

# Internal Audit

Lecture # 09

By: Kanchan Damithendra

What is Internal Audit?

# Scope and Objectives of Internal Auditing

- ❖ Monitoring of internal control. The establishment of adequate internal control is a responsibility of management which demands proper attention on a continuous basis. Internal auditing is ordinarily assigned specific responsibility by management for reviewing controls, monitoring their operation and recommending improvements thereto.
- ❖ Examination of financial and operating information. This may include review of the means used to identify, measure, classify and report such information and specific inquiry into individual items including detailed testing of transactions, balances and procedures.
- ❖ Review of the economy, efficiency and effectiveness of operations including non financial controls of an entity.
- ❖ Review of compliance with laws, regulations and other external requirements and with management policies and directives and other internal requirements.

# International Standard

- The International Auditing and Assurance Standards Board (IAASB) is an independent standard-setting body
- Serves the public interest by setting high-quality international standards for auditing, quality control, review, other assurance, and related services, and by facilitating the convergence of international and national standards.
- In doing so, the IAASB enhances the quality and uniformity of practice throughout the world and strengthens public confidence in the global auditing and assurance profession

<http://www.iaasb.org/clarity-center/clarified-standards>

# Local Standard (SLAuS)

## **General Principles and Responsibilities**

**SLAuS 200** - Objective and General Principles Governing and Audit of Financial Statements

**SLAuS 210** - Terms of Audit Engagements

## **RISK ASSESSMENT AND RESPONSE TO ASSESSED RISKS**

**SLAuS 300** - Planning an Audit of Financial Statements

**SLAuS 315** - Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

**SLAuS 320** - Audit Materiality

## **AUDIT EVIDENCE**

- SLAuS 500** - Audit Evidence
- SLAuS 501** - Audit Evidence – Additional Considerations for Specific Items
- SLAuS 505** - External Confirmations

## **USING WORK OF OTHERS**

- SLAuS 600** - Using the Work of Another Auditor
- SLAuS 610** - Considering the Work of Internal Audit

## **AUDIT CONCLUSIONS & REPORTING**

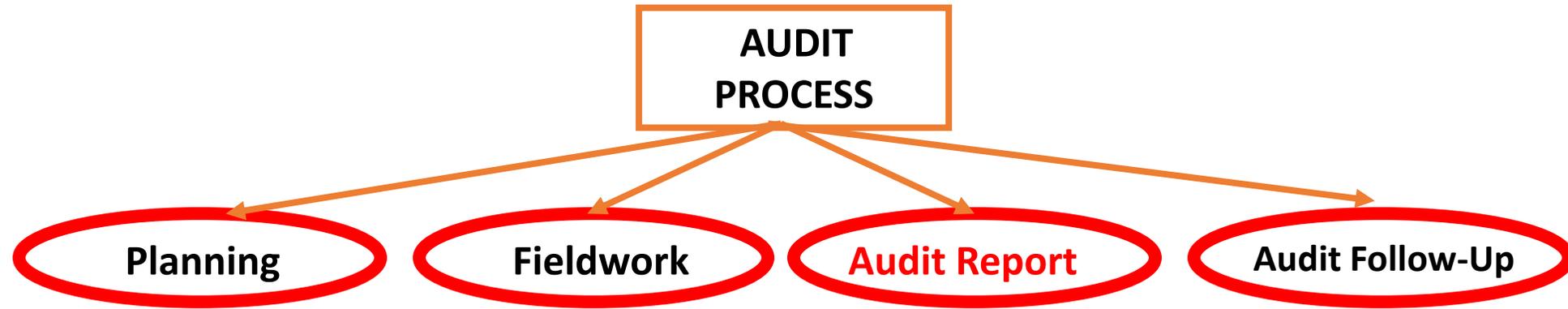
- SLAuS 700** - The Auditor's Report on Financial Statements
- SLAuS 710** - Comparatives

# Relationship Between Internal Auditing and the External Audit

No	Internal Audit	External Audit
1	Internal auditor is appointed by the management of the company.	External auditor is appointed by the shareholders of the company.
2	Legally internal audit is not compulsory.	External audit is compulsory by law.
3	Internal Audit work is a continuous throughout the year.	External Audit is done annually at the end of the fiscal year.
4	Internal auditor is employee of the company.	External auditor is an independent person.
5	Internal auditor has not to submit any report to the shareholders.	External auditor submits report to the shareholders.
6	Internal auditor checks all the transactions.	External auditor may apply test check.
7	Internal auditor gives suggestions to the management for the betterment of the business.	External auditor has no need to give suggestions unless he is asked.
8	Internal auditor primary duty is to find the frauds and errors	External auditor has to report about final accounts whether these are true or false

# Relationship Between Internal Auditing and the External Audit

No	Internal Audit	External Audit
10	Internal Auditor is a permanent employ of the organization.	External Audit is an independent contractor.
11	Internal Auditor reward is called Salary.	External Auditor reward is called fee.
12	Internal auditor has no right to attend the meetings of the company's shareholders.	External auditor has a the right to attend the meetings.
13	Internal auditor primary duty is to find the frauds and errors.	External auditor has to report about final accounts whether these are true or false.
14	Internal auditor checks all the transactions.	External auditor may apply test check.
15	For internal auditor any specific qualification is not compulsory.	For external auditor specific qualification is compulsory.



Announcement Letter

Initial Meeting

Preliminary Survey

Internal Control Review

Audit Program

Transaction Testing

Advice & Informal Communications

Audit Summary

Working Papers

Discussion Draft

Exit Conference

Formal Draft

Final Report

Client Response

Client Comments

Follow-up Review

Follow-up Report

Audit Annual Report to the Board



# Audit Planning



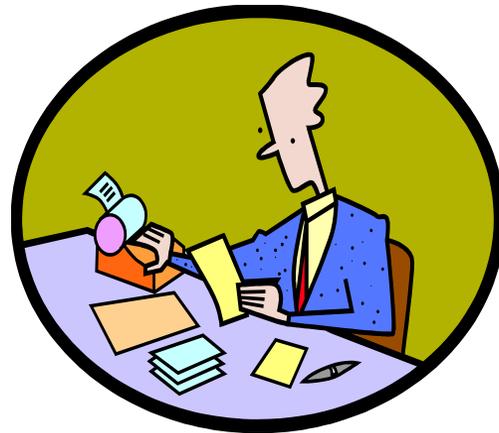
- The audit process is similar for most engagements and normally consists of four stages: Planning (sometimes called Survey or Preliminary Review), Fieldwork, Audit Report, and Follow-up Review. Client involvement is critical at each stage of the audit process. As in any special project, an audit results in a certain amount of time being diverted from your department's usual routine. One of the key objectives is to minimize this time and avoid disrupting ongoing activities.

# Planning

- During the planning portion of the audit, the auditor notifies the client of the audit, discusses the scope and objectives of the examination in a formal meeting with organization management, gathers information on important processes, evaluates existing controls, and plans the remaining audit steps.



- **Announcement Letter:** The client is informed of the audit through an announcement or engagement letter from the Internal Audit Director.
- **Initial Meeting:** the client describes the unit or system to be reviewed, the organization, available resources (personnel, facilities, equipment, funds), and other relevant information.



- **Preliminary Survey:** In this phase the auditor gathers relevant information about the unit in order to obtain a general overview of operations.
- **Internal Control Review:** The auditor will review the unit's internal control structure, a process which is usually time-consuming.



# Audit Program

- Preparation of the audit program concludes the preliminary review phase. This program outlines the fieldwork necessary to achieve the audit objectives.



# AUDIT REPORT

**Audit Step :** To communicate the results of the audit to management

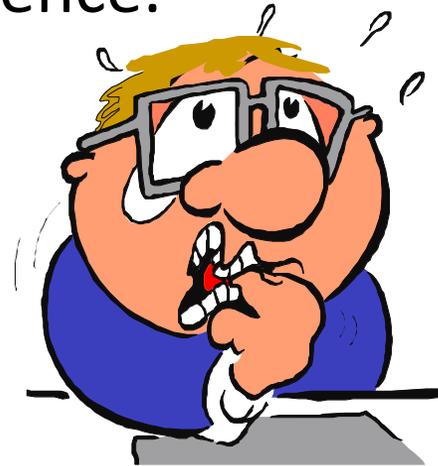
W/P No.	Est. Hrs.	Act. Hrs.
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<p>A.</p> <p>B.</p> <p>C.</p>	<p><b>Prepare a Draft Report:</b></p> <ol style="list-style-type: none"> <li>1. Write report introduction, background &amp; scope.</li> <li>2. Consolidate conclusion summaries into a report, x-ref</li> <li>3. Write memo for less significant items.</li> <li>4. Submit report for review &amp; clear review notes.</li> <li>5. Set up the Exit Conference and distribute Draft Report</li> <li>6. Conduct Exit Conference to brief on the audit results and request a date for completion of the corrective action plan. (Note: If any material changes to the audit report are identified, establish the date for revised report to be issued.)</li> </ol> <p><b>Obtain Corrective Action Plan</b></p> <ol style="list-style-type: none"> <li>1. Analyze the Corrective Action Plan for adequacy and document.</li> <li>2. Advise agency management of any apparent inadequacies in the Corrective Action Plan &amp; resolve.</li> </ol> <p><b>Prepare a Final Report:</b></p> <ol style="list-style-type: none"> <li>1. Add the revised Corrective Action Plan to the Draft Report to prepare the Final Report.</li> <li>2. Submit report for review &amp; clear review notes.</li> <li>3. Distribute the final report.</li> </ol> <p><b>REPORTING: Date Completed April 4, 2010      69      Total Hours:</b></p>	
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# Discussion Draft

At the conclusion of fieldwork, the auditor drafts the report. Audit's goal is to complete the audit and issue a draft audit report within 30 days after the completion of fieldwork.

Audit management reviews the audit working papers and the discussion draft before it is presented to the client for comment. This discussion draft is submitted to the client for review before the exit conference.



# Exit Conference

Internal Audit meets with the unit's management team to discuss the findings, recommendations, and text of the discussion draft. At this meeting, the client comments on the draft and the group works to reach an agreement on the audit findings.



# Exit Conference

Is an opportunity for the auditor, department management, process owners, and other to review and validate audit outcomes.

## **The Exit Conference should accomplish the following:**

- 1) Present observations and determine if the current operating context might affect past transactions.
- 2) Confirm facts, observations, and conclusions, e.g., that the findings are accurate.
- 3) Validate the cause leading to findings and present recommendations.
- 4) Estimate the effect of the findings on operations or its risk management.
- 5) Solicit draft management comments on the audit findings and determine if alternative recommendations adequately eliminate the cause of findings.
- 6) Define the timeline for issuing the final audit report and implementing recommendations.

# Audit Finding



## **Audit Findings**

### Reconciliation Supervisory Review (**Urgent**)

During our sample review of account reconciliations, it was noted that many account reconciliations were not being reviewed by the supervisor in Item Processing and Deposit Operations.

## **Recommendation**

We recommend management review all accounts at least monthly.

## **Action Plan**

The Supervisor of the Item Processing Department was advised of this requirement and has implemented changes as requested.

The Deposit Operations Manager will sign and review all account reconciliations. A secondary signature by the balancing associate and/or supervisor will also be implemented. This procedure is currently in place.

# Exit Conference Checklist

## Procedure

Set the date, time, and location of the exit meeting.

The agenda should include the following:

- Accomplishment of the audit objectives (theirs and ours).
- Discussion of potential audit findings and recommendations.
- Discussion of when management's responses will be due.
- Audit reporting process.
- Follow up process.

Document results of the exit meeting.



# Exit Conference

This section of the report summarizes the pertinent information regarding the Audit Exit Conference. It includes:



The date the conference was held.



The persons in attendance and their titles.



A statement that a summary of the Findings and Recommendations was discussed.

# Audit Exit Conference WP

**Audit Location (Faculty Division)**-----

**Audit Date**-----

**Lead Auditor**-----

**Audit team Member**-----

The main purpose of this meeting is to immediately present audit observation the audit and in such a manner so as to ensure that they clearly understand

**List Observations:**

The lead auditor should present observations, taking into account their perceived significance and identifying key non-conformance areas.

**Key Non-conformances:**



# Formal Draft

The auditor then prepares a formal draft, taking into account any revisions resulting from the exit conference and other discussions. This report is issued to the audited requesting a written response to

any audit findings and recommendations.

When the changes have been reviewed by audit management and the client, the final report is issued.



# AUDIT REPORT

Our principal product is the final report in which we present the audit findings and discuss recommendations for improvements. Once the fieldwork is completed, Internal Audit will draft a report to include the result of the audit including recommendations for improvement. After the draft report is completed, it will be forwarded to department management for review and discussion at a scheduled exit conference.



# Report Issuance Control Sheet

Spelling and Grammar Check

Performed by: \_\_\_\_\_PABLO\_\_\_\_\_

Quality Assurance Review (QAR)

Performed by: \_\_\_\_\_VILMARI\_\_\_\_\_

Approval of final draft with responses

Director of Audits: \_\_\_AMANDA\_\_\_\_\_

Engagement Manager: \_\_\_JOSE\_\_\_\_\_

Check all reports (original and all copies). Verify the following:

1. They contain all pages, in the appropriate order
2. All copies are straight and legible; and
3. The signature page has been signed.

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

## **Report Distribution\*:**

President

\_\_\_\_\_

Client Management

\_\_\_\_\_

Chief Business Officer

\_\_\_\_\_

Director of Internal Audit

\_\_\_\_\_

Chancellor

\_\_\_\_\_

Vice Chancellor for Academic Affairs

\_\_\_\_\_

Executive Vice Chancellor for Health Affairs

\_\_\_\_\_

Executive Vice Chancellor for Business Affairs

\_\_\_\_\_

Institution Compliance Officer

\_\_\_\_\_

Others (list)

\_\_\_\_\_

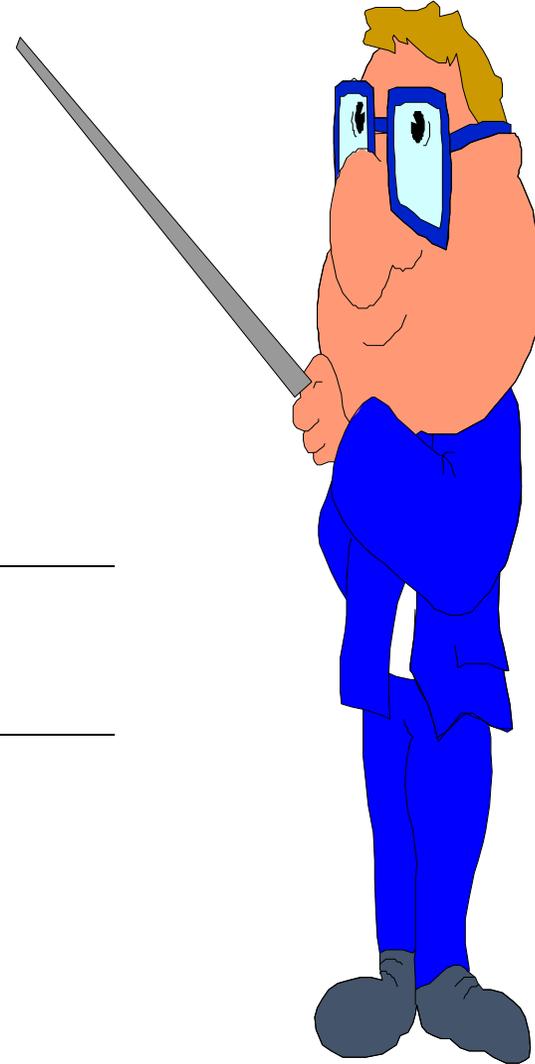
Reading File (unbound hard copy – stamped and placed in Reading File)

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Unbound hard copy provided to Office Associate

\* As determined by type of audit and institution where engagement is conducted (Academic, Medical, or System Administration).

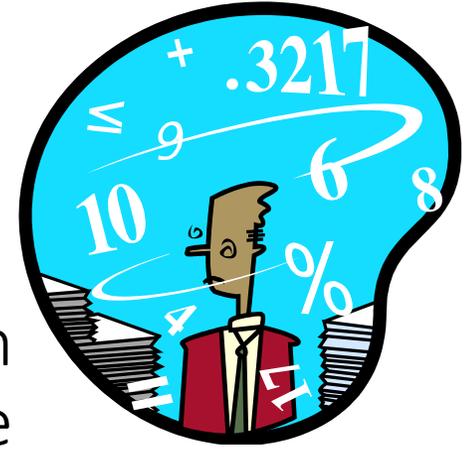
Compliance Officer should be included in report distribution if engagement involves a compliance issue.



# Final Report

After audited management has been given an opportunity to respond to the Preliminary Draft, the Final Draft Report is presented to the Accountability Oversight Committee for approval. Upon approval of the Final Draft the Final Report is issued.

Auditor distributes the final report the Chief Financial Officer, the Chief Accountant, the President, the Board of Directors, and other appropriate members of senior management. Final Reports are considered public information and will be available to anyone.



# Independent Auditors' Report

To the Board of Directors and Shareholders

Miami/Fort Lauderdale Area

- We have audited the accompanying balance sheets of **COMMERCIAL LENDING PARTNERS, LLC** as of December 31, 2009, 2008 and 2007, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.
- We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.
- In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of **COMMERCIAL LENDING PARTNERS, LLC** as of December 31, 2009, 2008 and 2007, and the results of its operations and its cash flows for the years then ended in conformity with accounting principals generally accepted in the United States of America.

Jose Cintron, MBA

April 4,2010

# Client Response

The client has the opportunity to respond to the audit findings prior to issuance of the final report which can be included or attached to our final report.

In the response, the client should explain how report findings will be resolved and include an implementation timetable. In some cases, managers may choose to respond with a decision not to implement an audit recommendation and to accept the risks associated with an audit finding



# Client Response Example

**Client Response (1)** - Treasury balances are reconciled monthly.

Treasury activity is reconciled daily. Differences are isolated to the period of October 1, 2002 and prior, and have been controlled since that date.

Adjusting entries are made with proper documentation and review.

Moving the function to a private sector financial institution has been

discussed and poses two major obstacles. The first obstacle is the negotiability of a private sector check versus a U.S. Treasury check.

This would obviously cause problems for account holders in remote locations as U.S. Treasury checks are readily negotiated by local merchants. A private sector financial institutions checks could not be as negotiable. The second obstacle is the financial resources required to obtain the services of a private sector institution.



# Client Comments

Finally, as part of Internal Audit's self-evaluation program, we ask clients to comment on Internal Audit's performance. This feedback has proven to be very beneficial to us, and we have made changes in our procedures as a result of clients' suggestions.



# Client Comment Example

"I would highly recommend Schmidt & Associates to any credit union currently searching for a quality auditing firm. I have been very impressed with the scope of the audits and the level of detail employed by representatives of the firm during their monthly and quarter contacts. Furthermore, I always receive prompt attention whenever I have questions regarding regulatory or compliance issues."

**Greg Kidwell**  
**Members First Credit Union**  
**Columbus, Ohio**  
11,000 Members, \$38 Million in Assets



# Audit Follow up

- Depending on the nature **of** the audit or the audit findings, the Follow-Up procedure may formal or informal”.



# Audit

Approximately one year of the final report, Internal Audit will perform a follow-up review to verify the resolution of the report findings.

- FOLLOW UP REVIEW
- FOLLOW UP REPORT
- AUDIT ANNUAL REPORT TO THE BOARD



# Followed up review

- The actions taken to resolve the audit report findings may be tested to ensure that the desired results were achieved.



# Followed up Report

- To resolve the original report findings.
- Unresolved findings will include a brief description of the finding, the original audit recommendation, the client response, the current condition, and the continued exposure to the board of company.



# Audit Annual Report

- Memorandum to the senior manager that notifies them that audit activities are underway and describes the follow-up process.

## **This memo should include:**

- timeframes for the project,
- a copy of the outstanding findings relating to areas reporting.
- a request that they distribute the findings to these areas and ask the managers to provide Internal Audit with the information requested,
- a statement that these comments were previously distributed as part of an audit report or close-out letter
- notification that the results will be reported to Board of Trustees.
- The Announce Memo report Findings Access database provides sample wording for the notification memo.
- The notification memo should be sent

