

External Vs Internal audit program and audit technique

Objective of audit

Internal audit

Internal auditing is conducted for the review of accounting and financial operation **as a basis for service to management** (internal users).This result also used by external auditor.

Internal audit focus on the soundness,adequacy and application of accounting, financial and other operating control and compliance with established policies and procedures and GAAS.

External audit

External audit is conducted to serve **as a basis for an expression of opinion** on the financial statements for the use or submission to the public or to other interested parties (ie. stockholder , creditors, investor,gov't etc..) and also for management.

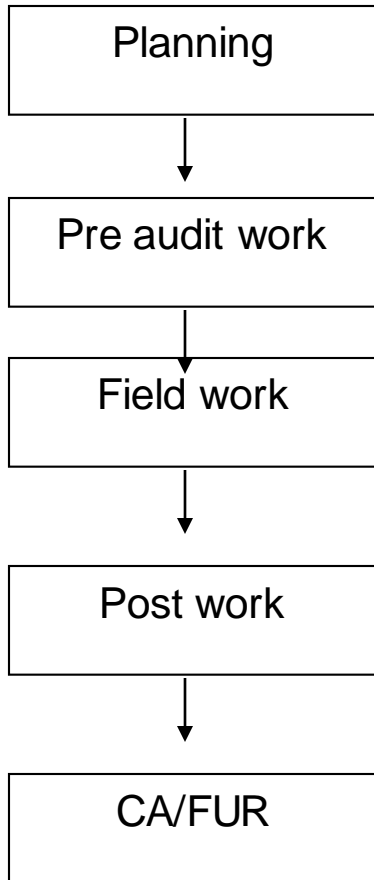
External audit focus on the fairness, consistency and conformity of financial statement with GAAP.

What are major types of services that the internal audit can provide in support to management ?

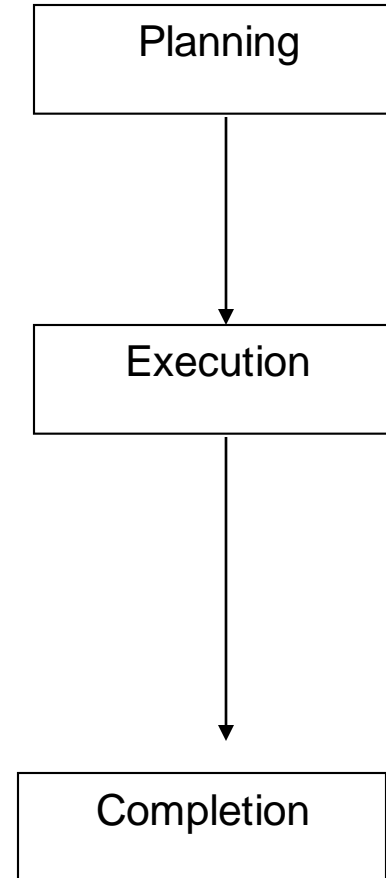
- Compliance
- Verification
- Protection of assets
- Appraisal of control
- Appraisal of performance
- Recommending operating improvement
- Other service training source of information

• Audit Procedure

Internal audit



External audit



Internal

Planning and pre-audit work

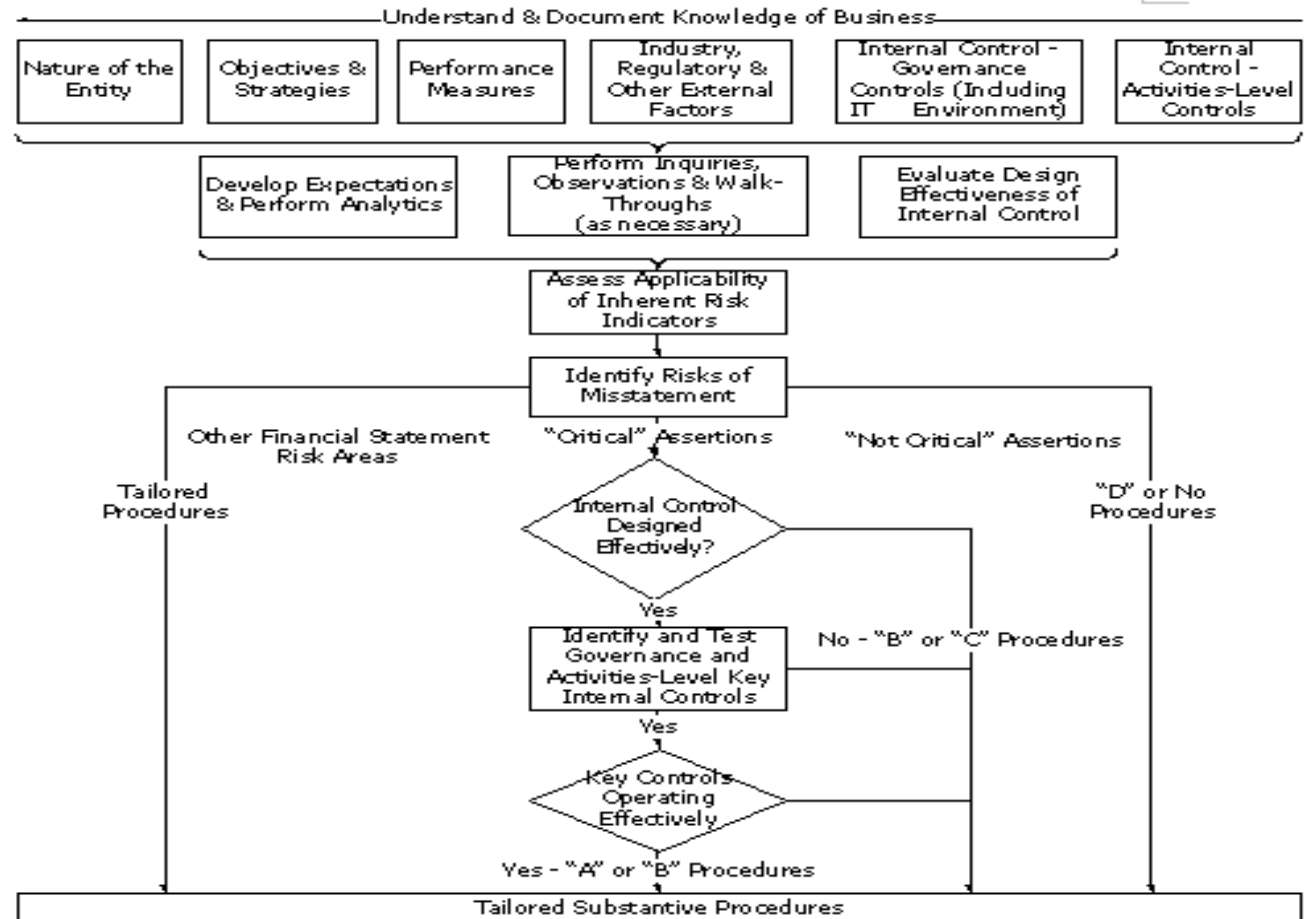
- Prepare audit plan
- Prepare audit letter
- **Seek to understand nature of the projects**
- Use appropriate audit program and prepare audit file
- Request document.

- Review all documents/information obtained to understand the system (internal control , accounting system..) and the ministries.
- Analytical review-financial status and its trend.
- Sample selection- based on exposed risk, size-budget
- Prepare all audit work before field work.

26/01/10

External

Planning



Knowledge of Business

- Identify where misstatements could occur in the financial statements and to better focus our audit efforts
- Tailor audit procedures to achieve an effective and efficient audit
- Determine whether special skills are needed to achieve the audit objectives.

Emphasis on Planning (Assess risk)

- errors produced by the accounting system
- fraudulent financial reporting
- misappropriation of assets
- errors in accounting for non-routine transactions
- errors in significant accounting estimates that are highly dependent on management judgment
- entity cannot continue in existence.

Materiality and De minimus

Financial Statement Assertions

- existence or occurrence
- completeness
- cut-off
- rights and obligations
- valuation or allocation (gross and net)
- presentation and disclosure.

Auditing the Assertions

The audit implications of assertions can be summarized as follows:

Assertion	Balance Sheet	Income Statement
Existence or Occurrence	Do recorded assets and recorded liabilities exist?	Did recorded transactions occur?
Completeness	Have all assets and liabilities been recorded?	Have all income and expenses been recorded?
Cut-off	Are all assets and liabilities recorded in the appropriate period?	Have all income and expenses been recorded in the appropriate period?
Rights and Obligations	Does the client own the recorded assets? Are the liabilities attributable to the client recorded?	Was the client really a party to the transactions, and were they for valid business purposes?
Valuation: Gross Net	Are amounts attributed to the assets and liabilities appropriately valued? Can assets (liabilities) be recovered (liquidated) at their stated value?	Have income and expenses been measured appropriately? Have income and expense been measured appropriately?
Presentation and Disclosure	Have the assets and liabilities been properly presented and disclosed?	Have income and expense been properly presented and disclosed?

To further illustrate, consider the following comparison of various financial statement assertions, the related audit objectives and sample procedures in the “B” approach to achieve such objectives:

Assertion	Audit Objectives	Audit Procedures
Existence or Occurrence	Existence of receivables.	Confirmation of accounts receivable balances.
Completeness	A liability has been recorded for all purchases.	Review unmatched receiving reports and unprocessed invoices.
Cut-off	Sales are recorded in the proper period.	Review sales records for a period before and after year-end.
Rights and Obligations	Cash in bank is held in accounts and not subject to restrictions.	Confirm arrangements directly with an appropriate official of the financial institution.
Valuation: Gross Net	Fixed assets are appropriately recorded at acquisition cost. Receivables are stated at net realizable value.	Examine appropriate supporting invoices or other documentation for additions. Review and evaluate aging of receivables to evaluate adequacy of allowance for doubtful accounts.
Presentation and Disclosure	Appropriate disclosure of loss contingencies not required to be accrued.	Inquire of the client's management and lawyers concerning litigation claims and assessments.

For Critical Assertions

- identify the types of potential misstatements
- consider factors that affect the risk of material misstatement
- consider where material misstatements are most likely to exist and
- determine the nature, timing, and extent of audit procedures.

- ***Audit Risk Model***

The Audit Risk Model is illustrated as follows:

- **AR = IR x CR x DR**
- AR = Audit Risk
- IR = Inherent Risk
- CR = Control Risk
- DR = Detection Risk

Detection risk may further be analyzed as follows:

- **DR = AP x SR**
- AP = Risk Associated with Analytical Procedures and Other Relevant Substantive Tests
- SR = Sampling Risk

Detection risk arising from the application of analytical procedures and substantive tests of details other than sampling (such as cut-off tests, tests of high value items, etc.) is a function of one or more of the following:

- ▲ the nature and effectiveness of the particular procedures adopted
- ▲ the reliability of the data to which the procedures are applied
- ▲ the level of detail at which data is available
- ▲ the number and value of the items examined.

Internal

Field Work

- Entry conference
- Perform substantive test and test of control.
Evaluate control and risk exposure based on the result of test.
- Clarification and discussion all issues arose
- Write draft audit report
- Exit discussion

External

Execution

- Perform substantive test base on the audit procedure that have been specifically tailored for an organization.
- Evaluate the weight of the evidence whether they provide the assurance that the financial statement are free of material misstatement.
- Clarification and discussion all issues arose to be put in Management letter.
- Write draft audit report and **management letter** for senior review

Audit evidence

I. Audit Process

- Identify the **critical and non critical assertions** so that the appropriate evidences can be obtained to support these assertion
- Specify **and performing procedure** to collect such evidence
- evaluating the **relevance and sufficiency** of evidences
- determining whether **the weight of the evidence** is positive or negative
- making the decision as to whether the **evidence supports** the assertion.

II. Procedure for gathering evidence

- Scan (scrutinize, peruse, search)
- Inquiry
- Examine
- Analysis (Inspect, observe, review, vouch, verify)
- Samples

III. Confirmation

- Inquiry
- Examine
- Samples

Internal

Post work

- Follow up on clarification needed.
- Complete audit files with complete review and clear all review notes
- Issue final draft audit report.
- Provide overall risk assessment rating.
- Issue final audit report and send feed back form.

CA/FUR

External

Completion

- Complete audit files with complete review and clear all review notes
- Issue final draft audit report to auditee.
- Received acceptance mail on the draft from auditee
- Issue final audit report and management letter .
- Up date permanent files

N/A

•Audit Techniques

Internal

- Analysis and examination of documents
- Observation
- Recalculation
- Tracing
- Vouching
- Confirmation
- Interview
- Physical verification

External

1. Recalculation

- Depreciation Method
- Liabilities
- Valuation of Inventory
- Allowance of Bad Debt
- Warranty expense and payable

2. Physical Observation

3. Confirmation

- Bank account balance
- Customers receivable balance
- Borrowers note terms and balance
- Agents inventory on consignment or in warehouse
- Lender note terms and balance
- Life insurance contracts
- Vendors account payable balance

4. Verbal Inquiry

5. Examination of Documents

Examination of documents

- a. Independent external documents
 - - Bank statements
 - - cancel checks
 - - Insurance policies
 - - Notes receivable
 - - Securities certificates
 - - Indenture agreement
 - - Elaborate contracts
 - - Title paper
 - - Vendors invoices
 - - Customers' purchase order
 - - Loan application
 - - Correspondence
- b. Internal Documents
 - - Sales invoice copies
 - - Sales summary reports
 - - Cost distribution report
 - - Loan approval memos
 - - Budget and performance reports
 - - Documentation of transactions with subsidiary or affiliate companies
 - - Shipping documents
 - - Receiving report
 - - Requisition slip
 - - Purchase Orders
 - - Credit/ Debit memos
 - - Transaction logs
 - - Batch control logs

Audit of “Cash balance”

- **Audit Objective**
- **The principle objective in auditing cash are to determine whether:**
- All cash on the balance sheet date **is held by the entity** or by other (e.g bank) for the entity.
- All cash owned by the entity at the balance sheet date **is included on the balance sheet.**
- Cash is **stated at its realizable value.**
- The entity owns, or **has a legal right to**, all the cash on the balance sheet at the balance sheet date. All cash is free of restriction on use, liens, or other security interests. If not, such restrictions, lien, or other security interest are identified.
- Cash is properly **classified, described, and disclosed** in the financial statements, including notes in conformity with prescribed accounting principle.

Audit Procedures

- **Analytical review procedures (ARPs)**
 - Compare the list of cash accounts with prior periods and investigate any unexpected changes (eg. credit balance, unusual large balances, new accounts, close accounts)
 - Review interest received and/or paid
- **Principle procedure**
 - **Confirm** cash held by others ; count or confirm cash on hand.
 - **Examine** client's bank reconciliation (recorded on a timely basis) obtain cutoff bank statements
 - **Test of cutoff** of cash receipts/disbursement, and transfers at BS date (unreleased check, Post dated checks)
- **General procedure**
 - review the cash a/c with GL for unusual items
 - review cash disbursement/receipts register for unusual items
 - review bank confirmations, minute, loan agreements, and other documents for evidence of restriction.
 - examine agreements relating to any escrow fund, compensating balance, and sinking fund and determine compliance with agreements and whether necessary disclosure have been made.
 - Confirm compensating balance arrangements