially, in securing and protecting its information;

Conducting Effective Audit

- (b) Evaluation of adequacy of controls to address risk of errors and irregularities with respect to financial, operational processing and reporting;
- (c) Cost and operational efficiencies in the collection, storage and processing and continuous availability of user Entities' information; and
- (d) Ensuring compliance with IT policies and standards, as well as contractual, statutory, and regulatory requirements.

2.2 Another objective is to issue ensure quality an independent audit reports on TPSP's Controls. These audit reports the User Entity to develop a trust on the controls at the TPSP. Conversely, these reports also help to build confidence with the TPSP in their own service delivery processes and controls.

2.3 Secondary objective of this standard is to prescribe requirement for the Internal Auditor in evaluating the TPAA report provided by Independent auditor covering effectiveness of customer processes of TPSP.

Part IV
Risk Assessment and Internal
Audit Function

Chapter 14

Enterprises Risk Management & Internal Audit

14.1 The business world is becoming increasingly complex due to new, evolving, and emerging risks. Organizations are giving risk management more importance, but implementing an effective risk management program takes time and efforts. Internal auditors are finding that they can play an important role in risk management.

14.2 The Internal Auditors can:

- Educate and train audit committees members and management on risk management concepts.
- Seek opportunities to perform more risk management consulting services in support of the risk management program, and formally communicate the results of those to the audit committee and management.
- Evaluate strategic risks; i.e., whether management has
 - ◆ Comprehensively identified key strategic risks,
 - ◆ Developed prudent risk management techniques to address those risks, and
 - ◆ Established sufficient monitoring of strategic risk “signposts” to identify risk occurrences in time to take the appropriate actions.
- Devote time, resources, and leadership to developing internal audit teams so that they have the skills and experience related to risk management.
- Use third-party and other internal resources to supplement the risk management skills of the internal audit activity.

Enterprise Risk Management

14.3 Value of an entity is maximized when management sets strategy and objectives to strike an optimal balance between growth and return and

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related risks, and efficiently and effectively deploys resources in pursuit of the entity's objectives.

Enterprise risk management encompasses the following:

- A. ***Aligning risk appetite and strategy*** – Management considers the entity's risk appetite in evaluating strategic alternatives, setting related objectives, and developing mechanisms to manage related risks.
- B. ***Enhancing risk response decisions*** – Enterprise risk management provides the rigor to identify and select among alternative risk responses – risk avoidance, reduction, sharing, and acceptance.
- C. ***Reducing operational surprises and losses*** – Entities gain enhanced capability to identify potential events and establish responses, reducing surprises and associated costs or losses.
- D. ***Identifying and managing multiple and cross-enterprise risks*** – Every enterprise faces a myriad of risks affecting different parts of the organization, and enterprise risk management facilitates effective response to the interrelated impacts, and integrated responses to multiple risks.
- E. ***Seizing opportunities*** – By considering a full range of potential events, management is positioned to identify and proactively realize opportunities.
- F. ***Improving deployment of capital*** – Obtaining robust risk information allows management to effectively assess overall capital needs and enhance capital allocation.

These capabilities inherent in enterprise risk management help management to achieve the entity's performance and profitability targets and prevent loss of resources. Enterprise risk management helps to ensure effective reporting and compliance with laws and regulations, and helps avoid damage to the entity's reputation and associated consequences. In sum, enterprise risk management helps an entity to get to where it wants to go and avoid pitfalls and surprises along the way.

Components of Enterprise Risk Management

14.4 Enterprise risk management consists of eight interrelated components. These are derived from the way management runs an enterprise and are

integrated with the management process. These components are:

- i. **Internal Environment** – The internal environment encompasses the tone of an organization, and sets the basis how risk is viewed and addressed by an entity's people, including risk management philosophy and risk appetite, integrity and ethical values, and the environment in which they operate.
- ii. **Objective Setting** – Objectives must exist before management can identify potential events affecting their achievement. Enterprise risk management ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.
- iii. **Event Identification** – Internal and external events affecting achievement of an entity's objectives must be identified, distinguishing between risks and opportunities. Opportunities are channeled back to management's strategy or objective-setting processes.
- iv. **Risk Assessment** – Risks are analyzed, considering likelihood and impact, as a basis for determining how they should be managed. Risks are assessed on an inherent and a residual basis.
- v. **Risk Response** – Management selects risk responses – avoiding, accepting, reducing, or sharing risk – developing a set of actions to align risks with the entity's risk tolerances and risk appetite.
- vi. **Control Activities** – Policies and procedures are established and implemented to help ensure that the risk responses are effectively carried out.
- vii. **Information and Communication** – Relevant information is identified, captured, and communicated in a form and timeframe that enable people to carry out their responsibilities. Effective communication also occurs in a broader sense, flowing down, across, and up the entity.
- viii. **Monitoring** – The entirety of enterprise risk management is monitored and modifications made as necessary. Monitoring is accomplished through ongoing management activities, separate evaluations, or both.

Enterprise risk management is not strictly a serial process, where one component affects only the next. It is a multidirectional, iterative process in which almost any component can and does influence another.

Encompasses Internal Control

14.5 Internal control is an integral part of enterprise risk management. This enterprise risk management framework encompasses internal control, forming a more robust conceptualization and tool for management.

Internal Auditing's Role with Strategic Risks

The Institute of Chartered Accountants of India (ICAI) has issued Standard on Internal Audit (SIA) 130, "Risk Management," states that :

The overall objective of clarify to the responsibilities of management and internal auditors. Over risk management, and to prescribe the essential requirements with regards to assessment, evaluation, reporting and providing assurance on risk management.

The purpose of this Standard on Risk Management is to:

- (a) Provide a common terminology by defining various risk management terms to prevent ambiguity or confusion on the subject matter;
- (b) Explain the responsibilities of the Board of Directors, risk management department and management with regard to risk management, as mandated by law and regulations; and
- (c) States the responsibilities of the internal auditor, especially when providing assurance on the risk management framework.

5. Responsibility of Internal Auditor

5.1 Unless specially excluded from the audit approach, the Internal Auditor shall plan and conduct risk based internal audits. This requires the application of risk management concepts to ensure that the audits are prioritised in areas of importance, appropriate resources are allocated effectively where needed most, audit procedures are designed to give due attention to important matters and issues identified and reported are significant in nature.

5.2 The nature and extent of audit procedures to be conducted in the area of risk management is dependent on the maturity of the risk management processes and framework in place. Where management has implemented a risk management framework, the Internal Auditor shall plan and perform audit procedures to evaluate the design, implementation and operating

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effectiveness of the organisation's risk management framework to provide independent assurance to management and those charged with governance

5.3 Where the independent assurance requires the issuance of an audit opinion over the design, implementation and operating effectiveness of risk management, this shall be undertaken in line with the requirements of SIA 110, "Nature of Assurance", especially with regard to the need to have a formal Risk Management Framework in place, which shall form the basis of such an assurance.

5.4 Where no formal risk management framework exists, the Internal Auditor shall design and conduct audit procedures with a view to highlight any exposures arising from weak risk or absent activities, make recommendations to implement and strengthen related processes and management improve risk management.

5.5 The Internal Auditor shall not assume any responsibility to manage the risks or to executive risk management decisions. It is not responsibility of the Internal Auditor to mitigate or resolve the risks.

Chapter 15

Major Risks

Global Risk

15.1 China is fully emerged market for textile industries. India is still an emerging market. Though India own set faces in of challenges to tap the opportunities, India's future has never looked brighter in the recent history of India.

China is having more manpower and at the same time the Government is supporting well in all aspects. Bulk production, cheap labour economic, taxes/duties, government support all make them to meet the worlds big competitions. India filled with small scale industries, less large companies, which less taxes/duties government support very less, high costs of manpower is not able to supply bult orders in time. Even though there is increasing trend in textile export from India, still China continues dominated in textile exports.

The countries which have been imposing obstacles on import of Chinese textiles will remove quota restrictions increasing opportunities of export from China and causing a decease in export of India.

"Due to poor infrastructure facilities, the production and transaction costs remain high in India".

Most of the Indian garment exports are fashion garments which have limited shelf life. Overall infrastructure, both port and land, are not yet developed to cater to bulk exports.

15.2 In China, all the industrial cities are connected by six lane express highways," Most of the units are in industrial zones that are set up with state-of-the-art facilities. They have five to six tier fly-over and underground tunnels to avoid traffic problems. With good infrastructure in place, the industry has better scope to flourish. The transit time taken by the Chinese units to move their goods from factories to destination is just a fortnight, as compared to a month's time in India.

In India the Sea port infrastructure is at present highly insufficient. Also shipping a container of garments from India to the US is costlier as compared to other Asian Countries. Non availability of direct sailing vessels also

Major Risks

increases transit time. Further, delays and inefficiencies in Indian Ports compared to other Asian Countries cause significant disadvantage to Indian exports.

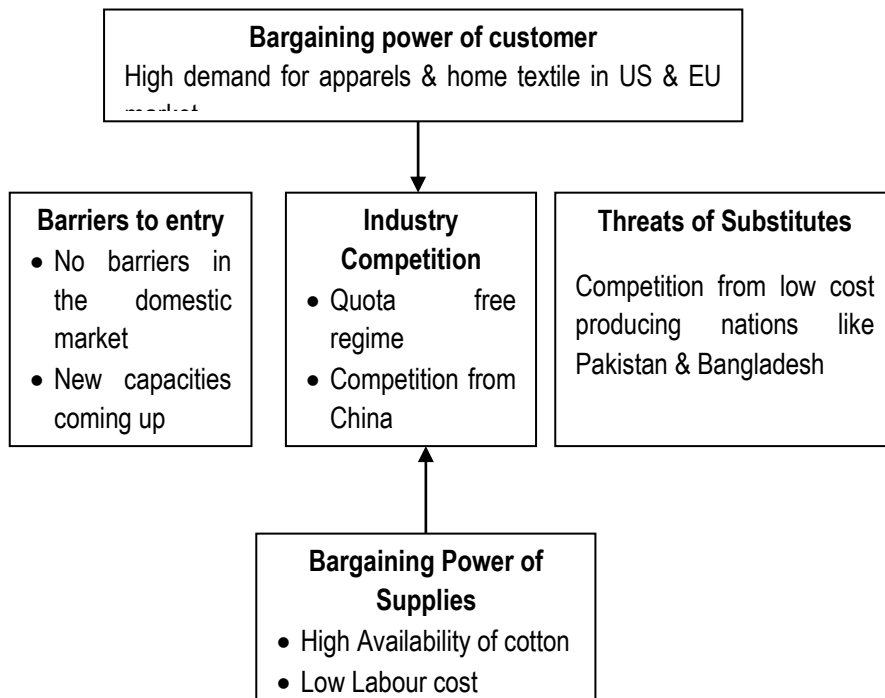
Two critical factors that cause problems to Indian textile industry are

- India has a very old and fragmented textile industrial infrastructure.
- In India infrastructure for textile is totally inadequate.

To overcome this infrastructure problem following measures may be taken:

- Increase the industrial infrastructure, to achieve economies of scale.
- Create infrastructure to service the needs of European textile markets.

15.3 The Indian textile industry may be analysed through the **Porter's five-factor model**.



Bargaining power of customer (demand scenario)

With dismantling of quotas, global textile trade is expected to grow. Although China is likely to become the 'supplier of choice', other low cost producers like India would also benefit as the overseas importers would try to mitigate

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their risk of sourcing from a single country. The two-fold increase in global textile trade is also likely to drive India's exports growth. India, in particular, is likely to benefit from the rising demand in the home textiles and apparels segment, wherein it has competitive edge against its neighbour. Nonetheless, a rapid slowdown in the denim cycle poses risks to fabric players.

Bargaining power of supplier (supply scenario)

India is the second largest producer of cotton in the world after China and has the largest area under cultivation. Cotton, being a key raw material in the textile and garment industry India has an abundant supply of locally grown long staple cotton, which lends it a cost advantage in the home textile and apparels segments. Other countries, like China and Pakistan, have relatively lower supply of locally grown long staple cotton. Low cotton prices due to a bumper cotton crop would enable India to lower its production cost and sustain pricing pressure.

Threat of new entrants

In the quota free regime, capacity expansion is game changer in the textile sector. Resultantly, smaller players who cannot venture into the global markets are flooding the domestic markets with excess supply, thus weakening the pricing scenario.

Threat of substitutes

Low cost producing countries, like, Pakistan and Bangladesh (labour cost 50% cheaper) are also posing a threat to India's exports growth.

Competitive rivalry

India's logistic disadvantage due to its geographical location can give it a major thumbs-down in global trade. The country is distant from major markets as compared to its global competitors like Mexico, Turkey and China, which are located in relatively close vicinity to major global markets of US, Europe and Japan. As a result, high cost of shipments and longer lead-time coupled with lack of infrastructure facility may prove to be major hindrances.

Political Risk

15.4 Political risk may be defined as the probability that a political event will impact adversely on a firm's profit. The risk that a new law or a change in an

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existing one could have a significant impact on an investment. Political risk represents the financial risk arising from sudden change in the policy by a Government.

This risk covers the following:

- Restriction on remittances in the buyer's country or any government action which may block or delay payment in rupees to the exporter.
- War between the buyer's country and India.
- War, revolution or civil commotion in the buyer's country.
- Imposition of new import licensing restrictions in the buyer's country or cancellation of a valid import license.
- Cancellation of an export license or imposition of new export licensing restrictions in India.
- Additional handling, transport charges due to interruption or diversion of voyage, which cannot be recovered from the buyer.
- Any other kind of loss occurring outside India and not within the control of the export or the buyer.

Political structure and political events impact significantly on executive decisions. Wars, riots, expropriation of property; assassinations and revolutions are obvious examples of events that can change the business environment radically. Expropriation probably is the extreme form of political risk, when a nation formally takes over the property of the firm, with or without payment of any compensation. Less obvious, but very important are changes in government policy affecting the conditions of market entry and continued operations.

The export marketer needs to evaluate both the probability of a political event that may change the environment, and also the probability that the event will impact on the exporting firm.

The main challenge is shorter lead-time. Several of our competing countries have substantially shorter transit times to Europe and USA, which are the main markets. Non availability of direct sailing vessels and excessive Government holidays (currently about 160 days a year including Saturday and Sunday's) also lead to a lot longer transit times from Indian ports. Most Indian garment exports being fashion garments, have very limited shelf life

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and hence it is important company to device ways to deliver consignments to our customers in the quickest possible time.

Garment export companies therefore demand that all apparel shipments be given the status of perishable items, so that it can be custom cleared on top priority, 24 hours a day and 365 days a year, this will put export shipments on sailing vessels or flying aircrafts, without waste of time, to as shorten the lead-times to various foreign destinations.

In order to fulfill the potential of India's textile industry, the Government must remove barriers that discourage foreign direct investment and stifle competition.

Operational Risk

15.5 Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

It is risk associated with the potential for system failure in a given market.

It is associated with systems processes and people such as succession planning, human resources, information technology, control systems and compliance with regulations.

In day to day business affairs, besides transaction related risks like credit risk and market risks, another important category is operational risk which signifies that for an organization to continue its operations, some external events like natural disasters, political events, civil disturbances war, etc. not directly connected with the organization may affect its functioning.

Operational risk may be defined from two angles as under:

- Operational risks are all those risks which cannot be classified as credit or market risks.
- Operational risk is an expression of the danger of unexpected direct or indirect losses resulting from inadequate or failed internal process, people and systems or from external events.

This risk covers

- External fraud- theft of information, hacking damage, third-party theft and forgery Business disruption and systems failures- utility disruptions, software failures, hardware failures.

- Execution, delivery, and process management – data entry errors, accounting errors, failed mandatory reporting, and negligent loss of client assets.

Employee/ Worker Health Risk:

15.6 Health and safety issues of employees are problem area in the textile industry.

It is necessary for the management to develop the Labour welfare condition to motivate the employees their beet measures.

15.7 This risk covers

- Illnesses
- Infections
- Injuries

The work environment in most units is unsafe and unhealthy. The persons working in such poor or below standard environmental are prone to occupational diseases.

Such illnesses arise due to: an excessively high temperature - or very low temperatures; dust; inadequate ventilation; inadequate lighting; excessive noise; lack of fire-fighting equipment; blocked exits; bad sanitation; unhygienic canteens; and lack of drinking water.

The types of illnesses, which may affect the employees are fever, headaches, eyesight problems, skin allergies, kidney infections, backache, stomach cramps, breathing difficulties and constant exhaustion.

It is not just workers' physical health that is undermined by these conditions but also their mental and emotional health as a result of excessive working hours, work pressure harassment.

Implicit overtime is when workers are not directly asked to perform overtime but know that they are not free to leave at the end of the day. This can be as a result of management's attitude or because quotas are so high that it is impossible to finish them during the working day and so workers are obliged to work overtime.

Employee strike for bonus, salary or better working conditions number the product significantly. Management should strike to avoid such incidents.

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Even though labour laws are not strict the social welfare of the workers is being looked after by the companies. Also the buyers insist on social audits to be conducted and if they find any violations they may even the supplies.

15.8 Benefits of Employee risk management:

- Minimum labour turnover and absenteeism case.
- Minimizing industrial disputes and peace.
- Creating permanent and settled labour force.
- Improvement in the efficiency of workers.
- Reducing damages to equipment, machinery and other assets.
- Medical checkup of employees.

Worker's efficiency is considerably improved when they feel safe in work place.

- Workers begin to evince more interest in their work when they find that they are being looked after well by their employers. Their morale gets boosted and the industrial relations improve.
- Employees will be able to concentrate better on their work.

Purchasing Power Risk

15.9 This is invisibly loss of purchasing power inflation. When inflation is present, the currency loses its value due to the rising price level in the economy. The higher the inflation rate, the faster the money loses its value. This risk is also known as inflation risk.

Example:

The cotton textile industry is dependent in the vagaries of nature. Availability of the required quality and quantity of cotton is critical for business and any damage or fall in crop production can adversely impact the price of cotton, which can impact business performance and profitability.

Technology Risk

15.10 Many institutions such as banks, investment management firms, insurance companies, brokerage firms, technology is a critical component of

any risk management. For institutions which rely heavily on technology, there is always the risk of the technology becoming the focus on risk management.

In order to survive in the highly-competitive market, India's cotton-centric textile manufacturers need to focus on upgrading their machinery besides creating new facilities and additional capacities. They require better machinery. Though domestic machines are competitive in terms of quality and price, the delivery schedule, which even extends to two to three years, is a matter of concern. Chinese machines require a delivery time of only four to six months; the Indian textile machinery manufacturers are not able to bridge the demand-supply gap.

The Government of India has to extend the Technology up gradation fund scheme in order to support the textile industry. The Indian textile industry has to invest heavily in systems and technology to reduce costs and lead times, also there is arrangement need for development of collaborative links between customers, vendors and partners to make the supply chain more efficient

Example:

The specialty work of garments units are hand embroidery, sequence works, crochet works, etc. China is producing garments in different varieties using various technologies and this has lead to reduction in export of garments from India.

Counter Party Risk

15.11 The risk that the other party in an agreement will default is known as the counter party risk. In an option contract, the risk to the option buyer that the writer will not buy and sell the underlying as agreed. In general, country party risk can be reduced when an organization has extremely good credit the following:

This risk covers

- Insolvency of the buyer.
- Buyer's protracted default to pay for goods received.
- Buyer's failure to accept goods, subject to certain conditions.
- Buyer's failure to obtain necessary import or exchange authorization from authorities in his country.

Example

Companies are allowing 30 days credit to the buyers and because of delay in payment by buyer the Indian companies are not able to continue their production for next order and not able to settle their credit.

Competitive Risk

15.12 Competitive risk arises when competitive forces stops you from achieving a goal. It is often associated with the risk of declining business revenue or margins due to the actions of a competitor.

Due to lack of planning, coordination and unsystematic process, losses may arise to the company.

Competition among the Indian companies are high and the new companies are not in a position to withstand in such competitions others.

Natural Hazard Risk

15.13 It is related to natural hazards, accidents and fire that can be insured.

This risk covers the following :

- Natural disaster
- Air pollution
- Water pollution
- Soil pollution
- Land pollution, etc.

The usual procedure, therefore, is to have an “all risk policy”. It is not worthwhile for an exporter to try to save on premium payments and opt for less comprehensive policy just because some banks, negotiating letters of credit may accept such a policy.

This risk is unavoidable and it cannot be transferred but this risk can be mitigated or accepted. Mitigation is a control approach that attempts to reduce the impact of an exploited vulnerability. Acceptance of risk is the choice to do nothing to protect an asset and to accept the outcome from any resulting exploitation.

Currency Risk

15.14 “Currency risk arises due to uncertainty in exchange rates”

Currency risk is a form of risk that arises from the change in price of currencies. Whenever investors or companies have assets or business operations across national borders, they face currency risk if their positions are not hedged.

The risk arises when a business operations or an investments value will be affected by changes in exchange rates. These risks usually affect business, individual investors who make international investors. This is also called as exchange rate risks.

The fluctuations in the exchange rate are effected due to supply and demand of the currencies.

Effect of exchange fluctuations

15.15 When quoting prices in terms of the foreign currency, the exporter knows how much money is to be received at the current rate of exchange. However, when the customer pays in sterling pounds, US dollars, Japanese yen or some other acceptable currency, the amount received in terms of rupees will depend upon the rate of exchange when the currency is converted. When the price is quoted in the foreign currency, the exporter accepts the risk of exchange fluctuations. Unless steps are taken to protect expected profits, a decline in exchange rates may reduce profits or even convert them into a loss.

Indirect risk involved in foreign exchange fluctuations

15.16 The most effective safeguard against unfavorable exchange fluctuations is when payment is to be made in the domestic currency, but even then they exchange fluctuations. Fluctuations following the closing of the sales contract may be so unfavorable that the foreign customer may refuse to accept the delivery, or unwilling to meet the financial obligations. Thus the exchange rate fluctuations may increase the exporter’s credit and commercial risks.

Any Government measure affecting the volume of exporters and importers influence exchange rates. A country may restrict the importation of certain goods in conformance with its economic policies in order to serve foreign

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exchange for projects with a higher priority. Furthermore protective tariff rates, import quota, license requirements, export subsidies, Governmental price control and trade agreements all have impact exchange control.

The exchange risk associated with a foreign denominated instrument is a key element in foreign investment. This risk flows from differential monetary policy and growth in real productivity, which results in differential inflation rates.

The hurdle in the path of growing textile exports from India is artificial pricing of the Chinese currency: which is giving undue advantage to the Chinese industry in the Global Market. Hardening of the Indian Rupee against US\$ has also seriously affected and eroded the bottom-lines of textile and garment exporting companies. If Government offers income-tax exemption to the textile industry in particular for the next 5 years, in India, the textile export companies will be better equipped to face competition from China and other competing nations.

Price Risk

15.17 It is Risk resulting from the possibility that the price of security or physical commodity may decline. Price risk is defined as “The risk that the value of a security or portfolio of securities will decline in the future”.

The Indian exporters face competition nationally and internationally. This has load to intense pressure on the profit margin of the Indian exporters and buyers are squeezing the prices every year.

A product pricing is a by which a firm charges the highest initial price that customer will pay. As the demand of the first customers is satisfied, the firm lowers the price to attract another, more price-sensitive segment. Therefore, the skimming strategy gets its name from skimming successive layers of creamy customer segments, as prices are lowered over a period of time.

Government intervention is to set an artificially high price through the use of a floor price designed to aid producers. It's the risk that you will lose money due to a fall in the market price of a security that the company owns.

Financial Risk

15.18 It is the uncertainty associated with how firms finance their businesses. Finance for the exporters is needed at four stages:

Major Risks

- First an exporter may need finance to develop an exportable product.
- Second finance is needed to upgrade export production through acquisition of new equipment's, new technology.
- Third pre-shipment is needed to acquire inputs that get converted into an export product.
- Fourth finance is needed for systematic marketing activities.

This risk is divided as follows :

- Credit risk
- Liquidity risk
- Settlement risk

Credit risk refers to the company's or governments inability to repay principle plus interest to the bondholder in a timely manner. This credit risk is also known as default risk. Credit risk is the risk that arises when a company or individual is unable to pay the contractual interest or principal on its debt obligations.

In simple terms credit risk is termed as the risk of non-payment.

The reduce credit risk is by monitoring the behavior of clients who wish apply for credit in the business. These clients may be business or individuals

Credit risk is the risk that arises when a counterparty will entities not meet an obligation when due, and will never be able to meet that obligation for full value. Bankruptcy of counterparty is often associated with such difficulties, but there may be other causes as well. In a payment netting system, losses from defaults due to the bankruptcy of counterparties can be measured as the principal amount due less recovery from defaulting parties. Forgone interest can also be an important loss. In an obligations netting system, losses from the default of counterparty would typically be calculated from the replacement costs of one or more contracts that are not settled. If, however, one party to a contract defaults after having received settlement payments from another party, but before making required counter-payments (in the same or another currency), the loss would again be for a principle amount (less recoveries).

Liquidity Risk: The risk that arises from the difficulty in selling assets when an investment may sometimes need to be sold quickly. Unfortunately, an

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insufficient secondary market may prevent the liquidation or limit the funds that can be generated from the asset. Liquidity risk is the risk that arises when, or settlement, payments will not be made when due, even though one or more counterparties do have sufficient assets and net worth ultimately to make payment.

This risk covers the following :

- A temporary inability to convert assets in to cash
- Operational difficulties of various kinds
- The inability of correspondents to perform settlement functions.

Settlement Risk: The risk that a party will default on clearing obligations to one or more counterparties is sometimes referred to as settlement risk. This risk may contain elements of either credit risk or liquidity risk, or both. The usage of the term "settlement risk" varies considerably, and may also depend on the situation being analyzed.

Season Obsolescence Risk

15.19 One more big risk in the textile and apparel industry is the shipping schedules and season change risk. The entire industry works on the basis of the season. For example if there is a spring 2023 collection, the finished product would need to reach the store before spring, the entire show room space is defined in foreign countries and the calculation is done back-wards to reach at what dates the shipping would happen, how many days for logistics, how many days for manufacture, for Qc for sample, etc. and then the final date is frozen (or fixed). Even if there is a small change in the schedule may have secure impact and finally air shipment may be required to be done, while the buyer would never pay for air shipment. This risk has to be clearly mentioned and most manufacturers lose money because of this risk.

Fraud Risk

15.20 Fraud is defined as an intentional act by one or more individuals among management, those charged with governance, or third parties, involving the use of deception to obtain unjust or illegal advantage. A fraud could take form of misstatement of an information (financial or otherwise) or misappropriation of the assets of the entity.

Major Risks

The primary responsibility for prevention and detection of frauds rests with management and those charged with governance. Management achieve this by designing, establishing and ensuring continuous operation of an effective system of internal controls. The internal auditor should exercise due professional care, competence and diligence expected of him while carrying out the internal audit. An internal auditor should use his knowledge and skills to reasonably enable him to identify indicators of frauds. However, the internal auditor cannot be expected to possess the expertise of a person with specialized knowledge and skills in detecting and investigating frauds.

Chapter 16

Records Maintenance in Textile Industry

16.1 Cost ascertainment involves collection, classification, and recording the costing data. This data is used for making plans, taking decisions and controlling costs. Cost records are statutorily required to be maintained in a cotton textile company as per the Cost Accounting Records (Cotton Textile) Rules, 1977. In this Chapter some issues relating to cost ascertainment in a cotton textile mill have been discussed keeping in view the requirements of this Rules.

Direct Materials Cost

16.2 Direct materials are those materials which can be identified and charged directly to the cost of the final product.

In textile industry, fibre is the basic raw material from which yarn and fabric are manufactured. For weaving mills, yarn is the direct material and grey cloth is the direct material for processors. About one half of the total cost in a cotton textile mill can be attributed to direct materials.

In order to spin yarn of different counts, different qualities of cotton are mixed together. The mills usually maintain a book called “**Mixing Book**” in which all mixings issued every day are recorded. Mixing is a highly specialized job and needs considerable technical skill. The purpose is to have the mixing as cheap as possible for a given count of yarn without sacrificing the strength of yarn and its other properties. At times the mixings for coarser varieties of cloth include some soft wastes which may either be purchased or may arise out of the internal processes.

The total cost of cotton depends on various factors viz. proportion of different grades of cotton used in mixing prices of different grades of cotton and quantity and sale value of waste.

Requirements of Rules Regarding Direct Materials

- The Cost Accounting Records (Cotton Textiles) Rules, 1977, require that proper records showing all the receipts, issues and balances, both in quantities and cost, of cotton, manmade fibres and filament yarn

from manmade fibres used in the manufacture of cotton textiles should be maintained.

- The Rules also provide that where cotton and/or manmade fibres are obtained from different sources including imports, separate records should be maintained for imported and indigenous supplies, variety wise.
- The names and specifications used for different varieties of cotton/manmade fibre/filament yarn from manmade fibre should conform to the nomenclature and specifications as prescribed by the Textile Commissioner.
- The records should indicate the actual quantity and value of each variety of cotton or other raw materials used in each mixing prepared for manufacturing different counts of yarn.

Waste

16.3 The processing of raw materials in a cotton textile mill results in the production of different types of wastes. Wastes arise from almost every process. Wastes can be broadly grouped into

(i) Soft waste

Soft wastes are those which are in the form of cotton fibre and hard wastes are those which are in the form of spun yarn. Soft waste and hard waste can further be grouped under three heads viz.

- usable in the same mixing
- usable in the lower grade mixing than that from which it emerges, and
- unusable waste which is usually sold through auction.

(ii) Hard waste.

The sources of hard wastes are remnants in the bobbins, off cuts of sized or unsized yarn on beams, etc.

It should be ensured that the percentage of wastes to input is reasonable keeping in view the various factors which affect such waste. The percentage of waste should not be materially different from the percentage in the past

and percentage of cotton tested in the mills unless special circumstances can reasonably be attributed to such variance.

Requirements of the Rules Regarding Waste

- (i) Soft Waste: Proper records should be maintained to show the quantity and realizable value of usable soft waste collected from each mixing in each cost centre of the spinning department, quantities reused in each mixing used in the waste plant, if there be any, sold out with the sales realization thereof and the balance lying in stock.

The quantity of this waste collected at regular intervals, say quarterly, during the relevant period should be reconciled with such waste for which due credit is afforded to the respective production on technical basis/past performance/trial run during the said period.

- (ii) Hard Waste: Proper records should be maintained to show the quantity and realizable value of hard waste collected, typewise, such as superfine, fine, medium coarse, etc. separately from spinning department and pre-weaving department, re-used in the waste plant, if any, sold out with the sales realization thereof and the balance lying in stock.

The quantity of this waste collected at regular intervals, say quarterly, during the relevant period should be reconciled with such waste for which due credit is afforded in the respective production on technical basis/past performance/ trial run during the said period.

Any waste cotton purchased for use in the manufacture of yarn should also be recorded properly regarding receipts, issues and balances both in quantity and value.

- (iii) Yarn: In case the company is purchasing yarn from outside sources for use in the manufacture of cloth, proper records should be maintained showing all the receipts, issues and balances, both in quantity and value. This record should be kept count-wise, separately for carded and combed varieties.
- (iv) Grey Cloth: In case the company purchases cloth in grey stage for processing, proper records should be maintained showing the quantity and cost of such purchases, issues to processing and balance in stock, fabricwise. Where the company receives cloth in grey stage for

processing only, proper records should be maintained showing the quantity of such receipts, issues to processing and balances in stock.

Sizing Materials

16.4 The sizing process consists of strengthening the yarn with a mixture so that it can stand the rigours of weaving. Normally, starch maize, tallow gum, etc. are used in the sizing solution.

Other Direct Materials

16.5 In addition to cotton there are some other direct materials used by the cotton textile industry. These are: dyes and chemicals, bleaching, finishing, mercerizing, printing, etc. As some of the materials may be consumed in more than one process, for accounting purposes as well as from cost control point of view, it may be necessary to departmentalize the costs of such materials.

For each product/class of products a formula (called 'Recipes') is worked out by the chemist. This formula shows the proportions of those materials to be used for each product/class of products.

Requirements of Rules regarding other Direct Materials

16.6 The Cost Accounting Records (Cotton Textiles) Rules, 1977 require that proper records should be maintained for sizing materials, dyes, and chemicals and other process materials/chemicals. These records should show the receipts, issues, and balances, both in quantities and costs of each item used. The cost should include all direct charges upto the mills wherever specifically incurred. The issues should be properly identified with the cost centres, departments and products manufactured. In case the issues made against the receipts prepared in advance, a periodic reconciliation between the actual consumption as per the receipts should be made both in quantity and value.

Separate records should be maintained in such details as may enable the company to work out –

- (a) The cost of sizing materials required per kg. of warp yarn seized
- (b) The material cost of dyeing or printing each type of cloth processed

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- (c) The process material/chemical cost in each of the processing cost centres/ departments.

Where any of the dyes and chemicals and processing chemicals are produced by the company; separate records, showing the cost of manufacture of such materials indicating the break-up of raw materials consumed for the production and conversion cost should be maintained in such details as may enable the company to determine the actual cost of such materials produced.

Recoveries of process materials and chemicals

Certain materials and chemicals are recovered from different processes which may or may not be re-used. Those which cannot be re-used due to lower concentration are sold. Sometimes, these materials and chemicals can be re-used or sold only after further processing.

Requirements of the Rules Regarding Recoveries of Process Materials and Chemicals

- The Rules require that proper records should be maintained indicating the quantity of materials or chemicals recovered from different processes.
- In the case of certain materials or chemicals thus recovered which cannot be re-used in the process due to lower concentration and are sold, the realization from such sales should be recorded and adjusted against the cost of consumption of the respective materials or chemicals, if practicable, or otherwise adjusted against the processes concerned on reasonable basis.
- Where further processing is necessary to make these materials or chemicals useable or saleable, as the case may be adequate records of cost involved for such further processing should be maintained.
- If such further processing is done by any outside agency, records showing the quantity sent for processing, quantity processed and the cost involved thereon should be maintained in detail.

Wages & Salaries

16.7 Direct wages cost is the second largest element in the cost structure of the various products of the cotton textile industry. In Indian cotton textile

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industry, basic wages are usually based on time. However, in certain cases basic wages are also payable on the basis of machines attended to by the workers. For example, in ring spinning, basic wage is related to the number of spindles attended to by him. From time to time, the Wage Boards appointed by the Government, award certain payments to the workers employed in the industry. These payments are termed as 'Wage Board Awards'. As in other industries, workers in the cotton textile industries also receive fringe benefits e.g. provident fund, bonus, gratuity leave with pay etc. These are usually related to the basic wage, dearness allowance and wage board award.

Accounting treatment of direct wages has two aspects:

- Identification, classification and charging these costs to respective cost centres, and
- Absorption of the total cost centre labour costs to products. In order to facilitate such an accounting treatment, it is imperative that the basic source documents viz. clock cards, time cards, piece work cards etc. are kept separately for each cost centre. After the direct labour costs have been allocated to the cost centres, the next step of absorption of the labour costs may be carried out as given below:
 - ✓ If the wages are payable on the time basis or on the basis of machines attended to by workers and the wages cost does not vary with output, the direct labour cost should be treated in the same way as the indirect labour cost.
 - ✓ Where the wages payable vary with the output achieved (piece rate system) absorption of direct labour cost is straight forward because the per unit labour cost is known in advance.

Requirements of the Rules Regarding Wages

The Rules require that proper records should be maintained to show the attendance and earnings of all employees and the cost centres or departments and the work on which they are employed. The records should also indicate separately:

- (i) Overtime wages earned;
- (ii) Piece-rate wages earned;

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- (iii) Incentive wages earned, either individually or collectively as production bonus or under any other scheme based on output
- (iv) Earnings of casual labour engaged on casual work under classified headings.

Idle time should be separately recorded under classified headings indicating the reasons thereof. This data should be maintained, as far as possible, cost centre-wise, otherwise for principal cost centres like ring frame, looms, bleaching, dyeing, printing, warehousing, etc. The method followed for accounting of idle time payments in determining the cost of the product should be disclosed in the cost records.

Any wages and salaries allocable to capital works such as addition or heavy repaired works to plant and machinery, buildings, or other fixed assets should be accounted for under the relevant capital heads.

Direct Expenses

16.8 A few expenses, other than direct materials and direct labour, are directly identifiable to the final product. Such expenses are termed as direct expenses. In the cotton textile industry, examples of direct expenses are sanforizing royalty, processing charges for the jobs under taken outside the mill etc. These can be charged to the final product directly.

Overheads

16.9 Overheads cannot be directly identified and charged to the final product. In other words, they are an aggregate of indirect materials, indirect labour and indirect expenses. Overheads can also be classified, according to the functions as follows:

- (ii) Factory overheads,
- (iii) Administration overheads, and
- (iv) Selling and Distribution overheads.

The following discussion pertains to the factory overheads. Since these costs cannot be directly charged to the final product a detailed procedure is required to charge them to the products.

Consumable Stores, Small Tools and Machinery Spares

16.10 In a textile mill a number of consumable stores, small tools, machinery spares, and items like bobbins, pirns, shuttles, rollers, etc. are used in the process of production.

Requirements of the Rules Regarding Consumable Stores

The Rules require that proper records should be maintained to show the receipts, issues and balances both in quantities and costs of each item.

In the case of consumable stores and small tools, the cost of which is insignificant, the company may, if it so desires, maintain such records for the main group of such items.

The cost of issues of consumable stores, small tools and machinery spares, should be charged to the relevant heads of account such as production, repairs to plant and machinery and repairs to buildings. Materials consumed on capital works such as additions to buildings, plant and machinery and other assets should be shown under the relevant capital heads.

Proper records should be maintained to show the quantity and cost of items which are not forming part of the machinery and replaced as and when necessary, such as bobbins of all sizes, pirns, winding cones, cheeses, reels, silver drums, rollers in frames, shuttles, etc. lying in the shop floor at the end of the relevant year in order to enable the company to arrive at the actual consumption of such items during the relevant year. The method followed for charging the cost of the products manufactured should be indicated in the records.

Sales realization of old and discarded stores materials scrap, etc. should be identified wherever possible with respective cost centres and credit given accordingly. Otherwise it should be deducted from the common mill overheads.

Spoilages, Rejections, Losses and Wastages

16.11 As with most of the processing industries, in the cotton textile industry also, there is wastage of material as it passes from one process to another. This wastage is inherent in the different processes and therefore its cost should be charged to the good units produced. The calculation of the cost of

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the finished product per unit for each cost centre after taking account of the wastage multipliers for the respective cost centres. The waste multipliers are calculated to determine the quantity of raw materials required to produce one unit of the finished product. In the case of spinning activity, a waste multiplier is also known as the Yarn Equivalent Factor. The formula used for its calculation for a cost centre is as follows :

100 - Total waste% (Upto and including the waste% at that cost centre)

100 - Total waste% in all cost centres.

It may be noted that the total waste percentage in the above formula has to be based upon the input of the first cost centre. The calculation of the waste multiplier is illustrated below :

Mixing : 30s

Cost Centres	Actual Waste %
(i) Mixing and Blow Room	6.00
(ii) Carding	7.60
(iii) Pre-comb Drawing	0.80
(iv) Combing	10.10
(v) Post-comb Drawing	0.50
(vi) Inter-roving	0.50
Ring-spinning	2.50
	<u>28.00</u>

Thus, for carding cost centre the waste multiplier is

$$\frac{100 - (6.00 + 7.60)}{100 - 28} = 1.2$$

If the per kg cost of yarn produced upto the 'carding' process is 'x' (before taking account of the wastages), the final per kg. cost of yarn produced upto the "carding" process can be determined by multiplying 'x' with the "waste-multiplier" for that process i. e. 1.2. This aspect has been amplified later under the heading "Calculation of the Cost of Production and the Cost of Sales'.

Requirements of Cost Accounting Records Rules Regarding Wastes

Proper records should be maintained showing the quantity and cost of wastages, spoilages, rejections and losses of raw materials, dyes and chemicals, process materials, consumable stores, small tools and machinery spares, whether in transit, storage, manufacture or for any other reason.

The method followed for adjusting the above losses as well as the income derived from the disposal of rejected and waste materials including spoilage, if any in determining the cost of product should be indicated in the cost records

In the case of cotton and man-made fibre, records of wastage spoilage and losses should be maintained in such a way that it may enables the company to work out the waste multipliers for each mixing at periodic intervals. Necessary records should be maintained showing the quantity and realisable value of hard waste derived in different departments, re-used, sold out and balance in stock.

The method followed for adjusting the above wastage as well as the income derived from the sale of such waste in determining the cost of product should be indicated in the cost records.

Separate records should be maintained for fents, rags, chindies, etc. arising out of finished fabrics, group-wise. Such grouping should be as per the one adopted by central excise authorities. Such records should enable the company to determine the incidence on this account in the cost of fabric. The quantity of fents, rags, etc. formed in the case of each fabric may be determined on technical basis if actuals are not available. In such cases reconciliation of such waste accounted for in the production on technical basis and that actually formed, group-wise should be made at regular intervals, say quarterly, within the relevant period.

Service Department Expenses

16.12 The Rules require that detailed records should be maintained to indicate expenses incurred for each service cost centre or department. These expenses should be apportioned to other service and production departments on an equitable basis and applied consistently.

Utilities

In textile mills, utilities like water, steam, power and humidification are required. The provisions of the Rules regarding the various utilities are given below:

(i) **Water:** Where water is treated or purified, proper records showing the quantity and cost of water treated and consumed in different cost centres or departments for the manufacture of processed fabrics, etc. should be maintained in such detail as may enable the company to furnish the necessary particulars. The cost of treated water allocated to the departments concerned should be on a reasonable basis and applied, consistently

(ii) **Steam:** Where steam is generated by the company, proper records showing the quantity and cost of steam generated and consumed in various cost centres or departments for the manufacture of cotton textile products should be maintained in such detail as may enable the company to furnish the necessary particulars. The cost of steam consumed by the cotton textile products and other products or other units of the company, if any, should be calculated on reasonable basis and applied consistently.

Where steam is generated and supplied by any other unit of the company to the textile unit, the cost of steam so supplied should be charged to the textile unit on a reasonable basis and applied consistently.

(iii) **Power:** Adequate records should be maintained for the quantity and cost of power purchased. If expenses are incurred for distribution of the power thus purchased, proper records to show such expenses should be maintained.

Where power is generated by the company itself adequate records should be maintained to show the cost of power generated and consumed by the different cost centres, departments, etc. of the textile unit of the company, in such detail as may enable the company to furnish necessary particulars.

Where power is generated and supplied by any other unit of the company to the spinning/weaving /processing departments of the textile unit, adequate records should be maintained to assess the quantity and cost of power so supplied. The rate charged by the supplying unit should be on a reasonable basis. Necessary records should be maintained to show the consumption of

power by various cost centres or departments. The cost of power allocated to products should be on a reasonable basis and applied consistently.

(iv) **Humidification:** Proper records should be maintained to enable determination of the cost of humidification and its distribution to different cost centres and departments.

Workshop/Repairs and Maintenance

16.14 The Rules require that proper records showing the expenditure incurred by the workshop under different heads and on repairs, and maintenance by the various cost centres and departments should be maintained. The records should also indicate the basis of charging the workshop expenses to different cost centres, departments and units. Wherever maintenance work is done by workers of any production cost centre, wages and salaries of such workers shall be treated as other direct expenses of the respective cost centre.

Expenditure on major repair works from which benefit is likely to accrue for more than one financial year should be shown separately in the cost records indicating the method of accounting in determining the cost of various products manufactured during the relevant period.

Expenditure incurred on works of capital nature should be capitalised. The cost of such jobs should include the expenditure on materials, labour and due share of the overheads. The jobs carried out by the workshop attached to the spinning, weaving or processing departments, for other units of the company and vice-versa should be charged on a reasonable basis and applied consistently.

Design Studio

16.15 The Rules require that proper records showing the expenditure incurred by the design studio, if any, should be maintained. The records should also indicate the basis of charging the studio expenses to the different cost centres and departments in the printing section.

Screen making, photo engraving, pentagraph, chromium plating and rotary screen making

16.16 The Rules require that proper records showing the expenditure incurred by these departments should be maintained. The records should also indicate the basis of charging the expenses of these departments, to the respective cost centres of the printing department and ultimately to the products. The basis so adopted should be reasonable and applied consistently.

Depreciation

16.17 Proper records should be maintained showing the cost and other particulars of fixed assets in respect of which depreciation is to be provided. These records should *inter alia* indicate the cost of each item of assets including installation charges, if any, the date of its acquisition the date of its installation and rate of depreciation. In respect of those assets, the original cost of acquisition of which cannot be ascertained without an unreasonable expenditure or delay, the valuation shown in the books on the first day of the financial year beginning on or after commencement of these rules should be taken as the opening balance.

The basis on which depreciation is calculated and allocated to the various cost centres and departments and to the products should be clearly indicated in the records. Depreciation chargeable to the different cost centres and departments should not be less than the amount of depreciation chargeable in accordance with the provisions of sub-section (2) of Section 205 of the Companies Act, 1956 (1 of 1956), and should relate to plant, machinery and other fixed assets in such cost centres and departments.

In the case of assets or group of assets on which depreciation is written off at the rate of 100 per cent in the relevant year, such depreciation should be spread over the number of years during which benefit is derived from such assets or group of such assets. In case the amount of depreciation charged in the cost accounts in any financial year is higher than the amount of depreciation chargeable under the aforesaid provisions of the Companies Act, the amount so charged in excess should be indicated clearly in the cost records. The cumulative depreciation charged in the cost records against any

individual item of asset should not, however, exceed the original cost of the respective asset.

Other Overheads

16.18 The Rules require that proper records should be maintained showing the various items of expenses comprising the overheads. These expenses should be analysed, classified and grouped into mills or processing house (works), administration and selling and distribution overheads. The method followed for allocation of the above categories of overheads to the cost centres, departments and absorption by the products should be indicated in the cost records.

Where the company is engaged in the manufacture of any other products in addition to cotton textiles, the records should clearly indicate the basis followed for apportionment of the common overheads including head office expenses of the company to the cotton textile activity, other activities and capital work.

In case any expenses included in the above categories of overheads can be identified with a particular activity or product, such expense should be segregated and charged to the relevant activity or product in the first instance and thereafter the remaining common expenses under the above categories of overheads should be allocated on a reasonable and equitable basis and applied consistently.

The details of administrative, selling and distribution overheads and the amounts applicable to yarn, cloth and processed cloth should be maintained in such a manner as to enable the company to fill up the necessary particulars in the cost of production and cost of sale statements of each count of yarn/type of cloth and processes cloth (fabric-wise).

Expenses on export

16.19 Proper records showing the expenses incurred in the export item of cotton textiles, if any, should be separately maintained so that the cost of export sales can be correctly determined for each type of the product exported.

The expenses incurred on exports as well as any export incentives, such as cash subsidy, drawback duty and benefit derived out of the import

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entitlement licence issued, etc. if any, should be reflected separately in the cost of sales statements relating to export sales.

Packing

16.20 Proper records should be maintained showing the quantity and the cost of various packing materials such as hessian cloth, polythene paper, boards, packing boxes, mild steel wires, hoops and buckles used for different types of packing of yarn, cloth and processed cloth separately. In the absence of actual consumption of such materials for each type of packing, apportionment of material cost should be made on the basis of quantity requirement as per standard specifications, in such cases, reconciliation of major material cost as per standards and that as per actual should be made periodically, say quarterly.

Records should also be maintained showing the other expenses incurred in-respect of packing. Where expenses are of a general nature and cannot be identified directly with the types of packing, apportionment of such expenses to the different types of packing should be on equitable basis and the basis of such apportionment should be clearly indicated in the cost records and applied consistently. The records should be kept in such a manner as to enable the company to fill up the necessary particulars.

Separate records for expenses incurred on special packings made for exports of yarn/cloth in grey stage, processed cloth should be maintained and exhibited in the relevant cost of sales statements for exports.

Research and Development Expenses

16.21 Proper records showing the details of expenses, if any, incurred by the company for research and development according to the nature of such research, namely, development of products, existing and new, processes of manufacture, existing and new, design and development of new plant facilities, market research for new products, etc. should be maintained separately.

The method of charging these expenses to the cost of products during any year should be indicated in the cost records. Wherever the utility of such research extends over more than one financial year such expenses should be treated as "deferred expenses" and charged to the cost of the products on some equitable basis which is to be followed consistently.

Yarn/Cloth in Grey Stage for Self-consumption

16.22 Proper records should be maintained showing the quantity and cost of each item of yarn and cloth transferred to another department/unit of the company for self-consumption. The rates at which transfers are affected should be at cost.

Work-in-progress and Finished Goods Stock

16.23 Adequate records should be maintained showing the cost of work-in-progress in each productive cost centre of the spinning, weaving, and processing departments of the company. Proper records showing the opening stock, production, issues for further processing/sales and closing stock of all the finished products like yarn of various constructions and processed and finished cloth of the various constructions designs, etc should be maintained.

The method followed for determining the cost of work-in-progress and finished goods stocks should be indicated in the cost records so as to reveal the cost elements that have been taken into account in such computation. The method adopted should be followed consistently.

Calculation of the Cost of Production and Sales

16.24 After identification and recording of various items of costs, the next step is the determination of the cost of production and the cost of sales of yarn, grey cloth and finished cloth. Following steps are involved in the determination of the cost of production and the cost of sales:

Spinning

The following steps may be taken for the determination of the cost of yarn spun and of the yarn sold:

- (1) Calculation of the quantity and value of total cotton issued for the manufacture of carded and combed yarn for both warp and weft. The computation should be mix-wise with corresponding reduction due to wastages to arrive at the output of warp and weft yarn.
- (2) Preparation of an input-output analysis, showing input, wastages and output in each processing cost centre upto yarn stage. This data is in mix-wise quantities.

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- (3) Computation of total output of yarn for whole of the spinning department showing input, wastages and output taking the relevant data from (1) above.
- (4) Computation of net mix-wise cost as follows:
(Cost of input as per step (1) x cost per Kg. of the mix)—Credit for wastes collected as per steps (2) and (3).
- (5) Computation of waste multipliers for each cost centre mixing-wise. Data is taken from step (1)
- (6) Computation of cost-centre-wise conversion cost upto and including spinning. The conversion cost includes direct wages and salaries; utilities like water, steam, power etc.; consumable stores; bobbins; pirns; repairs and maintenance; mill overheads; depreciation; share of administration overheads; research and development cost, etc. Conversion cost should be calculated per machine shift/spindle shift.
- (7) Computation of conversion cost per Kg. for each mixing as follows:
Conversion cost per machine shift/spindle shift as per step (6) X
Production per machine shift/spindle shift in Kgs. as per step(1)
- (8) Computation of conversion cost of yarn per Kg. count-wise for each cost centre which is to added to the total cost = conversion cost per Kg. as per step (7) X waste multiplier as per step (5).
- (9) Computation of cost of production of yarn count-wise, separately for warp and weft by following calculation:
 - (i) Cost per Kg. of mixing used = Net Cost per Kg. of mixing as per step (4) X Waste multiplier as per step (5).
 - (ii) Cost of production per Kg. of yarn = Cost per Kg. of mixing used as (i) above + Conversion cost per Kg. of mixing as per step (8).
 - (iii) Total cost of production of yarn spun cost of production per Kg. of yarn as per (ii) above X Total Quantity of yarn spun as per step (1).
- (10) Computation of the cost of yarn sold. This involves the following steps:
 - (i) A stock statement showing the quantities and values of opening stock, production during the year, yarn issued for further

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processing, issued for sales and closing stock, is prepared. This information is also given mixing-wise and count-wise. Relevant cost data taken from step (9).

- (ii) To the cost of yarn issued for sales as given in (i) above are added cost of reeling/winding, cost of packing, share of administrative expenses, selling and distribution expenses, bonus, interest, gratuity, etc. to determine the cost of sales. The difference between sales realization' and 'cost of sales' is the margin on the sale of the yarn.

Weaving

For calculating the cost of grey cloth manufactured and sold the following steps may be followed:

- (1) Computation of conversion cost from winding to weaving for each cost centre. The conversion cost includes direct wages and salaries; utilities like water, steam, power, etc; consumable stores; sizing materials; bobbins, pirns, shuttles etc. Conversion cost should be calculated per spindle shift/loom shift/machine shift and cost per Kg/Metre.
- (2) Computation of sort-wise cost of production of cloth in grey stage. This includes following items of cost from step (1):
 - (i) Cost of yarn for warp and weft
 - (ii) Winding cost for warp and weft
 - (iii) Warping
 - (iv) Sizing cost—materials and others
 - (v) Drawing-in cost
 - (vi) Loom-shed cost.

From the above is deducted realization on account of wastes.

Cost of yarn can be taken from (A) above or if it is purchased from outside, the purchase cost plus other direct charges should be taken.

Winding charges include cost of cone, pirn winding etc. If the cloth is calendared or any other finishing is done the conversion cost of such process must also be included.

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- (3) Computation of the cost of grey cloth sold: This involves the following steps :
- (i) A stock statement is prepared. This includes sortwise information of quantities and values of production of grey cloth as per step (2), fents, rags, and chindies, good production, opening stock of good grey doth, issued for further processing, issued for sales (including consignment sales), and closing stock
 - (ii) To the cost of grey cloth issued for sales as given in (i) above are added share of administrative expenses, selling and distribution expenses, bonus, interest, gratuity, packing expenses, to determine the cost of sales. The difference between 'sales realisation' and 'cost of sales' is the 'margin' on the sale of the grey cloth.

Processing

Computation of the cost of finished cloth usually involves the following steps :

- (1) Calculation of the cost centre-wise conversion cost in the Bleaching section. This includes expenses on account of process materials e.g. for desizing, scouring, bleaching, wetting agents, chemicals for mercerizing; utilities like water, steam, power, singeing, chemical mixing, rope washing, cooling plant, caustic recovery plant; process house/mill overheads, etc. Conversion cost should be calculated per Kg./Metre/Machine Shift/Hour.
- (2) Calculation of cost centre-wise cost of production in the Dyeing section. This includes expenses on account of process materials like chemicals; utilities like water, steam, power, pigment padding, developing, fast colouring, soaping, drying; mill/process house overheads.
- (3) Calculation of cost centre-wise cost in the Printing section This includes cost of process materials; utilities like water, steam, power, soaping, drying, roller engraving, screen making, design department, chemicals mixing etc.
- (4) Computation of cost in the Finishing section in respect of different departments like damping, calendaring, sanforizing, tabelizing, etc.

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- (5) Computation of cost of different types of packing like yarn packing (Full Bale; 3/4 Bale; 1/2 Bale, etc.), cloth packing (Rollers, Bales, etc.), and Export Packing. This includes packing material cost like hessian, cheese, card board, polythene; wages and salaries in respect of folding, reeling, inspection, stamping, cutting, baling and bundling etc.; consumable stores.
- (6) Computation of the cost of processed and finished cloth (Proforma L of Schedule II of the Rules). This includes following expenses:
 - (i) Cost of cloth at grey stage (issued from weaving)
 - (ii) Bleaching cost as per step (1)
 - (iv) Dyeing cost as per step (2)
 - (v) Printing cost as per step (3*)
 - (vi) Finishing cost as per step (4)
- (7) Computation of the cost of sales of processed cloth. This involves the following steps:
 - (i) A sortwise stock statement is prepared. This may include quantities and values of production of the processed cloth as determined in step (6), fents, rags and chindies, good production of the processed cloth, opening stock—pre-packed and packed, cloth packed during the year, packed cloth issued for sales, closing stock etc.
 - (ii) To the cost of processed packed cloth issued for sales as computed in (i) above are added share of administrative expenses, selling and distribution expenses, bonus, interest, gratuity. The difference between the 'sales realization' and the 'cost of sales' is the 'margin' on processed cloth sold during the year.

NOTES:

- (i) In the case of controlled cloth, the cost data required should be given for each sort in the said proforma.
- (ii) Export of yarn/cloth/in grey stage/processed cloth should be exhibited separately in the relevant cost statements and the same should be excluded from the cost statements of yarn/cloth

meant for sale in the internal market. Value of export incentives, if any, should be shown in the respective cost of sales statements.

- (iii) The transfer of finished products which form the raw materials for subsequent products should be made at the cost of production of such finished products.

Miscellaneous Requirements of Cost Accounting Records (Cotton Textiles) Rules, 1977

16.25 In addition to the cost records required to be kept for the various elements of cost as detailed above, the Cost Accounting Records (Cotton Textiles) Rules, 1977 require the following records to be maintained by a company manufacturing cotton textiles:

Production Records

Quantitative records of all finished and packed production, issues for further processing, department wise, issues for sales and balance in stock both packed and in pre-packed condition of:

- (1) different counts and types of yarn (both grey and processed)
- (2) all sorts of cloth in grey stage
- (3) all sorts of processed and finished cloth produced should be maintained by the company.

In the process departments, the records of production of different machines, count group-wise and variety-wise only need be kept. The cost of all finished and packed production may be kept in detail. Details of the quantity of cotton blankets produced, if any, from waste cotton should also be kept in the cost records.

Adequate records to show the production of yarn/cloth in grey stage, processed cloth in various stages of production in the respective intermediary productive departments should also be maintained

Reconciliation of Cost and Financial Accounts

The cost records should be reconciled periodically with the financial books of account so as to ensure accuracy. Variation, if any, should be clearly indicated and explained. The period for which such reconciliation is affected

Records Maintenance in Textile Industry

should not exceed the period of the financial year of the company. The reconciliation should be done in such a manner that the profitability of the products under reference can be correctly adjudged and reconciled with the overall profits of the company.

A statement showing the total expenses incurred and income received by the company under different heads of account and the share applicable to cotton textile activity of the company should be made giving therein the basis of allocation of the total expenses and income duly reconciled with the financial accounts for the period.

Adjustment of Cost Variances

Where the company maintains cost records on any basis other than actual, such as standard costing, estimated cost, etc., the records should indicate the procedure followed by the company in working out the cost of products under such system. The method followed for adjusting the cost variances for determining the actual cost of the products should be clearly indicated in the cost records. The cost variances should be shown against the relevant heads. The reasons for the variances should be detailed in the cost records.

Records of Physical Verification

Records of physical verification should be maintained in respect of all items held in stock such as cotton, synthetic fibre, yarn, etc. dyes and chemicals, processing materials, machinery spares, fuels finished goods, copper cylinders, printing screens, yarn dyeing spools etc., and fixed assets. Reasons for shortages/surpluses arising out of such verification and the method followed for adjusting the same in the cost of the products should be indicated in the records.

Inter-company Transactions

In respect of supplies made or services rendered by the company to its holding company or to its subsidiary or to a company under the same management as defined in Section 370 (IB) of the Companies Act, 1956, or to a company in which a director of the company is also a director in such companies and vice versa, records should be maintained showing contracts entered into, agreements or understanding reached in respect of :

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- (a) purchase and sale of raw materials, finished products (yarn/ cloth in grey stage, processed cloth, etc.), process materials, chemicals, dyes and rejected goods including scrap, etc.
- (b) utilization of plant facilities.
- (c) supply of utilities.
- (d) administrative, technical, managerial and any other consultancy services

These records should also indicate the basis followed for arriving at the rates charged between them so as to enable determination of the reasonableness of the rates charged or paid for such services.

Statistical Records

Particulars of contracts entered into for purchase of cotton and sale of finished goods should be maintained in detail indicating separately the percentage of commission, carrying cost, etc. Data regarding available and actually utilized spindle shifts/loom shifts/ machine shifts in the spinning, weaving and processing departments respectively, as well as related data in sub-production centres of such departments should be maintained. The reasons for stoppages and under utilization under classified headings should be recorded. Records showing yield of yarn estimated and actually obtained from each type of mixing of cotton used for yarn production, production of yarn per spindle shift for each type of mixing for each type of frame used, production of different machines count group-wise and variety-wise in the processing departments, speed and efficiency of all the spindles/ looms/other machines where necessary for calculation of cloth cost in each production cost centre, etc., should also be kept. Records detailing the method of control exercised by the company in respect of efficiency in each productive department like spinning, weaving, processing, etc., losses, rejections, wastages in process should also be maintained.

Such records, which enable the company to identify, as far as possible, capital employed separately for yarn/cloth in grey stage/ processed cloth should be kept. Fresh investments on fixed assets that have not contributed to the production during the relevant period should be indicated in the records.

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Detailed records showing the quantity and sale proceeds realized, for each variety of yarn/cloth in grey/processed cloth sold during the relevant period should be maintained, so as to enable the company to determine the actual sales realization per unit of the product sold.

Statistical and other records maintained in compliance with the provisions should be such as would enable the company to exercise, as far as possible, control over the various operations and costs with a view to achieve optimum economies in costs.

The data maintained in the cost records should be reconciled with the various returns submitted to the Textile Commissioner and Central excise authorities, under the various control orders and notifications issued from time to time in respect of cotton, yarn and processed cloth.

Chapter 17

Internal Audit Checklist

17.1 An Internal Auditor normally reviews the operations of an enterprise to appraise their effectiveness and to ensure that control system in the organization functions effectively. For both internal and statutory auditor a knowledge of the industry, financial accounting system, cost accounting system is necessary.

Areas of Internal Audit

17.2 Areas of Internal Audit are as follows:

- Constitution/Status of the entity
- Plant
 - Location
 - Segments (Yarn, Fabric, Garment, etc.) available
 - Types of machinery installed
 - Spare parts and Tools
 - Types of products manufactured
 - Versality in product manufacturing
 - Quality control of raw materials
 - Process control
- Inventory
- Export documentation
- Routine accounts checking
- Quality control of finished product
- Design (in house)
- Energy Saving
- Compliance of Government Rules (State, Central)
- Commercial

- Purchases
- Sales
- Allied Others

This chapter deals with internal audit of various segments in textile industry. The effectiveness of internal audit is measured by the identification, monitoring and control of risk activities. The internal auditor should focus on the risk implications of the analysis and reporting of internal audit.

The following are the broad areas where the internal control designed to assess the functioning of the organization.

Constitution/Status of the Entity

17.3 Examine the constitution of the entity. (For eg. MOA and AOA for Private Limited Company, Partnership Deed of Partnership Firm).

Check whether the provisions of the governing Act are complied with.

Procurement of Raw Material

17.4 In the textile industry, the following items are normally purchased for the purpose of consumption:

- (i) Cotton/ yarn/ grey cloth.
- (ii) Wastes scraps for lower grade mixings
- (iii) Sizing materials
- (iv) Other consumable stores
- (v) Polyester Fibre
- (vi) Viscose

Cotton

It is most important raw material in the Textile Industry. Cotton price varies significantly due to its seasonal nature.

The history of Commodity Derivatives in India dates back to the 19th century when the Cotton Trade Association started futures trading in 1875, barely about a decade after the commodity derivatives started in Chicago. Over a period the derivatives market developed in several other commodities in

India. Following cotton derivatives trading started in Oilseeds in Mumbai in the year 1900, Raw Jute and jute goods in Kolkata in 1912, Wheat in Hapur in 1913 and Bullion in Mumbai in the year 1920.

Polyester

Polyester is a term often defined as “long-chain polymers chemically composed of at least 85% by weight of an ester and a dihydric alcohol and a terephthalic acid”. In other words, it means the linking of several esters within the fibers. Reaction of alcohol with carboxylic acid results in the formation of esters.

Polyester also refers to the various polymers in which the backbones are formed by the “esterification condensation of polyfunctional alcohols and acids”. Polyester can also be classified as saturated and unsaturated polyesters.

Saturated polyesters refer to that family of polyesters in which the polyester backbones are saturated. They are thus not as reactive as unsaturated polyesters. They consist of low molecular weight liquids used as plasticizers and as reactants in forming urethane polymers, and linear, high molecular weight thermoplastics such as polyethylene terephthalate (Dacron and Mylar). Usual reactants for the saturated polyesters are a glycol and an acid or anhydride.

Unsaturated polyesters refer to that family of polyesters in which the backbone consists of alkyl thermosetting resins characterized by vinyl unsaturation. They are mostly used in reinforced plastics. These are the most widely used and economical family of resins.

Characteristics of polyester

- Polyester fabrics and fibers are extremely strong.
- Polyester is durable: resistant to most chemicals, stretching and shrinking, wrinkle resistant, mildew and abrasion resistant.
- Polyester is hydrophobic in nature and quick drying. It can be used for insulation by manufacturing hollow fibers.
- Polyester retains its shape and hence is good for making outdoor clothing for harsh climates.
- It can be easily washed and dried.

Viscose

Viscose is a unique form of wood cellulose acetate that can be used for the manufacture of different types of products that are used in the medical industry, when the cellulose is treated with caustic soda. Sometimes referred to as cellulose xanthe in this state, viscose is ideal for the creation of dialysis membrane and other medical tools that must be soft and supple to the touch.

Created from a combination of natural and man-made components, viscose can also be made into the more common form of rayon that is used for many types of textile products, including clothing. Viscose rayon has a silky appearance and feel, and also has the ability to breathe in a manner similar to cotton weaves. In addition to being an inexpensive material to use in lightweight clothing, viscose can also be used for such textiles as tablecloths, napkins, furniture slipcovers, and sheeting. One of the properties of viscose rayon is that the fabric tends to drape very well, which makes it ideal for use in simple curtains, as well as more formal draperies.

Purchase of Cotton

To make cotton fit for use in a textile mill, it is ginned to remove cotton seeds and other impurities. After ginning, cotton is pressed into bales of usually half a candy each (one candy =784 lbs.). Rates of cotton are usually quoted per candy. In India, the main varieties of cotton suitable for spinning yarn upto 80 counts are:

- 320F,
- Dig Vijay,
- Kafyan,
- Desi,
- Shankar ,
- J 34
- MCU 5,
- V797,
- Varalaxmi,
- Jaidhar,

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- Wagad etc.

Cotton being an agricultural produce, its price depends upon various factors. The size of the crop in a particular year plays an important part in the determination of the price of cotton to compensate. The efforts of the grower and to ensure at the same time that the final product is within reach of the common man. However, there have been wide fluctuations in prices of cotton during the past few years and the industry has passed through uncertain conditions. The price of cotton also depends upon its colour, staple length, presence of dirt, dust, other impurities etc.

Textile mills have a dual system of buying cotton. Depending upon the market conditions, expectation of fluctuations in prices, their own requirement and availability of the right type of cotton at the right time, the mills usually make contracts with intermediaries for the purchase of cotton for immediate delivery or deferred delivery.

Sometimes cotton is also purchased by mills directly through their own staff or through agents appointed for the purchase of cotton from the ginning factories. In the latter case purchases are made on behalf of the textile mills and the purchase price plus all expenses incurred in that connection are recoverable from them. Such merchants are usually allowed some commission/ brokerage for rendering their services. All these expenses and commission/brokerage become a part of the cost of cotton and have to be accounted for accordingly by the mills.

Cotton trade has another peculiar feature. Many times, because of the shortage of funds or for other reasons, cotton is purchased but it is required to be carried by the merchants on the account of the mills for such period as may be considered necessary by the mills. The mills in such cases have to pay interest charges, storage charges, insurance etc. for the period the cotton is required to be carried. Such charges add to the cost of cotton. This system enables the mills to take advantage of price at a particular time and also ensures quality without having to invest ready money. The charges thus paid are usually termed as 'carrying charges'. Interest is the major portion of carrying charges. Carrying charges are usually included in the purchase cost of cotton.

Where contracts for direct purchases of cotton are made, the payment is usually made on the basis of the weighment at the time of the receipt of goods in the mills. When commission purchases are made, the weight

usually acceptable to the mills is the spot weight of cotton. In any case, a bale-wise record is usually kept to record weighment at the time of the receipt of cotton in the mill. This weight, particularly in the case of commission-purchases is usually compared with the spot weight for which payments have to be made, to determine the reasonableness of gain or loss in transit.

It may be emphasised that where the 'property' in cotton has passed to the mill, whether its delivery has been obtained or not, should be accounted for as cotton purchased. Where cotton has been weighed and set apart by the supplier for the mill pursuant to the contract, it should be accounted for as purchases.

Inventory

The textile mills usually maintain proper quantitative records for purchases, issues and stocks of all qualities of cotton and other inputs. The mills, which obtain bank finance on the pledge/hypothecation of cotton are also expected to adhere to the norms of stocks fixed by the bank.

Normally the stock in a cotton textile mill consists of the following:

- (i) Raw materials—cotton, purchased yarn, waste, etc.
- (ii) Dyes and chemicals
- (iii) Consumable stores and spare parts
- (iv) Stock-in-process
- (v) Finished goods—cloth, yarn for sale, fents, garments, etc. if any,
- (vi) Wastes—saleable and usable.

Physical verification of stocks is usually done by the management in the normal course and a list of discrepancies is prepared. Reasons for differences, if significant, are to be found. Sometimes there is tendency to show shortage arising on such verification as consumption by obtaining consumption slips from the consuming departments and excesses are adjusted by showing them as returns from the departments. This practice should in all circumstances be discouraged. No shortage or excess should be adjusted without proper scrutiny and any adjustment in the books of accounts should be made only after obtaining approval of the appropriate authority in the mill.

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The method of valuation of stocks should be one in accordance with the generally accepted accounting principles and should be followed consistently. Guidance on what constitute the generally accepted principles of valuing stock is available from Accounting Standard 2—Valuation of Inventories, issued by the Accounting Standards Board of the Institute of Chartered Accountants of India. In case there is a change in the method of valuing stock, the effects of such change should be worked out and, if material should be disclosed in the accounts.

Sales

Sales in a textile mill can be broadly classified under the following:

- (i) Sale of controlled cloth.
- (ii) Sale of other cloth
 - (a) Export
 - (b) Government & semi-government departments
 - (c) Civil sales
 - (d) Sales through agents on consignment basis
 - (e) Sale of fents, rags and chindies
 - (f) Retail sales
- (iii) Sale of yarn
- (iv) Sale of wastes/scrap

Export Sales

- In respect of sales in export market, the proceeds of sale are recorded from the sales invoices.
- The price, terms of payment, adjustments for foreign currency fluctuations etc. are contained in such sale contracts.
- At times the services of middlemen may have been obtained in the procurement of such export orders. Contract/ agreement with such agents contain terms regarding the commission or other payments.
- In case, the agents belong to a foreign country, the RBI's permission is needed before remitting the amount of commission, etc.

- In case, revaluation of currency has taken place after the sale has been effected in law (the contract being in foreign currency) but before recovery of the sales proceeds, proper adjustments for such currency fluctuations, if they are to the account of the seller, will have to be made.
- Proper adjustment of expenses incurred to execute such contracts i.e. freight, insurance, transport etc. in the case of CIF contracts are made in respect of all exports made during the year. When goods have been sent out from the mill, but they are lying at the port pending shipment, at the closing date such goods are not treated as sales if the property in the goods has not passed to the buyer but are included in stock.
- The terms and conditions of the various export incentive schemes (e.g. cash incentives, or incentives in the form of import licenses or replenishment licenses) are not uniform, therefore, a set accounting treatment may not be equally appropriate in every case.
- Due care should be exercised by the managements in ascertaining the correct and complete terms and conditions of the scheme applicable.
- The time honoured dictum (based on the generally accepted principle of conservatism) that anticipated profits should not be taken credit for in the accounts unless they have accrued, but expected losses should be provided for, would serve as a guiding rule in deciding the extent to which benefits not yet received under the export incentive scheme should be taken credit for.
- However, an equally important guiding consideration should be that the accounts should show a true and fair view of the trend of the actual results over a number of years.
- Thus, that accounting treatment should be adopted in respect of such benefits which, in the facts and circumstances of the case, comes nearest to reconciling what may be the conflicting requirements of these two considerations.

Sale to Government Departments

Sale to Government and Semi-Government departments are generally finalised on the basis of tenders. At times, a price escalation clause is also found in such sale contracts. Proper adjustment in this regard is made in

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respect of all such sales irrespective of whether the claim by the company or the purchaser has been made or not unless there are special reasons for not doing so in which case a note in the accounts may have to be given to disclose the position. Sales to Government/Semi-government departments are usually made without resorting to middlemen. However, Mills may choose to utilise such services.

The usual practice of billing in case of sales to Government departments is that the first bill is raised for 90% or 95% of the sales value and the balance amount is billed by a second bill. If the goods have been actually delivered 100% of the agreed price should be accounted for as sale.

Civilian Market

Bulk of the sales takes place in the civilian market. The selling organization depends upon the marketing policies of the company. Usually, sole selling agents' selling agents/distributors/authorized stockiest are appointed by the company for sales in the civilian market. Agreements are entered into with such agents, specifying the services to be rendered by them and their remuneration.

The prices in the civilian market are subject to wide fluctuations; these are fixed by the management from time to time.

Sale of Fents, Rags and Chindies

Sale of fents, rags and chindies has also to be properly accounted for in the books of accounts. Having recorded the production and stock of such goods, the rates at which such goods are sold should be properly recorded with reference to the management policy in this regard and/or the rates fixed the purpose from time to time.

Retail Sales

Many companies have their own retail outlets. Such retail outlets can be managed:

- (a) on the basis of contract to some outside party
- (b) company's own department or some other system. In the former case generally the responsibility for stock, insurance etc. rests with the contractor. In any case, proper accounting of sales and expenses must be made. In case the retail outlet is the company's own department,

proper quantity and other records regarding receipts, sales and stocks must be kept.

Where the volume of business transacted at the retail outlets is large, it becomes difficult to maintain elaborate quantity records for each variety and design without incurring large expense. In such cases it may be proper to carry out the stock taking at periodical intervals say six monthly or quarterly and reconcile the total retail account by taking into account the sale value of opening stock, of goods sent to retail outlet and of closing stock and reconcile the balance with the sale proceeds during the period. Difference, if reasonable, can be due to genuine cutting shortages or other minor clerical errors which may be ignored by the management on business considerations.

This system can work only if the selling prices are pre-determined and there are no changes during the period. Considerable difficulties have to be faced in cases where there are frequent changes in selling rates.

Sale of yarn

Sale of yarn is generally made to power looms and hand looms in the civilian market. If there are long term contracts with any purchaser there should be proper accounting of sales. Selling prices of usable or non-usable wastes sold is also decided by the management from time to time.

Sale of Scrap

Scraps are usually sold periodically by auction. A list giving quantity of goods put up for auction is prepared by the management. The auction is normally held through approved auctioneer. The auction bids are subject to management sanction.

Sale of Controlled Cloth

Controlled cloth scheme was introduced by the Government to ensure production of cheaper varieties of cloth for the poorer section of the society. Prior to the declaration of the 'Integrated Textile Policy' in August 1 1978, all mills were obliged to produce a part of their total production to conform to the specified categories. Because, the production of such cloth entailed a loss to the mills and the sickness in the textile industry was feared to spread alarmingly. Therefore, the Government decided in 1978 to withdraw this obligation. Presently, only the mills under the National Textile Corporation

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are required to produce controlled cloth. The losses suffered on this account by the NTC mills are being reimbursed by the Government.

Consignments Sales

At times goods may be sent to some party on consignment basis. In such cases till the goods are sold by the consignee, they are the property of the consignor. Proper accounts of goods sent on consignment, goods sold and balance lying in stock with the consignee should be received from the consignee and sales account and sales tax, GST, etc., adjusted properly. The consignee's remuneration should be appropriately accounted for with reference to the agreement with him and the amount of sales. If any, expenses have also been allowed proper accounting thereof should be made.

Model Checklist of Generalized Areas

A Model Checklist of generalized areas is being given which may help to internal auditor to conduct the audit in these areas is given below. The above list is not exhaustive and some points may be different from situation to situation or environmental wise or segment wise but have been provided considering the peculiarity of the financial transaction as well as operational activities taking place in this industry. The other usual modes of verification also need to be followed.

Administration

- Review of selection process of various Contractors i.e. Security, Canteen, Housekeeping, Routine maintenance (AMC), Doctor, etc.
- Review of agreements and bill passing system.
- Comment on system of Authority Level Matrix being in place and report deviation.

Accounts and Finance

- Checking of Current Asset and Current Liability.
- Provisioning and cut off procedures/ Adherence to book closure process and timeliness
- General expense system of sanction and deviations.
- Compliance with applicable Accounting Standards.

Internal Audit Checklist

- Control over voucher preparation, modification and deletion.
- Check the calculation of commitment charges paid to financial institutions
- Check the rebate received from financial institutions for prompt payment of interest.
- Check that the debt servicing is done properly and on due dates
- Check that the terms of loan in respect of interest payment and loan repayment are followed correctly.

Cash Transaction

- Check that physical verification of Cash is carried out periodically.
- Check that adequate security arrangement for Custody of Cash is exist.
- Check that proper cash retention limits prescribed have been and adhered objectively.
- Check that adequate insurance cover for protection of cash has been obtained.
- Check that all required cash transaction records are maintained.
- Check that verification of funds requirement and its efficient utilization as per HO directive with optimal balance.
- Verification auditing of cash book.
- Verification of accounting of cash receipts.
- Verification of authorization of expenditure and payment.
- Check that adequate Fidelity Insurance of cashier and related staff has been obtained.
- Check that of treatment given to excess and shortage found in cash; if frequency of discrepancy is more then steps are taken to strengthen control.
- Check that rotation of duties in Cash/Bank department is implemented.
- Key management.

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Bank Transactions

- Review of requirement of funds whether proper groundwork is carried while planning periodic cash flow.
- Ensure proper review of receipts of funds from HO/ CFD.
- Check that custody of Blank Cheque Books and the procedure of recording for the same.
- Check that blank signed cheques are properly recorded in register and its uses is monitored and accounted.
- Check that blank signed cheque are physically verified periodically and cancelled, after return of signing authority.
- Check that Internet transaction through CC limit is restricted and all govt. payment done through current accounts in all the units.
- Check that the required funds is approved and transferred to this account by cheque?
- Verification of Bank Receipts with the pay-in-slips.
- Verification of booking of Bank Commission with bank advice.
- Verification of Funds Transfers electronically (RTGS/NEFT) whether any discrepancy noticed in approvals and transaction details.
- Check that authorized signatories only conduct such transactions.
- Check that electronic fund transfers are recorded in separate register and physically signed by competent authority for authentication of transaction.
- Verification of Bank Reconciliation of Operative and Non Operative Banks.
- Check that bank reconciliation is prepared by person not involved in accounting of bank transaction and rotation of duty is implemented. Check that unit CFO has counter signed the Bank Reconciliation Statement.
- Check that interest charged by bank represent the transaction cost and is as per stipulated conditions of agreement.

Internal Audit Checklist

- Check that the entries shown in Bank Reconciliation have been followed up by the designated officer not being the preparer of reconciliation statement or the accountant concerned.
- Verification of Accounting of Stale Cheque.
- Check that cheques are printed through computer software and signed along with voucher approval.
- In case of yourself transfer, Check that accompanying list is also signed by cheque signatory and such instruction is passed on the bank.
- Check that the FDR's reported to be kept with authorities are verified or a certificate is obtained on periodical basis from the custodian.
- Check that withdrawal of signing authority (for exiting employees) is informed to bank immediately.
- Check that, in case of withdrawal of signing authority, for un-presented cheques, payees are informed for replacement of cheques and bank for stop payment.
- Check that post dated cheques are posted in the memorandum register and kept in adequate custody?

Imprest Transaction (Accounting and clearance)

- Review the process/stipulation of granting Permanent Imprest and Temporary Imprest.
- Review closing of Imprest whether time limits for submission of Imprest are observed.
- Review of expenditure through Imprest. Check that expenditure incurred for the same purpose for which it was granted.

Booking of Expenditure

- Verification of revenue expenses incurred in the light of delegation of power and is within the permissible budget limits.
- Check that no personal expenses have been debited to company accounts?
- Verification of proper sanction for incurring of expenditure and verification of following a proper procedure laid down by company.

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- Verification of power bills with respect to actual unit consumption, check if any penalties and extra payments are levied. Also indicate material nature of defaults leading to such fine or extra payments.
- Whether adequate documents are attached to the vouchers signifying the expenditures evidence and authority.
- Whether proper cut off procedures have been followed for recognition of expenses/ incomes.
- Check that project/ estimates are prepared before incurring expenses on works contract (revenue/ capital) and variance with reason analyzed and corrective action taken.
- Verification of capital expenditure with respect to provisions of Company Act and requirement of Accounting Standards.

Payment Procedure

- Check the company's policy and procedure for making payments.
- Check whether all such payments have been made through e-payment or as per HO directives
- Check that the bank details of the payee have been received correctly from the authorized representative
- Check the e-payment details provided by the payee.
- Verify whether the payments made through Cheque can be made through e-payments with proper safeguard.
- Check complaint of non receipt of payment after e-payment.
- Check whether reasons were obtained from bank for non-payment and efforts were taken to resolve the problem.
- Whether all electronic transactions are recorded in register and signed by competent authority for authentication of transaction.
- Whether passwords of handlers of e-payment are shared or are used by the owner of the password only.

Time-office and employees transactions

- Review of all other HR policies in place and their implementation.

Internal Audit Checklist

- Check that recruitment of employees, contractors and consultants are done as per company policy.
- Check that photo ID card issued to all employees and whether same are taken back at the time of separation.
- Review of attendance system and records of all employees (including contractor employees).
- Comment on adequacy and effectiveness of training programs and records maintained.
- Review of policy and maintenance of records of leave.
- Review of system the preparation and payment of salary, wage bills, overtime bills, LTA, Medical reimbursement, loans, advances, leave encashment, etc. including deductions on account of PF, ESI, TDS etc.
- Comment on staff turnover and reasons for leaving. Whether exit formalities are duly complied with?
- Comment on maintenance, updation and control over personnel files.
- Check that job rotation is done as per company policy.
- Check that employee complaints are properly addressed and resolved.
- Comment on actual manpower against budgeted.
- Verification of Salary Bills / Supplementary salary Bills/Wages sheets.
- Verification of Overtime Bills with the original attendance records and labour union agreements along with the good work payments and senior management approval.
- Verification of regular yearly increments granted to employees.
- Verification of Leave encashment with respect to policy and entitlement (Regular & On Retirement).
- Verification of Medical Reimbursement/ Medical Claims/ Major Expenditure on medical treatment.
- Review of Travelling Advance and Final Settlement of traveling expenses Check that, frequency is high and outstanding is longer. If yes what steps are taken to control the same.

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- Review of Service Book and Leave Account.
- Verification of Adhoc Gratuity payment and Final Gratuity Payment.
- Review of Provisions for Gratuity/ Leave Encashment/ Medical Reimbursement).
- Verification of Pay Fixation on increment and on Wage revision.
- Verification of payment of Ex-gratia and Bonus, if any.
- Verification of payment made under Workman Compensation Act, if any.
- Review and verification of Income Tax Calculation of staff, payment and deduction.
- Verification of reconciliation of deductions made on account of IT, PF, ESI, etc. and deposits on thereof.
- Verification that all other major recovery and payment are being done properly or otherwise.
- Review of payment of Advances to Employee (Furniture, Computer, Festival, Car, etc.)
- Verification of assets given to employees under scheme and accounting thereof.

Raw Material purchase/Creditors (PSF/VSF/Cotton etc.)

a) Cotton purchase

- Review and verification of procedure of advance payment to cotton supplier (Ginner/ Broker, etc.) and its reconciliation.
- Check that cotton procurement as per cotton policy (for regular consumption and stock purpose)
- Check that cotton buyer, intimate immediately on finalization of contracts about quality, price, delivery and payment terms to respective units and purchase order are fed immediately into ERP on receipt of contract details.
- Check that superior quality is purchased and used where inferior quality/ cheap cotton is sufficient to meet customer requirements.

Internal Audit Checklist

- Check that QC test is conducted for each lot received as per sample size specified and deduction memo/ debit note is raised in case of deviation within permissible limit otherwise rejected and returned back (moisture, trash, elongation, Strength Average Staple length, etc.)
- In case of advance payment, check that value of money is received back for returned goods.
- Check that daily, monthly and yearly price chart is maintained for each quality of cotton to predict price trend.
- Check that purchases have been made in small quantities at higher rates where bulk purchases could have been made at cheaper rates.
- Check that records are kept to monitor the future price indexes in the global Market. Check that these are being used in buying decisions.

b) *Purchase of PSF/ VSF, ETC.*

- Review and verification of procedure of advance payment to fiber supplier companies and its reconciliation.
- Check that it is ensured that total ordered quantity is dispatched by supplier, within the calendar month so that any upward price change is not affecting purchase cost as price as on date of dispatch will prevail.
- Check that commitment quantity is lifted so that lifting/turnover discount is availed to the extent agreed.
- Check that all available incentives/discount have been accounted for.
- Check that credit-note on account of various incentive scheme available is adjusted timely in further payment/deliveries
- Check that for all adjustments in prices, proper documentation is available from the suppliers.

Purchase Procedure and Review

- Check that tender/RFQ procedures have been followed like, inviting limited/ open tender as per the delegation of powers, time given to participate in the tender, formation of tender committee, opening of sealed tender by the tender committee, conducting negotiations, etc.

Technical Guide on Internal Audit of Textile Industry

- Check that tender includes technical qualification parameters and whether any proven sources have been ignored for participation in tender for no valid reason.
- Check that the rates at which orders have been placed appear to be competitive and reasonable compared to the previous purchases rates.
- Check that the company policy (Through CCD/ Direct, emergency/ Regular, Revenue/ capex, authority level etc) of purchases is followed by all the units uniformly.
- Check that the Repeat Orders placed are based on orders placed earlier with proper tendering; check that other conditions governing the placement of Repeat Orders are followed.
- Check that any attempt has been made to split the tenders to keep the value of the contract within the delegated powers of the approving authority.
- In case of cancellation of tenders, check that approval of competent authority has been obtained stating the reason for cancellation.
- Check that the same items have been re-tendered; if so, whether the rates at which order has been placed are higher than the rates received for the tender cancelled.
- Check that indents of same items from different units are clubbed at the office of Material Resource Section or CCD before tendering.
- Unusual time taken to place orders (from the date of indent).
- Check that material have been supplied within the stipulated time ; if not, whether liquidated damages have been imposed.
- Time taken to inspect the store materials (after the supply), to prepare Store receipt, to send the bill to Accounts department for payment, to pass the bill for payment and make payment
- Check that the payment made are as per the terms and conditions of the order, especially taxes and duties, whether tax concessions are availed.

Internal Audit Checklist

- In case of delay in supply, check that the Purchase department takes follow up action. Some instances of abnormal delay in supply to be given.
- Maintenance of records, such as, Tender Register, Supply orders, Bill Passing Register, etc.
- Check that purchases have been made in small quantities at higher rates where bulk purchases could have been made at cheaper rates.
- In case of local purchase, whether the materials purchased have been consumed immediately.
- Check that local purchases made are within the powers delegated to the approving authority.
- Check that any local purchases have been made when the materials were in stock or waiting for inspection.
- Whether advance payments made to suppliers are outstanding for a long time; list of such advances (separately for capital and spares) with age and reason for non adjustment.
- Total no. of contracts placed up to period of audit No. of contract/orders Value:
 - i) Open tender
 - ii) Limited tender
 - iii) Repeat order
- Check that repetitive orders are given even when materials are in inventory.

Imports

- Check payments to Clearing House agents, air freight, demurrage.
- Check utilization of benefits: EPCG, DEPB, Duty drawback, Advance licensing, etc.

Creditors Management

- Enquire about advances unadjusted for more than reasonable time.
- Enquire about non-payment of credit balances.

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- Check earnest money/security deposit and old outstanding balances.
- Check exceptional transactions.
- Check supplier account reconciliation and balance confirmations.

Works Procedure and Various works

- Check that tender has been given or quotation were invited.
- Check that detailed estimate is prepared and approved by the Competent Authority.
- Check that financial terms and conditions of the order.
- Check that clauses for applicable taxes and duties and other relevant expenses.
- Check that compliance of various applicable statutes on work order.
- Check that compliance regarding statutory dues, like, PF, ESIC, etc. on contractor's payments.
- Check that order execution schedule is given in the order
- Check that qualifying criteria is meet.
- Check that price comparative statement of the work order
- Check that price variation conditions in the order
- Check that comprehensiveness of the terms and conditions of the order.
- Check that work is not split up in the small works so as to bypass the Delegation of Power (DOP) requirement.
- Check that clauses relating to liability and losses of property/third party liability.
- Check that clause relating to measurement of work.
- Check that clause relating to the supply of material in terms of rate and value at which it will be given.
- Check that all terms and conditions which are order specific and there is no scope for ambiguity.
- Check that work order by approving authority as per DOP.

Internal Audit Checklist

- Check that order is being issued is within the validity of the order.
- Check that per day compensation or a piece work compensation is competitive as compared to similar works in the vicinity.

Passing of supplier's bills

- Check that invoice with all the terms and conditions of the order.
- Check that recovery for late delivery.
- Check for that advance adjustment if paid against the order.
- Check that there is adequate recovery of security deposit.
- Check that bills are duly passed by competent authority.
- Check that discounts/ rebate if any have been given.
- Check that TDS, if applicable has been deducted and deposited at prescribed rate.
- Check that correct account heads have been debited or credited.
- Check that payment advice is supported by original invoice for drawing cheques and the same are duly endorsed.
- Check that due care is taken before making payment on duplicate invoice.
- Check that payments are made within due dates.

Passing of works bills

- Check that invoice are raised as per all the terms and conditions of the order.
- Check that measurement as recorded in the Measurement Book with Running Bills.
- Check that the bill and measurement have been internally verified as prescribed.
- Check that recovery for delayed execution of work.
- Check that proper VAT credit has been taken.
- Wherever applicable, check that WCT has been deducted and deposited/ adjusted.

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- Check for the advance adjustment if paid against the order.
- Check that adequate recovery of security deposit/ retention money is made.
- Check that bill is duly passed by competent authority.
- Check that discount/rebate if any has been given.
- Check that TDS as applicable has been deducted.
- Check whether recovery for the material issued to the party has been affected.
- Check that correct account head have been debited or credited.

Sales & Dispatch (Final product, Rejects, Scrap)

- Adherence to Sales Policy, credit period and credit limits-analysis of Sales in excess of credit limit.
- Process of creating and maintaining customer master.
- Variance of actual and booking rates.
- Contract booking system – Domestic / Export. Alterations with proper authorization. Compliance of terms of contract.
- Check that amendments made in customers order (sales order) are duly approved/ authorized.
- Sales Return system including method of calculation of its ageing for valuation purpose.
- System audit of dispatch planning, Report on delay in deliveries with reasons.
- System of dispatch/ invoicing including cash discount.
- Comment on OTP (On Time Performance).
- Bill passing and payment system of Logistic.
- Transit insurance coverage.
- Review the system of sale of waste.

Export Sales

- Check the process of appointment of Agents/ Sub Agents, renewal of agreement.

Internal Audit Checklist

- Check that commission paid to agent is as per agreement.
- System of Order booking, Contract with the customers.
- Check that export shipment is against schedule.
- Review system of document negotiation with Banks.
- Check export related expenses – Container detaining, demurrage, etc.

Debtors Management

- Debtor's ledger scrutiny, Critical & doubtful Debtors to be specifically mentioned with the recovery progress and action plan.
- Recovery of interest on delayed receipts.
- Enquire about incentives, discounts & commission and its authenticity.
- Scrutiny of debit/credit notes.
- Samples and that proper accounting.
- PDC cheques management, follow-up and authorization in case of holding beyond due date/cheque dates, cases of cheque returns and delay in taking legal action.
- Check Customer reconciliation and balance confirmations
- Approval and accounting for bad/doubtful debts.
- Check that credit limits fixed are frequently relaxed.
- Check that Debit/Credit Notes have been issued after proper authorization and documentation?

Preventive Maintenance

- Check that schedule of preventive maintenance is adhered to.
- Check that all the plant and machineries are covered under preventive maintenance schedules.
- In case of deferment of parts replacement/ overhauling, a comprehensive note is prepared and approved by competent authority
- Check that all such cases of deferment are reviewed and documented periodically till the same is taken on scheduled maintenance/ replacement of parts.

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- Check if abnormal stoppages have occurred and if they relate to non-adherence to schedules quantify the losses.
- Planning for availability of spares.
- Substitute for imported machine spares.

Investments

- Check that proper documentations are available for the investment showing intentions, repayment, return on investment details.
- Check that investments made are duly authorized by the investment committee.
- Check that documents signifying the ownership are kept in authorized custody and have been periodically verified.
- Check that interest/ dividend receipts and repayments are as stipulated.
- In case of strategic investment, joint ventures, subsidiaries, check that adequate due diligence has been done.
- Check that due diligence report is comprehensive and gives a clear opinion on the proposed investment.
- Check that conditions precedents have been complied before the investment is made.
- Check that there are any overrun's or delays in the investment object? Check that there is any loss or continuation of a loss since long.

Price variation and Penalty/ Liquidated Damages

- Check that price variation clause is applied correctly as per formula given in the order.
- Check that penalty and liquidated damages are recovered from the party as per terms and conditions of the contract.

Inventory Management (Stores)

- Maintenance of records such as MRN, Issue slip, Requisition slip, Purchase Indent, Budget and special sanction, etc.
- Check that inventory levels (minimum, maximum, re-order and economic order) are fixed and adhered to.
- Number of Instances of emergency/ urgent purchase or issue without following prescribed procedures is recorded separately to review the planning system and inventory requirements.
- Check that emergency spare, regular and other (as and when required) are separately classified/categories in ERP system.
- Check that discarded/obsolete and disposable items are identified time to time and disposed-off with approval of competent authority.
- Check that records are computerized and detailed comments about the effectiveness of computerization.
- Check that requirement projected in the Budget is substantially higher than the previous period's consumption; if so, whether justification has been given.
- Check that any item has been included in Budget, the consumption of which was NIL in the previous year. If so, whether the quantity projected has been justified.
- Check that materials are consumed before the preparation of Stores receipts.
- Physical verification of store materials at random periodically is conducted and adjustments in books are adequate.
- Check that issue of stores materials on loan are properly recorded.
- Status of recovery of stores materials issued on loan.
- Check that there are any cases of materials received short or in damaged condition and whether claim has been made with insurance company/ from supplier for replacement
- Details of avoidable, wasteful expenditure like wharfage, etc.

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- Check that non-moving and slow-moving stores items have been identified, list prepared and circulated to other units and Headquarters before disposal.
- Check that the actual physical count sheets are preserved until the internal auditor verification is complete.
- Maintenance of records for scraps along with their approximate value should be maintained.
- Comments about the scrap to dispose of major items, since when lying as scrap, their approximate value etc. Check that disposal procedure is adequate.
- Check that concept of ABC analysis is prevalent in the company and uses for operating.
- Maintenance of records in Major Stores, value of inventory, period the spares have been lying in Major stores including return of unused store material from sub Stores.
- Check that number of items of store materials and their quantities issued by the Major Stores tally with those received by the sub Stores.
- Check that sub stores draws materials from Main Stores when it is already in its stock.
- Check that the materials issued by Stores are issued and received by authorized persons.
- Check that the materials are properly arranged and stacked to locate them easily.
- Check that physical control on Field-oriented Control (FOC) materials lying in the plant is adequate.
- Check that value of inventory in terms of number of months' consumption of stores and spares and comparison with previous year's figures should be made.
- Check that stores materials are lying in shop floor unconsumed for a considerable period of time; if so, reason therefore and determination of their NRV.

Internal Audit Checklist

- Details of reconciliation between price stores ledger and financial ledger need to be furnished for taking action.
- Check that stores/surplus of charged off stores are approved by higher authority for taking action.
- Check that the consumption is booked as per consistent pre determined practice

Physical Verification of the Inventory

- Check that physical verification of inventory taking of all stores material completed at appropriate intervals and proper reconciliation carried out.
- Check that perpetual inventory system is adequate to cover entire inventory in one year.
- Check that inventory verifications conducted independent of stores and stores staff? Examine the responsibility of the person involved in inventory taking.
- Check that there is proper authority in approving the adjustment of differences in the inventory findings. Check that approval and adjustments done promptly.
- Compare the shortages and excess of present inventory findings with those of previous two or three years and ascertain the reason for difference in the same item. Examine the steps taken to stop the recurrences of such differences.
- Check that slow and non moving items are regularly reviewed and appropriate action is taken.
- Check that scrap salvage and unusable inventory are identified regularly and disposed off as per procedures laid down.
- Check that the actual physical count sheets are present until the internal auditor's verification is completed.

Assets Management

- Comment on maintenance of Fixed Assets Register.
- Sale of any fixed asset/surplus asset with relevant approvals and as per disposal policy of the company.

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- Scrutiny of repair account to ensure that no items of capital nature are included therein
- Scrutiny of additions to fixed assets so that no revenue expenditure has been capitalized.
- Interest and other expenses having direct nexus whether capitalized.
- Adherence to preventive maintenance schedule, Authorization on fixation/revision of maintenance schedule.
- Check that depreciation is being charged as per Accounting Policy of the Company.
- Check tagging and movement/ transfer of fixed assets.
- Custody and Control over Original Title Deeds.
- Report Idle and under- utilized assets.
- Bill processing and payment system.
- To review the system of assets given to Employees.

Capitalization of Fixed Assets

- Examine the procedure of capital expenditure authorization. How such authorization is evidenced. Review and see compliance in case there is an authorization procedure in writing.
- In case, actual expenditure exceeds the sanctioned amount. Check that there subsequent authorization for the additional expenditure. Check that the sanctioned obtained before or after the expenditure is incurred.
- Is the amount of capital expenditure reflected in cash flow statement so that fund is available at the appropriate time? Examine whether actual expenditure is according to cash flow.
- Examine the purchase order/contract issued for acquiring capital asset
- Examine and review the technique applied for assessing the productivity and profitability of capital fixed asset.
- Check that transaction is capitalized to correct account head.
- Check that all the direct cost incurred is capitalized except taxes for which credit is available.

Internal Audit Checklist

- Review whether requirements of AS-10 are complied with.
- Review depreciation charged on these assets for the construction period
- Review as to the compliance of schedule VI to the companies Act.
- Check whether, separate capital cost is computed as per Companies Act and Income-tax Act
- Check that fixed assets registers have been kept and maintained and are updated on regular basis.
- Check that adequate depreciation is charged as per Schedule XIV of Companies Act.
- Check that assets are revalued and whether the write off is adequate after revaluation.
- Examine the assets write off policy and comment on the variance and adequacy.

Insurance:

- Validity of Insurance coverage and adequacy of Insurance & Risk coverage including additions during the year.
- Review of various risks covered in insurance.
- Checking of follow up on pending claims and refunds.

Physical Verification of the Fixed Assets

- Check that fixed asset register has been updated till the date of the physical verification.
- Check that the physical verification was conducted periodically as per policy approved by the Audit committee.
- Check that scrap salvage and unusable/discarded/disposable assets are identified regularly and disposed off as per procedures laid down.
- Check that the fixed asset register mentions the location of the fixed asset.
- Verify that the asset was found at the same location as mentioned in the fixed asset register.

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- Check that the asset was transferred to any other location? if yes whether proper documents are maintained for such transfers and the fixed asset register is duly updated
- Check that any material discrepancy was noticed during the physical verification of the asset. If yes whether such discrepancy was duly reconciled or that adjustment were made in the books of accounts and fixed asset register.

Accounting Standards Compliance

- Check that the compliance of applicable accounting standards are communicated at the execution level and also ensure the implementations of the same.
- Check the inventory valuation with respect to AS-2/ IND-AS-2.
- Check the depreciation in the light of AS-10/ IND-AS 16.
- Check that revenue is recognized in accordance with AS-9/IND-AS 115.
- Check the capitalization of Fixed Asset as per AS-10// IND-AS 16.
- Check the compliance of AS-11 i.e. Accounting of Foreign Exchange Transaction.
- Check that the interest is accounted for as per accounting standards (AS-16) for borrowing cost.
- Check the compliance to all other accounting standards applicable to the company.

Financial charges

- Check the calculation of guarantee fee paid/payable.
- Check the calculation of commitment charges paid to financial institutions.
- Check the rebate received from financial institutions for prompt payment of interest.
- Check the interest subvention received/receivable.
- Check the TUF subsidy receivable.
- Check that the debt servicing is done properly and on due dates.

Internal Audit Checklist

- Check that the terms of loan in respect of interest payment and loan repayment are followed correctly.
- Check that security created in favour of lenders are registered with ROC are immediately discharged on repayment of debt/ loan.
- Check any guarantees issued by bank on behalf of company or guarantee given by company to others are immediately recorded in guarantee register maintained and are within the limit specified in companies Act or share-holders approval.

Information Technology Controls

- Review compliance of IT policy.
- There is control over sharing of ID & Password.
- Abuse / misuse of ERP/ SAP.
- Proper Audit Trail is available or not.

Reconciliations

- Check whether preparation of reconciliation and maintenance of Books are done by separate employee.
- Check Inter unit Reconciliation & Report on Deviations.
- Check reconciliation of sub-ledger to main ledger.

Security and safety system:

Check that various safety and security measures already in place and comment on adequacy and improvement, if any are :

- Safety measures and its effectiveness.
- Security system (Personal and assets).
- Comment On the Existing Security Systems in the Plant.
- Review of Adequacy of Records and Controls at the Main Gate.

Fire and Safety Equipment

- Proper fire and safety equipment available.
- The equipment accessible (i.e. is it unblocked).
- Flammables stored in flammable storage cabinets.

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Operation of Machinery or Complex Apparatus

- Indicator lights on the apparatus in an O.K. or safe condition.
- The apparatus producing normal sounds, odors, parts, or results.
- The apparatus equipped with data recorders or monitors that track the condition of the apparatus.
- There maintenance logs or other records that track the condition of the apparatus if necessary.
- Proper lock/tag techniques being practiced.

Common Tools and Equipment

- The workers are using the right tool for the job.
- The workers using the tools correctly.
- If necessary, are the workers have been trained to use the tools.
- The tools in good and safe working condition.
- The tools have been inspected recently.
- The tools are stored in appropriate locations.

Work Area and Housekeeping

- The work areas neat in appearance.
- All aisles and walk-ways are sufficiently wide for personnel and moving equipment.
- All aisles used by moving equipment have clear line-of-sights.
- All walking/working surfaces have barricades or hand guards to protect personnel from hazards.
- The chemicals are properly inventoried and stored away.
- The lighting is adequate.
- The exit is clearly marked and easy to find.
- All overhead are items secured.
- All stairs are in good and safe condition.
- All ladders are properly secured or stored away.

- The overall building is in good working condition.

General Procedures

- The personnel and building occupants know evacuation procedures for fire and weather alarms.
- Building occupants such as lab visitors have point-of-contacts within the building.
- The area manager sufficiently aware of work being done by lab visitors or employees from other area.

Personnel Ergonomics, Focus, Training, and PPE

- The personnel are working in a manner that is free of unnecessary physical exertion.
- The personnel are practicing good ergonomics.
- The personnel seem sufficiently focused on their job, especially jobs where there are hazards present.
- The personnel is trained to do the job and are aware of the hazards and mitigations.
- The job appear suited to the personnel.
- If necessary, the personnel are using PPE.
- For work near machinery, the personnel are wearing proper clothing.
- If necessary, the personnel are wearing TLD badges in radiation areas.

Warehousing & Storage

Control Features

- Sufficient storage space is available and the layout of storage facilities is suitable to meet the operational requirements of the organization.
- Goods are effectively stored in order to provide an efficient service to customers and internal users.
- Materials, goods and products are adequately and securely stored in order to facilitate their prompt identification and dispatch.

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- The optimum warehouse locations are utilised to maximise the efficiency of distribution to customers, etc.
- All goods are adequately protected from damage, deterioration and loss, in order that they remain in optimum condition for use.
- All stock movements are valid, authorised and properly executed.
- Goods are stored safely.
- Staff are appropriately trained in the handling of goods in order to avoid damage to the goods and injury to staff.
- Adequate and serviceable materials handling devices as an aid to efficiency and cost effectiveness.
- Hazardous items are safely stored.
- All relevant regulations and legislation are complied with.
- Stocks are used in rotation.
- Adequate and relevant insurance cover is provided for both the stocks and storage facilities.

Risk Issues

- Management aware are of the current and future storage capacity requirements, and what is the evidence of effective planning to the meet the identified demands.
- How does management decide where to locate warehouses, and is adequate account taken of the relevant logistical, transport and customer service considerations?
- The storage locations (i.e. bins or bays) are adequately identified to enable the prompt location of stock units.
- Storage facilities adequate to protect goods from damage or deterioration.
- How can management be assured that all stocks are adequately protected from theft and pilferage?
- What measures are in place to prevent unauthorised access to the storage areas?

Internal Audit Checklist

- How can management be certain that all movements of stock are valid, authorised and correctly executed?
- Goods (especially hazardous materials) are stored safely and in accordance with established regulations and good practice, and how can management be assured that this is the case.
- Staff are adequately trained in the various materials handling techniques, and how can management confirm this.
- The efficiency of the storage facility enhanced with the use of appropriate handling devices (trolleys, pallets, forklift trucks, cranes, etc.) and how can management be assured that all such devices are serviceable and contributing the overall cost effectiveness of the operation.
- How can management be sure that all the relevant regulations and legislation are being complied with?
- What mechanisms to ensure that adequate, up-to-date and relevant insurance cover is in place for both the stocks and the storage facilities?

Detailed Issues

- Space is allocated in order to cope with peak loads rather than normal or minimum requirements?
- Management are provided some spare storage capacity as a contingency to cater for expansion, etc. (and how was this accurately determined).
- Space usage is monitored and action taken to avoid wasted or excess space.
- Raw materials, goods and finished goods are appropriately segregated.
- How does management avoid excess storage space and aim to contain the costs of providing storage facilities?
- Fast moving items accurately are identified and conveniently located for efficient handling.
- Items adequately are trailed to all the relevant storage locations.

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- Stocks are used in rotation (as appropriate) in order to avoid the build up of older or outdated items.
- There sufficient space between storage locations to enable effective and safe access, the use of handling equipment, and the safe evacuation of the building in case of emergency.
- How can management be assured that production and sales requirements are promptly and accurately advised to the warehouse?
- Specific responsibilities for the warehouse operation have been allocated (and does this include maintaining an awareness of current materials handling trends and relevant regulations).
- How can management be assured that packaging, storage and handling techniques are adequate to protect the goods from damage and deterioration?
- Damaged items are promptly identified and appropriate action taken (and how is this evidenced).
- The appropriate environmental conditions (i.e. air conditioning, humidity, and temperature) are provided and maintained at the required level.
- Storage areas are well lit for safely and security purposes.
- What physical and other security measures are in place to protect goods and personnel, and are they regularly tested for effectiveness?
- Adequate and operational intruder alarms systems are installed and regularly tested.
- Adequate and operational fire prevention, protection, and containment facilities are provided, and they are regularly tested and maintained.
- The fire containment systems (i.e.. sprinklers, foam inlets, etc.) would cause significant damage to stocks.
- What measures prevent staff pilferage of stock items?
- Adequate staff are provided to meet the operational demands of the organisation, and how does management determine and maintain the staffing requirements.

Internal Audit Checklist

- Staff are aware of the required and safe handling techniques and how is this confirmed.
- Management have provided adequate and suitable protective equipment and clothing for staff, and how is its use confirmed.
- How can management be sure that goods are stacked and stored safely?
- Sufficient and adequate facilities are provided for moving heavy items, and are staff aware of the correct use of such facilities?
- Delicate items are adequately protected during storage and when being moved.
- How is the accuracy of data input from other systems (i.e. Stock control or Sales order processing) confirmed?
- How is data output to other systems (i.e. Distribution) confirmed?

Foreign Exchange

- Review of foreign transactions for compliance with Company policy / Board mandates.
- Review of deal execution, confirmation and settlement.
- Review of deal capture in system and manual MIS.
- Review of settlements (cash / hedge cancellation / rollover cash flows / delivery).
- Review of transaction documentation pertaining to foreign exchange.
- Checking of accounting for forex transactions.

Review Production Resource Optimizations/Comment on Inefficiencies, Wastage etc. Comment on Idle Resources, under utilization of capacity etc.

- Review the system of monthly target setting process
 - Area wise (domestic and export)
 - Product mix wise
 - Sold / confirm order
 - Reliability of unsold program/ process of estimation/achievement

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- Evaluation on market info as prices.
- Actual production laid and program change analysis
 - Change memo
 - Approval
 - Reason
 - Impact
- Analyze reason of efficiency losses
 - Utilisation%
 - Reason, corrective action
 - Review machine wise capacity utilization (under-load/idle run/idle lying)
 - Reason analysis of abnormality/repeatation.
- Review month wise usable and saleable waste (stage wise) and waste stock tally.
- Review month wise stage wise WIP stock movement
- Standard lot size v/s actual lot size: Lot change/ quality change/ repeat lot/ quality/ frequency at each stage since mixing to spinning.

Packing cost analysis

- Compare standard v/s actual packing cost per Kg/m.
- Packing Material quantity tally: Should be v/s actual.
 - on fresh packing
 - on re-packing (with reason)
- Wastage, sample packing, change in standard packing, etc.
- Free (sales promotion scheme): policy v/s actual.

Quality Issues- Complaint analysis

- Customer complaints/claims management – process for recording customer complaints, classification, escalation mechanism, response time, follow up mechanism, pending customer complaints/claims.

- Nature of complaints.
- Repetition of complaints.
- Corrective action taken on previous complaints.
- Cost of Complaint
 - (a) Claim Amount,
 - (b) Settled Amount, and
 - (c) Loss of Customer.

Statutory Compliances

- Verification of receipts/ acknowledgements for the payment of statutory dues like Income tax, VAT, Central Sales Tax, WCT and Service Tax, etc.
- Check that proper GST credits are availed timely and there is adequate periodic inspection procedure for reviewing balances.
- Check that statutory dues have been deposited in time and whether any penalty has been imposed on this account.
- Reconciliation of recoveries and payment of statutory dues and other salary related deductions with financial ledger.
- Review of pending cases and show cause notice status, whether timely submission/ appeal made, wherever required.
- In case of decision against the company, if company does not want to go appeal against the order, check that appropriate note by competent authority supported by legal advice is recorded.
- Check that in case of major appeals/ disputes with tax department, an approval of strategy is obtained from business heads.
- Check that appropriate provision made or shown as contingent liability.
- Check that checklist for statutory compliance in place and followed-up periodically (ideally monthly) by independent employees within the organization for verification of compliance.
- Compliance with Company Act and Other Applicable Laws (SEBI clause 49, RBI, Pollution control, Industrial Act, etc.) including the

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compliance of Standards on Internal Audit (SIA) 17 so far it relates to compliance of laws and regulations in internal audit.

- Check whether the legal counsel(s) periodically updates the management of implications and compliances requirements of laws and new legislations.

Conclusion

In this changing scenario, the role of internal auditor has become very crucial and important in discharging their duties properly and efficiently, particularly for timely detection of irregularities and lapse. For His internal auditors, who are given the task of substantive checking, must be fully abreast with the changes in functioning and operational activities of the entity at all levels.

The system of Internal Control is methods and procedures adopted by the management of an entity to assist in achieving management's i.e., efficient conduct of its business, including adherence to management policies, the safeguarding of assets, prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of the reliable financial information. The system of internal control extends beyond those matters which relate directly to the functions of the accounting systems.

The internal audit now a days is not limited to the audit of financial transactions but the audit of operational activity or operative audit.

The internal auditor should apply analytical procedures for risk assessment at the planning and overall review stages of the internal audit.

An analytical approach needs also to be made with respect to the following:

- Productivity
- Source and application of funds
- Cash generation
- Trends of profit and other financial growth
- Measurement of profitability
- Trend of cost structure
- Liquidity or working capital position

Internal Audit Checklist

- Return on capital employed
- Whether there is over-trading
- Stock exchange quotation of shares for a number of years to examine the trends over a period so as to have a comparative study by analysing with the facts and figures in Annual reports. Stock Exchange. Quotation are not presented in the Annual Reports in India).
- Dividend trends
- Return on investment
- Trends in the rate and quantum of dividends
- Yield potential
- Ploughing back of profits
- Inter-firm and intra-firm comparisons
- Management of corporate capital

Part V

Concluding the Audit and Reporting the Findings

Chapter 18

Audit Reporting and Documentation

Audit Reporting

As per “SIA 370, Reporting Results”

18.1 Reporting of internal audit results are generally undertaken in two stages:

- (a) At the end of a particular audit assignment, an “Internal Audit Report” covering a specific area, function or part of the entity is prepared by the Internal Auditor highlighting key observations arising from those assignments. This report is generally issued with details of the manner in which the assignment was conducted and the key findings from the audit procedures undertaken. This report is issued to the auditee, with copies shared with local and executive management, as agreed during the planning phase.
- (b) On a periodic basis, at the close of a plan period, a comprehensive report of all the internal audit activities covering the entity and the plan period is prepared by the Chief Internal Auditor (or the Engagement Partner, in case of external service provider). Such reporting is normally done on a quarterly basis and submitted to the highest governing authority responsible for internal audits, generally the Audit Committee. Some part of the aforementioned Internal Audit Reports may form part of the periodic (e.g. Quarterly) report shared with the Audit Committee.

This is the phase where the audit team interact with audit unit and discuss the conclusion drawn on the audit findings and prepare the audit report. This phase starts once the audit execution is completed and audit teams compiles its observation/irregularities or abnormalities noticed during audit execution stage. The following are the key tasks involve in audit reporting phase:

- Preparation of draft audit report
- Closing meeting
- Finalisation of audit report
- Submission of audit report to unit audited

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- Review of audit report by unit audited
- Approval and issue of final audit report (together with certification of accounts)

The overall objective of Reporting Results is to highlight the effectiveness of internal controls and risk management processes to enhance governance in line with the Internal Audit Charter (or Terms of Reference, in case of external service provider).

Preparation of draft audit report

18.2 Based on the response received from audit unit against the audit **observations**, the following two situations could arise:

- If response is satisfactory: then such audit observation can be dropped.
- If response is unsatisfactory or not received: then it shall be converted into final observations and a complete list of final observations will be prepared which will be further used in preparation of draft audit report.

Thereafter, audit in-charge with the support of other team members will prepare a draft audit report which need to be discussed with the unit in the closing meeting. The audit in charge will share the draft audit report with audit unit for discussion together with the forwarding letter in prescribed format.

Process for preparation of Draft Audit Report

18.3 The following are the key steps audit party should follow in preparation of draft audit report :

Step 1 - Compilation of audit Observations: The audit team will prepare a compilation of audit observations identified during the period under audit and ensure that responses against each of the identified audit observation have been received and duly examined in relation to its compliance.

Step 2 - Classification of audit observation: After drafting of audit observation, next step is to classify the audit para into different category including impact analysis.

Step 3 - Review of draft report by audit in-charge: Under this step, audit in-charge will perform a review of the draft audit report prepared and will give

comments and suggestions to the audit party team, in case of any observation noted.

Closing meeting

18.4 The audit in-charge together with other member of audit team will arrange **for a closing meeting with the** head of the audit unit and other officer/ officials who assisted in audit. The closing meeting should be held on the last day of audit where in following points need to be discuss:

Inform the audit unit about the audit findings (discuss the draft observations, which have been included in the draft audit report)

- Obtain audit unit's response on the draft observations
- Provide reasons for acceptance or rejection of audit unit responses
- Provide adequate guidance to the audit unit about corrective actions to be taken against each audit observations
- Provide guidance to audit unit about their rights and available remedies
- Suggestion for improvement of the accounting, financial management and general performance of the audit unit

Section I: A sample format of Minutes for Closing Meeting is given below:

Particulars	Information
Name of Department	
Date of meeting	
Place of meeting	
Members present (total no.)	
Members present (total no.)	
Agenda of the meeting	
Key issues discussed in the meeting	
Distribution of minutes to	
Signature of the members present	
Name of Minutes keeper	

Section II: Executive Summary

This section of the audit report will include an executive summary indicating the findings obtained by the audit team during audit. The section is divided into two parts, i.e., Summary of financial findings and Compliance findings.

Section III: Management Information Report

This section would include the general information related to the Risk based Audit conducted for the respective audit unit assigned to the audit team. It would include the following sub-sections:

1. *General information*
2. *Previous audit observations and compliance*
3. *Observations, conclusions and recommendations*
4. *Physical Verification of stores/Utilisation of Vehicles*
5. *Test Audit Note*
6. *Epilogue*
7. *Name, Address and Date & Place of Signature of Audit party members*

Audit Documentation

18.5 **Content and sufficiency of Documentation (refer Para 3.2):** The content and extent of documentation is a matter of professional judgment since it is neither practical nor necessary to document every matter or observation. However, all significant matters which require exercise of judgment, together with the Internal Auditor's conclusion thereon, shall be included in the internal audit documentation. Professional judgement is applied well if documentation helps achieve the objectives listed under Section 2, above.

Nevertheless, documents shall be:

- (a) sufficient and complete to avoid the need for follow-up inquiry;
- (b) useful and relevant to the objectives of the audit procedure;
- (c) undergo at least one level of review or approval; and
- (d) dependable and reliable to allow a peer reviewer to reach the same conclusion.

18.6 Nature of Documentation (refer Para 3.1): Documentation includes written records (electronic or otherwise) of various audit activities and procedures conducted, including evidence gathered, information collected, notes taken, and meetings held. It includes, for example, internal memoranda, letters of confirmation and representation, checklists, external reports and correspondence (including e-mail) concerning significant matters. Abstracts or copies of the entity's records, significant and specific contracts and agreements may be included as part of internal audit documentation, if and when appropriate.

These documents need not necessarily be printed on paper and soft/electronic/ digital version may be used and filed. However, where alternate method of recording and storage is used, it must be reproducible in print form if required, similar in nature to the original documents.

The ownership and custody of the internal audit work papers shall remain with the Internal Auditor. Where part of the audit work is outsourced to an external audit service provider or an expert, and reliance is placed on the work papers to issue the internal audit report, the ownership of the work papers shall be assumed by the Internal Auditor from the third party. However, where reliance is placed only on the report of the third party who insists on retaining ownership to their work papers, adequate provisions shall be in place to have access to the work papers, if and when required (e.g., for quality review purposes).

Chapter 19

Concluding Procedures

19.1 The internal audit team leader should finally review the working papers to see that the audit has been conducted according to plan and it has achieved its objectives. He should make note of any audit procedures that could not be completed because records were not produced by the department or due to lack of time. It is time to decide finally whether all audit observations would find place in the report or some would be dropped in view of the department's reply. Team leader should check the supporting evidence for each observation that is proposed to be included in the report. He should satisfy himself about the sufficiency and relevance of the evidence. He should then prepare a draft report which will include his report on:

- Effectiveness of controls and any major / minor weaknesses in them;
- Non-compliance with law, codes and government orders with assessment of possible loss; and
- Any matters relating to propriety of transactions.

The format of the draft report shall be same as final report and all the applicable quality checks equally hold good for draft report also except that the title of the report shall be "Draft Internal Audit Report".

The internal auditor should also comply with the Standard on Internal Audit (SIA) 390 "Monitoring and Reporting of Prior Audit Issues" issued by the Institute of Chartered Accountants of India (ICAI).

"1.1. This Standard deals with the responsibility of the internal auditor in monitoring and reporting of prior audit issues, usually in the form of an "Action Taken Report (ATR) of previous audits".

2.1. The specific objectives of this Standard are to ensure:

- (a) Proper monitoring and closure of open issues from prior audits;
- (b) Independent validation of corrective actions taken by the auditee;
- (c) Escalation of any concerns in case of delays in closure of issues; and
- (d) Timely reporting of status to those charged with governance."

Exit Conference

19.2 Internal Auditor should seek appointment for an exit conference, preferably with the head of the department once the final draft report is ready. A copy of the draft report should be given to the HoD at least a couple of days in advance so that he and his team have time to study it and prepare themselves for the meeting. The purpose of exit conference is to give the department an opportunity to place additional facts, its views, etc. on the audit findings.

Essentially, it is an opportunity for Internal Auditor to seek confirmation of facts given in the audit report and the department's views on the audit recommendations. If the exit conference takes place in right spirit, the audit report becomes an agreed document between the department and the internal audit. Request for exit conference can be made through a formal letter to the management enclosing the draft audit. The following should be the approach to the exit conference:

- Auditee department should be given opportunity to initiate the discussions and offer their views on the report;
- In case of disagreement, auditee department should be able to substantiate their views with supporting evidence; and
- Auditor may agree to reconsider his conclusions in the light of the information provided by the management.

A record of discussions of exit conference should be kept on file as a part of audit working papers. It is not necessary for the department's representative to sign it. A copy of the record prepared by Internal Auditor may be given to the department for their information. In case they disagree with any part of the record it is for the department to convey it to the Internal Auditor. The record helps document reasons for dropping any audit paragraph.

Reporting audit findings

19.3 Audit report is the final deliverable of audit process and reflects the quality of audit. Hence, auditor should take utmost care will drafting the report.

On the basis of the internal audit work completed, (refer Para 4.1) the Internal Auditor shall issue a clear, well documented Internal Audit Report

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which includes the following key elements:

- (a) An overview of the objectives, scope and approach of the audit assignments;
- (b) The fact that an internal audit has been conducted in accordance the Standards of Internal Audit (refer Para 4.2);
- (c) An executive summary of key observations covering all important aspects, and specific to the scope of the assignment;
- (d) A summary of the corrective actions required (or agreed by management) for each observation; and
- (e) Nature of assurance, if any, which can be derived from the observations.

The nature of assurance, if any, to be provided shall be in line with Standard on Internal Audit (SIA) 110 “Nature of Assurance” as pre-agreed with the auditee at the planning stage.

The content and form of the Internal Audit Report is to be established by the Internal Auditor based on his best professional judgement, in consultation with the auditee and, if necessary, with inputs from other key stakeholders. No internal audit report shall be issued in final form unless a written draft of the report has previously been shared with the auditee. (refer Para 4.3).

The internal audit report shall be issued within a reasonable time frame from the completion of the internal audit work.

Following up audit report

Internal Audit Committee should set up a framework for effective follow-up.

Follow-up guidelines should be issued by them and checked independent of audit field work. The following are the indicative guidelines for effective monitoring:

Action	Time frame
Issue of Draft Report to Head of the Department	Immediately on completion of field work
Exit conference	Within one week from issue of draft report

Concluding Procedures

Issue of Final Audit Report	Within 10 days from exit conference
Action on I A irregularities	Within 20 days from the issue of final Report
Action on I B irregularities	Within 6 months from the issue of final Report
Action on other irregularities	Within 2 months from the issue of final report

Modes and Channels of Communication (refer Para 3.2): The manner in which information is exchanged (e.g., verbal, written, picture, video, etc.) is the mode of communication. The medium used to exchange information (e.g., through phone, hard-copy (paper), email, file exchange, etc.) is the channel of communication.

Periodicity and Time-line of Communication (refer Para 3.2): The Internal Auditor, jointly in consultation with management, shall determine the nature and timing of communication. It is necessary that certain matters are conveyed during, or by a certain point in time, of the internal audit.

Appendix

Online and Other Resources

List of related websites:

www.aepcindia.com

www.textileworld.com

www.texprocil.com

www.ncto.org

www.textileindustrydirectory.com www.citiindia.com

www.handlooms.com

www.itcti.com

Research Associations

1. Ahmedabad Textile Industry Research Association (ATIRA)
2. Bombay Textile Research Association (BTRA)
3. Northern India Textile Research Association (NITRA)
4. Indian Jute Industry's Research Association (IJIRA)
5. Man-made Textile Research Association (MANTRA)
6. The Jute Corporation of India Limited
7. The Synthetic & Art Silk Mills Research Association (SASMIRA)
8. Wool Research Association (WRA)

Ministry of Textiles, Government of India

1. Ministry of Textiles, Government of India
2. Textile Commissioner
3. Technical Textiles
4. Development Commissioner for Handlooms