

Internal Audit Tools and Techniques

Lesson 5

KEY CONCEPTS

- Data Gathering ■ Data Analysis ■ Work Papers ■ Permanent File ■ Current File ■ Sampling ■ Flowchart ■ Questionnaires

Learning Objectives

To understand:

- Data Gathering and its methods
- Data Analytics Techniques, Tools, and Usage in Audit
- The concepts of documentation, nature and purpose of documentation, Important aspects in Documentation, Form, content and extent of documentation, audit file, Type of File , Permanent File, Current File
- The need for working papers, ownership and custody of working papers, Guidelines for preparation of working papers, Documents Checklist
- Audit evidence, Sources of Audit evidence, sufficiency and appropriateness of audit evidence, types of audit evidence, relevance and reliability of audit evidence. The Importance of written representations and the objectives, External Confirmation and its relevance
- Internal Audit Techniques such as Vouching, Inquiry and Confirmation, Reconciliation, Testing, Physical Verification, Analytical Procedure, Computation, Flowchart, Observation
- Audit Sampling, Application of Audit Sampling Techniques, Sample Selection Methods, Sampling Risk, Evaluating Results of Audit Sampling
- Flowchart and Internal Control Questionnaire
- Audit in Automation Environment

Lesson Outline

- Data Gathering
- Data Analysis, Interpretation and Reporting
- Documentation / Work Papers
- Audit Evidence
- Process Mapping including Flowcharting
- Steps in evaluation and its techniques
- Use of Sampling Techniques and its tests
- Flowcharts and Internal Control Questionnaires
- Automation
- Lesson Round-Up
- Test Yourself
- List of Further Readings

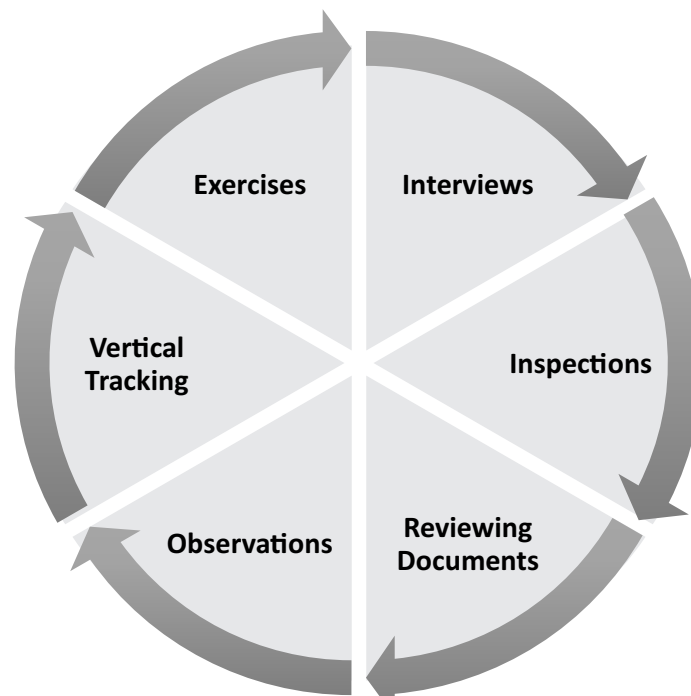
DATA GATHERING

Knowing how to look, where to look, and what to look for is the key to meeting the audit objectives. Therefore, data gathering is a big and highly important part of any internal audit. It is up to the Internal Auditor to decide which method or methods of collecting information to use for the audit and how to coordinate his or her actions with the auditee.

An Internal Auditor should always support his or her conclusions about an audit with information gathered by as many different methods as possible. Restricting oneself to only one viewpoint is unlikely to produce an accurate result. When a problem is found, it is important to dig deeper and identify the extent and the root cause of the problem.

Carrying out all the chosen data gathering tasks diligently will help the Internal Auditor conduct a successful audit.

There are six basic methods of gathering information during an audit. Depending on the type of information that needs to be obtained, the Internal Auditor will need to determine which method, or combination of methods, should be used.



(i) Interviews

Interviewing is a powerful data collection technique, which works well on its own and is often used to support other techniques, such as observation. The interviewee's insights can guide the Internal Auditor's decisions about what to observe. The most important thing to remember when interviewing is to always talk to the right person. It sounds obvious but talking to the person who has the information you need can save a lot of time and confusion. In addition, as an Internal Auditor, being prepared for interviews is vital. Having a list of questions ready in advance and using them to guide the interviewee through the discussion in a neutral way will result in an informative, constructive and positive discourse. Communication is a key element to the success of any audit. The more effectively the Internal Auditor interviews personnel, the more useful information will be gathered. The objective of an interview is to get the person to talk. Open-ended questions will allow the interviewee to demonstrate his or her understanding of the requirements,

procedures and show evidence of compliance. Questions may be asked several times in different ways or to different people depending on their level of responsibility (Operator, Supervisor, etc.) in order to get a complete answer.

Interviews are of two types: structured and unstructured (i.e., less structured). A structured interview is one in which auditors ask the same questions of numerous individuals or individuals representing numerous organizations in a precise manner, offering each interviewee the same set of possible responses. In contrast, an unstructured interview contains many open-ended questions that are not asked in a structured, precise manner. With unstructured interviews, different auditors interpret questions and often offer different explanations.

(ii) Inspections

When inspecting something, it is good practice to start with general observations and proceed to more specific elements. First, the Internal Auditor will have a good overall look around the facility and then examine specific items more closely, noting anything that does not seem quite right. It is important to ask questions throughout the inspection. The big picture must make sense and any detail that doesn't fall into place needs to be scrutinized. If a problem is found, the Internal Auditor must investigate (dig deeper) to explore the extent of the finding. This can involve looking at similar processes in other areas, talking to more people and checking more examples. The aim is to determine if this is an isolated case or a systemic problem, and if possible, the extent of the issue and any impact or potential impact on product.

(iii) Reviewing Documents

When reviewing company records, the Internal Auditor can use a number of techniques. Random sampling is one of them. It gives a general idea of the quality of record keeping and exposes the potential problem areas. However, one sample taken in one given period of time is usually not enough to form accurate conclusions. It may be more effective to check records based on a common characteristic that seems to be problematic and systemic. When reviewing documents, the Internal Auditor should check them for currency and validity. Another important aspect of record keeping is clarity. Documents should be clear regardless of who reads them. Details vary but, in general, every document should carry a title, an owner and a revision status. If any of this information is missing, the Internal Auditor should ask why. The revisions noted should be checked against the master record. Changes must be authorized, signed and dated by an authorized person.

(iv) Observations

The simplest way to check how a process works is to observe it in action. Observing a routine activity for a couple of hours can give the Internal Auditor opportunity to see how something is done under normal circumstances. He or she should ask questions about what they see, making sure at all times not to interfere with the processes they are observing, as that may cause the personnel not to carry out their tasks as they usually do.

(v) Vertical Tracking

This method, which is also referred to as "vertical auditing", consists of following a specific development from the beginning until the end, simultaneously checking all the records that are produced in the process. Applying the vertical tracking technique can lead the Internal Auditor to areas that were not initially part of the scope, but it does facilitate a bigger picture view, as this allows the Internal Auditor to see how the various parts of a given program work together.

(vi) Exercises

The aim of an exercise is to test something that is usually done at the facility as part of the routine. However, the Internal Auditor gets to pick the time and the circumstances for the test. The subject of testing can be the

personnel, the program, or the equipment. An Internal Auditor should not run an exercise without the knowledge and cooperation of the auditee. Doing so is likely to have negative consequences as unannounced actions may breach certain facility-specific rules or regulations which the Internal Auditor is unaware of.

DATA ANALYTICS, INTERPRETATION AND REPORTING

Data Analytics may be defined as the science of examining raw data with the purpose of drawing conclusions about that information. This would involve the discovery, interpretation, and communication of meaningful patterns in data.

Auditors have been using data analytics to derive meaning or identify exceptions to the rules. However, data analytics approaches enable them to do more than just to identify exceptions or describe the data.

As a process, data analytics encompasses the process of accessing data, extracting data, preparing the data, using the data for analytics, carrying out various analysis to discover and interpret the patterns and relationships in the data.

By analyzing data from a variety of sources against control parameters, business rules, and policies, internal audit can provide fact-based assessments of how well automated controls are operating. It can also be used to determine if semi-automated or manual controls are being followed by seeking indicators in the data. By analyzing 100 percent of relevant transactions and comparing data from diverse sources, internal audit can identify instances of fraud, errors, inefficiencies, or non-compliance.

Techniques for Data Analytics

Data is presentation of facts or events in a numeric or representational form. Historically, the main forms of data to be analysed have been in numeric form. The text and image data (information) has been analysed manually. So have the audio or video data been analysed manually. Digitalisation has, now, made it possible to convert all kinds of information, text, image, video or audio, apart from the numerical data to be datafied, i.e., represented through a set of numerical dataset. This makes it possible to analyse and draw insights not only from numerical data but also text, image, audio and video datasets.

Statistics is the science of dealing with numeric data – collection, analysis, presentation and interpretation. It is also used to estimate about a population by analysis of a sample dataset drawn from the population.

Statistical Techniques

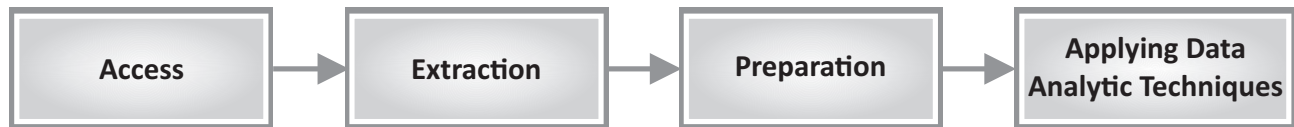
The most basic of the statistical techniques would be representing data in a simple tabular form and finding measures of central tendencies, viz, mean, median and mode. While interpreting the central tendencies, it is also important to have a measure of the spread or variance in the dataset, viz., standard deviation, variance, range, quartiles etc. These two measures are descriptive measures which describe the behaviour of the dataset and allow the auditor to make an estimate of the population characteristic from analysis of a sample dataset. When described over a period of time or along a class or geographically, these present a trend.

Visualisation Techniques

The results of statistical analysis can be better appreciated when they are visually presented. With the tools available today, visualisation in different forms is possible. Some of the visualisation techniques are the scatter plots, line plots, box plots, pie charts, vector plots, polar plots, bubble plots, heat maps etc.

Tools for Data Analytics

The data analytic process involves access to the datasets, extraction of datasets, preparation of the datasets, applying data analytic techniques and storing of the datasets and the results.



Access

The access to databases may be as per any of the modes such as:

- Manual Records
- Sharing the data on removable disk
- Read only rights in the audited entity systems
- Electronic transfer of data
- Cloud services – online data access
- Real time data sharing.

The tools should have the capacity to be able to access the datasets through any of these modes. Most tools available now a days are capable to access data through any of the modes available.

Extraction

The distinction between access and extraction needs to be understood wherein the extraction of data/ datasets means identifying and obtaining the relevant datasets for the purpose of analytics, whereas the access would refer to the access to the complete database from the auditee and also involves the physical transfer of the datasets from the auditee to the auditor's environment. The stage of extraction requires understanding of the datasets to identify the relevant datasets from the databases accessed and then extract them in the auditor's environment. This stage requires the data environment to be created at the auditor's end to be able to read the database. Further, the relevant datasets are extracted from the database by running appropriate queries. Most tools have connectors available to link to different database environments.

Preparation

While the extraction phase involves extracting the relevant datasets, the dataset may not be ready to be subjected to analysis as it may have missing values, null values, zero values, duplicates, gaps or outliers. These have the impact of distorting the picture derived from the data analysis. Further, there may be requirements to add two datasets through join or by appending them or even to split the dataset into two or more sets, as required. Undertaking activities to address the data deficiencies or to add or split datasets is what is called data preparation.

Applying data analytic techniques

The techniques described in the previous section are applied on the datasets through the use of algorithms built into the modern day analytic tools. It is the detail to which the tools have the capability to analyse that may distinguish them. While there are quite a few licensed tools available, many of the data analytic tools today are available as open source tools. It is for the auditor to decide on the usefulness of the tools keeping in mind the security of the data being handled through the tools as well as the sustainability, if the data analytic results are to be used repeatedly.

Usage of Data Analytics in Audit

The data analytics may be used in any of the stages of Audit – audit planning, audit execution, reporting. But, as can be clearly seen from the above discourse on use of techniques and tools, data analytics is useful in drawing

insights on the datasets. This makes data analytics useful for the audit planning phase. Audit planning involves setting of audit objectives, scope, methodology for audits. The insights on datasets can be used to decide on all of these. During the audit execution stage, data analytics can be useful in identifying exceptions, drilling down etc. At the reporting stage the data analytic results and the conclusions drawn from the audit process may be reported using appropriate visualisation techniques.

The patterns from the data analytics become important for auditors from the fact that trends and patterns have the potential of identifying unusual events, even though no rules are broken.

Conclusion

Data analytics has the potential to assist the Auditor in discharging his crucial role in providing assurance on the delivery of public services to the people of a country. It helps him in drawing insights and relevant conclusions about large and complex functions carried out by the entity. It assists him in deriving all relevant insights from the available information making the process of the audit more efficient and effective. Knowledge of data analytic process and techniques would play a crucial role in equipping the Auditor to deal with the intricacies present in datasets available.

DOCUMENTATION / WORK PAPERS

Meaning of Documentation

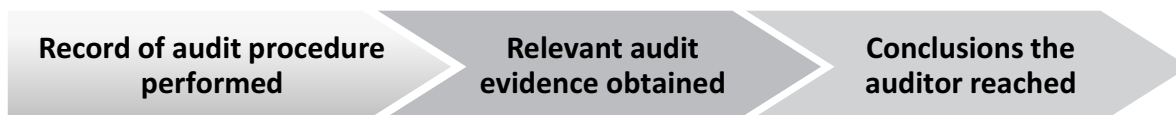
The word “document” is used to refer to a written or printed paper that bears the original, official, or legal form of something and can be used to furnish decisive evidence or information. “Documentation” refers to the act or an instance of the supplying of documents or supporting references or records.

“Documentation” refers to the working papers prepared or obtained by the auditor and retained by him, in connection with the performance of the audit.

SA 230 on “Audit Documentation”, deals with the auditor’s responsibility to prepare audit documentation for an audit of financial statements.

During the performance of the Internal Audit, the internal auditor also needs to report on the adequacy of systems and process in the company. The internal audit function greatly assists the other auditor like Secretarial Auditor and Statutory Auditor in determining the extent to which he can place reliance upon the work of the internal auditor.

Audit Documentation refers to the record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor reached. (terms such as “working papers” or “work papers” are also sometimes used.)



The important aspects to be considered in this context are:

1. **Organisational Status** - Whether internal audit is undertaken by an outside agency or by an internal audit department within the entity itself. The internal auditor reports to the management, in an ideal situation he reports to the highest level of management and is free of any other operating responsibility. Any constraints or restrictions placed upon his work by management should be carefully evaluated. In particular, the internal auditor should be free to communicate fully with the external auditor.
2. **Scope of Audit Function** - The external auditor should ascertain the nature and depth of coverage of the assignment which the internal auditor discharges for management. He should also ascertain to what extent

the management considers, and where appropriate acts upon internal audit recommendations.

3. **Technical Competence** - The external auditor should ascertain that internal audit work is performed by persons having adequate technical training and proficiency. This may be accomplished by reviewing the experience and professional qualifications of the persons undertaking the internal audit work.
4. **Due Professional Care** - The external auditor should ascertain whether internal audit work appears to be properly planned, supervised, reviewed and documented. An example of the exercise of due professional care by the internal auditor is the existence of adequate audit manuals, audit programmes and working papers.
5. **Monitoring of internal control** - The internal audit function may be assigned specific responsibility for reviewing controls, monitoring their operation and recommending improvements thereto.
6. **Examination of financial and operating information** - The internal audit function may be assigned to review the means used to identify, measure, classify and report financial and operating information, and to make specific inquiry into individual items, including detailed testing of transactions, balances and procedures.
7. **Review of operating activities** - The internal audit function may be assigned to review the economy, efficiency and effectiveness of operating activities, including non- financial activities of an entity.
8. **Review of compliance with laws and regulations** - The internal audit function may be assigned to review compliance with laws, regulations and other external requirements, and with management policies and directives and other internal requirements.
9. **Risk management** - The internal audit function may assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.
10. **Governance** - The internal audit function may assess the governance process in its accomplishment of objectives on ethics and values, performance management and accountability, communicating risk and control information to appropriate areas of the organization and effectiveness of communication among those charged with governance, external and internal auditors, and management.

Illustration 1:

A new team member of the auditors of ABC Limited was of the view that Audit Documentation does not help in planning the audit of any company. Explain whether Audit Documentation has any relation with regard to planning the audit of a company?

Solution:

Audit Documentation helps in planning the audit of a company in a proper manner and also helps in conducting the audit of that company in a more effective way.

Form and content of Documentation

The form and content of audit documentation should be designed to meet the circumstances of the particular audit. The information contained in audit documentation constitutes the principal record of the work that the auditors have performed in accordance with standards and the conclusions that the auditors have reached. The quantity, type, and content of audit documentation are a matter of the auditors' professional judgment. The Audit documentation therefore is not restricted to being only on papers, but can also be on electronic media.

Generally the factors that determine the form and content of documentation for a particular engagement are:

- (a) The nature of the engagement.

- (b) The nature of the business activity of the client.
- (c) The status of the client.
- (d) Reporting format.
- (e) Relevant legislations applicable to the client.
- (f) Records maintained by the client.
- (g) Internal controls in operation.
- (h) Quality of audit assistants engaged in the particular assignment and the need to direct and supervise their work.

Audit File

Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.

Illustration 2:

While auditing the books of accounts of a company, a team member of the auditors was of the view that with regard to audit of the company, no relation exists between Audit File and Audit Documentation. Explain the relationship between Audit File and Audit Documentation

Solution:

Audit file may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement. The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report.

Permanent and Current Audit files

In the case of recurring audits, some working paper files may be classified as permanent audit files, which are updated currently with information of continuing importance to succeeding audits. In contrast current audit files contain information relating primarily to the audit of a single period.

Content of permanent audit file

- (a) Copy of initial appointment letter if the engagement is of recurring nature.
- (b) Record of communication with the retiring auditor, if any, before acceptance of the appointment as auditor.
- (c) NOC from previous auditor.
- (d) Information concerning the legal and organisational structure of the entity. In the case of a company, this includes the Memorandum and Articles of Association. In the case of a statutory corporation, this includes the Act and Regulations under which the corporation functions, i.e.
 - (i) In case of partnerships- Partnership deed.
 - (ii) In case of trusts- Trust deed.
 - (iii) In case of societies- Certificate of registration/ Rules and Bye-laws.
- (e) Organisational structure of the client.

- (f) List of governing body including Name, Address and contact details. For instance, the list of directors in case of a company, list of partners in a partnership and list of trustees in a trust.
- (g) Extracts or copies of important legal documents, agreements and minutes relevant to the audit.
- (h) A record of the study and evaluation of the internal controls related to the accounting system. This might be in the form of narrative descriptions, questionnaires or flow charts, or some combination thereof.
- (i) Copies of audited financial statements for previous years.
- (j) Analysis of significant ratios and trends.
- (k) Copies of management letters issued by the auditor, if any.
- (l) Notes regarding significant accounting policies.
- (m) Significant audit observations of earlier years.
- (n) Assessment of risks and risk management.
- (o) Major policies related to Purchases and Sales.
- (p) Details of sister concerns.
- (q) Details of Bankers, Registrars, Lawyers, etc.
- (r) Systems and Data Security policies.
- (s) Business Continuity Plans.

Need for Audit Documentation

The audit working papers (current and permanent) for a client audit engagement should be sufficiently detailed to enable another appropriately experienced and competent auditor who is not familiar with the client to obtain an overall understanding of the engagement.

Need for Working papers

The need for Working papers listed as follows:

- (a) They aid in the planning and performance of the audit;
- (b) They aid in the supervision and review of the audit work and to review the quality of work performed, in accordance with AAS 17 “Quality Control for Audit Work”;
- (c) They provide evidence of the audit work performed to support the auditor’s opinion;
- (d) They document clearly and logically the schedule, results of test, etc.;
- (e) The working papers should evidence compliance with technical standards;
- (f) They document that Internal control has been appropriately studied and evaluated; and
- (g) They document that the evidence obtained and procedures performed afford a reasonable basis for an opinion;
- (h) They retain a record of matters of continuing significance to future audits of the entity;
- (i) They enable an experienced auditor to conduct quality control reviews in accordance with Statement on Peer Review issued by the Institute of Chartered Accountants of India;
- (j) The process of preparing sufficient audit documentation contributes to the quality of an audit;

- (k) They fulfill the need to document oral discussions of significant matters and communicate to those charged with governance, as discussed in AAS 27, "Communication of Audit Matters with those Charged with Governance.

Retention of Working Papers/ Documents

The auditor should retain the working papers for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention.

Ownership and custody of Working Papers

Working papers are the property of the auditor. The auditor may, at his discretion, make portions of or extracts from his working papers available to his client.

Illustration 3:

A director of a company was of the view that Audit Documentation of a company is the property of that company. Comment on the contention of the director regarding the audit documentation of the company?

Solution:

Audit Documentation of a company is not the property of the company rather Audit Documentation is the property of Auditor of that company.

General Guidelines for the preparation of Working Papers

The auditor should adopt reasonable procedures for custody and confidentiality of his working papers General guidelines for the preparation of working papers are:

1. **Clarity and Understanding** – As a preparer of audit documentation, step back and read your work objectively. Would it be clear to another auditor? Working papers should be clear and understandable without supplementary oral explanations. With the information the working papers reveal, a reviewer should be able to readily determine their purpose, the nature and scope of the work done and the preparer's conclusions.
2. **Completeness and Accuracy** – As a reviewer of documentation, if you have to ask the audit staff basic questions about the audit, the documentation probably does not really serve the purpose. Work papers should be complete, accurate, and support observations, testing, conclusions, and recommendations. They should also show the nature and scope of the work performed.
3. **Pertinence** – Limit the information in working papers to matters that are important and necessary to support the objectives and scope established for the assignment.
4. **Logical Arrangement** – File the working papers in a logical order.
5. **Legibility and Neatness** – Be neat in your work. Working papers should be legible and as neat as practical. Sloppy work papers may lose their worth as evidence. Crowding and writing between lines should be avoided by anticipating space needs and arranging the work papers before writing.
6. **Safety** – Keep your work papers safe and retrievable.
7. **Initial and Date** – Put your initials and date on every working paper.
8. **Summary of conclusions** – Summarize the results of work performed and identify the overall significance of any weaknesses or exceptions found.

Documents Checklist

S. No.	Particulars	Yes/No/ NA	Remarks/ Working Papers Ref
1.	Whether the audit documentation is prepared on a timely basis?		
2.	<p>Whether the audit documentation is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the following?</p> <p>(a) The nature, timing, and extent of the audit procedures performed to comply with the SAs and applicable legal and regulatory requirements;</p> <p>(b) The results of the audit procedures performed, and the audit evidence obtained; and</p> <p>(c) Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.</p>		
3.	<p>While documenting the nature, timing and extent of audit procedures performed, whether the following was recorded</p> <p>(a) The identifying characteristics of the specific items or matters tested;</p> <p>(b) Who performed the audit work and the date such work was completed; and</p> <p>(c) Who reviewed the audit work performed and the date and extent of such review.</p>		
4.	Whether the documentation includes discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.		
5.	Where it is identified that information is inconsistent with the auditor's final conclusion regarding a significant matter, whether it is documented as to how the inconsistency was addressed?		
6.	Where it is considered necessary in exceptional circumstances to depart from a relevant requirement in a SA, whether the audit documentation reflects how the alternative audit procedures performed achieved the aim of that requirement and the reasons for the departure.		

S. No.	Particulars	Yes/No/NA	Remarks/ Working Papers Ref
7.	Where in exceptional circumstances, new or additional audit procedures are performed or new conclusions are reached after the date of the audit report, whether the following were documented? <ul style="list-style-type: none"> (a) The circumstances encountered; (b) The new or additional audit procedures performed, audit evidence obtained, and conclusions reached, and their effect on the auditor's report; and (c) When and by whom the resulting changes to audit documentation were made and reviewed. 		
8.	Is it ensured that after the assembly of the final audit file has been completed, no deletion or discard of audit documentation of any nature has taken place before the end of its retention period?		
9.	Where it is necessary to modify existing audit documentation or add new audit documentation after the assembly of the final audit file has been completed, whether the following were documented? <ul style="list-style-type: none"> (a) The specific reasons for making them; and (b) When and by whom they were made and reviewed. 		

Illustrative Working Paper Format

XYZ Limited Nature of Assignment HO/Unit: Area: Sub-area: Balance as per Balance Sheet: Balance as per General Ledger: Difference: Reason for difference if any: Checking Notes: Observations: Conclusions:	Audit Firm's name Article Assistants name For the period_____ Date of audit Reviewed by:
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AUDIT EVIDENCE

Audit evidence may be defined as the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.

Illustration 4:

Explain the relationship between Audit Evidence and Opinion of Auditor?

Solution:

There exists a very important relationship between Audit Evidence and opinion of the Auditor. While conducting an audit of a company, the auditor obtains audit evidence and with the help of that audit evidence obtained, the auditor forms an audit opinion on the financial statements of that company.

Characteristics of Evidence in an Audit

1. **Nature** refers to the type of information received. It can be received in many forms – presentations, orally, or through physical records.
2. **Relevance** refers to the pertinence of the information to provide an opinion.
3. **Reliability** refers to determining whether the material can be trusted or relied upon to form an opinion. The source of the information needs to be considered.
4. **Source** refers to whether the accounting evidence was obtained directly from the audited company or an external source. External source information is preferable since it is less subject to manipulation than internally sourced information.
5. **Sufficiency** refers to whether the information provided is enough to provide an opinion or make an accurate judgment.

Illustration 5:

Explain whether sufficiency and appropriateness of audit evidence mean simplicity and ease of obtaining audit evidence.

Solution:

Sufficiency and Appropriateness of audit evidence does not mean simplicity and ease of obtaining audit evidence rather sufficiency of audit evidence is related to the quantity of audit evidence and appropriateness of audit evidence is related to quality of audit evidence.

Sources of Audit Evidence

Some audit evidence is obtained by performing audit procedures to test the accounting records.

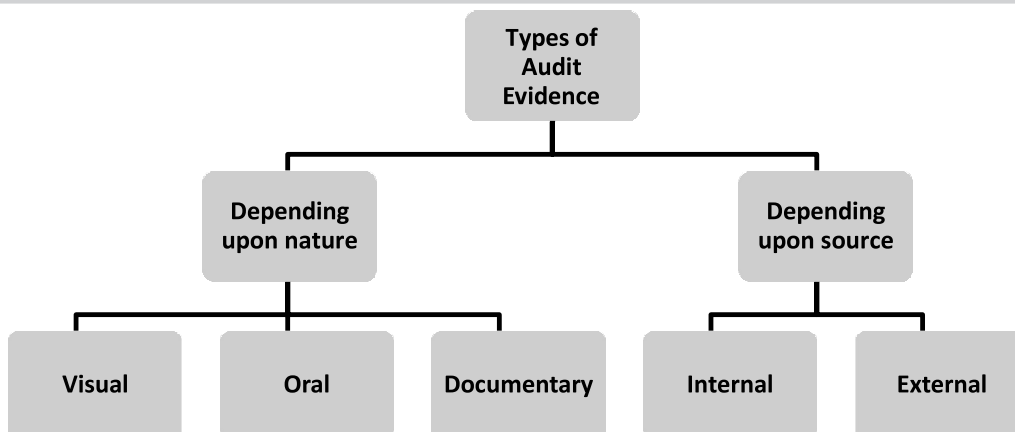
- through analysis and review,
- re-performing procedures followed in the financial reporting process,
- and reconciling related types and applications of the same information.

Through the performance of such audit procedures, the auditor may determine that the accounting records are internally consistent and agree to the financial statements. More assurance is ordinarily obtained from consistent audit evidence obtained from different sources or of a different nature than from items of audit evidence considered individually.

Example: Corroborating information obtained from a source independent of the entity may increase the assurance the auditor obtains from audit evidence that is generated internally, such as evidence existing within the accounting records, minutes of meetings, or a management representation.

Note: Information from sources independent of the entity that the auditor may use as audit evidence may include confirmations from third parties, analysts' reports, and comparable data about competitors.

Types of Audit Evidence



Depending upon nature:

1. **Visual:** For example, observing physical verification of inventory conducted by the client's staff.
2. **Oral:** For example, discussion with the management and various officers of the client.
3. **Documentary:** For example, fixed deposit certificate, loan agreement, sales bill etc.

Depending upon source:

1. **Internal Evidence:** Evidence which originates within the organisation being audited is internal evidence. Eg: received note, inspection report, copies of cash memo, debit and credit notes, etc.
2. **External evidence:** The evidence that originates outside the client's organization is external evidence. Eg: Purchase invoice, supplier's challan and forwarding note, debit notes and credit notes coming from parties, quotations, confirmations, etc.

Illustration 6:

Audit evidence obtained internally from within the company under audit are more appropriate from the reliability point of view as compared to audit evidence obtained externally. It is valid?

Solution:

Audit evidence obtained externally is more appropriate from reliability point of view as compared to those which are obtained internally. The reason that audit evidence obtained externally is more appropriate from the point of view of reliability is that there is a very low risk that they can be altered or changed.

Written Representations

SA 580- "Written Representations" deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance.

Written representations may be defined as a written statement by management provided to the auditor to confirm certain matters or to support other audit evidence. Written representations in this context do not include financial statements, the assertions therein, or supporting books and records.

Written representations are necessary information that the auditor requires in connection with the audit of the entity's financial statements. Accordingly, similar to responses to inquiries, written representations are audit evidence.

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

Illustration 7:

Taking written representation from management instead of Banker's certificate in support of Fixed deposits is sufficient?

Solution:

Although written representations provide necessary audit evidence, they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal. Furthermore, the fact that management has provided reliable written representations does not affect the nature or extent of other audit evidence that the auditor obtains about the fulfillment of management's responsibilities, or about specific assertions.

Applying the above to the given problem, the auditor would further request the management to provide him with the Banker's certificate in support of fixed deposits held by the company.

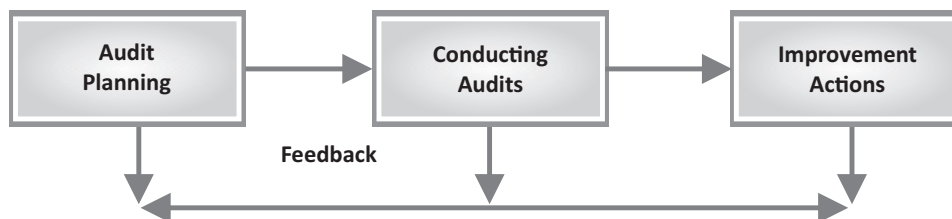
External Confirmation

SA 505- "External Confirmations", deals with the auditor's use of external confirmation procedures to obtain audit evidence. SA 500 indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.

- Audit evidence is more reliable when it is obtained from independent sources outside the entity.
- Audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference.
- Audit evidence is more reliable when it exists in documentary form, whether paper, electronic or other medium.

PROCESS MAPPING INCLUDING FLOWCHARTING

Internal Audit Process



1. Establish and communicate the scope and objectives for the audit to appropriate management.
2. Develop an understanding of the business area under review. This includes objectives, measurements and key transaction types. This involves review of documents and interviews. Flow charts and narratives may be created if necessary.
3. Describe the key risks facing the business activities within the scope of the audit.

4. Identify control procedures used to ensure each key risk and transaction type is properly controlled and monitored.
5. Develop and execute a risk-based sampling and testing approach to determine whether the most important controls are operating as intended.
6. Report problems identified and negotiate action plans with management to address the problems.
7. Follow-up on reported findings at appropriate intervals. Internal audit departments maintain a follow-up database for this purpose.

STEPS IN EVALUATION AND ITS TECHNIQUES

AUDIT PLAN: An audit plan lays out the strategies to be followed to conduct an audit. It includes the nature, timing and extent of audit procedures to be performed by the team members. The auditor shall develop an audit plan while considering the following:

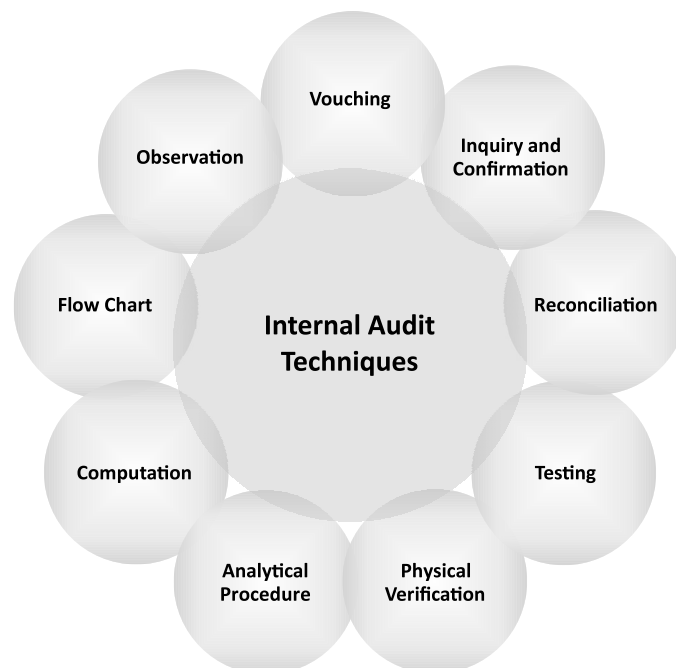
- (a) The nature, timing and extent of planned risk assessment procedures.
- (b) The nature, timing and extent of audit procedures at the assertion level.
- (c) Other planned audit procedures that are required to be carried out so that the engagement complies with Standard on Auditing (SA).

INTERNAL AUDIT TECHNIQUES

Evidences are very important for an Auditor to form an opinion regarding financial statements. If Auditor fails to collect proper evidence, it will reduce the reliability of audit report. The method of collecting evidence is called audit technique.

An Internal auditor uses Internal Audit tools/techniques to ensure that controls, processes and policies are adequate and effective, and that they adhere to industry practices and regulatory mandates. An internal auditor also checks a corporation's financial statements to ensure that such reports are prepared in accordance with generally accepted accounting principles.

An auditor can apply various techniques of auditing which may be applied by the auditor under different circumstances of audit, the various techniques of the audit are summarised as under:



1. Vouching:

While verifying various transactions, the auditor examines the supporting documents and records. This technique is otherwise called vouching. The purpose of examining the documents and records is to confirm the authenticity (genuineness) of the transaction and :

- to find whether the transactions and the supporting document are appropriate.
- to ensure whether the transactions are authorized (approved).
- to ensure whether the classification of the transaction is proper.

While the scrutiny of documents, the auditor comes across the various records and documents and if he comes across any unusual transactions, he verifies the same thoroughly. This is called scanning of records, which requires experience and expertise. The auditor can rely on the documents depends on the origin (source) of the documents and the efficiency of the internal control system in operation. Also the written confirmation of the management of the company could be considered in case the supporting documents are not available.

Documents which have their origin in the hands of the third parties and held by third parties are more reliable than the documents which have their origin in the organization itself and held by the organization. One can classify the documents into four major categories according to their origin and availability.

- a. Documents which have their origin in the hands of the third party and held by them – **Most reliable evidence.**
- b. Documents which have their origin in the hands of the third party and held by the organization – **More reliable.**
- c. Documents which have their origin in the hands of the organization and held by the third party – **Reliable.**
- d. Documents which have the origin in the hands of the organization and held by the organization – **Reliable only if the internal control is effective.**

2. Inquiry and Confirmation

Inquiry: Seeking information from persons belonging to the organization or from outside organization is called inquiry. This method is used to collect in-depth information about any transaction.

Confirmation: Confirming the information available with the records of the organization or with the persons mostly from outside the organization through an inquiry is confirmation.

Inquiry and confirmation can take place either orally or in writing. The best example for inquiry and confirmation is confirming the balances of debtors shown in the accounting records with the debtors of the organization.

3. Reconciliation

Reconciliation is a technique used by an Auditor to know the reason of differences in balances. For example, to know the difference in the bank book of the client and the bank balance as appeared in the bank statement or pass book, the Auditor prepares the reconciliation statement. The same method may be used for debtors, creditors, etc.

4. Testing

Testing is a technique of selecting representative transactions out of whole accounting data to draw a conclusion about all items.

5. Physical Verification

If an item can be measured in physical term, the same may be verified for quantity and quality (if possible). By physical examination, the auditor can ensure the availability of the item. However, the ownership of the items cannot be verified through this method.

6. Analytical Procedures

The purpose of analysis is to ensure consistency of accounting methods and also to evaluate the efficiency of the management by comparing the results of several years. The several analytical procedures are Reconciliation, Ratio Analysis; and Variance Analysis. The auditor also applies the analytical procedures to help the management in decision making. Such analytical techniques are Marginal Costing, Standard costing etc.

7. Computation

An auditor makes appropriate calculations and verifies the accuracy of the accounting records. For example, the auditor computes the depreciation to be charged for the year, by taking into consideration, the value of the asset (cost), the date of purchase, the rate of depreciation, etc., to verify the accuracy of the depreciation charged by the organization. The auditor also traces a particular transaction from the origin to check the book keeping procedure.

8. Flow Chart

The Flow Chart technique is used by an Auditor to determine the stages of transaction and the generation of documents at all levels of transactions

9. Observation

The auditor observes a particular procedure being carried by the organization. Examples are observation of the internal control measures that are adopted in transactions involving cash, procedures followed on receipt or issue of material, etc. The auditor makes his observations to evaluate the efficiency and effectiveness of the system followed by the organization.

The auditor studies the nature of the business and also the prevailing circumstances and selects the techniques to be applied. While conducting the audit, he may change his technique according to the changes observed in the circumstances. The suitable audit techniques adopted by the auditor helps him to carry on the audit efficiently.

CASE STUDY

1. **Company X was manufacturer of PVC. The finished product is in powder form and is sold in standard packaging of 25 kg bags. The bags are filled through an automated packing line and the quantity filled in bags is controlled through an online check weigher installed in the packaging line itself. In addition, tolerance limits were fixed for short/ excess filling in terms of number of grams per 25 kg bag. During the process review, the internal auditor carried out weighing of bags on a standalone weighing scale, selecting adequate sample and observed that in a large percentage of bags comprised in the sample, the actual quantity filled far exceeded the defined tolerance limits, i.e., 50 gms per 25 kg.**

Functional head's response: This was only a statistical aberration and any such excess giveaways would get detected through other compensatory controls (manual) available like, random weighing of bags in a stand alone mode.

What should the Internal Auditor do in this situation?

Solution:

The internal auditor should co-ordinate with the commercial head and the warehouse in charge and took larger samples for study and validation of quantity bagged. In addition, the samples should be taken at different points of time. If, in all cases the results were consistent with the initial findings. By extrapolating the findings for over one year period, the quantity giveaways and cost implications (factoring both negative and positive variations) should be demonstrated to the functional head, along with live instances where the compensatory controls had failed to detect excess giveaways.

Accordingly, system based control viz., installation of check weighers in the conveyer, after filling level in the load cell should be recommend to introduced. This will result in to:

- (i) Reduction of dependency to manual checking.
- (ii) Increased accuracy level, since all bags are weighed after filling in load cell.
- (iii) Reduction of labour in the filling and weighing section in the plant.

- 2. Company C started a Special Grade Fibre Manufacturing Plant for the first time in the country using imported technology. The products did not meet the quality parameters and were not accepted by the market, hence, the plant was closed down. The fiber intermediaries were left unused and not disposed for many years along with the imported chemicals and catalyst purchased for the manufacture of this product.**

What should be the advice as an Internal Auditor in this situation?

Solution:

Internal auditors pointed out the situation with the suggestion that:

- (i) the intermediary product may have market for fibre manufacturer and, therefore, classify as special product and dispose off.
- (ii) the purchase orders for chemicals and catalyst should have the buy back clause so that the failed chemicals will be re-exported to the supplier at the pre-determined prices.

The process owners did not want to make any attempt to dispose off the intermediaries and the unutilised chemicals catalyst, stating that these materials do not have ready market.

Internal Auditor should follow-ups and persuasion with Research and Development Team of the company and identifies the possibility that the intermediaries can be sold to fibre manufacturers by sending sample and explaining the properties of the intermediaries. Further, the foreign vendors who supplied the chemical and catalyst should be given the left over chemicals sample and may be re-exported at appropriate price.

- 3. Internal auditor carried out a physical verification of Fixed Deposit Receipts on a surprise basis and tallied it with the Ledger balance. Finding no discrepancy the auditor submitted an assurance report. Finance head expressed the view that since this exercise was always carried out by the statutory auditors at the end of the year, this was a redundant exercise.**

What should be the response of Internal Auditor in this situation?

Solution:

Internal auditor Response: Physical verification was done on a surprise basis to test that the controls are in place for custody of the Fixed Deposit Receipts and traceability rather than as a mere physical verification exercise. Since the controls were found to be in place an assurance report was issued by the internal auditor.

4. **Company D manufactured polyester fibres. In manufacture of one grade of fibres, the company used old PET Bottles as a raw material. The PET bottles were procured in bulk and payment was made on the basis of weight stated in the invoice. On review of weight bridge data, the internal auditor observed major difference between the invoice weight and actual weight of material delivered. The process owners explained that the weight difference was on account of the moisture content in the material, which varies over time and evaporates during transit.**

What should be the advice as an Internal Auditor in this situation?

Solution:

The internal auditor should highlight the weight difference together with the annualized financial implication to the management and insisted for fixing a tolerance limit of moisture content and to fix variable price based on the moisture content.

5. **Company B was involved in manufacturing and selling of “paints”. As per the routine procedure, physical verification of finished products was taken by the internal auditors in the mid of March so that the final report can be submitted before the year end. If any discrepancy is noticed it can be suitably adjusted in the books to give the correct financial statements. During the physical verification, certain discrepancies were noticed by the internal auditor and a draft report was submitted to the concerned functional head stating the differences noticed in the various ranges of the paint. On seeing the draft report, the functional head told his deputy to look into it and come back on the queries after completing his routine job. The deputy, therefore, gave last priority to the draft report. Internal auditor after 7 days of the issue of draft called upon the functional head to have a meeting so as to close out the report. Functional head during the telephonic discussion stated, “I have a lot of priority work to attend, for me sales is the most important activity. If we do not achieve our target the company is going to be under trouble and I do not want to inform the top management that I have been busy replying the Internal Audit Report. Any way what you are going to inform me has already happened isn't it? Audit is merely a post mortem job.”**

What should be the advice as an Internal Auditor in this situation?

Solution:

Internal Auditor should state that sales has to be accorded top priority, but if you come to know after taking the order that the actual stock is less you will not be able to honour your commitment and the customer will lose faith in you. Hence, request you to look at the actual stock figures and report”.

6. Satyam Computers

B Ramalinga Raju, the founder of Satyam Computers, got into trouble after he admitted to inflating the company revenue, profit and profit margins for every single quarter over a period of 5 years, from 2003-2008. The amount misappropriated in this case is estimated to be around Rs. 7,200 crore.

In April 2015, Ramalinga Raju and his brothers were sentenced to 7 years in jail, and fined Rs. 5.5 crore.

Following are the common governance and audit problems, which have been noticed in the collapse of Satyam:

- **Unethical conduct** - Founders wanted to make money by avoiding paying taxes, cooking books, and pay offs; revealed some alarming truths that he was concealing for a long period by confessing to a fraud of Rs 7,800 crores (\$1.47 billion) on Satyam's balance sheet.

- **A case of false books and bogus accounting** - These figures of accrued interest were shown in balance sheets in order to suppress the detection of such non-existent fixed deposits on account of inflated profits. The investigations also detailed that the company had deliberately paid taxes of about 186.91 crores on account of the non-existent accrued interests of Rs. 376 crores, which was a considerable loss for the company.
- **Unconvinced role of independent Directors** - The Satyam episode has brought out the failure of the present corporate governance structure that hinges on the independent directors, who are supposed to bring objectivity to the oversight function of the board and improve its effectiveness. They serve as watchdogs over management, which involves keeping their eyes and ears open at Board deliberations with critical eye raising queries when decisions went wrong.
- **Questionable role of Audit Committee** - The true role of audit committee in précis is to ensure transparency in the company that financial disclosures and financial statements provide a correct, sufficient and creditable picture and that, cases of frauds, irregularities, failure of internal control system within the organization, were minimized, which the committee failed to carry out.
- **Dubious Role of Rating Agencies** - Credit rating agencies have been consistently accused of their lax attitude in assessing issuers and giving misleading ratings without thorough analysis they failed to warn market participants about the deteriorating condition of company.
- **Questionable Role of Banks** - While sanctioning short term loans why not the banks posed any question as to why the company which was supposedly cash rich as per the financial statements was taking loans from them.
- **Fake Audit** - The audit firm of Satyam have been auditing their accounts since 2000-01. The fraudulent role played by the Audit firm in the failure of Satyam. Partners of Audit Firm according to the SFIO findings had admitted they did not come across any case or instance of fraud by the company. However, founder admission of having fudged the accounts for several years put the role of these statutory auditors on the dock.

USE OF SAMPLING TECHNIQUES AND ITS TESTS

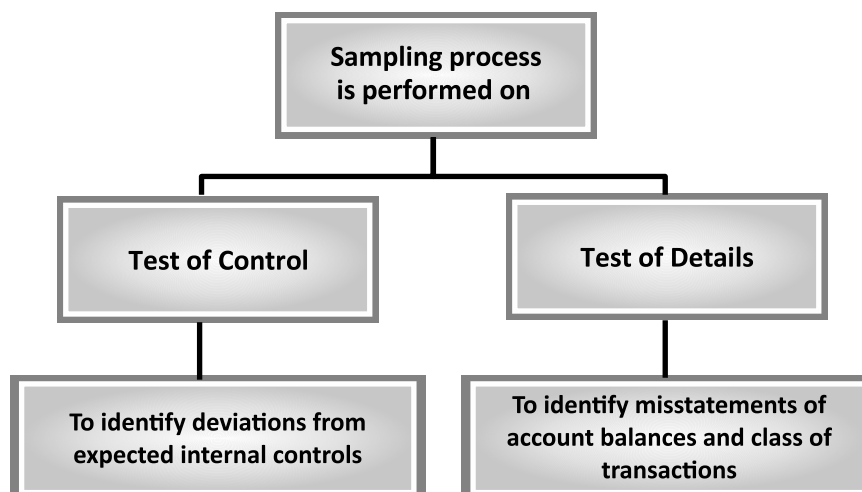
'Audit Sampling' refers to the application of audit procedures to less than 100% of items within a population relevant under the audit, such that all sampling units (i.e all the items in the population) have a equal chance of selection. This is to ensure that the items selected represent the entire population which enables the auditor to draw conclusions and express his opinion based on a pre-determined objective.

"Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions."

The auditor should select sample items in such a way that the sample can be expected to be representative of the population. This requires that all items in the population have an opportunity of being selected.

Sample must be representative

Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.



Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion about the population, from which the sample is drawn. Audit sampling can be applied using either

- non-statistical or
- statistical sampling approaches.

Statistical sampling is an approach to sampling that has the random selection of the sample units; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.

Audit testing done through this approach is more scientific than testing based entirely on the auditor's own judgment because it involves use of mathematical laws of probability in determining the appropriate sample size in varying circumstances.

For Example: An auditor while verifying the Purchases during the year realised that the purchase transactions in that year are more than 45000 in number, then in such case, statistical sampling will be highly recommended in the audit program.

Non-statistical sampling is a sampling approach that does not have the above features's considered as **non-statistical sampling**.

For example, March, June and September may be selected in year one and different months would be selected in the next year, On basis of value of items, top 10 highest value. Etc.

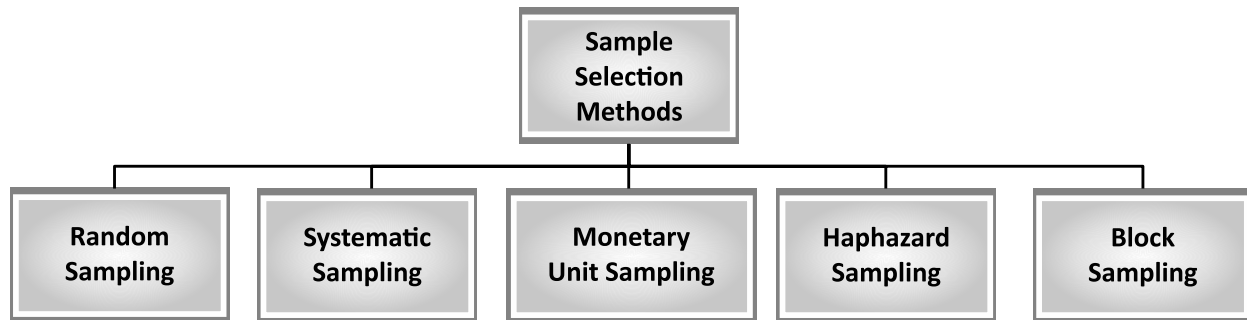
An attempt would be made to avoid establishing a pattern of selection year after year, i.e the way of selecting samples, to maintain an element of surprise as to what the auditor is going to check.

Another fact about the sampling technique should be noted. It can never bring complete reliability; it cannot give precisely accurate results. It is a process of estimation. It may have some error. What error is tolerable for a particular matter under examination is a matter of the individual's judgment in that particular case.

Example: Mr. X may consider that in his estimation of stores valuation, an error of 2% may not be material; he also decides that he needs at least 98% reliability of the result. He is to pick up the requisite number of items of the stores for reliability of the result. The requisite number he can get from the random number table. The question of reliability of the result is directly linked with the reliability of the internal control and of the books and records; when these are satisfactory, lesser degree of reliability of the sampling estimation may suffice – if these are not satisfactory, the auditor may have to decide upon a higher degree of reliability which can only be obtained from a larger sample.

The factors that should be considered for deciding upon the extent of checking on a sampling plan are following:

- (i) Size of the organisation under audit.
- (ii) State of the internal control.
- (iii) Adequacy and reliability of books and records.
- (iv) Tolerable error range.
- (v) Degree of the desired confidence.



Random Sampling: Random selection ensures that all items in the population or within each stratum have a known chance of selection. It may involve use of random number tables. Each item in a population is selected by use of random number table either with a help of computer or picking up a number in a random way (may be randomly from a drum)

This method is considered appropriate provided the population to be sampled consists of reasonably similar units and fall within a reasonable range i.e. it is suitable for a homogeneous population having a similar range.

Example The population can be considered homogeneous, if say, trade receivables balances fall within the range of Rs. 55,000 to Rs. 2,25,000 and not in the range between Rs. 525 to Rs. 10,50,000.

Stratified Sampling: This method involves dividing the whole population to be tested in a few separate groups called strata and taking a sample from each of them. Each stratum is treated as if it was a separate population and if proportionate of items are selected from each of these stratum.

Example 1: In the above case, trade receivables balances may be divided into four groups as follows:-

- (a) balances in excess of Rs. 10,00,000;
- (b) balances in the range of Rs. 7,75,001 to Rs. 10,00,000;
- (c) balances in the range of Rs. 5,50,001 to Rs. 7,75,000;
- (d) balances in the range of Rs. 2,25,001 to Rs. 5,50,000; and
- (e) balances Rs. 2,25,000 and below

From these above groups the auditor may pick up different percentage of items from each of the group. From the top group i.e. balances in excess of Rs. 10,00,000, the auditor may examine all the items; from the second group 25% of the items; from the third group 10% of the items; and from the lowest group 2 per cent of the items may be selected. Random sample is chosen from each stratum using random number tables.

Systematic Sampling: Systematic selection is a selection method in which the number of sampling units in the population is divided by the sample size to give a sampling interval.

Example: If in a population of branch sales, particular branch sales occur only as every 100th item and the sampling interval selected is 100. The result would be that either the auditor would have selected all or none of the sales of that particular branch. If Accountant A is responsible to record all transaction in a particular month and Accountant B for next month ; if this structure is same throughout the year, and the auditor determines as his sample to check every transaction of alternate months, then only one accountant's work is checked by the auditor i.e. either Accountant A or B depending upon which month the checking started from. The work of other is overlooked and there could be a possibility of material misstatement in the transactions recorded by him. Therefore, systematic sampling when chosen as a method should be carefully applied to bring together every type of transaction within its purview. More than one starting point can be considered to minimize such risk.

Monetary Unit Sampling: It is a type of value-weighted selection in which sample size, selection and evaluation results in a conclusion in monetary amounts.

Haphazard sampling: Haphazard selection, in which the auditor selects the sample without following a structured technique. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias or predictability (for example, avoiding difficult to locate items, or always choosing or avoiding the first or last entries on a page) and thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.

Block Sampling: This method involves selection of a block(s) of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most populations are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population.

Example: Take the first 200 sales invoices from the sales day book in the month of September; alternatively take any four blocks of 50 sales invoices. Therefore, once the first item in the block is selected, the rest of the block follows items to the completion.

Sampling Risk

The risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. This risk will always be in existence when auditor uses sampling technique in conducting his audit.

IF THE ACCEPTABLE SAMPLING RISK IS LOW, LARGER SAMPLE SIZE IS NEEDED

Sampling risk can lead to two types of erroneous conclusions:

- (i) In the case of a test of controls, that controls are more effective than they actually are, or in the case of a test of details, that a material misstatement does not exist when in fact it does. The auditor is primarily concerned with this type of erroneous conclusion because it affects audit effectiveness and is more likely to lead to an inappropriate audit opinion. This is because of over reliance on the internal controls.
- (ii) In the case of a test of controls, that controls are less effective than they actually are, or in the case of a test of details, that a material misstatement exists when in fact it does not. This type of erroneous conclusion affects audit efficiency as it would usually lead to additional work to establish that initial conclusions were incorrect. This is because of under reliance on the test of controls and detailed substantive procedures performed by the auditor. Here risk of giving wrong opinion is minimum but it will lead to more detailed checking which is time consuming.



Non-Sampling Risk The risk that the auditor reaches an erroneous conclusion for any reason not related to sampling risk.

Examples of non-sampling risk include use of inappropriate audit procedures, or misinterpretation of audit evidence and failure to recognize a misstatement or deviation.

CASE STUDY

In analyzing the deviations and misstatements identified, the auditor observed that many have a common feature, for example, type of transaction, location, product line or period of time. State the action point of Internal Audit in such situation?

Solution:

- The auditor may decide to identify all items in the population that possess the common feature, and extend audit procedures to those items. In addition, such deviations or misstatements may be intentional, and may indicate the possibility of fraud.
- Therefore, the auditor shall investigate the nature and causes of any deviations or misstatements identified, and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit.
- In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor shall obtain a high degree of certainty that such misstatement or deviation is not representative of the population.
- The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population.

Evaluating Results of Audit Sampling

The auditor shall evaluate-

- a) The results of the sample; and
- b) Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested.

Illustration 7:

State with reasons (in short) whether the following statement is correct or incorrect:

- i. The method which involves dividing the population into groups of items is known as block sampling.
- ii. Universe refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.
- iii. Non Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.
- iv. Sample need not be representative.
- v. The objective of stratification is to increase the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
- vi. When statistical sampling is used to select a sample, sample need not be representative because the statistical sampling takes care of the representation.
- vii. Stratified Sampling is used for homogeneous population.
- viii. Non statistical sampling is considered to be more scientific than the statistical sampling.
- ix. In case of Statistical sampling, auditor's bias in choosing sample is involved.
- x. In stratified sampling, the conclusion drawn on each stratum can be directly projected to the whole population.
- xi. Low acceptable sampling risk requires larger sample size.

Solution:

- i. **Incorrect:** The method which involves dividing the population into groups of items is known as cluster sampling whereas block sampling involves the selection of a defined block of consecutive items.
- ii. **Incorrect:** Population refers to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.
- iii. **Incorrect:** Statistical sampling is an approach to sampling that has the random selection of the sample items; and the use of probability theory to evaluate sample results, including measurement of sampling risk characteristics.
- iv. **Incorrect:** Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.
- v. **Incorrect:** The objective of stratification is to reduce the variability of items within each stratum and therefore allow sample size to be reduced without increasing sampling risk.
- vi. **Incorrect:** Whatever may be the approach non-statistical or statistical sampling, the sample must be representative. This means that it must be closely similar to the whole population although not necessarily exactly the same. The sample must be large enough to provide statistically meaningful results.

- vii. Incorrect:** Stratified sampling is used when the population is diversified i.e heterogeneous. The population is divided into sub population having similar characteristics. Sample are then chosen from these sub populations which are called as Stratum. Therefore, stratified sampling is not useful in case of homogeneous population.
- viii. Incorrect:** Statistical sampling uses scientific method of choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non statistical sampling, auditors' judgment and past experience is used to choose samples without any scientific method.
- ix. Incorrect:** Statistical sampling uses scientific method choosing samples from a given population. The use of probability theory is involved in statistical sampling so that every sampling unit has an equal chance of getting selected. In the non statistical sampling, auditor's judgment and past experience is used to choose samples without and scientific method. Hence, personal bias is involved in Non statistical sampling and not Statistical.
- x. Incorrect:** In case of stratified sampling, the conclusions are drawn on the stratum. The combination of all the conclusions on stratum together will be used to determine the possible effect of misstatement or deviation. Hence the samples are used to derive conclusion only on the respective stratum from where they are drawn and not the whole population.
- xi. Correct:** Sampling risk arises from possibility that the auditor's conclusion based upon sample may be different from conclusion that would have been reached if same audit procedures were applied on the entire population. If acceptable sampling risk is low, large sample size is needed.

FLOWCHARTS AND INTERNAL CONTROL QUESTIONNAIRES

Flow Chart

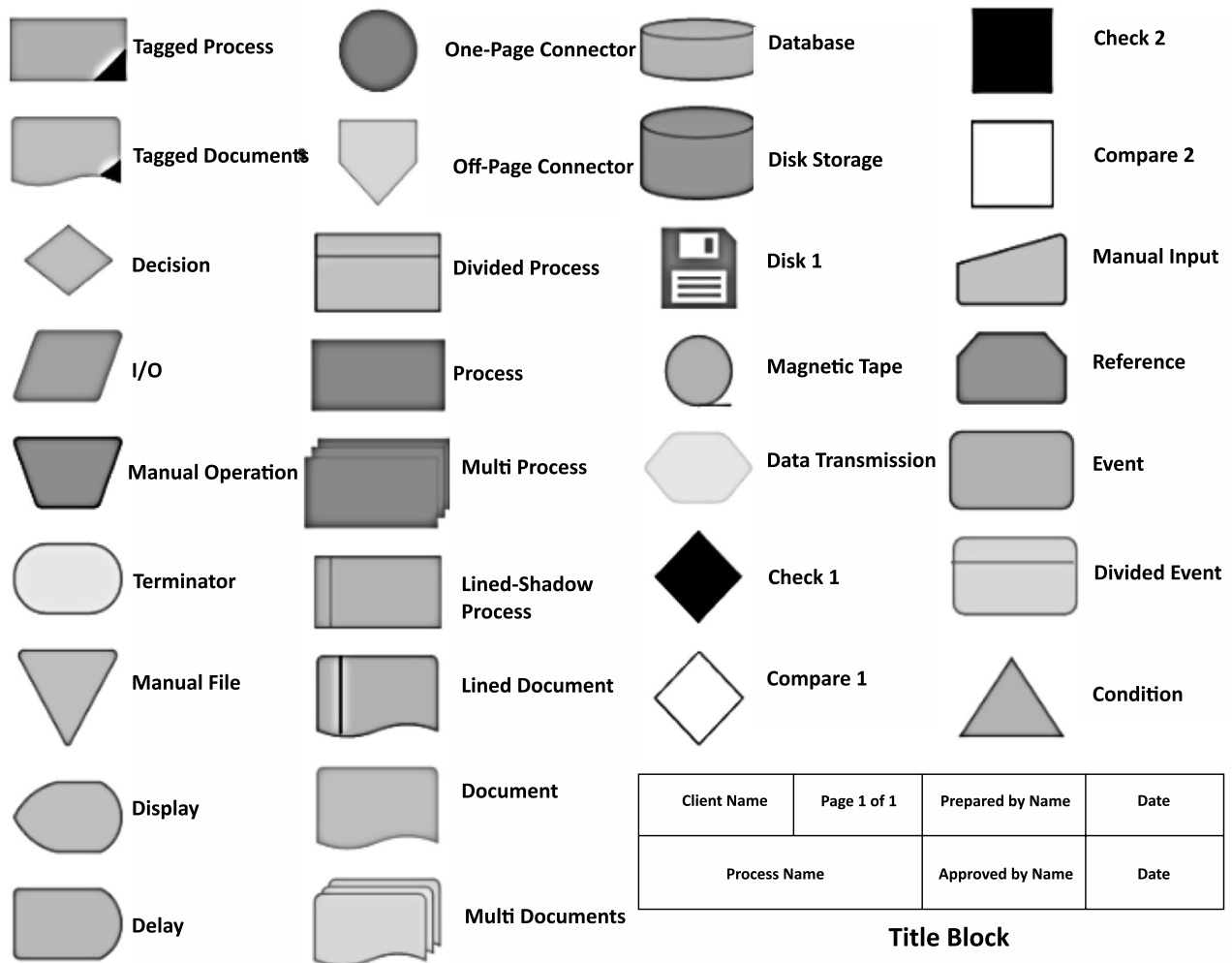
A flowchart is a type of diagram that illustrates workflows or different process from beginning to end and help attain the objectives of an internal auditing exercise. The flowchart symbols create visual clarity, thus allowing the viewers to follow through the stages of a process easier and without experiencing complications.

A well prepared flowchart would help in identifying the choke points in a business processes, the points of leakage or wastage of resources, highlight the important decision points in a business hierarchy, track the outcomes that flow from such avenues, and evaluate the efficacy of creating alternative points of decision. This is therefore not only useful for a specific audit activity but business managers and other stakeholders can also use these diagrams to track the flow of actions that drive a business. These flowcharts also enable business enterprises to create scope for process improvement and thus improve business outcomes. With ever increasing demand of Internal Auditors' assistance in fraud prevention, flowcharts could also be designed specifically to identify the scope of fraud inside a business process.

A flowchart is a type of diagram that represents a workflow or process. It shows the two most common items in a flow: Processing steps (as boxes) and Decisions (as diamonds). The order, or sequence, of the various activities, is shown by arrows and they are used to design, analyze, document and manage processes.

- Document Flowcharts, Showing Controls Over A Document-Flow Through A System
- Data Flowcharts, Showing Controls Over A Data-Flow In A System
- System Flowcharts, Showing Controls At A Physical Or Resource Level
- Program Flowchart, Showing The Controls In A Program Within A System

A flowchart for internal control and auditing consists of a mixture of elements from these four general types as follows:



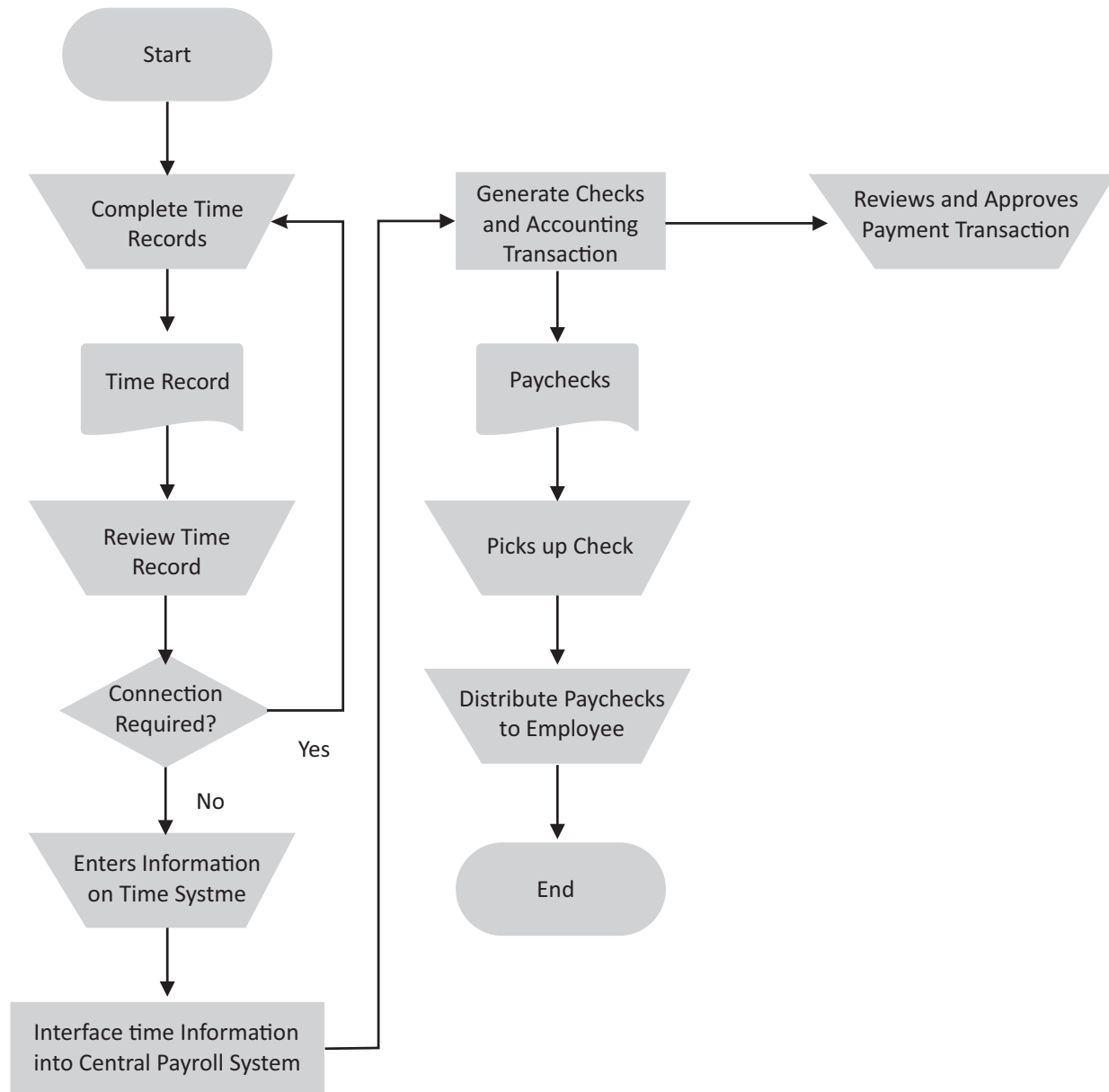
Client Name	Page 1 of 1	Prepared by Name	Date
Process Name		Approved by Name	Date

Title Block

Flowchart Example for Internal Control and Auditing – Payroll Function

The example below describes a Payroll function scenario using a flowchart for internal control purposes.

It starts from the felicitous employee “Joe” who complete the time record and submitted it to his supervisor, verified by Sven – the accountant and eventually issue a paycheck by Tami. Finally, the Summary payroll reports will be automatically generated by the system for internal auditing.



Internal Control Questionnaire

An internal control questionnaire is a document which an auditor provides to employees of a company before performing an audit. The questionnaire is useful to determine which areas the audit should focus on. When employees answer the questions, the auditor knows whether the company is keeping accurate records overall, and has evidence that shows who is responsible for which documents.

APPENDIX B

Internal Control Questionnaires – Instructions

This tool is designed to assist departments in identifying a project/work area for its Control Self-Assessment (CSA) Work Program.

If the department has already identified a specific project or function for review, consult with Internal Audit staff to assess the specific controls of that activity.

1.	<p>Determine which area or areas present the most risk or would offer the most benefit from a control self-assessment for your department.</p> <p>Internal Control Questionnaires (ICQs) are provided in the following areas (refer to each worksheet in this Excel file):</p> <ul style="list-style-type: none"> - General Internal Controls - Finance - Cash - Finance - Revenue and Accounts Receivable - Finance - Expenditures and Accounts Payable - Expense Reports - County Properties & Fixed Assets - Payroll - Legal and Program Requirements - Information Systems <p>Brief descriptions of each work area are provided in the header of most worksheets.</p> <p>The content in each worksheet/category may not address a work process that is unique to your department. In this case, review the questions in the worksheet to help you hone in on an area you'd like to review.</p>
2.	Once an area has been identified for your CSA, answer each question in the relevant sheet(s). Only complete the worksheets most relevant to your CSA.
3.	Provide an explanation for each "no" response in the designated boxes.
4.	Once all relevant worksheets have been completed, if there is more than one "no" response, determine the area that presents the highest risk to your department. The area of highest risk should be the focus of your Control Self-Assessment Work Program.
5.	Refer to the Control Self-Assessment Work Program (Appendix A) for information on completing your CSA.

Questionnaire - General Internal Controls

The “General Internal Controls” questionnaire addresses the overall tone and operations of a department/ agency. General internal controls set the stage for how work is conducted.

Answers must be based on observed facts, analyses or statements made by knowledgeable and reliable persons. Provide an explanation for each “no” response.

	GENERAL INTERNAL CONTROLS	YES	NO	NOT SURE	N/A
1.	Are the organization's mission, goals and objectives clearly defined in writing?				

2.	Are the organization's mission, goals and objectives communicated to all employees?				
3.	Are the operating and accounting policies, procedures, budgets, organizational charts, accounting manuals, chart of accounts, policy directives and memoranda etc. properly documented?				
4.	Does your department have an Ethics Policy and/or Code of Conduct?				
5.	Are year-to-date revenues and expenditures monitored by upper management and periodically compared to budgeted amounts?				
6.	Are confidential records stored in secure areas with access to a limited number of employees?				
7.	Is a record retention policy in place to ensure that records are retained in accordance with legal and audit requirements?				
8.	Do employees receive adequate training to perform their duties?				
9.	Does management evaluate employee performance regularly and hold individuals accountable for their internal control responsibilities?				
10.	Are there procedures for employees to report unusual activity, or a mechanism to anonymously report suspicions of fraud?				
11.	Are internal controls in place to achieve objectives and respond to risks?				
12.	Are internal control monitoring activities in place, with a process in place to evaluate results?				
13.	Have there been any recent changes to any of the following areas: <ul style="list-style-type: none"> – Regulatory or operating environment – Management personnel – Information systems – Expansion of operations – New technology 				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

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Questionnaire - Finance - Cash

The questions in the “Finance” module are best answered by a manager(s) who is familiar with all aspects of department’s financial operations.

“Cash” includes currencies (coins, Treasury notes, banknotes), checks, money orders and other legal tender of the United States. The subsections under “Cash” include “General”, “Cash Collections”, “Cash Disbursements” and “Petty Cash Funds and Change Funds”. Answer the questions in the sections that are applicable and/or are known high risks for your department.

Answers must be based on observed facts, analyses or statements made by knowledgeable and reliable persons. Provide an explanation for each “no” response.

<i>GENERAL</i>		<i>YES</i>	<i>NO</i>	<i>NOT SURE</i>	<i>N/A</i>
1.	Is each revolving fund, trust fund and bank account established pursuant to specific written authorization by the Board of Supervisors, the County Treasurer and/or the County Auditor-Controller?				
2.	Is formal responsibility for each fund (including signature authority) vested in a specific County official(s)?				
3.	Are revolving funds, trust funds, and bank accounts reconciled to their accountable balances on a regular basis? Are the reconciliations performed or reviewed by a high level official?				
4.	Are cash overages and shortages identified, reported and corrected on a timely basis?				
5.	Is cash (including currency, coin, checks, money orders, etc.) physically safeguarded from theft and fraud?				
6.	Are cash losses reported to the District Attorney, Auditor-Controller and the County Risk Manager in accordance with the Manual of Accounting Policies and Procedures (MAPP), issued by the Auditor-Controller’s Office?				

Provide an explanation for each “no” response under “General-Finance-Cash”. Indicate the question # for which you are referring:

--

<i>CASH COLLECTIONS</i>		<i>YES</i>	<i>NO</i>	<i>NOT SURE</i>	<i>N/A</i>
7.	Are the following duties performed by separate individuals? <ul style="list-style-type: none"> ● Receipting ● Posting ● Depositing ● Reconciling 				

CASH COLLECTIONS		YES	NO	NOT SURE	N/A
8.	Are all cash collections recorded immediately when received on pre-numbered receipt forms, cash register tapes and/or mail logs?				
9.	Does the information on the receipt include: date, amount, payer, method of payment, purpose of payment, cashier's name and account distribution?				
10.	Are the original copies of voided receipts marked "void," attached to the other copies of the receipt and retained for audit purposes?				
11.	Are checks restrictively endorsed immediately when received?				
12.	Are mail remittances listed immediately when received?				
13.	Are unidentified mail remittances promptly returned to the payer or deposited into a suspense account for further research?				
14.	Are collections transmitted promptly and intact by branch offices to the central office? Are the branch collections recorded on a batch transmittal log and slip? Are the transmitted amounts logged in, counted, reconciled and receipted by the central office, and are all variances or discrepancies immediately investigated?				
15.	Are controls in place to ensure that cash collections are not commingled with other funds, except change funds?				
16.	Is cash counted and reconciled to accountability (undeposited receipts and change funds) at the end of each shift?				
17.	Are cash overages and shortages properly accounted for, and are shortages replenished from a cash difference fund rather than offset against overages?				
18.	Are collections properly recorded, classified and summarized in a cash receipts journal?				
19.	Are collections deposited intact and on a daily basis into the County Treasury or a bank account authorized by the Board of Supervisors, the County Treasurer and/or the County Auditor-Controller?				
20.	Are deposits and collections reported to the Auditor's Office on the monthly deposit register?				
21.	Are deposits and collections verified to the appropriate Alcolink accounts on a regular basis?				
22.	Are receipts physically inventoried and accounted for on a periodic basis?				

CASH COLLECTIONS		YES	NO	NOT SURE	N/A
23.	Is the cashing of personal checks from County funds and cash collections prohibited?				
24.	Is a Board-approved fee levied on all returned checks?				
25.	Is cash on-hand and in-transit safeguarded from theft and fraud?				

Provide an explanation for each “no” response under “Cash Collections”. Indicate the question # for which you are referring:

--

CASH DISBURSEMENTS		YES	NO	NOT SURE	N/A
26.	Are the following duties performed by separate individuals? <ul style="list-style-type: none"> ● Preparing vouchers/checks ● Approving vouchers/authorizing disbursements ● Reconciling disbursements ● Maintaining custody of cash 				
27.	Are disbursements made only from authorized expenditure accounts, trust funds, revolving funds or bank accounts and, except for petty cash payments, paid only through online vouchers, pre-numbered warrants/ checks, and/or journal entries?				
28.	Are controls in place to ensure that all disbursements are reasonable, necessary and made in accordance with state and federal regulations and County polices (as defined in the MAPP, MOUs, County Administrative Code, letter orders, OMB Circular A-87, etc.)?				
29.	Are cash advances prohibited except as authorized under special circumstances by the Board of Supervisors?				
30.	Are all disbursements supported by properly approved, original vendor invoices, employee claims, and/or contractor invoices and, if appropriate, contracts, purchase orders and receiving reports?				
31.	Are controls in place to ensure that only authorized personnel approve vouchers and sign warrants/checks?				
32.	Do voucher approvers or check/warrant signers review the supporting documentation before approving the voucher or signing the check?				

CASH DISBURSEMENTS		YES	NO	NOT SURE	N/A
33.	Are all disbursements properly recorded, classified and summarized in a cash disbursements journal?				
34.	Are warrants and checks mailed out immediately after proofing and signing and not returned to the persons who prepared or approved them?				
35.	Are adequate controls maintained over unused, returned and voided checks/warrants and signature stamps, plates and files?				

Provide an explanation for each “no” response under “Cash Disbursements”. Indicate the question # for which you are referring:

--

PETTY CASH FUNDS AND CHANGE FUNDS		YES	NO	NOT SURE	N/A
36.	Are procedures for the use of petty cash funds clearly established and do they include: <ul style="list-style-type: none"> ● Clear definitions of authorized uses, including restrictions on the amount and type of disbursements? ● Prior approval of disbursements? ● Reimbursement only upon submission of receipt and/or other supporting documentation? ● Cancellation of voucher and supporting documentation? ● Timely replenishment of the fund? 				
37.	Are controls in place to ensure that petty cash funds are not commingled with cash collections and other funds?				
38.	Are petty cash funds and change funds counted and reconciled to their accountable balances on a regular basis? Are the reconciliations performed or reviewed by someone other than the custodians of the funds?				
39.	Are cash funds counted and verified on a surprise basis by a supervisor?				
40.	Are overages/shortages identified, reported and corrected on a timely basis, and are shortages not offset or netted against overages?				

Provide an explanation for each “no” response under “Petty Cash Funds and Change Funds”. Indicate the question # for which you are referring:

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Questionnaire - Finance - Revenue and Accounts Receivable

The questions in the “Finance” module are best answered by a manager(s) who is familiar with all aspects of department’s financial operations.

Answers must be based on observed facts, analyses or statements made by knowledgeable and reliable persons. Provide an explanation for each “no” response.

<i>REVENUES AND ACCOUNTS RECEIVABLE</i>		<i>YES</i>	<i>NO</i>	<i>NOT SURE</i>	<i>N/A</i>
1.	Are the following duties performed by separate individuals? <ul style="list-style-type: none"> ● Providing services ● Preparing billings ● Approving billings ● Receiving payments ● Posting, adjusting and reconciling accounts 				
2.	To the maximum extent possible, is revenue from all eligible sources identified, recorded and collected?				
3.	Are billings generated in a timely manner for all services rendered, goods sold and costs incurred?				
4.	Are all billings promptly recorded as accounts receivable?				
5.	Are authorized fee schedules used for all goods and services?				
6.	Are billing rates and service fees reviewed periodically to ensure that all costs, including indirect costs, are recovered to the maximum extent possible?				
7.	Are invoices pre-numbered and accounted for?				
8.	Are statements of accounts regularly sent to all debtors?				
9.	Are billings checked for accuracy before mailing?				
10.	Are the outstanding balances of individual accounts receivable summarized and reconciled to the control balances on a regular basis?				
11.	Are credits and refunds approved by an appropriate level of authority?				
12.	Is an aged trial balance (i.e., a listing of receivables grouped by age: 0-30 days, 31-60 days, 60 - 90 days, over 90 days) prepared on a regular basis to evaluate the adequacy of the collection process and to identify old, unpaid accounts which should be pursued for collection or written-off?				

13.	Are overdue accounts pursued for collection and, if appropriate, referred to Central Collections or other collection agencies?				
14.	Are uncollectible accounts identified and submitted to the Board of Supervisors on an annual basis for discharge from accountability?				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

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Questionnaire - Finance - Expenditures and Accounts Payable

The questions in the “Finance” module are best answered by a manager(s) who is familiar with all aspects of department’s financial operations.

Answers must be based on observed facts, analyses or statements made by knowledgeable and reliable persons. Provide an explanation for each “no” response.

EXPENDITURES AND ACCOUNTS PAYABLE		YES	NO	NOT SURE	N/A
1.	Are the following duties performed by separate individuals? <ul style="list-style-type: none"> ● Receiving goods ● Preparing vouchers or checks ● Approving vouchers and/or authorizing disbursements ● Posting adjustments and reconciling accounts 				
2.	Are procedures in place to ensure that all liabilities represent valid obligations and that all obligations are properly authorized, supported, recorded and classified?				
3.	Are expenditures made only from authorized budgetary accounts, trust funds, revolving funds or bank accounts and only through online vouchers, pre-numbered warrants/ checks, and/or journal entries?				
4.	Are controls in place to ensure that all expenditures are reasonable, necessary and made in accordance with state and federal regulations and County polices (as defined in the MAPP, MOUs, County Administrative Code, letter orders, OMS Circular A-87, etc.)?				
5.	Are procedures in place to ensure goods and services are obtained at competitive prices?				
6.	Are all payments and obligations based on properly approved, original vendor invoices, receipts, employee claims, or contractor invoices, and, as appropriate, contracts, purchase orders, receiving reports or other valid payment authorization?				

EXPENDITURES AND ACCOUNTS PAYABLE		YES	NO	NOT SURE	N/A
7.	Do voucher approvers review the supporting documentation before approving the voucher?				
8.	Are invoices checked for mathematical accuracy and matched with purchase orders and receiving reports prior to payment?				
9.	Are controls in place to ensure that all available vendor discounts are taken, that cash flow is maximized and that vendors are paid on a timely basis?				
10.	Are individual accounts payable summarized and reconciled to control balances on a regular basis?				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

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Questionnaire - Expense Reports

The questions in the “Expense Reports” module are best answered by a manager(s) who is familiar with all aspects of department’s financial operations.

Answers must be based on observed facts, analyses or statements made by knowledgeable and reliable persons. Provide an explanation for each “no” response.

EXPENSE REPORTS		YES	NO	NOT SURE	N/A
1.	Does your department require original receipts for all expenses claimed?				
2.	Does your department have any internal control to detect duplicate expenses in the absence of original receipts?				
3.	Are allowable expenses clearly explained in your department's policies and procedures?				
4.	Do certain expenses require pre-approval? If so, are they clearly outlined in your departmental policy? Are the pre-approvals documented and enforced?				
5.	Are there allowable expenses that need to be more clearly defined and/or need to be more restrictive(than the policies imposed by MAPP)?				
6.	Are expenses submitted for reimbursement in a timely manner? Do guidelines prescribe any deadline for submission? Does the department ensure that expenses are posted in Alcolink in their proper fiscal year?				

<i>EXPENSE REPORTS</i>		<i>YES</i>	<i>NO</i>	<i>NOT SURE</i>	<i>N/A</i>
7.	Are expense reports reviewed by a supervisor or independent person prior to reimbursement?				
8.	For how long are expense reports and all supporting documentation retained?				
9.	Does your departmental policy define the consequences of fraudulent submissions?				
10.	Is proper justification provided for expenses, before they are incurred?				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

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Questionnaire - Properties & Fixed Assets

Properties include such non-monetary and non-digital assets as land, buildings & fixtures, furniture and equipment that are owned or leased. For practical purposes only items with estimated value at 5,000 or above are considered. Computers are considered under “Information Systems”.

Answers must be based on observed facts, analyses or statements made by knowledgeable and reliable persons. Provide an explanation for each “no” response.

<i>PROPERTIES & FIXED ASSETS</i>		<i>YES</i>	<i>NO</i>	<i>NOT SURE</i>	<i>N/A</i>
1.	Are the following duties performed by separate individuals? <ul style="list-style-type: none"> ● Authorizing fixed asset acquisitions, transfers, and disposals ● Posting, adjusting and reconciling fixed asset records ● Maintaining custody and using fixed assets ● Taking inventory of fixed assets and reconciling to accountable balances 				
2.	Are written policies and procedures in place regarding the acquisition, capitalization, depreciation, physical inventorying, transfer to salvage and discharge from accountability of fixed assets?				
3.	Are capital acquisitions authorized at an appropriate level of authority and in conformity with prescribed policies?				
4.	Are adequate detailed records of fixed assets maintained, including identification numbers, locations, descriptions, original cost and, if appropriate, accumulated depreciation?				

PROPERTIES & FIXED ASSETS		YES	NO	NOT SURE	N/A
5.	Is a regular maintenance schedule followed to maintain the usefulness and value of the assets?				
6.	Is inventory taken on fixed assets and reconciled to their accountable balances on a regular basis?				
7.	Are dispositions and transfers of fixed assets authorized and made in conformity with prescribed policies?				
8.	Are fixed assets physically safeguarded from theft, fraud and misuse?				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

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Questionnaire - Payroll

Answers must be based on observed facts, analyses or statements made by knowledgeable and reliable persons. Provide an explanation for each “no” response.

PAYROLL		YES	NO	NOT SURE	N/A
1.	Are the following duties performed by separate individuals? <ul style="list-style-type: none"> ● Authorization of changes in payroll status (hiring, promotion, termination) ● Approval of timesheets ● Data entry of payroll information ● Distribution of payroll warrants ● Reconciliation of payroll records 				
2.	Are written personnel and payroll policies and procedures in place regarding job descriptions and classifications, hiring, promotion, termination, timekeeping, salary rates, MOU provisions?				
3.	Are changes in employee status (hiring, promotion, termination) approved at an appropriate level of management and do the changes conform to established policies and procedures?				
4.	Is authorizing documentation on file for each employee regarding the employee's appointment, job classification, salary rate and step, proof of citizenship and required documentation?				

PAYROLL		YES	NO	NOT SURE	N/A
5.	Are controls over employee timekeeping adequate? Specifically: <ul style="list-style-type: none"> ● Are all employees required to prepare and sign time sheets? ● Are time sheets reviewed and signed by the immediate supervisor? ● Are leaves of absence (vacation, sick leave) approved by the immediate supervisor? ● Is overtime authorized at an appropriate level of authority? 				
6.	Where appropriate, is employee time documented in sufficient detail so that salaries can be properly allocated to programs and functions within the organization?				
7.	Are payroll warrants reviewed prior to distribution by an appropriate level of management to ensure that they are reasonable and accurate and that no unauthorized changes have been made?				
8.	Are payroll warrants distributed by someone other than the employees who prepared or input the payroll information?				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

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Questionnaire - Legal and Program Requirements

Answers must be based on observed facts, analyses or statements made by knowledgeable and reliable persons. Provide an explanation for each “no” response.

LEGAL AND PROGRAM REQUIREMENTS		YES	NO	NOT SURE	N/A
1.	Has the organization established procedures to ensure that all legal and program requirements are identified and complied with?				
2.	Does the organization periodically evaluate the efficiency, economy and effectiveness with which its program goals and objectives are achieved?				
3.	Are official bonds and insurance policies adequate for the needs of the organization and, where appropriate, have they been submitted to the County Risk Manager for review?				
4.	Are procedures in place to ensure that revenue from all eligible sources is properly identified, billed and collected?				

LEGAL AND PROGRAM REQUIREMENTS		YES	NO	NOT SURE	N/A
5.	Does the organization have controls in place to ensure that subrecipients of federal, state and County funds are monitored on a regular basis to ensure compliance with contracts, grant agreements, the Single Audit Act, policy and procedures and other requirements from the funding sources?				
6.	Does the agency/entity have procedures in place to ensure that subrecipients which receive federal funds comply with general and specific federal program requirements, including: <ul style="list-style-type: none"> ● Political activity ● Prevailing wages ● Civil rights ● Cash management ● Federal financial reporting ● Cost principles ● Matching ● Eligibility ● Specific program requirements 				
7.	Are all required financial reports submitted in a timely manner adhering to required deadlines?				
8.	Are procedures in place to ensure that questioned costs and other reported audit findings are reviewed and corrected in a timely manner?				
9.	Does the organization have policies and procedures in place to ensure that persons are not discriminated against on the basis of race, color, national origin, age, handicap, sex or religion?				
10.	Does the organization have policies and procedures in place to ensure a drug-free workplace?				
11.	Does the organization have policies and procedures in place to ensure a safe and secure workplace?				
12.	Does the organization have policies and procedures in place to ensure a workplace free of sexual harassment?				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

Questionnaire - Information Systems

The questions in the “Information Systems” module are best answered by a manager(s) who is familiar with all aspects of information systems/technology.

The subsections under “Information Systems” include “Computer Equipment”, “Protection of Information”, and “Usefulness of

Information”. Answer the questions in the sections that are applicable and/or are known high risks for your department. Answers must be based on observed facts, analyses or statements made by knowledgeable and reliable persons.

Provide an explanation for each “no” response.

<i>COMPUTER EQUIPMENT</i>		<i>YES</i>	<i>NO</i>	<i>NOT SURE</i>	<i>N/A</i>
1.	Is the Countywide Computer Use Policy adopted and implemented?				
2.	Are policies specific to work units developed to protect equipment?				
3.	Is physical access to equipment limited to authorized personnel?				
4.	Are instructions and training provided to new equipment users?				
5.	Is equipment breakdown promptly reported and acted on?				
6.	Are purchases of equipment coordinated and planned to ensure long-term compatibility?				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

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<i>PROTECTION OF INFORMATION</i>		<i>YES</i>	<i>NO</i>	<i>NOT SURE</i>	<i>N/A</i>
7.	Is a person designated as security administrator to ensure the security of information?				
8.	Is access to data and program files restricted to authorized personnel?				
9.	Is access to sensitive electronic information restricted by password?				
10.	Are procedures established for the retention and back up of critical computer files?				
11.	Is there a policy to control the risks from internet usage?				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

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USEFULNESS OF INFORMATION		YES	NO	NOT SURE	N/A
12.	Is the usefulness of output from information systems periodically evaluated?				
13.	Are users periodically surveyed as to the usefulness of the information they receive?				
14.	Are users kept informed of new capabilities of the system?				

Provide an explanation for each “no” response above. Indicate the question # for which you are referring:

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AUTOMATION

Let us first understand what the term “Automated Environment” means. An automated environment basically refers to a business environment where the processes, operations, accounting and even decisions are carried out by using computer systems – also known as Information Systems (IS) or Information Technology (IT) systems. Nowadays, it is very common to see computer systems being used in almost every type of business.

Think about how banking transactions are carried out using ATMs (Automated Teller Machines), or how tickets can be purchased using “apps” on mobile phones, etc. In these examples, you can see how these computer systems enable us to transact business at any time and any day.

Key features of an Automated Environment

- i. Enabling faster business operation
- ii. Accuracy in data processing and computation
- iii. Ability to process large volume of transactions
- iv. Better security and controls
- v. Less prone to human errors
- vi. Provides latest information

While it is true that the use of IT systems and automation benefit the business by making operations more accurate, reliable, effective and efficient, such systems also introduce certain new risks, including IT specific risks, which need to be considered, assessed and addressed by management. To the extent that it is relevant to an audit of financial statements, even auditors are required to understand, assess and respond to such risks that arise from the use of IT systems.

Given below are some situations in which IT will be relevant to an audit

- Increased use of Systems and Application software in Business (for example, use of ERPs).
- Complexity of transactions has increased (multiple systems, network of systems).
- Hi-tech nature of business (Telecom, e-Commerce).
- Volume of transactions are high (Insurance, Banking, Railways ticketing).
- Company Policy (Compliance).

In some of the above situations it is likely that carrying out audit using traditional substantive audit procedures may be difficult or even not feasible if the company prepares, records and conducts majority of business activities through IT systems only.

Another area where IT can be relevant to audit is by using data analytics using computer assisted audit techniques (CAATs). By using data analytics, it is possible to improve the effectiveness and efficiency of an audit.

Data Analytics for Audit

In today's digital age when companies rely on more and more on IT systems and networks to operate business, the amount of data and information that exists in these systems is enormous. A famous businessman recently said, "Data is the new Oil".

The combination of processes, tools and techniques that are used to tap vast amounts of electronic data to obtain meaningful information is called data analytics. While it is true that companies can benefit immensely from the use of data analytics in terms of increased profitability, better customer service, gaining competitive advantage, more efficient operations, etc., even auditors can make use of similar tools and techniques in the audit process and obtain good results. The tools and techniques that auditors use in applying the principles of data analytics are known as Computer Assisted Auditing Techniques or CAATs in short.

Data analytics can be used in testing of electronic records and data residing in IT systems using spreadsheets and specialised audit tools viz., IDEA and ACL to perform the following:

- Check completeness of data and population that is used in either test of controls or substantive audit tests.
- Selection of audit samples – random sampling, systematic sampling.
- Re-computation of balances – reconstruction of trial balance from transaction data.
- Re-performance of mathematical calculations – depreciation, bank interest calculation.
- Analysis of journal entries
- Fraud investigation
- Evaluating impact of control deficiencies.

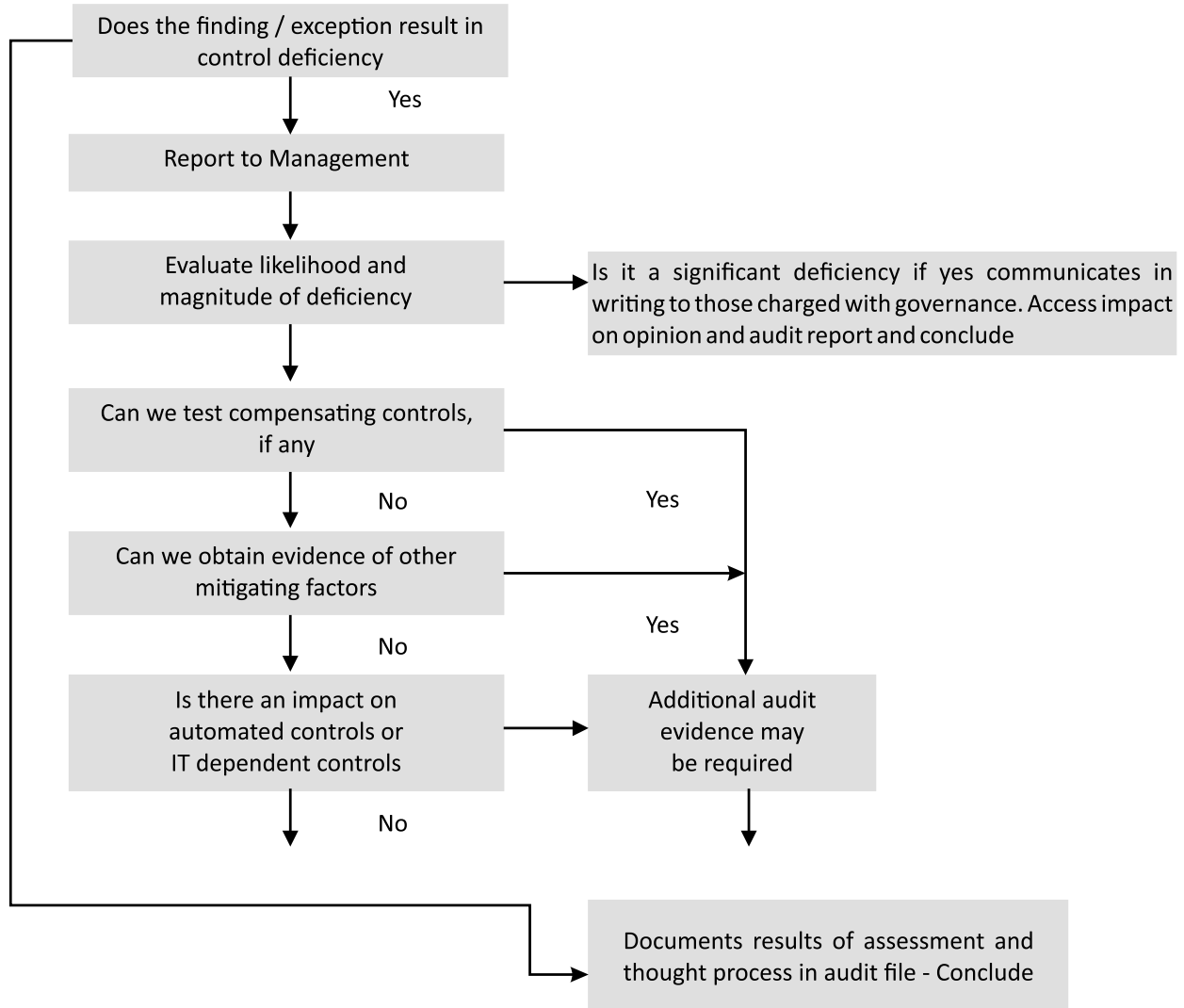
Assess and Report Audit Findings

At the conclusion of each audit, it is possible that there will be certain findings or exceptions in IT environment and IT controls of the company that need to be assessed and reported to relevant stakeholders including management and those charged with governance viz., Board of directors, Audit committee. Some points to consider are as follows:

- Are there any weaknesses in IT controls?
- What is the impact of these weaknesses on overall audit?
- Report deficiencies to management – Internal Controls Memo or Management Letter.
- Communicate in writing any significant deficiencies to Those Charged with Governance.

The auditor needs to assess each finding or exception to determine impact on the audit and evaluate if the exception results in a deficiency in internal control. Refer to the flowchart to learn how this assessment should be carried out. This approach and thought process is the same when auditing in an automated environment or when auditing in a more manual environment.

An approach to access audit findings



A deficiency in internal control exists if a control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or the control is missing.

Evaluation and assessment of audit findings and control deficiencies involves applying professional judgement that include considerations for quantitative and qualitative measures. Each finding should be looked at individually and in the aggregate by combining with other findings/deficiencies.

LESSON ROUND-UP
<ul style="list-style-type: none"> ● An Internal Auditor should always support his or her conclusions about an audit with information gathered by as many different methods as possible. ● There are six basic methods of gathering information during an audit. Depending on the type of information that needs to be obtained, the Internal Auditor will need to determine which method, or combination of methods, should be used.

- a) Interviewing
- b) Inspection
- c) Reviewing Documents
- d) Observation
- e) Vertical thinking
- f) Exercises.

- **Data Analytics** may be defined as the science of examining raw data with the purpose of drawing conclusions about that information. This would involve the discovery, interpretation, and communication of meaningful patterns in data.
- The **data analytic** process involves access to the datasets, extraction of datasets, preparation of the datasets, applying data analytic techniques and storing of the datasets and the results.
- “**Documentation**” refers to the working papers prepared or obtained by the auditor and retained by him, in connection with the performance of the audit. **SA 230 on “Audit Documentation”**, deals with the auditor’s responsibility to prepare audit documentation for an audit of financial statements.
- **Audit file** may be defined as one or more folders or other storage media, in physical or electronic form, containing the records that comprise the audit documentation for a specific engagement.
- The auditor should retain the working papers for a period of time sufficient to meet the needs of his practice and satisfy any pertinent legal or professional requirements of record retention.
- Working papers are the property of the auditor. The auditor may, at his discretion, make portions of or extracts from his working papers available to his client.
- **Audit evidence** may be defined as the information used by the auditor in arriving at the conclusions on which the auditor’s opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information.
- **Types of Audit Evidence**
 - Depending upon nature:**
 1. Visual: For example, observing physical verification of inventory conducted by the client’s staff.
 2. Oral: For example, discussion with the management and various officers of the client.
 3. Documentary: For example, fixed deposit certificate, loan agreement, sales bill etc.
 - Depending upon source:**
 1. Internal Evidence: Evidence which originates within the organisation being audited is internal evidence. Eg: received note, inspection report, copies of cash memo, debit and credit notes, etc.
 2. External evidence: The evidence that originates outside the client’s organization is external evidence. Eg: Purchase invoice, supplier’s challan and forwarding note, debit notes and credit notes coming from parties, quotations, confirmations, etc.
- **SA 580- “Written Representations”** deals with the auditor’s responsibility to obtain written representations from management and, where appropriate, those charged with governance.

- **SA 505- “External Confirmations”**, deals with the auditor’s use of external confirmation procedures to obtain audit evidence. SA 500 indicates that the reliability of audit evidence is influenced by its source and by its nature, and is dependent on the individual circumstances under which it is obtained.
- An Internal auditor uses **Internal Audit tools/techniques** to ensure that controls, processes and policies are adequate and effective, and that they adhere to industry practices and regulatory mandates. An internal auditor also checks a corporation’s financial statements to ensure that such reports are prepared in accordance with generally accepted accounting principles.
- **‘Audit Sampling’** refers to the application of audit procedures to less than 100% of items within a population relevant under the audit, such that all sampling units (i.e. all the items in the population) have a equal chance of selection. This is to ensure that the items selected represent the entire population which enables the auditor to draw conclusions and express his opinion based on a pre-determined objective.
- **“Population refers** to the entire set of data from which a sample is selected and about which the auditor wishes to draw conclusions.”
- **A flowchart** is a type of diagram that illustrates workflows or different process from beginning to end and help attain the objectives of an internal auditing exercise. The flowchart symbols create visual clarity, thus allowing the viewers to follow through the stages of a process easier and without experiencing complications.
- **An internal control questionnaire** is a document which an auditor provides to employees of a company before performing an audit. The questionnaire is useful to determine which areas the audit should focus on. When employees answer the questions, the auditor knows whether the company is keeping accurate records overall, and has evidence that shows who is responsible for which documents.

TEST YOURSELF

(These are meant for re-capitulation only. Answers to these questions are not to be submitted for evaluation)

Correct/Incorrect

State with reasons (in short) whether the following statements are correct or incorrect:

1. “Audit Documentation”, the working papers are not the property of the auditor.
2. Purchase invoice is an example of internal evidence.
3. Sufficiency is the measure of the quality of audit evidence.
4. Inquiry alone is sufficient to test the operating effectiveness of controls.

Answer:

1. *Incorrect:* As per SA 230 on “Audit Documentation” the working papers are the property of the auditor and the auditor has right to retain them. He may at his discretion can make available working papers to his client. The auditor should retain them long enough to meet the needs of his practice and legal or professional requirement.
2. *Incorrect:* Internal evidence is the evidence that originates within the client’s organisation. Since purchase invoice originates outside the client’s organisation, therefore, it is an example of external evidence.

3. Incorrect: Sufficiency is the measure of the quantity of audit evidence. On the other hand, appropriateness is the measure of the quality of audit evidence.
4. Incorrect: Inquiry along with other audit procedures (for example observation, inspection, external confirmation etc.) would only enable the auditor to test the operating effectiveness of controls. Inquiry alone is not sufficient to test the operating effectiveness of controls

Practice Question:

1. Explain audit documentation along with example.
2. “Although written representations provide necessary audit evidence yet they do not provide sufficient appropriate audit evidence on their own about any of the matters with which they deal”. Discuss.
3. Explain stating clearly objectives of the auditor regarding written representation.
4. Most of the auditor’s work in forming the auditor’s opinion consists of obtaining and evaluating audit evidence. Explain.
5. What is meant by sufficiency of Audit Evidence?
6. What is the meaning of Sampling? Also discuss the methods of Sampling.
7. Explain the factors to be considered while determining the extent of checking on a sampling plan.
8. What precautions should be taken by the auditor while applying test check techniques?

LIST OF FURTHER READINGS

- **Handbook on Internal Auditing**

Author : CA Kamal Garg

Publishers : Bharat’s

- **Compendium of Standards on Internal Audit**

Author: ICAI

Year of Publication: 2022
