



**BENAZIR INCOME SUPPORT PROGRAMME**  
GOVERNMENT OF PAKISTAN



**INTERNAL AUDIT MANUAL**

**PART - TWO**

The document has been produced with the assistance of Asian Development Bank

## **PART TWO: PERFORMING AN AUDIT**

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## 1. INTRODUCTION

This Part of the Audit Manual provides guidance on how to carry out an audit. It sets out the methodology to be used by internal audit wing in BISP. The methodology relates primarily to systems audits (which will form the basis of the majority of the work done by internal audit. However, the same basic approach and principles apply to other types of audit, for example performance audits and information technology audits.

All audit staff are expected to make themselves fully aware of the contents of this Part of the Audit Manual, and to use these procedures in their audit work. In some cases it may be necessary to adapt the procedures to reflect the situation in a particular department/wing and those changes should be approved by the Head of Internal Audit.

When carrying out audits every auditor needs to keep in mind the need to comply with the Professional Standards set out in Part 1 of the Audit Manual. To help you in your day-to-day work the relevant Standard is shown at the start of each of the main stages of the audit process.

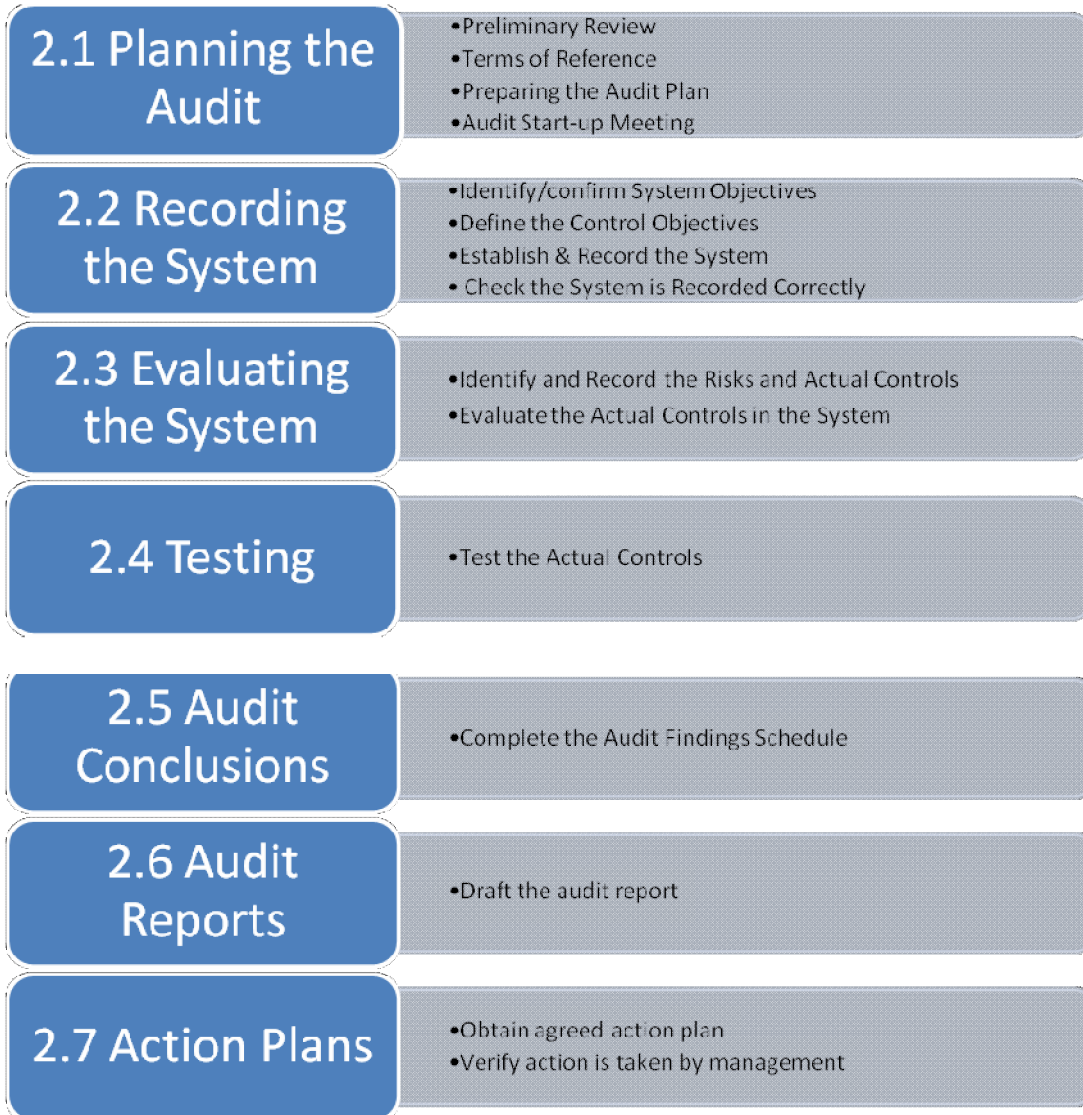
In general, good systems audits depend upon:

- (a) Careful planning of each audit, in order to determine where the work should be done and to allocate resources, effectively. Planning also helps to ensure that the concepts of risk and significance together are properly considered and that audits are tailored to the circumstances of the audited body
- (b) recognising that each part of an individual audit needs to be viewed in the context of the full audit plan, i.e., that no single audit stands alone
- (c) adopting a constructive and positive approach to the way the audit is done
- (d) reporting to management, in a timely and appropriate way, highlighting matters of significance arising from audit work and making suitable recommendations for corrective action
- (e) establishing arrangements to ensure that the audited organisation has properly considered any matters identified during the audit and implemented agreed actions.

Section 2 of this Part of the Manual sets out the main stages of an audit, and provides guidance on how to approach each of them. The remaining sections deal with some other key areas that impact on the effectiveness of internal audit . follow-up audits, the structure of audit files and the supervision of individual audits (to be developed later).

## 2. THE MAIN STAGES OF AN AUDIT

These are as follows:



## 2.1 PLANNING THE AUDIT

### 2200 Engagement Planning

Internal auditors must develop and document a plan for each audit, including the audit's objectives, scope, timing and resource allocations.

Planning is a critical stage for any audit. It ensures that managers are actively involved in the audit right from the beginning and that the audit focuses on the right things. There are four main steps to the planning process and these are set out in detail below.

#### ***Step 1 - Preliminary review***

Approximately six to eight weeks before the audit is scheduled formal notification should be sent to the department/wing concerned informing them that an audit will be taking place and that Internal Audit staff will be carrying out some preliminary work before holding the formal set-up meeting.

The notification should take the form of a brief letter informing the director responsible for the area to be audited of:

- The name of the audit . with reference to the annual audit plan
- The fact that it will be necessary to carry out some preliminary work (involving meetings with directors and, possibly, some staff) to establish the precise scope and focus of the audit
- The fact that a formal meeting to set up the audit will take place before the audit begins.

This fact-finding exercise (known as a preliminary review) is designed to provide an overview of the area to be audited. It also acts as the basis for planning the audit, and for determining:

- The objectives of the audit;
- The extent of audit coverage and identification of any specific areas that are to be given emphasis because they are high risk, are of critical importance to the system and/or suffer from weaknesses which are already known (e.g. the system depends upon computer systems which are outdated);
- Target dates for completion of each stage of the audit work; and
- Which auditors are to be employed on the audit and who is to be responsible for supervising the audit and ensuring the quality of the audit work.

The preliminary review should clearly define the audit of the system as set out in the annual work plan; establish the boundaries of that system (where they start and where they finish) and identify any interfaces with other systems and any other related audits that are planned in the future. This provides the basis for drafting the Terms of Reference for the audit, including the objectives, scope and coverage of the audit, which should then be agreed with management responsible for the area under review.

The preliminary review could involve:

- A review of the business and operational plans of the area to be audited (where available);
- A review of current organisation charts;

- An assessment of budget and management information (where available) ;
- Initial discussions with management to establish their objectives for the area to be audited, and
- A review of relevant legislation, regulations, instructions etc.

The review of previous audit reports (where work has been carried out in the past) is an important part of the preliminary review. Such reports can provide an insight into the level of control at the time of the last audit, and an opportunity to establish whether or not agreed recommendations relating to previous audits have been implemented by management. It is also useful to review any relevant reports produced by the Auditor General of Pakistan (AGP).

At meetings with heads of departments and units during this stage of the audit you should try to:

- identify and discuss the objectives the system is designed to achieve;
- discuss the relevant business activities and gain an understanding of any significant risks that may impact upon them;
- obtain an overview of the roles, responsibilities and reporting lines of the staff involved ;
- discuss any concerns or particular areas the manager concerned would like audit to review, and
- discuss the possible scope of the audit.

At the end of the preliminary review it is often useful to hold a meeting with the management of the department or unit concerned to discuss the initial findings

### ***Step 2 - Terms of Reference***

#### **2210 Engagement Objectives**

Objectives must be established for each engagement.

#### **2220 Engagement Scope**

The established scope must be sufficient to satisfy the objectives of the engagement.

#### **2230 Engagement Resource Allocation**

Internal auditors must determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints and available resources.

Having done all this, the Terms of Reference for the audit should be prepared. These set out the scope, approach, and timescales for the project. The template below shows the information which should be included in the Terms of Reference.

## Template for Terms of Reference

Working Paper Ref.

Prepared by: .....

Reviewed by: .....

<b>Audit Plan Ref:</b> Audit 4/2015 . Low Value Procurement
<b>Key Business/System Objectives:</b>  To procure low value goods and services at the lowest cost To use local providers of goods and services as much as possible
<b>Audit Objectives:</b>  To review the adequacy and effectiveness of the controls over the procurement of low value goods and services To establish whether the procurement of low value goods and services is in accordance with public procurement guidelines (PPRA)
<b>Scope of Audit:</b>  The audit will cover the systems for preparing and approving requisitions; the procedures for placing orders and the procedures for ensuring the receipt of goods and services.
<b>Key Contacts:</b>  Names
<b>Previous Audit Findings:</b>  None . this is the first audit of this system
<b>Points to note:</b>  The head of the procurement department was only appointed three months ago and has no prior experience of procurement.
<b>Timing of audit:</b> The audit is schedule to start on 11 July 2015 and fieldwork will be completed by 29 July. A draft report will be available by 12 August
<b>Auditor(s):</b>  Names

The audit objectives are an important part of the Terms of Reference. They must be clear and concise and relate to the key areas of concern to be addressed by the audit. An example of possible audit objectives is shown below.



**Possible objectives for a payroll audit**

To conduct an audit of the payroll systems in BISP to ensure that they comply with all relevant legislation, laws, management policies and procedures.

To establish that the payroll systems operate so that staff are paid correctly and on time.

To establish that the payroll procedures are efficient and effective.

### Step 3 - Audit Plan

the development of an audit plan. Below is a template for an audit plan. The plan should indicate the expected audit days to be spent on each stage of the audit. It should also include time for review and supervision by the Head of Internal Audit.

## INTERNAL AUDIT PLAN

AUDIT NAME: Payroll  
AUDIT NUMBER: 01/2015  
AUDIT DURATION 4 - 22 July

Stage	Date from / to	Auditor name/ days	Auditor name/ days	Auditor name/ days	Total for the stage
		Fakhar	ABC		
Planning the audit		3			3.0
Recording the system		2			2.0
Evaluating the system . including testing		4			4.0
Audit conclusions		1			1.0
Audit report		3			3.0
Management/supervision			1		1.0
TOTAL		13.0	1.0	0.0	14.0

Once completed the audit plan should be approved by the Head of Internal Audit.

#### ***Step 4 - The audit start-up meeting***

This is the final step of the planning stage, and comprises the following activities.

##### *Notification of the audit*

Before the audit start-up meeting formal notification of the audit should be prepared and sent to the Head of the department/unit responsible for the system that is to be audited. This letter should cover the following:

- The subject of the audit . with reference to the annual audit plan where appropriate or, for a consulting audit, indicating that the audit is a management request
- The objectives and scope of the audit
- The start date of the audit
- Who will be doing the audit.

The notification of the audit should also propose a meeting (the audit start-up meeting) to discuss the audit and finalise the necessary arrangements.

An example of a letter of notification is given below.

## Notification of the Audit

**Benazire Income Support Programme  
Government of the Pakistan**  
HQ, Islamabad

Number:

**Attn: Head of Unit/Wing Mr (Ms)**  
.....

**INTERNAL**

**Subject: Review of the Procurement Processes**

In accordance with the annual audit plan agreed for 2015 the Internal Audit Wing would perform an audit of Low Value Public Procurement by the BISP. The coverage and objectives of this audit will be as follows:

**1. Coverage**

The audit will cover the systems for preparing and approving requisitions; the procedures for placing orders and the procedures for ensuring that the required goods and services are received.

**2. Objectives of the Audit**

The objectives of the audit will be:

- To review the adequacy and effectiveness of the controls over the procurement of low value goods and services
- To establish whether the procurement of low value goods and services is in accordance with public procurement guidelines (PPRA)

**3. Date of commencing the audit**

The audit is planned to start on 11 July 2015.

**4. Conducting Audit**

The audit will be carried out by \_\_\_\_\_ and \_\_\_\_\_. Upon completion of the fieldwork, we will prepare a draft audit report that will be sent to you for your consideration. After that, we will organise the exit interview in order to discuss our recommendations and to consider any comments you may have. Following that a final report will be issued.

**5. Opening Interview**

We will be in touch with you shortly to discuss the proposed coverage and objectives of the audit. If there are any specific concerns you have about the systems for Low Value Procurement we will be very happy to discuss these with you at this meeting.

**Head of Internal Audit,  
(name)**

**Delivered to: (name), Head of procurement  
[Copy to: Director to Chairperson, BISP]**

### *Start-up meeting*

This meeting should be held with the Head of the department/wing or unit to be audited. The Head of Internal audit should be involved, together with the auditor carrying out the work.

The meeting is intended to:

- Introduce the auditor to the management of the department or unit;
- Outline the purpose of the audit and give a brief overview of the methodology to be used . if this is the first time an audit has been done in the department or unit it will be necessary to give a more detailed explanation of the way the audit will be carried out;
- Provide an opportunity for management to suggest particular areas which they think should be examined;
- Discuss Internal Audit's proposals on the possible focus of the audit; and
- Explain that they will be kept informed of the progress of the audit, and that management's assistance will be welcomed throughout the audit.

Some guidance on how to approach the opening meeting with management is given in Appendix A.

Following the meeting Minutes should be prepared and retained on the audit file. Those minutes should be kept brief . possibly in the form of bullet-points.

## 2.2 RECORDING THE SYSTEM

### 2300 Performing the Engagement

Internal auditors must identify, analyse, evaluate and document sufficient information to achieve the engagement's objectives.

This part of the audit requires the auditor to obtain a clear understanding of the relevant system. This is achieved by interviewing the directors and staff who operate, and are responsible for, the system being audited and by reviewing relevant written procedures and other documentation relating to the way the system operates.

Interviews form a key part of the audit process and it is important that they are handled in an effective way. Guidance on arranging and handling meetings is provided in Appendix A.

#### ***Step 1 - Identify & confirm the system objectives***

However, before starting to record the system it is necessary to find out the objectives that management has for the system (the system objectives).

When you are trying to find out what the system objectives are you should remember that in every system there will be a hierarchy of objectives - starting with those objectives set by senior management and working down to the objectives of the people involved in the detailed operation of the system.

For example in procurement system the objectives set by senior management might include:

- To ensure that Pakistani law, legislation and requirements are met when placing procurement contracts e.g. PPRA
- To reduce the cost of procurement by 5% each year for the next three years;
- To make the existing system for approving expenditure more efficient, and
- To reduce the backlog of invoices awaiting payment.

System objectives such as these are often set out in a formal way . for example as part of the strategic plan for the organisation . but sometimes there may be other informal, undocumented system objectives and the auditor needs to be alert to the possible existence of these.

Operational objectives will often be broader and more generic at the management level, and become more specific for staff at lower levels in the organisation. For example, the Head of the Procurement function may have an objective that is:

- to ensure all procurement is carried out in accordance with the Public Procurement Rules.

The procurement staff, however, may have more specific objectives that relate to their specific role, for example:

- to ensure that three tenders/quotations are obtained or
- to ensure that tenders received are not opened before the due date.

## **Step 2 - Define the control objectives**

Control objectives are a key part of the audit process. They provide the primary focus for the evaluation of the system of control. By obtaining an understanding of what the objectives of the system are, it will help you to identify what the control objectives of the audit should be. The control objectives you set need to be consistent with the objectives of management in the organization, and should be discussed and agreed with management . ideally before you start any evaluation of the controls in place.

Control objectives provide the framework for each systems audit assignment. They should detail the various aspects of a system's objectives, and provide the basis for evaluating the actual controls in the system. Control objectives should be specific enough to provide the basis for this evaluation. Control objectives that are generalisations such as "to ensure that support services are adequate" should be avoided.

Considering the relevant laws can be a useful starting point for identifying control objectives, but the nature and types of risk that could impact upon the system together with the control environment must also be considered.

One useful way of developing control objectives is to think about the organizational structure relating to the area you are auditing. This involves:

- Identifying the main wings/units affected by the audit;
- Establish the main activities carried out by each of those main wings/units;
- Determining the management objectives of each of those activities, and
- Developing the control objectives which will help ensure the achievement of the management objectives for each of the main activities.

As a simple guide it may be useful to work on the basis of one control objective for each activity . although this rule should not be applied too rigidly. It is recommended that there should be no more than 6 to 8 control objectives for any audit.

For example with procurement the main wings/units involved could be: the wing(s) requesting the supplies, services or works; the purchasing/contracts section; the wing(s) receiving the goods or services and the accounts department.

For each of those sections or units you can then establish the activities which they carry out and this will help you to decide on the control objectives. So, for procurement:

- The *wing requesting the supplies, services or works* will be concerned with preparing the commitment request/purchase requisition and (in many cases) receiving the supplies, services or works. A possible control objective could be:
  - to ensure that all purchase commitments are prepared correctly and at the right time±
- *Purchasing/contracts section* will be involved in: processing purchase requisitions; ordering; tendering and contracting; maintaining the supplier database etc. A possible control objective could be:
  - to ensure that all purchases are made on the basis of suitably authorized commitment requests and in accordance with laid down procedures±
- *Accounts department* will be receiving invoices; validating and paying invoices; maintaining supplier payment files etc. A possible control objective could be:
  - to ensure that invoices are only paid for goods or services which have actually been received, and in accordance with the terms set out in the purchase order±

Another approach to developing comprehensive control objectives is to consider aspects of control such as:

- Has the system been adequately planned?
- Are the operations adequately supervised and controlled?
- Is the system periodically reviewed?
- Is suitable management information produced?

Control objectives should relate to the specific features of the system and the way in which the activities are carried out in order to achieve the system objectives. They should also be specific and show the purpose of control - and not the control itself. For example:

- In a purchasing audit one control objective might be to ensure that invoices are paid only for goods or services which have been received;
- In a payroll audit a control objective could be to ensure that payments are made only to valid employees of the organization; and
- In a security audit a control objective could be to make sure that only accredited staff and visitors are permitted to enter the building.

Wherever possible the system objectives and the control objectives relating to the system should be identified before work starts on recording the system and they can then be reviewed and revised, as necessary, once the system has been recorded and you have a full understanding of how the system works.

Further examples of control objectives for some of the common systems will be provided later.

Once the control objectives have been identified it is advisable to try to ensure that the director who is responsible for the system to be audited agrees with objectives assigned to the system and the control objectives, which have been developed by internal audit.

### ***Step 3 - Establish and record the system***

*Why do we need to do this?*

The main reasons for describing the system are:

- To confirm the auditor's understanding of the system;
- To establish any interfaces between systems;
- To establish how the system fits within the department or unit under review and the organisation as a whole; and
- To provide a basis for assessing the extent to which internal controls prevent or detect and correct errors.

The description of the system forms the basis for the auditor's judgments, conclusions, and recommendations. It also should provide a good basis for the evaluation of the strengths and weaknesses in internal control. Exclude any things which are not significant to the audit because recording the system can often take up a lot of time.

The auditor should decide which technique or combination of techniques for recording systems is most appropriate, taking into account the nature and complexity of the system, the audit objectives and any earlier audit work done.



### *Sources of information*

These can include:

- Files and papers from earlier audits;
- Organisational and procedural manuals used in the organisation;
- Interviews and informal discussions with managers and staff (detailed guidance on interview techniques is contained in Appendix A);
- Observation of the physical environment and the working methods used. It is particularly useful where there is no physical evidence remaining after the event that something has happened. Remember that the presence of the auditor may influence the behavior of staff and the practices observed may not, therefore, be typical. It may also be difficult to substantiate the evidence;
- Documents and records used in the system;
- Reports prepared by the M&E Wing;
- Any other reports relating to the area under review; and
- Management information (e.g. budgets and other reports e.g. ones showing outputs, number of transactions processed, cash flows, revised plans).

### *Extent of the systems description*

This should be detailed enough to allow the user and the person reviewing the audit to understand how the system works and how internal control is achieved. Depending on the objectives of the audit, in some cases it may be necessary to record the complete system and in others it may only be necessary to record key areas of the system.

When recording the system it is important to:

- Record the system as it **actually** operates and not as the regulations or procedure manuals say it should operate;
- Identify and record all types of procedures and transactions covered by the system under review (including exceptions such as public holidays, staff holiday periods, unusual hours etc.);
- Look carefully for controls - they may not always be clearly indicated or easy to identify;
- Record only the elements of the system essential to the audit evaluation;
- Copy only essential documents. Unnecessary copying of documentation can be wasteful and tends to make it difficult to review audit files, and
- Remember that the description of the system found in such documentation may be out of date and incomplete.

### *Steps to be taken when documenting systems*

Depending upon the nature and complexity of the system, the audit objectives and the results of the previous audit the auditor should carry out the following activities:

- Establish an outline/overview of the system to enable you to decide on whether to use narrative or flowcharts to document the system, and also to decide which of the main sub-systems it will be appropriate to describe separately;
- Obtain a detailed description of the systems and internal control features from discussions with departmental personnel. This should include:

- A record of which processes and procedures are carried out and by whom;
  - A record of any changes in or exceptions to the normal procedures for different types or groups of transactions (raising a commitment, an adjustment to salary payments, preparing contracts . e.g. those of high value;
  - A record of arrangements made to cover lunch hours, holidays or, for more significant transactions, peak flows of transactions;
  - Copies of all documents and forms used in the process; and
  - Copies of all computer reports which form part of the system, for example payroll listings showing names, salaries; lists of all requests for payment; fixed asset registers together with their purpose **and** the way they are used.
- Record information on flowcharts or notes. If possible compare them with internal procedure manuals;
  - Perform walk-through tests (see below) to ensure that the system actually does operate in the manner which has been described. (This should include both manual and computer systems;
  - Finalise the narrative or flowchart; and
  - Cross reference copies of documents and reports to the flowcharts. Blank copies of each of the main documents should be held in Section F . *Sample Documentation±* . of the Permanent Audit File.

When preparing this documentation, the auditor should remember that the amount of documentation should be limited to what is needed to identify and record the internal controls.

If they provide adequate explanation, copies of standard documentation and significant reports or summaries may form part of the audit record. System records should also show the sources of information e.g. manuals, interviews.

### *Systems documentation techniques*

The auditor should decide which technique of documenting systems is the most suitable for each audit: narrative descriptions, flowcharts or a combination of the two.

#### *(i) Narrative Descriptions*

A narrative description helps to give a complete and detailed picture of the system and should include:

- System objectives and targets;
- Links and interfaces with other systems;
- The environment in which the system operates;
- The allocation of authority and responsibility;
- All key controls and systems processes;
- Exceptional situations or cases that may need to be dealt with by the system e.g. certain very high level payments or commitments may have to be approved at the most senior level, whilst all others are approved at Head of Department or Head of Unit level; and
- Ad hoc controls such as management reviews.

Narratives may cover detailed descriptions of the movement of documents etc through the system, but in some cases these can be better recorded through flowcharts (see below).

To make them easier to understand it is often useful to divide narrative descriptions into:

- A simple overview of the system; and
- Separate detailed descriptions of the main constituent parts of the system.

Full use should be made of headings when preparing narrative descriptions to make it easy to identify the steps in the system and the key areas of activity. Narrative descriptions should also be set out and organised in a logical way in order to give a clear picture and make referencing and updating easier.

Wherever possible the source of the information and the names and titles of people interviewed should be recorded.

The narrative description should be recorded on the System Record document that is shown below.

*Narrative Description template*

<b>System Record Document</b>	
<b>Title of audit: 5/2015 = Staff recruitment</b>	
<b>Prepared by &amp; date:</b>	<b>Reviewed by &amp; date:</b>
Activity No.	Description of activity
<b>1</b>	Head of unit/wing prepares request to recruit a new or a replacement member of staff. Forwards request to Secretary
<b>2</b>	Request approved/rejected by Secretary If rejected, approval returned to Head of Wing Approved requests sent to HR Unit/Wing.
<b>3</b>	Review of request by HR Wing. Check it is consistent with agreed systematisation.
<b>4</b>	Approval by Head of HR Wing.
<b>5</b>	Request sent to Chairperson (CP) for final approval
<b>6</b>	After approval by CP the Selection Panel is set up. CP approves membership of the Selection Panel. Details of the position and the type of person required are sent to the Panel.
<b>7</b>	Position is advertised in accordance with the regulations
<b>8</b>	Applications are received and processed by HR Wing. Checks are made to ensure that all documents requested are included with each application. Copies of the documents for each candidate are made and sent to each member of the Selection Panel.
<b>9</b>	Selection Panel reviews the applications and selects candidates for interview. A report is produced of the initial selection process.
<b>10</b>	Interview date and times set by Panel and HR Wing arrange interviews for candidates selected for interview. Invitation letters are sent to candidates.
<b>11</b>	Etc

*(ii) Flowcharts*




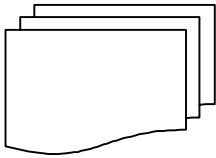
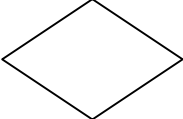

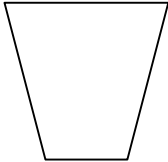
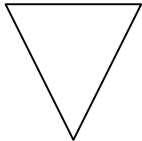
Flowcharting is a diagrammatic method of recording and describing a system which shows the flow of documents or information and the related internal controls within a system. Flowcharts can help:

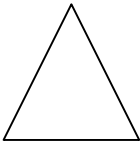

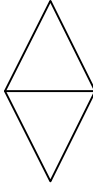


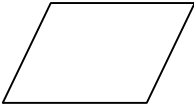
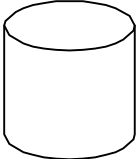

- To obtain a perspective on the whole system
- Gain an appreciation of the auditee's objectives
- Identify division of duties
- The person supervising the audit to identify areas which are not being covered by the review.

Flowcharts consist of symbols, each with a specified meaning, a brief explanatory text and connecting lines. The extent of any explanatory text depends primarily on the complexity of the processes and on who is going to use the flowchart.

Set out below are the standard symbols which should be adopted by Internal Audit. Microsoft Excel provides a basic flowcharting facility that will be adequate for the preparation of most flowcharts. There are also various audit flowcharting software packages that can be purchased.

## Common flowchart symbols

Symbol – manual/computer	Description
	Start or end point of flowchart
	Direction of flow of the activities in the process. Connects symbols on the flowchart.
	Process or operation. This can include a control e.g. signing a document, checking the contents of a document.
	Multiple documents . where there is more than one copy of a document prepared. The number of each copy in top right hand corner . 1, 2, 3 etc.
	Decision . yes or no; approve or reject; or alternative courses of action (if a±do this if b±do that)
	Connector . i.e. to another point in the flowchart on same page; to another point in the same flowchart on another page; or to a point in another flowchart. Identifying letter or number to be inserted in centre of symbol
	Manual operation . e.g. counting cash; preparing a hand-written receipt for money; checking existence of assets etc
	Extract data/information from a document or other source

Symbol – manual/computer	Description
	Merge one or more documents
	Collate a document or a number of documents
	Sort documents . for further processing, filing etc
	Preparation of a document, report, purchase requisition, invoice for charges
	Manual input to a computer based system . via keyboard or other process
	Computer input or output
	Magnetic disc storage/processing
	Computer tape storage/processing

It is sometimes useful to prepare an overview flowchart that shows the main steps of the system and the interrelationships between them. More detailed flowcharts can then be prepared for the various parts of the system. For example: in a procurement audit the overview flowchart might show the main steps in the procedure from the point at which goods or services are requested to the point at which the goods and services are received. More detailed flowcharts could then be prepared for each of the main stages such as requisitioning; tendering; evaluation and award of the contract; receipt of the goods or services etc.

Careful thought needs to be given to the number of levels required when flowcharting, and the auditor should limit the number of levels of a flowchart to whatever is necessary to depict clearly and precisely the system being audited, and to make it possible to identify the controls that exist in the system and possible areas of inadequate control.

There are two main types of flowchart:

1. **Horizontal flowcharts** (system flowcharts) describing the horizontal distribution of responsibilities (units, positions etc) by using columns; and
2. **Vertical flowcharts** depict the flow of transactions from first to last (beginning to end).

**When carrying out your audit you need to decide which is the most appropriate type of flowchart to use.**

Example of a horizontal flowchart:

Your flowchart should be divided into a number of columns as shown in the diagram below. The first column is for a brief description of each operation, while the other columns should be headed up with the title of a single individual or the names of a unit/department involved in the process - see the sample template below. Microsoft Excel provides the facility to prepare flowcharts, and it is recommended that this is used for speed of preparation and ease of correction.

If you wish to prepare flowcharts manually you should use A3 landscape paper and try to restrict the number of columns to a maximum of five or six to make the flowchart less cramped and easier to use.

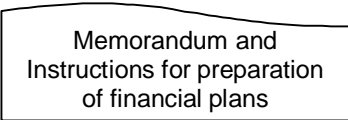
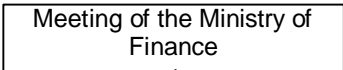
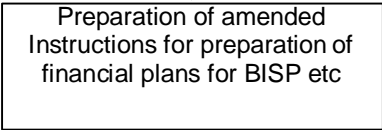
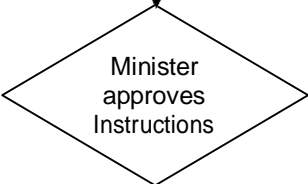
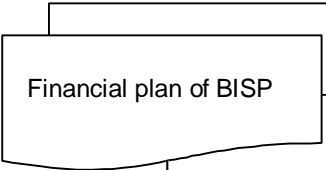
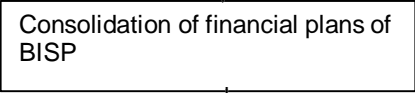



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**Example Format for Horizontal Flowcharts**

Purchasing system – audit (x) _____					Prepared by and date: _____
Op No	Description of each operation	Unit requesting supplies or services	Purchasing unit	Unit receiving supplies or services	Invoice payment Unit

**Example for Vertical Flowcharts**

Activity number	Details of activity
1.	 <pre> graph TD     A[Memorandum and Instructions for preparation of financial plans] --&gt; B[Meeting of the Ministry of Finance]     B --&gt; C[Preparation of amended Instructions for preparation of financial plans for BISP etc]     C --&gt; D{Minister approves Instructions}     D --&gt; E[Financial plan of BISP]     E --&gt; F[Consolidation of financial plans of BISP]     F --&gt; G{Minister approves Proposed Plan}                     </pre>
2.	
3.	
4.	
5.	
6.	
7.	

When preparing flowcharts remember:

- Flowcharts are primarily designed to show document flows rather than operations . although other operations can be explained by means of narrative notes if necessary;
- To avoid mixing up the regular process and exceptional processes (two or three transactions per period) on the same flowchart. Prepare separate charts for the regular and the exceptional process or processes;
- To consider whether it is better to record the system by preparing one or more basic flowcharts which show the main flows in the system(s) - supplemented by narrative description where necessary;
- To flowchart the **actual** system. In a very few cases it may be necessary to record the official system, and in those cases the charts must be labeled clearly to show whether it is the official or the actual system which is shown;
- The end product doesn't need to be a masterpiece . so don't waste time trying to make it perfect;
- That each flowchart should have a title, the date it was prepared and dates of any amendments to it and the name of the person who drafted it;
- To make sure that the processing of all documents (and of every copy of each document) is shown in full on the flowchart; and
- To think carefully before preparing a flowchart. Ask yourself whether it's really necessary or whether narrative description will be just as effective and less time-consuming.

### **Advantages and Disadvantages of Flowcharts**

Advantages of flowcharting are:

- Information can be easily communicated and assimilated;
- Flowcharts highlight the relationship between different parts of the system;
- The auditor can see the whole flow of documents: potential bottlenecks can be identified easily;
- Flowcharts offer a consistent method of recording;
- The auditor has to obtain a clear understanding of information flows in order to draw up a flowchart of a complex system; and
- Cross-referencing (e.g. being able to see any links and overlaps) between systems is made easier.

Disadvantages of flowcharts:

- The time they can take to prepare;
- They are limited in scope and may not identify managerial and organisational controls (e.g. the way in which activities are divided between different work units or responsibilities are divided) ;
- The techniques and conventions have to be learned and practiced;
- Their creation may be more time consuming than a narrative description;
- They may become outdated quickly when a system is changing frequently . and they take a lot of resource to keep up to date. A narrative record may be more cost effective;
- Complex flowcharts may confuse rather than clarify; and
- Auditors usually need some training and experience before becoming proficient in preparing them.

It is often useful to use a combination of narratives and flowcharts . using flowcharts to describe more complex parts of the system. If flowcharts are used as well they and the narrative descriptions should be cross-referenced to each other.

### **Other points to consider**

#### ***Organisation Charts***

The organisational structure relating to the system under review should be recorded. A copy of an existing organisation chart will suffice, as long as it is accurate and up to date.

An up-to-date chart will show details of the information chain, reporting relationships and responsibilities. It is also useful in identifying staff and deciding where audit testing needs to be done. The date the chart was prepared should be recorded.

The chart may include:

- Main sections/branches with a description of their functions;
- Job titles, grades and names of staff together with lines of responsibility; and
- Any other reporting lines . e.g. reports provided outside of the organisation, e.g. to the MoF.

#### ***Minimum Contents of System Documentation***

Whichever method is used for documenting the procedures in each system there are certain items which should be included on every system file. These are:

- Examples of documents, with descriptions of their purpose and use. These documents and reports should be filed in the order in which they are used in the system, and cross-referenced to the narrative note or flowchart;
- Examples of reports, whether computerised or manually prepared, describing their purpose and use;
- Details of the number of transactions passing through the system (volume summaries). These are essential to a full understanding of the context of the system in relation to the overall activities of the entity. It is therefore necessary to summarise data such as:
  - Number of transactions(e.g. Number of concluded contracts);
  - Value of transactions; and
  - Seasonal fluctuations.
- Forms used to evaluate the system.

It may also be useful for the auditor to know the number of employees or an analysis of the transactions by value or age to assist in the evaluation of risk when a weakness is highlighted.

#### **Step 4 – Check the system is recorded correctly**

It is important to ensure that the system is recorded accurately because it provides the basis for an evaluation of internal controls and for deciding on a programme of audit tests.

#### **Walk-through testing**

In conducting walk through tests, the auditor looks primarily for evidence of the existence of controls. This may involve examining a small number of different transactions at each stage of the process or following one transaction through from start to finish. The aim of this type of testing is to make sure that the system works in the way it is described in the systems narrative or flowcharts and to confirm the controls in place at each stage.

Normally transactions are followed from start to finish (final processing) . known as cradle to grave . However, sometimes it is more convenient and practical to start from completion of processing. It is important to consider documents which pass through any sub-systems (e.g. overtime payments in a payroll system) and to look carefully at each file of documents and ask yourself why they are kept and where they are kept.

#### **Verify the system with management**

It is often useful to discuss your understanding of the system with management and to obtain their agreement with your record of the system. This will help to avoid unnecessary discussion or debate at a later stage in the audit. In some cases it may be appropriate to ask the manager to signify agreement to your record of the system in writing.

#### ***What to do with differences between the systems record and the walk-through test.***

When this happens there are two possible reasons:

- The system record you have prepared is wrong, or
- The system record is correct but the system is not working properly.

If there is a difference, or any other information is identified which is inconsistent with the flowchart, you should refer back to the original source(s) of the information before doing any more work. This is important because, if the system record has to be amended the paths for the transaction walk-through may have to be changed.

When the difference is the result of a breakdown in the system, you will normally need only to record this fact on your working papers. This information should then be taken into account in the evaluation of internal control.

## 2.3 EVALUATING THE SYSTEM

### 2130 A1 - Control

The internal audit activity must evaluate the adequacy and effectiveness of controls in responding to risks within the organisation's governance, operations and information systems regarding the:

- ~ Reliability and integrity of financial and operational information;
- ~ Effectiveness and efficiency of operations and programmes;
- ~ Safeguarding of assets; and
- ~ Compliance with laws, regulations, policies, procedures and contracts.

### Step 1 - Identify and Record the Risks and the Actual Controls

Once you know how the system works you need to review the control objectives you identified at the planning stage of the audit to establish whether they are appropriate and whether additional control objectives are needed.

When you are satisfied with the list of control objectives you then need to prepare a separate Control evaluation record for each control objective.

After that you should identify:

- The risks relating to each of the control objectives, and
- the actual controls operated in that system. These should be shown clearly in the systems description you have prepared.

#### *Identifying risks*

The internal audit evaluation should take account of the likelihood of undesirable events occurring (risk) and their significance to the organisation (materiality). Internal auditors should use their judgment to determine what level of control is appropriate in the light of their evaluation of the risks and materiality involved.

Risk may be viewed as the chance (or probability) of one or more of the organisation's objectives not being met. When you are identifying risks it is important to remember to keep the control objective in mind at all times. The risks you are looking for are those that might impact upon the achievement of the control objective. Try to be sensible and realistic about the risks you include. Identified risks should be recorded in Column 1 of the Control Evaluation Record shown below.

Materiality is an assessment of the significance of a failure to achieve the objective. Materiality may be measured in terms of the financial consequences, the relative importance of the objective concerned, or the sensitivity of the areas concerned. In considering materiality, internal auditors should take into account: the possible direct and indirect financial consequences; the importance of particular management objectives in the context of the organisation's overall objectives; the potential for embarrassment or adverse publicity. Internal auditors should also take into account the cost of reacting to a failure, as well as the effects of the potential failure itself. Such costs may

include the costs of any investigation, taking corrective action and supplying appropriate explanations to the regulatory authorities, if relevant.

For each risk you identify you should decide whether the level of risk is ~~High~~ ~~Medium~~ or ~~Low~~ and note that in Column 2 of the Control Evaluation Record.

Where appropriate, and when time allows, the risks identified should be discussed and agreed with management.

Typical categories of risk are:

- **Error** . is there a possibility an error could occur during the process in question or that information held in a key data file or store (eg details of supplier; employee records) could contain errors. Eg. Tender documentation provided to suppliers does not include all the information they need.
- **Fraud** –could the process or information be deliberately manipulated for personal gain which might go undetected? **Ex.** *Employee is in the position to award a contract in return for payment in cash, assets (cars) or services (holidays).*
- **Theft** . in the delivery of the systems objectives and the performance of the activity under review are there physical assets which someone could remove for personal benefit? **Ex.** Laptop computers which are not locked away could be taken from the office
- **Regulatory** . could the process or system fail to meet local laws, rules and regulations; the laws of Pakistan and any rules and regulations laid down by the Federal government **Ex** *Risk that Guidelines for preparing the financial plan for indirect budget beneficiaries issued by F&A Wing are not in accordance with the Guidelines on budget preparation issued by the MoF*
- **Disclosure** . is there a possibility of unauthorized disclosure of information or of the way in which the system or process operates which might lead to loss, embarrassment or other disadvantage? **Ex.** *Important information for public procurement are disclosed before the Public procurement Committee opened bids or the name of the bidder who won the award is disclosed before the procedure is completed*
- **Disruption** . is there a possibility of loss or disruption which would make it difficult or impossible to operate the system or process or could lead to the loss or corruption of data. **Ex.** *The existing software for additional/support books-recordings is attacked by a computer virus, and the last regular back-up was done two months ago – resulting in a lack of valid data for report preparation*
- **Value for Money (VFM)** . is there the possibility of uneconomic, inefficient or ineffective use of resources in the performance of the process or system? **Ex.** *Is it the right moment to invest in adaptation of objects in one area of culture when there is an evidence on other object more in danger in some other area*

Alternatively, the following risk prompts can be used to identify risks. They can help to stimulate ideas of what could go wrong within a system, what impact it could have and how likely it is to occur.

- É Failure to ò
- É Missed opportunity for ò
- É Ineffective ...
- É Inability to ò
- É Reliance on ò
- É Inadequate ò
- É Delay in ò
- É Incompatible with...
- É Loss of ò
- É Non-compliance with ò
- É Lack of ò
- É Conflict between ò
- É Inappropriate ò
- É Disruption to ò
- É Increase in ò
- É Concentration of ò
- É Inconsistent ò
- É Reduction of



**Control evaluation record**

Prepared by: í í í í í í í í .

Date: í í í í .

Working paper number: 10/1

Reviewed by: í í í í í í í í ...

<b>Risk/Control Evaluation Record</b>						
<b>Control Objective:</b> To ensure that suitable procedures exist for placing new starters on the payroll						
<b>1. Risk</b>	<b>2. Risk level H/M/L</b>	<b>3. Control</b>	<b>4. Control Adequate?</b>	<b>5. Test Reference</b>	<b>6. Control Effective?</b>	<b>7. Comments</b>
1.1 The wrong people could be put on the payroll	M	A list of the names of all new starters added to the payroll is produced monthly and reviewed by the Head of Payroll Section	Yes			
1.2 The required checks on new starters may not be made (certificates, references etc)	M	A checklist for action required when appointing new staff should be completed by Recruitment section and sent to Payroll Section.	Partially	WP15/1	No - Tests showed that the checklist is sent to Payroll Section, but that it is frequently filed without any review	
1.3 The wrong salary could be paid	M	The monthly check of the list of names of all new starters by the Head of Wings	No	WP15/2	No ó tests of the list of names show that they do not contain any salary details.	
<b>Conclusion:</b>						

## ***Step 2 – Identify the actual controls in the system***

Controls are actions and procedures established by the auditee to ensure that the objectives of a system are met. Based on the systems description you have prepared you should then identify the **actual** controls that exist in that system in respect of each of the risks you have identified. These actual controls should be recorded in column 3 of the Control evaluation record. **Remember** that for some risks more than one control may exist.

The actual control should be adequately described, cross referring to supplementary notes if necessary. If a control is absent from a particular area then this fact should be recorded on the Control Evaluation Record, instead of a control description.

One simple way of identifying what the actual controls in a system are, is to use the following categories of control to prompt your ideas:

- **Segregation of duties:** the functions of authorising transactions; recording the transactions; and custody of the associated assets should be undertaken by separate staff;
- **Organisation:** there should be a clear organisation chart and all staff should have up to date job descriptions that clearly indicate their responsibilities;
- **Authorisation and approval:** all transactions and decisions should be formally authorised by nominated staff;
- **Physical:** there should be suitable controls over access to offices, assets, controlled stationery, and computer systems;
- **Supervision:** all staff and activities should be adequately supervised by someone who understands the process and will detect deviations from accepted practice;
- **Personnel:** appointment of staff should be adequately controlled; all staff should be suitably trained for their post and appraised regularly;
- **Arithmetical and accounting:** checking / re-performing tasks carried out by others; costing (adding up) orders, invoices, payroll etc; reconciliation between the bank and accounting records; control accounts; and
- **Management:** production of suitable financial and operational management information; use of exception reports; critical review and enquiry by management.

Further guidance on types of control is given in Appendix B

## ***Step 3 – Evaluate the actual controls in the system***

Once you have identified the controls that actually exist you can then go on to assess whether these controls are likely to be adequate. However, you need to remember that internal auditing is not simply a series of stages that can be completed one after the other. When you go on to test the controls you have identified, you may discover that there are additional controls or that some

controls are not actually operating as expected. If so, you will then have to go back and revise your system description to ensure it reflects the actual controls that are operating in practice.

Internal auditors obviously want to see controls are in place, but they need to be there for a purpose . that is to ensure that the system or process achieves its objectives. Controls are only needed to reduce the risks to the achievement of these objectives to an acceptable level. This means that there may be circumstances when internal auditors suggest that certain controls should be removed, for example, if they are unnecessary or they do not really help to reduce the level of risk.

At this point in the audit you will need to make an assessment of the system and each of controls in that system to establish the ADEQUACY OF CONTROLS.

### ***Assessing the Adequacy of Controls***

This requires the auditor to consider each control objective in turn to establish whether or not each control objective will be achieved by the actual controls which have been identified. This often involves using audit judgement. Just because a particular control is specified in the law or in the system manual does not necessarily mean that it is adequate in the particular system being audited.

At the same time you should also consider which of the actual controls in place are most likely to ensure that the control objective will be achieved. It is normally only those controls that should be tested. The decision whether or not to test each control should be recorded in Column 4 of the Control evaluation schedule and, if applicable, the test reference should then be recorded in Column 5 of the Control evaluation schedule.

If the internal auditor, after initial evaluation, concludes that a control is not effective or is not required (whether because it duplicates another control or it doesn't actually ensure achievement of the control objective) there is no point in testing this control . and this fact should be recorded in Column 5 of the Control evaluation schedule.

### ***Compensating controls***

There will be occasions when controls you expect to find are missing. If this happens, you should search for controls that compensate for this potential weakness. For example, in auditing a purchasing system one control objective might be that procedures for ordering, payment and recording of expenditure are properly documented and complied with, but in practice there are no procedure manuals (an expected control to meet the objective). However, the staff that operate the system are all highly experienced and knowledgeable, and are closely supervised. In these circumstances, internal auditors may consider the experience and knowledge of the staff and the level of supervision adequately compensate for the absence of manuals, and thus they may conclude that the control objective is adequately achieved despite the absence of such manuals.

Internal auditors should evaluate each existing control to consider whether it is adequate. In addition, they should evaluate the whole spectrum of controls that may help to ensure that a particular control objective is achieved.

## 2.4 TESTING THE CONTROLS IN THE SYSTEM

### *Effectiveness of Controls*

Testing the operation of the actual controls enables us to establish whether or not the control is being operated both effectively (ie that is doing what it is intended to do) and consistently.

Audit testing can be a very time-consuming part of the audit process, sometimes taking up to half the time available for the audit. This means it is important to ensure:

- audit tests are carefully planned
- there is adequate evidence of the testing which has been done, and
- audit conclusions can be fully supported by the testing done.

Internal auditors use testing to evaluate the operation of the system and to form or corroborate an opinion about the adequacy or otherwise of control. This is done by measuring particular characteristics of selected transactions or processes and comparing the results with those expected.

Tests of control are conducted to provide evidence about the effective operation of the internal control systems. However, please remember that:

- **not all controls need to be tested**, and tests should normally be limited to those controls identified during the assessment of the adequacy of the controls (see above)
- some controls contribute to the achievement of more than one control objective, and may therefore appear on the Control evaluation record more than once. Clearly such controls, if selected, should only be tested on one occasion (i.e. **not** each time they appear on the control evaluation record).

It is also important to understand that it is the way the control works, and not the accuracy of the underlying transactions, that is being tested. In general, there should be evidence that controls are being performed. For example: with controls over document streams (eg purchase orders), the evidence may be the authorising officer's initials or, for periodic controls such as bank reconciliations, the evidence may be the reconciliation itself. The test should be designed to check that this evidence is present.

### **Step 1 – prepare Test Programmes**

Using as a basis the Control Evaluation Records you have completed, a Test Programme (TP) should be prepared for each control objective. Guidance on the nature and extent of any testing is given below. Keep in mind that, normally, testing will only need to be done for each of the risks for which there is no control in place or where the control that is in place is considered to be inadequate.

It is important to remember that controls are not necessarily a good thing in their own right, and that they should only be tested as long as they are considered to have a significant impact on the success of the system. Thus the testing undertaken should reflect the overall nature of the system, your understanding of it and whether there are compensating controls in place.

The testing you do should establish whether a particular control:

- really does provide reasonable assurance that the control objective is achieved, and/or
- that it will reduce the potential risks of not achieving the control objective to acceptable levels.

A form for recording test programmes is set out below.

**INTERNAL AUDIT DEPARTMENT**

---

**TEST PROGRAMME**

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**Control Objective 1: To ensure that tender documentation is properly prepared and is handled in a way that ensures bids submitted are appropriate and correct.**

Test (Note 1)	W/P Ref.	Test Results (Note 2)	Signature /Date	Substantive Tests (Note 3)
1.1. Confirm by review of files and enquiry that no member of staff is involved in both the preparation and approval of tender documents.		Discussions with staff and review of 3 tender files indicated that there is adequate segregation of duties.		
1.2. Examine two current tender documents to ensure that they contain all the appropriate documents and elements as per public procurement requirements.		Checklist of documents submitted by tenderer missing in respect of one tender. Checks extended to three more files revealed no similar discrepancies		

Test (Note 1)	W/P Ref.	Test Results (Note 2)	Signature /Date	Substantive Tests (Note 3)

**Note 1:** The Test column should contain a brief outline of the test to be carried out, including the number of documents etc to be tested and the precise objective of each test.

**Note 2:** The Test Results column should provide a brief summary of the result of the test. More detail will be contained in the relevant working papers.

**Note 3:** The Substantive Test column will only be used in exceptional cases . eg where it appears from the initial tests that there is a significant lack of control or a major breakdown of control. In such cases it maybe appropriate to carry out a higher level of testing.

### Things to consider when deciding on the tests to include in your Test Programme

There are three main things to consider when you are developing test programmes: the type of test; the sample size and the testing technique to be used.

#### A - Type of test

The first thing is to decide on the type of test to be carried out. There are three main types of testing . compliance, re-performance and substantive testing.

*Compliance testing* The aim of compliance testing (i.e. test of controls) is to confirm that existing controls are operating as intended and are reliable and effective. An example is checking that each invoice has been initialled to indicate that it was authorised by an appropriate manager. The primary aim of compliance tests is not to identify errors, mistakes or potential fraud, but to identify controls that are not always performed as required. The reasons for any errors or omissions and the reliability of controls are more important to internal auditors than any individual mistakes or omissions. **Compliance testing should be the default type of testing to be used during systems auditing.**

*Re-performance testing* is necessary to confirm the quality of the control in operation. While compliance testing provides evidence that controls have operated it is necessary to ensure that the control is operating as designed. For example, while evidence of management review may be present in the form of a signature on a document, it is still necessary to re-perform that control to ensure that it is being operated correctly.

*Substantive testing* is intended to enable a conclusion to be reached on the completeness, accuracy and validity of information and records. It is concerned with outputs rather than the adequacy of controls and therefore has a limited role to play in system based auditing. It is, nevertheless, sometimes used as a means of demonstrating the existence or seriousness of weaknesses . for example where little or no control exists or when the auditor is unable to convince management by any other means. It is also used in financial auditing when it is necessary to confirm figures and balances in the accounting records.

## B – The size of the test sample

### *Sample sizes*

Most systems-based audits will involve the use of sampling for testing. Next you need to decide on the size of the test sample. Those samples should be selected from a whole set of data (the population). The population needs to be defined in advance as it affects the selection of items and the evaluation of results. A sampling unit is any of the individual items that constitute the whole relevant population.

In order to be representative of the population, the sampling units to be examined should be selected at random. Audit staff are encouraged to select samples on a statistical basis, where this is practicable. It is unlikely, however, that available audit resources will allow this in which case a quasi-random selection method is recommended. The selection of records to be tested should be done without any intended bias towards a particular section of the population or time period.

In general, the sample size depends on the frequency with which the control is operated. For example, some controls are operated daily or over document streams (e.g. authorising invoices) while others are operated weekly or monthly (e.g. performing reconciliations). There is also a smaller sample size for systems, which are not considered material to the financial statements (and are being considered on a cyclical basis as part of the wider corporate governance responsibilities).

It is recommended that the following guidance is adopted for determining the sample sizes to be used. On some audits it may be necessary to select larger samples, but that should only be done with the approval of the Head of Internal Audit.

<b>Frequency</b>	<b>Sample Size</b>	
	Systems material to the financial statements	Systems subject to cyclical review
<b>Daily</b>	30	15
<b>Weekly</b>	5	5
<b>Monthly</b>	2	2

Internal auditors should consider the following points when selecting a sample of transactions to test:

- The sample should be selected from the total population, for example, when testing that all payments have been authorised the sample should be selected from a bank statement or payments register rather than from a file of paid invoices;
- The period covered by the sample should be appropriate. This should normally be the period since the last audit of the system. However, the sample should be weighted towards the current financial year, especially if the last audit was several years ago. If the system has changed significantly, the sample should only include the period since the changes were introduced;
- The method of sample selection should be recorded. The sample should include all significant types of transaction; and

Testing should be focused on high-risk areas.

As a general rule substantive testing is only used in exceptional cases by internal audit.

Substantive tests are carried out in order to gather evidence on the completeness, accuracy and validity of information contained in the accounting records. The need to conduct substantive tests on underlying transactions depends, in part, on the assessed level of control risk. Control risk is the risk that a material fraud or error, or other significant matter will not be prevented or detected because of weaknesses in the accounting and internal control system. Audit staff, of the appropriate seniority, should assess the level of control risk based on the results of the preliminary assessment and the test of control carried out. This assessment is a matter of professional judgement, but the following may serve as a general guide:

Test of	Control Results		Indicative Level of Control Risk
Sample size	30	15	
Number of Failures	0	0-1	LOW
	*1-2	2	MEDIUM
	>2	>2	HIGH
Preliminary Assessment	HIGH		
Control absent			

*\* It should be noted that where one error out of a sample of 30 is found, audit staff have the option of assessing control risk as medium or conducting a further 30 tests. Provided no further errors are found in the additional sample, control risk may be assessed as low.*

Substantive testing is concerned with the accuracy and completeness of outputs rather than the adequacy of controls. An example is checking that the amounts paid are the same as the value on the invoice. **Substantive testing, therefore, should have only a limited role to play in systems auditing.** Nevertheless, internal auditors sometimes use it as a means of demonstrating the existence or seriousness of weaknesses, when they are unable to convince management by any other means. Internal auditors should bear in mind that substantive testing is usually not economical and may weaken their arguments if it fails to produce evidence of actual errors. In most cases, satisfactory results from the testing of a particular control may preclude the need for any substantive tests to be undertaken in that area. Substantive tests should be carried out, however, in areas where the audit risk is of a sufficient level to warrant it. This may be due to:

- No control being in place to address a particular control objective and
- Tests of control showing that a control is either not operating or that the incidence of failure is sufficient to give cause for concern.

#### *Conducting substantive tests*

Conducting tests of control is relatively straightforward, as the evidence of the control operating is generally a signature or initial or perhaps simply the existence of a document. For substantive tests, forming an opinion on the reliability and appropriateness of the available evidence is more involved. Audit staff should, in examining assets, documents or accounting records, avoid accepting them or any supporting explanations at face value, and should bring to bear a reasonable amount of professional skepticism.



Audit staff test only a sample of the transactions of an audited body and there is inevitably a risk of either giving an inappropriate audit opinion on the financial statements or not reporting a significant matter concerning the wider public sector audit responsibility.

### **C – The testing technique(s) to be used**

There are a number of different ways that internal controls can be tested. Internal auditors should seek to use the most cost-effective source of evidence on the reliability of each control to be tested. The nature of the control will influence the way auditors test it, and there are five main methods of testing:

- Observation is particularly important where there is no permanent record of activities . discrete observation can reveal whether there is improper access to a restricted area;
- Interviewing is useful when evidence is absent or unclear. Care should be taken because the behavior of the auditor could affect the attitude of the person being interviewed and an insensitive approach could lead to an un-cooperative and defensive reaction;
- Verification involves independently confirming the truth, accuracy, or validity of transactions. However, the internal auditor's prime role is to evaluate and test the controls, not to confirm the validity of the data itself. When using verification tests, auditors should ensure that they are related to the operation of controls. Methods used are:
  - Comparison - with some ascertainable fact or standard, e.g. that instruction manual are up-to-date or staff have attended appropriate training courses at prescribed intervals;
  - Confirmation - checking statements of performance, e.g. checks with customers that supply delivery response times are as stated by the supplier; and
  - Vouching - checking a transaction against supporting documentation, e.g. a payment to a supplier against the corresponding order and goods received note.
- Reperformance is particularly relevant where calculations or measurements have been supposedly checked as a control and the auditor wishes to check that the control actually operated;

Analytical review consists of reviewing the reasonableness of significant ratios, trends or other data. For example, a comparison of the ratio of payroll costs to the number of employees over several months. Thus it is primarily a substantive test but it may provide evidence of the quality of the general control environment.

### **Step 2 – Carry out the tests set out in the TP**

When carrying out the tests it is important that those tests are adequately recorded. A separate working paper should be prepared for each test and should show:

- the purpose of the test
- details of the test carried out . sample size and details of the sample (dates; documents reviewed; serial numbers etc)
- what was actually checked
- results (findings) of the test
- conclusions.

The results of the test should be recorded on the TP and also on the Control Evaluation Record in Column 6 (Effectiveness of Control). Where appropriate, additional comments should be inserted in Column 7 of the Control Evaluation Record.

It is important to keep in mind that a failure when testing is any item where either the expected evidence is not present or the control has otherwise been found not to operate. Audit staff should be concerned with what the failures infer about the effectiveness of the relevant controls and the related potential scope for fraud and error. Any failures should be investigated by audit staff as it may be possible to localise the cause e.g. if they only occurred when a particular employee was on holiday. In general, the value of any error arising from the failure is not in itself important because, at this stage, it is the control (not the transaction) that is being tested.

## 2.5 ARRIVING AT AUDIT CONCLUSIONS

### **2320 Analysis and Evaluation**

Internal auditors must base conclusions and engagement results on appropriate analyses and evaluations.

This is the stage of a system based audit where the auditor considers the results of all the work you have done before preparing the draft report. However, it's not limited to this stage and it's important that you think about your findings, conclusions, and possible recommendations throughout the evaluation and testing stages of the audit.

### ***Audit findings form***

The Audit Findings Form (see below) provides a useful structure for handling the information you have obtained and to think things through in a logical way when writing the audit report. It is designed to help you to establish the causes of the issues or weaknesses which have been identified from the evaluation of the system of control, and to develop suitable recommendations.

It should be completed as you are doing your testing when the nature and significance of control weaknesses are established. Wherever possible try to group related weaknesses together on the Audit Findings Form. This will make it easier to plan your audit report.

### ***Completing the Audit Findings Form***

#### ***Issue/Weakness***

This should reflect the issue or weakness identified by audit tests. It is not necessary to provide a lot of detail - a description of only one or two short sentences will normally be enough. For example: procurement invoices are not arithmetically checked before being approved for payment.

#### ***Causes***

It is important to identify the real underlying cause, and not the symptom, of each weakness. If you don't do this it is unlikely that your recommendation will result in improved control. When completing this section of the form you should ask yourself:

- *'Why is this happening or not happening?'*

#### ***Effects***

Here you should record the actual or potential impact of the weakness you have identified. This could include: increased cost; delay; inability to make good decisions because information is not available; failure to meet targets or objectives; loss of control over documents etc. Your audit tests will provide you with the information you need to determine the effects. If possible, try to quantify

what the effect might be. This will allow you to make a stronger case and help to convince management of the need to implement your recommendation.

It is also worth considering

- What is the effect on performance, control, efficiency etc.?
- Why do management need to know this?'

### ***Audit file reference***

This is a simple cross reference to the working papers which provide the detail and supporting evidence for the weakness.

### ***Conclusion***

A brief conclusion should be given in respect of each weakness. It should normally be only one or two sentences which sum up the situation.

For example: the failure to check invoices arithmetically makes it impossible to be certain that the correct amount is being paid to the supplier. This could result in the organisation paying more than it should for goods and services.

Setting out the conclusion in this way can also be helpful when you are writing the audit report.

### ***Recommendations***

You should note down the **main elements** of your recommendations. Keep in mind the causes of the weakness and make sure that your recommendation will deal adequately with each of them. The recommendations internal auditors make may include the following:

- Introducing further controls;
- Refining or amending existing controls to make them more effective;
- Ensuring that existing controls are applied regularly and consistently;
- Reducing unnecessary controls; and
- Introducing best practices.

Further guidance on arriving at conclusions is given in the Audit Report Writing section of Section 2.6 below.

Using this form will help you in your exit meeting with management (further guidance on handling exit meetings is given in Appendix A) and provide you with a good basis for discussing your conclusions and recommendations. It will also aid discussion of any alternative solutions to issues and weaknesses which may be suggested by the auditee.

It is also good practice to discuss your findings informally with management before starting to draft the audit report, and the form can help you to do this.

The following is an example of how to use the Audit Findings Form

Payroll system

- Weakness . there is no procedure to ensure that all new employees are correctly entered onto the payroll;
- Causes:

- Lack of feedback to Personnel by Payroll Section, and
  - No independent check of all new starters within Payroll section.
- Effects:
  - A new employee could be put onto the payroll at the wrong time and at the wrong point on the salary scale;
  - The organisation will pay the incorrect salary;
  - Poor initial impression given to the new employee; and
  - A ghost employee could be put on the payroll.
- Conclusion . this is a significant weakness that provides scope for error or deliberate manipulation of the payroll.

**INTERNAL AUDIT DEPARTMENT**

**AUDIT FINDINGS FORM**

Working Paper Ref.No. 0 0 0 0 0 0 0 0 0 0

<b>Audit:</b> 1/2011			<b>Financial Year:</b> 2011		
<b>Prepared by:</b>			<b>Date:</b>		
<b>Reviewed by:</b>			<b>Date:</b>		
<b>Weaknesses</b>	<b>Causes of weaknesses</b>	<b>Consequences of weaknesses</b>	<b>Audit File Ref. No.</b>	<b>Conclusions</b>	<b>Recommendations</b>
1. Some personal files are incomplete	<ul style="list-style-type: none"> <li>- failure to check that all necessary documents are on the file prepared for each new employee</li> <li>- Difficult for staff to update and check files because the files are not located near to where they work</li> </ul>	<ul style="list-style-type: none"> <li>- validity of the appointment may be questioned</li> <li>- new employee may be appointed on wrong terms and conditions</li> <li>- difficulties could arise if it becomes necessary to terminate the employee's appointment</li> </ul>		Inadequate employee records could result in the wrong payments being made, and could lead to confusion over the exact status of the employee at some future date.	All new employee files should be reviewed for completeness and accuracy before they are filed. A checklist at the front of the file might assist this process.
2.					

## 2.6 AUDIT REPORTING

### **2400/2410 Communicating Results**

Internal auditors must communicate the results of engagements.

Communications must include the engagements objectives and scope as well as applicable conclusions, recommendations and action plans.

### **2440 Disseminating Results**

The head of internal audit must communicate results to the appropriate parties.

### ***Introduction***

This section of the Audit Manual is concerned with reports on individual audit assignments. It covers:

- The purpose and function of an audit report;
- The types of audit reports and alternatives to them;
- Some guidance on the structure and content of audit reports.

Audit reports should provide an assurance on the system under review; and form the basis of the overall assurance on the internal control system to be provided in reports to the head of the organisation.

It is vital to remember that the audit report is the only tangible product of an audit and, as such, is Internal Audit's shop window. It is the culmination of the planning, time and effort which goes in to an audit, and reflects the quality and thoroughness of the audit. The quality of the report will have an important influence on the view of internal audit held by senior management of the organisation. An inadequate audit report may negate the best audit work and finest conclusions. It may also damage the reputation and status of Internal Audit.

### ***Purpose and functions of an audit report***

The principal objectives of audit reports are:

- To communicate the problems identified and the causes of those problems;
- To explain the effects and repercussions of those problems and quantify them where necessary;
- To measure performance - by providing analyses and appraisals - and to highlight areas in which greater efficiency and effectiveness may be achieved, and waste eliminated;
- To convince management of the need for change;
- To suggest practical and cost effective solutions;
- To provide a basis for follow up to ensure that appropriate action has been taken.

There are three main functions of an audit report. First, it is an *action document* - unless the report achieves action it will have been a waste of time for everyone involved in the audit. To achieve action the report should provide the client with a brief, objective assessment of control in the area

under review and highlight any significant weaknesses identified. It should also bring out the impact of those weaknesses on the level of control and demonstrate to management that they need to do something about it:

- By explaining the risks involved, and
- By quantifying, where possible, those risks and any potential benefits.

Second, it acts as a *formal, permanent record* of: the audit work undertaken and the conclusions drawn from it, and the level of control which exists in a particular area at a specific point in time. Finally, a good report - by communicating professionalism and competence - *demonstrates Internal Audit's objectivity and independence* and shows that auditors can help to improve efficiency and effectiveness.

**Types of audit report**

A written report should be issued after each audit to provide a formal record of the results of the audit. There are basically two types of audit report which can be considered - a Standard Report and an Audit Memoranda.

*The Standard Report* is the type most frequently used. It comprises three main sections - the Executive Summary, the Action Plan, and the Detailed Report.

*Audit Memoranda* are normally shorter than Standard Reports and are used:

- For quick and special reviews carried out at the request of management to report the results of follow-up audits;
- Where only relatively minor points arise from the audit;
- As an interim report on longer audits.

An alternative to an audit report is a *Presentation* or oral report. This involves a formal verbal presentation of the audit findings and discussion of the action to be taken by management. The advantages and disadvantages of reports and presentations are set out in the table below.

<b>Presentation Method</b>	<b>Advantages</b>	<b>Disadvantages</b>
<b>Presentations</b>	<ul style="list-style-type: none"> <li>• Interactive</li> <li>• Flexible</li> <li>• Can help gain acceptance</li> <li>• Aid discussion of complex issues and solutions</li> <li>• May increase chance of action</li> <li>• Can focus on high priority issues</li> <li>• Internal Audit can influence action</li> </ul>	<ul style="list-style-type: none"> <li>• Can't put across all the evidence</li> <li>• Can be difficult to communicate complex data leading to misunderstandings</li> <li>• Need facilitation skills and two people</li> <li>• Need to be well prepared</li> <li>• May be dominated by one individual or issue</li> <li>• Auditee may still want report</li> </ul>



<b>Standard reports</b>	<ul style="list-style-type: none"> <li>• Good for detailed evidence and complex data</li> <li>• Can provide background and context</li> <li>• Evidence is readily available to reader</li> <li>• Some auditees prefer them - more authoritative</li> </ul>	<ul style="list-style-type: none"> <li>• Can be time-consuming to produce</li> <li>• Long reports may not be read in full</li> <li>• Sometimes too much to assimilate</li> <li>• Can be untimely due to delays in preparation</li> </ul>
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### ***The structure of audit reports***

The precise structure of audit reports should be decided by the Head of Internal Audit. The important thing is for every audit report in each organisation to have the same house style. This makes it easier for line management to use and understand them and helps to build up an image for the internal audit unit.

Audit reports . typically should contain:

- Report Cover;
- Contents page;
- Executive Summary;
- Action Plan;
- Detailed Report;
- Appendices/annexes.

Guidance on the detailed content of each of the sections in standard audit reports is given in the following sections.

#### **The Report Cover**

This should set out the report title, date of issue and report number. Some audit units adopt logos which are printed on the cover. It may also be worth considering the use of different colour covers for different types of audit review (systems, VFM etc).

#### **Contents Page**

This should include the report title, details of each of the main sections of the report and a list of all appendices.

#### **The Executive Summary**

The Executive Summary should stand alone and convey the main points to the reader without the need for them to refer to the Detailed Report. It should enable senior management to establish quickly and easily:

- The scope and main objectives of the audit;
- Why it was done;
- The nature and scale of the system or activity reviewed;
- The main conclusions of the audit, and
- The principal recommendations.

This is the most important part of the report. It is the main opportunity to encourage the reader to look at the Detailed Report and either take action, or ensure that appropriate action is taken. It should not normally be more than three typed pages in length and should include the following sections.

**Introduction and background** . covering:

- Appropriate details of the area under review, including an indication of the significance or value of the topic/system and any significant or unusual aspects of which the reader should be aware;
- The scope and principal objectives of the audit;
- Any important areas excluded from the review, and why
- When and why it has been audited.

**Main Conclusions** - which should paraphrase the most important conclusions reached in the Detailed Report. These are often set out on a section by section basis, but sometimes it can be more effective to identify any common themes which run through the report. Any overall opinion must reflect accurately the findings and comments in the Detailed Report. Keep to the major issues arising and try to avoid raising any minor conclusions in this section.

**Principal recommendations** - this should list only the key (high priority) recommendations that feature in the Action Plan and each of them should relate to one or more of the main conclusions.

The key thing to remember is that the Executive Summary should stimulate interest which will lead to action.

**The Action Plan** . should be placed immediately after the Executive Summary and list all the recommendations contained in the Detailed Report (see section 4)

## **The Detailed Report**

### **Format**

The main body of the report should be divided into suitable sections, each clearly headed, e.g.

Placing purchase orders . The order of the sections will be determined during the report planning process. It may reflect the relative significance of the audit findings, a chronological sequence or simply follow the order in which events occur in the system.

Normally recommendations should be placed at the end of each section. However, if a section is particularly long, and/or deals with a variety of issues, recommendations can be inserted at appropriate points in the section. Recommendations should be placed in a separate paragraph(s) preceded by the subheading **Recommendations** in boldtype.

### **Content**

Each section should contain details of the relevant findings. It is important to highlight the underlying causes of weaknesses and their impact on performance or the level of control. Failure to do so is one of the biggest single weaknesses of audit reports. Ask yourself:

- Why is this happening or not happening? ;
- What is the effect on performance, control, efficiency etc.? ;
- Why do management need to know this? .

Recommendations should be included which deal with those underlying weaknesses.

Descriptive material should be restricted to what is needed to establish the nature and extent of any weaknesses identified. It is not necessary to provide full and detailed descriptions of every part of the system under review.

It is often useful to include graphs, tables, and charts to quantify and illustrate facts and data. Beware of overusing graphs etc, as this can obscure the message and sometimes irritate the reader.

The report must be factual. Subjective comments are not acceptable. Where it is necessary to make value judgements or assumptions, their basis should be clearly stated.

Avoid the use of long paragraphs wherever possible.

Don't be afraid to say when something is being done well, or to refer to good points you have found. Be careful you don't overdo this.

## **Recommendations**

In developing your recommendations there are some simple things that you should try to remember. They should:

- Be based on reliable information;
- Deal with the underlying cause of the problem, and not just the symptoms;
- Describe precisely what needs to be done;
- Suggest who should be responsible for taking action;
- Be clear, concise and simple;
- Be unambiguous;
- Be achievable;
- Refer to a discrete action point - i.e. each recommendation deals with a single point.

Where an auditee has already taken action, or agreed to do so, this should be stated in the report.

## **Paragraph numbering** . some simple rules

Reports should adopt a simple one-part numbering system (1; 2; 3 etc) beginning with the Executive Summary and continuing to the end of the report. Every paragraph should be numbered.

Recommendations may be numbered (R1, R2, R3 etc) so that they can be readily identified.

Headings and sub-headings should not be numbered.

## **Finalising the report**

Before finalising your report there are a number of key checks you need to make. At the very least you should ask yourself the following questions:

- 1) *The Executive Summary*
  - a. Does it motivate the reader to want to read the detailed report?
  - b. Do the main conclusions reflect accurately the major issues and conclusions contained in the detailed report?

- c. Does each key recommendation relate to one or more of the main conclusions?

2) *The Detailed Report*

- a. Are the conclusions appropriate and meaningful?
- b. Are weaknesses and benefits quantified where appropriate?
- c. Is the need for corrective action sold? Have you explained the effects of the issues you have identified? Use the so what? test.
- d. Do your recommendations deal effectively with the underlying causes of the problem?

3) *General*

- a. Is the tone of the report appropriate?
- b. Where appropriate and possible have you tried to be positive?
- c. Is the report easy to read and understand?
- d. Have you deleted all unnecessary words and phrases?

You could also use the following checklists to help ensure you produce high quality draft and final reports.

**Audit report quality assurance checklist**

**Report content**

		Draft	Final	N/A
1.	The audit report includes:			
	• transmittal letter			
	• title page			
	• table of contents			
2.	The audit report contains an executive summary (2/3 pages maximum)			
3.	The detailed report includes:			
	The purpose of the audit, including the origin/source, as appropriate			
	The scope of the audit, including time period covered, functions or processes reviewed, and audit techniques used, as appropriate			
	Background information describing- the activity:			
	• the audit result			
	• the audit finding			
	• the audit conclusion			
	• the audit recommendations			
	• the action plan			
	• all the correct appendices			
4.	A draft report is clearly labelled draft±			

**Report quality, tone, and appearance**

		Draft	Final	N/A
1.	The report is clear and concise, free of unnecessary detail			
2.	The conclusions expressed in executive summary and the body of the report are consistent			
3.	Report is broken into sections and each is clearly labelled			
4.	Descriptions of operating procedures, if required, are kept short and concise			
5.	The structure of the report is logical and easy to follow			
6.	Jargon, technical language, clichés, and colloquialisms are avoided			
7.	Acronyms and abbreviations are defined before being used			
8.	Active voice predominates			
9.	The report is direct and to the point			

### Report quality, tone, and appearance (continued)

		Draft	Final	N/A
10.	Headings are informative and descriptive			
11.	Opening sentences are strong and attention-getting			
12.	Main points are presented first			
13.	The report has a balanced tone			
14.	Findings are worded constructively			
15.	Recommendations are directed toward achieving desired results without prescribing step by step actions			
16.	Report has a professional appearance			
17.	Spelling ,grammar and punctuation are correct			

### ***Draft report and the audit exit meeting***

Once the audit report has been drafted it is good practice to issue it to management in draft form and use it to form the basis of discussions with management at the Audit Exit Meeting.

The purpose of an exit meeting with the auditee is to develop a mutual understanding of the content of the draft report. If possible the draft report should be sent in advance to those people who will be attending the meeting. This will give them a chance to read it and make the meeting much more useful.

The meeting should also help to avoid any misunderstandings or misinterpretations of fact by providing the opportunity for the auditee to clarify specific items and to express views on the issues raised in the report and the conclusions and recommendations. This should make it much easier to finalise the report and for management to complete the Action Plan.

Following the meeting the audit report should be amended and/or clarified where appropriate and necessary and a final version of the report should be issued together with the Action Plan for completion and return by management (see section 4 below for more guidance on Action Plans).

## 2.7 ACTION PLANS

Action plans are vital to recording and monitoring the action taken by management on Internal Audit's recommendations. They make follow-up audits easier and more effective. An Action Plan should be prepared for every standard audit report. It details what management have agreed to.

A template for an Action Plan is shown below. It lists every recommendation contained in the audit report and shows for each of them:

- The comments of management;
- Who is responsible for action, and
- The date by which action will be taken.

### INTERNAL AUDIT DEPARTMENT

#### ***ACTION PLAN - REPORT No:***

<i><b>Rec No</b></i> (1)	<i><b>Recommendation</b></i> (2)	<i><b>Priority</b></i> (3)	<i><b>Comments of Management</b></i> (4)	<i><b>Action Agreed</b></i> Y/N (5)	<i><b>Person Responsible</b></i> (6)	<i><b>Implementation Date</b></i> (7)

#### ***Completing the action plan***

**Internal Audit is responsible for completing the sections headed 'Rec No' , 'Recommendation' and 'Priority' before the report is issued to the auditee.**

**Column (1) Recommendation number (RecNo)** - This is the number given to each recommendation in the Detailed Report (R1, R2, R3 etc). The Action Plan should include every recommendation made in the audit report and the recommendations should be listed in the order in which they appear in the Detailed Report.

**Column (2) Recommendation** - Each recommendation is included here, worded exactly as it

appears in the Detailed Report.

**Column (3) Priority** - This indicates the level of importance of the recommendation:

- **High:** A serious breakdown in control requiring immediate action by management;
- **Medium:** Weaknesses in control which need management action in the near future;
- **Low:** There is no significant risk arising from the weakness, but remedial action is recommended.

**The remaining sections are normally completed by the auditee, as follows:**

**Column (4) Comments of management** - This is to enable management to record their views on the recommendation. These could be simply to accept the recommendation; to accept it with minor amendments; or to propose an alternative solution to the problem. Unless the recommendation is accepted without change, the reasons for any changes or for rejecting it should be recorded here.

**Column (5) Action Agreed** – management should just indicate whether or not they agree to the suggested action with a simple yes or no

**Column (6) Person responsible** - This should record the name and title of the person who is to take responsibility for implementing the recommendation. Depending upon the nature of the recommendation, this could be either the person who will actually be making the changes, or the manager who is responsible for the unit, department, or sector to which the recommendation relates.

**Column (7) Implementation date** - The date by which management intend to make the recommended changes.

### ***Dealing with the completed action plan***

The Action Plan should be sent out with the final audit report and the Head of Internal Audit should ensure that it is completed and returned . together with any other management comments within ten working days. The completed Action Plan should be reviewed to ensure that:

- Recommendations have been accepted;
- Any alternative proposals by management are acceptable;
- An appropriate person has been made responsible for implementing each recommendation;
- Suitable dates for implementation are proposed.

When the report is issued to the Head of the Organisation, the completed Action Plan should be inserted after the Executive Summary and a copy of it placed on the Permanent Audit File.

Based on the timings set out in the action plan the Head of Internal Audit should schedule a follow-up audit . if necessary before the next planned audit.



### 3. FOLLOW-UP AUDITS

#### **2500 A1 – Monitoring Progress**

The head of internal audit must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

Too often this is the part of the audit process that is either done badly or not at all. In fact it is one of the most important stages of any audit. If internal audit fails to make sure that its recommendations are implemented, then all of the investment in doing the audit may be wasted.

The timing of the follow-up should be determined in relation to the significance and impact of the recommendations and the criticality of the system which has been audited. It should also take account of the implementation dates given in the Action Plan completed by management. It is important that time for follow-up audits is provided in the short term (annual) plan and that any specific follow-up audits are scheduled upon completion of each audit.

There are three main ways of following-up an audit, these are:

#### **By letter asking the auditee to confirm action has been taken**

In many cases, and certainly for those audits containing minor audit findings, this will be the most appropriate approach. Checks should then be made at the next scheduled audit to ensure appropriate action was actually taken and that the controls were implemented properly.

#### **Scheduling a specific follow-up audit**

This may involve either:

- An interim review of the systems and controls which have been introduced. This could include discussions with management to determine how they are operating and a limited programme of testing to ensure they are working as intended, or
- A full systems audit to establish that the correct action has been taken and controls are working effectively. Where no action has been taken by management the audit should establish and quantify the impact of the failure to establish adequate control.

In deciding whether to do an interim review or a full systems audit some things to consider are:

- The risk, importance and materiality of the system;
- Known changes in organisational objectives or priorities since the audit was done;
- The stability of the system (systems which are subject to frequent change are less likely to be suitable for interim reviews and may have to be subject to a full audit more frequently);
- The extent of the changes recommended in the audit report;
- Any indication that significant changes or new systems developments may have taken place.

**Follow-up as part of the next audit**

It should be standard practice on any scheduled audit to carry out a follow up to establish the extent of implementation of the recommendations made at the last audit. This should be done at the start of the audit so that audit testing can be adjusted appropriately. The audit report should highlight clearly any further action which needs to be taken in relation to the last audit.

## AUDIT FILES

### 2330 Documenting Information

Internal auditors must document relevant information to support the conclusions and engagement results.

The working papers and any other documentation related to each audit assignment should be held on dedicated audit files. Those files should be structured in a clear and logical way in order to make it easy for anyone to find what they need and to understand what has been done, and why. The files can be held in electronic or paper form.

Appropriate use of indexes and of cross-referencing between documents and sections of the files is vital if documentation is to be accessible and assist the auditor to carry out the audit efficiently. This will also help anyone using or reviewing the files to follow the steps taken during the audit and to understand how conclusions were reached.

Maintaining well organized and structured audit files:

- Enables the audit to be conducted in a logical manner;
- Helps ensure comprehensive coverage;
- Aids understanding;
- Makes it easier to identify weaknesses and draw the correct conclusions;
- Enables progress and findings to be readily reviewed;
- Makes report drafting easier;
- Facilitates the location of papers; and
- Provides a formal record of the work undertaken.

Two types of file should be maintained for each audit - the Permanent File and the Current File.

*The Permanent Audit File* - contains all the ongoing information about the system, unit or department under review. It provides essential background knowledge to the person undertaking the audit and should be reviewed at the start of each new audit of that system etc. It should also be updated at the end of the audit.

*The Current Audit File* - which documents all the information collected during the current audit. It contains a detailed history of the current audit from the start when you determine the scope and objectives through to the completed Implementation Plan. It is advisable to create this file at the start of the audit and, as far as possible, to build it up during the course of the audit.

A suggested structure for each of these files is given below.

**Permanent Audit File**

<b>SECTION</b>	<b>TITLE</b>	<b>CONTENT</b>
<b>A</b>	General background information	To include: <ul style="list-style-type: none"> <li>• Terms of reference for the audit</li> <li>• Operational and/or financial objectives for the system/area under review</li> <li>• Organisation charts for the unit/area under review</li> <li>• Budgets and expenditures for the area being audited</li> <li>• Volume of transactions . or other appropriate measure of the scale of the system</li> <li>• Other background information and relevant documents (copies or references, as appropriate)</li> </ul>
<b>B</b>	Reports to management	Copies of all internal audit reports (draft and final versions) Action Plans (All correspondence and other documentation should be kept in the relevant current audit files)
<b>C</b>	Copies of other relevant reports	Reports of SAI (extract relating to the system under review) Consultancy Reports for the area under review
<b>D</b>	Draft of policies and procedures in operation	Rulebooks, Detailed procedures and Guidance issued in relation to the area under review
<b>E</b>	Relevant job descriptions and authority limits	<ul style="list-style-type: none"> <li>• Rulebook on organizational structure with organizational chart and list of employees . related to area under review</li> <li>• Job descriptions and other relevant documents</li> </ul>
<b>F</b>	Sample documentation	Blank copies of any relevant forms used in the system under review

**Current Audit File**

<b>SECTION</b>	<b>TITLE</b>	<b>CONTENT</b>
<b>1</b>	Audit supervision and review papers	The completed Audit Review Record and any detailed notes and comments by Head of Internal Audit
<b>2</b>	Audit planning documents	Audit Plan Terms of reference Notes on initial discussions etc with the Ministry/organization Projected and actual time budgets
<b>3</b>	Previous audit report	Copy of the previous Internal audit report, including relevant correspondence and action plan
<b>4</b>	Points forward	List of points highlighted for future work by internal audit
<b>5</b>	Current audit report	Draft Internal Audit Report with Action plan Final Internal Audit Report All relevant correspondence Minutes of exit and final meetings
<b>6</b>	Follow -up to last audit	Details of tests done to check implementation of recommendations made Summary of current state of implementation
<b>7</b>	Systems and Procedures in operation	To include flowcharts, narrative descriptions and sample documentation, as appropriate
<b>8</b>	Control Objectives	To list control objectives per each identified system
<b>9</b>	Audit Findings Form	Evaluation of weaknesses, causes and effects
<b>10, 11, 12, etc.</b>	Working papers- divided into sections(e.g. by sub-system) as appropriate	To include: Control& Risk Evaluation forms TEST PROGRAMMEs and other details of tests carried out Notes of meetings with staff and managers

### **3.1 SUPERVISING INDIVIDUAL AUDITS**

#### **2340 Supervising Audit Assignments**

Audits must be properly supervised to ensure objectives are achieved, quality is assured and staff developed.

This section of the Audit Manual should be developed when Internal Audit is fully established and there is sufficient capacity to carry out effective supervision activities.

In the meantime, the Head of Internal Audit should review the work of audit staff at each stage of an audit. HIA should conduct regular reviews of the work of IA teams in order to ensure that audits are carried out in accordance with the guidance in this audit manual.

## COMMUNICATION SKILLS AND TECHNIQUES

### *The opening meeting with management*

#### **Purpose of the meeting**

The opening meeting with management is very important. It sets the tone for the entire audit and provides the opportunity to establish the proper atmosphere and to begin building effective working relationships.

At the opening meeting you should:

- Explain the role of internal audit (only if it is the first time an audit has been done in the organisation), and to emphasise that the main objective is to provide constructive help and advice;
- Discuss and agree the scope and objectives of the audit . making it clear that you welcome any questions and also the views and suggestions of management;
- Ask for the views of management on any problems which may exist in the activities which fall within the scope of the audit. This helps to demonstrate that you welcome their input and that you are not just looking to be critical of what they are doing;
- Discuss the timing of the audit . and any difficulties which could arise from it (eg the absence of key personnel, new systems development etc). You need to beware of the danger of management raising timing difficulties as a way of having the audit postponed;
- Establish who you need to see at the beginning of the audit. It is also important to agree with management that you can make direct contact with staff, rather than clearing all meetings etc with the line manager;
- Set out the procedures that will be adopted for:
  - Confirming audit findings;
  - Discussing the draft report;
  - Issuing the final report.
- Explain that everything will be treated in confidence;
- Establish the normal working hours of staff in the department, where they are located (particularly if some work is done outside of the organisation's offices) and any other office routines . to make it easier to arrange meetings, locate people etc.;
- Make it clear that you will need access to all relevant files and documents;
- Ask for the use of an office/desk during the course of the audit . if necessary.

A well-conducted opening meeting can ensure that the audit is conducted in a friendly and positive atmosphere. It can make the difference between active cooperation and open hostility. A record of the opening meeting should be made and filed on the current audit file.

## ***The exit meeting***

### **Purpose**

The purpose of an exit meeting with the auditee is to develop a mutual understanding of the content of the draft report and of any other audit concerns that are not set out in the report. If possible the draft report should be sent in advance to those people who will be attending the meeting. This will give them a chance to read it and make the meeting much more useful.

It is intended to avoid any misunderstandings or misinterpretations of fact by providing the opportunity for the auditee to clarify specific items and to express views on the significant audit concerns, recommendations and other information presented in the draft report. In this way the formal response from the auditee should not contain any surprises for the auditor. Additionally, the exit meeting should serve as an opportunity to develop a feeling that the report is offered in a spirit of working together to improve the way things are being done.

### ***Timing***

The Head of Internal Audit should contact management to determine a suitable time and location for the exit meeting. This should normally be immediately after completion of the fieldwork.

### ***Attendees***

Attendees should include anyone who may be able to object to the validity of the report's contents and anyone having responsibility for the area or the situation needing corrective action - whether or not they personally would take the action or would be affected by the action.

### ***Discussion***

The exit meeting can be either a difficult confrontation or an open and courteous discussion. The discussion topics at each exit meeting will vary depending upon the specific audit concerns identified and who is attending the meeting. At a minimum, the auditor should:

- Summarize the audit including what was done (objectives, scope, procedures);
- State why it was done . the thought process behind your decisions;
- Outline the risks identified;
- Outline the significant audit concerns and the recommendations for dealing with the associated risk;
- Indicate the significant audit concerns which have already been corrected, and
- Refer to any less significant concerns identified in the audit.

The auditor should be willing and able to discuss all matters in whatever detail is necessary. It is also important to make it clear that all significant audit concerns have been discussed with management and that the report contains no surprises. You may also want to thank them for the cooperation obtained during the audit - if that is appropriate.



### ***Avoiding Confrontation***

The auditor should be prepared for the possibility of conflict when presenting the concerns in the audit report and should be able to retrieve information, support facts and amplify findings without difficulty or delay. To encourage the avoidance of confrontation during the exit meeting, the auditor should:

- Be polite throughout the meeting;
- Avoid the use of non-personal phrases (e.g., try not to start a sentence with "you" when disagreeing);
- Make efforts to get on common ground;
- Avoid backing the auditee into a corner.

### ***Addressing Confrontation***

First, it is important not to mistake the airing of views with disagreement. Often all that is necessary is to let the auditees express their views. Perhaps they do not really disagree but merely want a chance to justify their position or to explain the reasons for the conditions the auditor found. After they have made their point, they may be perfectly willing to let the wording of the draft stand as written. In some situations, offering to quote the auditee may end the disagreement.

Auditors must react and adjust their approach according to the discussions and facts presented. The auditor must maintain a state of fairness and objectivity, and be concerned only with what is factual and significant. This means that the auditor should be open to changes that make for a more understandable and more accurate report and do not compromise the audit findings, conclusions, and recommendations.

### ***Draft Revisions***

The auditor should be willing to accept wording changes or other suggested revisions that they believe are appropriate - as long as the changes do not alter the audit opinion or change the focus of any significant audit concern or corrective action. When there is an irreconcilable disagreement and there is no misinterpretation of fact (the facts must be agreed upon), the auditor may then point out that they must report matters as they see them and that they are willing to incorporate the auditee's views, or response, as well.

### ***Ending the meeting***

At the end of the meeting it is useful to summarise the points arising from the meeting and to confirm what the next steps will be and the anticipated timing of the issue of the final report.

## ***Interview techniques & effective communication***

### **Introduction**

Interviews are a key part of the audit process. They are an important way of obtaining and confirming information and facts about the way systems and controls are being operated. At the same time they represent an opportunity to create and maintain good relations between the audit department and its clients, and to impress the client with the professionalism of internal audit.

There are two types of interview . directive and non-directive. The directive interview is intended to obtain specific information about verifiable facts . for example the procedure for paying purchase invoices. In this type of meeting the auditor plans the meeting to establish what information is needed and determines questions which will provide that information. The auditor controls the meeting throughout, setting the tone and pace, and keeping the discussion in line with the planned objectives. The advantage of directive interviews is that they give the auditor exactly what he/she wants to know. The disadvantage is that they discover very little else.

In contrast the non-directive interview is intended to achieve understanding and build confidence with the auditee. Direct questions are avoided and the interview is structured only to the extent that the auditor identifies and opens up broad areas of discussion. This approach has the potential to uncover new areas for audit, but non-directive interviews have to be well controlled or they can be very long and time-consuming.

There is no best method of interviewing. The approach depends on the person being interviewed, the nature of the audit, the type of information needed and the time available. In many cases interviews are a combination of the two approaches, starting with a directive approach to get the information needed and ending with a non-directive approach to allow the interviewee to broaden out the discussion.

Whichever approach you take there are a number of things you need to do to maximise the benefit gained from your interviews. The main steps are set out in the following sections.

### **Planning the interview**

If you have a good relationship with the interviewee, or have already met him/her several times, then it may be possible to call in casually and unexpectedly. If not then it is normally best to plan the interview and to make a proper appointment in advance.

In planning for the interview you should:

- Decide what the purpose of the meeting is;
- Decide what information you want from the interviewee;
- Give adequate notice of the interview . wherever possible. Try to take account of peak workloads in the department when scheduling the interview;
- Always carry out the interview in the interviewee's office (unless he/she insists otherwise). It is important that the setting for the interview should put the interviewee at ease and preferably be free from interruptions. It should also allow the auditee to talk without being overheard;
- Tell the interviewee what the purpose of the meeting is;
- Give advance notice of any specific information you need;
- Prepare any files or documents you need to take with you;
- Write down the questions you want to ask.

When you are arranging interviews try not to schedule them one after the other. Allow some time in between so that you can review your notes while the points are still fresh in your mind.

### **Opening the interview**

Resist the temptation to rush straight into the interview. Instead start by making an effort to put the interviewee at ease and establish rapport with him/her. Devote time to some general conversation in order to get the interviewee talking easily. For example, if it's the first time you have met it may be useful to comment on the interviewee's office (it could be particularly large or have a nice view of the city) or the office building in general (for example, if it is a new building, or one the auditee has just move into). Whatever you say make sure that it is sincere. The first few minutes of the meeting are often particularly important when the interviewee appears apprehensive, or is a junior member of staff.

If, however, the auditee appears pressed for time, small talk may be unwelcome and irritating to them. Open the interview according to the mood of the auditee - but always try to be informal, friendly, and natural.

It is a matter of judgement when it is the right time to start the interview proper. The main thing is to do this when the interviewee is relaxed enough and in the right mood. This switch needs to be done tactfully. e.g. you could say: I'm concerned that I may be taking up too much of your time, perhaps I could ask you ...

Before starting the main part of the interview it is useful to check how much time the interviewee has available. This allows you to adjust your approach, speed and focus if necessary.

### **The interview**

It is important not to conduct the interview like an interrogation. Keep in mind at all times that the auditee should do most of the talking and that you need to listen carefully.

During the interview it is worth remembering:

- That you should not talk down to the interviewee no matter how junior the person is;
- To maintain a helpful, pleasant and interested manner. even if the interviewee is unpleasant and uncooperative;
- To look at the interviewee when he/she is talking and when you are asking questions. Avoid staring, which can cause embarrassment or tension, by looking away briefly from time to time;
- To smile, nod your head in agreement etc whilst the interviewee is talking to show attention, interest and agreement;
- To avoid doing anything that may indicate you disagree with, disapprove of or don't believe anything said;
- Not to comment unfavourably or challenge anything said. However, you should ask for clarification and explanation where necessary;
- Not to get involved in an argument;
- To be alert for reactions which may indicate that he/she is unsure of or doesn't understand what has been said;
- To think carefully about the answers you are given. First, to decide what is fact and what is opinion, and second to decide the future direction of your questioning.

## **Keeping the discussion on the right track**

You need to be prepared to accept that a certain amount of time will be wasted in any interview . mainly because interviewees will not keep to the point. Some are more likely to wander off the point than others. It is essential that you try not to introduce any digressions into the interview or encourage the interviewee to make any digressions.

When you need to get the interviewee back onto the point it is important to try to do so tactfully. Controlling such digressions can be a major problem. If you do it too obviously you run the risk of upsetting the interviewee and losing their cooperation. If you don't control them you will waste time and probably not get all the information you need. Try at all times to show a keen interest in what is being said and avoid all signs of frustration or impatience.

## **Closing the interview**

Once you have achieved everything you want of the interview, then you need to take the initiative in bringing it to an end. However, if the interviewee is obviously willing to talk and is giving you useful information do not stop just because you have taken up the scheduled time . useful information can sometimes be lost that way.

In closing the interview follow the normal rules of courtesy and common sense. This means you should always:

- Thank the interviewee for their time and their help;
- Ask them to call or email you if, after the meeting, they think of anything else which is important or relevant;
- Confirm any action points agreed during the interview . e.g. agreement to provide documents, further information etc.;
- Leave yourself the opportunity to go back for further information or clarification by saying something like: ~~It's~~ possible that I may need to clarify something when I go through my notes. If so would you mind if I called you or came to see you again for a few minutes?

## **After the interview**

Try to read through your notes as soon as possible after the interview. Make any amendments to the notes and identify any additional information or clarification needed.

If you have agreed to do something or to provide something to the interviewee make sure you do this as soon as possible. If you don't do so it will damage your credibility and your relationship with the interviewee.

## **Things to remember about effective communication**

### ***Verbal communication***

You will only get the information you need if both you and the interviewee attach the same meaning to the questions you ask and to the answers he/she gives. It is very easy to interpret words and phrases in a different way from that intended by the speaker. In order to reduce the risk of misunderstandings it may be helpful:

- To think carefully about each question you ask, and try to phrase them in a clear and unambiguous way;
- To keep each question as short as possible . and don't ask several questions all at once;

- To use short, simple, familiar words to maximise the chance that the interviewee will interpret them correctly;
- To avoid the use of jargon and technical terms that the interviewee may not understand;
- To avoid the use of vague, general or imprecise words (such as quickly or often) or abstract words (such as successful) which can be interpreted in a number of different ways;
- To avoid asking questions, which could produce an emotional reaction from the interviewee (e.g. What do you think is causing the poor performance of your sector or unit?!).

### ***Non-verbal communication***

Non-verbal communication is an important part of the communication process, and interviewers often forget to watch for and respond to non-verbal messages which are given out by the interviewee.

Examples of things to look out for are:

- The head nodding to signify understanding and acceptance;
- The frown that signifies lack of understanding or confusion;
- The set expression of the face or mouth that indicates disagreement;
- The flickering of the eyes that signifies uncertainty about how to answer . or unwillingness to answer.

Don't forget that you too send out non-verbal messages, and you can make use of them to help the interview to run smoothly and effectively. For example, you can use facial expressions, your eyes, movements of the head and body, smiles and hand gestures to show enthusiasm for the audit and agreement with the points being made by the interviewee. Non-verbal messages can help to make what you are saying more acceptable to the interviewee (e.g. if you ask a question in a rather forceful way which could cause offence, a smile at the end of the question can help to make it more acceptable). You can also try to encourage and compliment the interviewee . for example, nodding your head slowly whilst the interviewee is talking shows that you are both listening to and understanding what is being said.

The most important thing to remember is to make sure that your facial expressions, eyes, body movements, and gestures cannot be interpreted as indicating a lack of interest in, disagreement with or disapproval of what the interviewee is saying. Also, smiling is an effective way of creating a pleasant, friendly atmosphere and of encouraging the interviewee.

### ***Asking questions the right way***

First, remember not to talk too much, this is one of the biggest mistakes made by auditors when they are interviewing.

There are two kinds of questions, the '**open**' question, and the '**closed**' question.

**Open** questions usually force the interviewee to think about the answer, and give the freedom to reply in the way he/she thinks best. They can produce a wide variety of possible answers. Open questions often begin with words like: Why, How, What and Which. For example: Why is it necessary to check the document at this stage?, How does the information in this report help you? , What changes would you like to see to the way this procedure operates?

Closed questions allow the interviewee much less choice in his/her replies, often resulting in a Yes or No answer. For example: Do you review this document/report? Are the current procedures working well?, So you prepare this document yourself then? Closed questions have a tendency to produce an answer the interviewee thinks the auditor wants to hear and not the true situation.

They allow little room for discussion and make it difficult for the interviewee to develop his/her own ideas. However, they are useful to get specific items of information or to confirm basic facts and figures.

When asking questions it is useful to remember:

- To be as friendly and pleasant as possible, and to smile;
- To watch the interviewee's facial expressions to check whether they understand or are confused;
- Not to rush the interviewee to give an answer . keep quiet and glance away if necessary;
- If the interviewee is unable to answer the question after a reasonable time, suggest you move on to the next point and come back to it later.

When it comes to the questions themselves:

- Try to think them out in advance as part of the planning for the meeting . but be prepared to be flexible in the light of the answers you are given;
- Keep each question clear and concise and limit it to a single point or issue;
- Use words and language which the interviewee will understand and can relate to;
- Don't ask too many questions which cover any aspect too broadly;
- Try to ask your questions in a logical order, but be prepared to follow up points of interest as they arise.

### ***The importance of listening***

Most people find listening very hard. It is very difficult to listen attentively for more than about 30 minutes, after that our concentration drops. There are many reasons why people don't listen well, including:

- Getting distracted by something the interviewee says or does, or the way he/she appears. This could include annoying mannerisms or ways of speaking, their physical appearance or the way they dress;
- The temperature of the room, an uncomfortable chair etc;
- Failing to listen because you are tired or have other things on your mind;
- Failing to look at the interviewee and losing the benefit of any non-verbal communication.

To improve your listening skills you should:

- Look at the interviewee when he/she is talking;
- Sit up . to increase your mental alertness;
- Pay full attention and concentrate on trying to understand what is being said;
- Try not to let yourself get diverted.

Most importantly, don't talk too much. Too often internal auditors waste valuable time by interrupting the interviewee and expressing their own views and opinions at great length. Remember, your main role in these meetings is to get the interviewee to talk.

## ***Taking notes***

There are many ways of taking notes and you need to develop an approach which works for you. Some things to consider are:

- Asking the interviewer at the start whether they mind if you take notes;
- Don't make your note-taking too obvious, as it can put the interviewee off;
- Keep note-taking to the minimum, but making sure you record the key points;
- Don't look at your notepad except when you are writing;
- Try to keep your notes intelligible and legible so that you can make sense of them after the meeting;
- Review your notes as soon after the meeting as possible, and clarify and amplify them wherever necessary.

## TYPES OF CONTROL

There are four basic types of control:

- *Preventive* - designed to prevent the occurrence of inefficiencies, errors, or irregularities. These cannot guarantee that the controlled factor will not occur but reduce the chance of it occurring. Examples include division of duties and setting authorization levels;
- *Detective* - designed to detect and correct inefficiencies, errors, or irregularities. They may not give absolute assurance since they operate after an event has occurred or an output has been produced, but they should reduce the risk of undesirable consequences as they enable remedial action to be taken. Detective controls are most effective when they form part of a feedback loop in which their results are monitored and used to improve procedures or preventive controls. Examples include post-payment checks, stock verification and bank reconciliations;
- *Directive* - designed to cause or encourage events necessary to the achievement of objectives. Examples include clear definition of policies and procedures, the setting of targets, and adequate training and staffing;
- *Corrective* - to identify and evaluate alternative courses of action, to implement appropriate measures to remedy the situation and minimize damage.

In practice the above categories may not be clearly distinguished and a single control may operate to cover two or more functions. Supervision, for example, covers three categories.

### Some examples of internal controls

These examples start with the higher level controls, followed by intermediate and then low level controls. They are relevant to both manual and computer-based systems.

### High level controls

#### *Planning*

This involves establishing aims, objectives and targets and the means by which they are to be achieved. Good planning includes:

- Clear definitions of objectives and targets;
- Forecasting of activity, operational requirements and external factors which may affect the achievement of objectives;
- Specifying desired levels of control taking account of risk;
- Setting standards of performance;
- Defining, wherever possible, the outputs of a system and criteria for measuring them;
- Evaluating different options for achieving objectives;
- Anticipating contingencies, and devising suitable action to take in response;
- Indications of the relative priorities of objectives, targets and their related activities;
- Budgetary constraints.



### ***Written guidance***

Management's policies and operational procedures should be documented to ensure that all staff are aware of them and work together to achieve objectives. Written guidance and procedures manuals should be:

- Clear, unambiguous and easy to refer to;
- Accessible to all relevant staff;
- Subject to checks by management to ensure that they are read and understood;
- Reviewed regularly, and any changes brought to the attention of staff and implemented promptly.

### ***Organizational controls***

These involve allocating responsibility to individuals or groups so that they work together to achieve objectives in the most efficient manner. Accountability and authority should be allocated to match responsibility. Major principles of good organization include:

- Providing clear and documented definition of the responsibilities of individuals and groups for resources, activities, objectives and targets;
- Establishing clear reporting lines;
- Finding the most efficient balance of duties between different organizational groups;
- Establishing the most effective spans of command without creating more levels in the management chain than necessary;
- Establishing effective means of communication throughout the organization;
- Separating duties to avoid conflicts of interest or opportunities for abuse;
- Avoiding undue reliance on any one individual, particularly for internal control.

### ***Intermediate level controls***

#### ***Monitoring performance***

Management needs to monitor performance to ensure that operations are conducted to achieve the optimum economy, efficiency, and effectiveness. Quality control should be built in to systems.

Management should establish its needs for, and use of, information about activities. Relevant information may be in the form of statistics, accounts, analyses, or reports. It may be produced on a regular schedule, at management's discretion, or only when predetermined exceptional conditions are met. Management information should be reviewed regularly to ensure that it is relevant to needs and is being effectively used.

Management information should include measures and indicators of performance in respect of efficiency, effectiveness, economy, and quality of service. This involves identification of inputs, including costs, and outputs and relating them to objectives.

The results of monitoring provide the basis for future action and should be linked to procedures for correcting or adjusting activities accordingly.

#### ***Evaluation***

Policies and activities should be evaluated periodically for economy, efficiency, and effectiveness. They should:

- Be planned from the beginning of the operation;

- Have well-defined objectives and scope;
- Establish yardsticks or standards with which to make comparisons;
- Consider measures and indicators of performance;
- Identify outcomes;
- Identify follow-up action and provide the input for reappraisal of future options.

### *Staffing*

Adequate staffing of management functions and operations is essential for a system to function to its full capability. Weaknesses in staffing can lead to mismanagement, error and abuse which can negate the effect of other controls. The major aspects of staffing which have control implications are:

- Identifying and reviewing the staffing needs: numbers, grades, experience and expertise levels;
- Recruiting and selecting staff to meet the needs;
- Monitoring performance of individuals and groups;
- Arranging training and other staff development measures to achieve the full potential of staff capability.

### *Supervision*

Supervision is the function by which managers scrutinise the work and performance of their staff. It provides a check that staff are performing to meet standards and in accordance with instructions. It includes checks over the operation of controls by staff at lower levels. Good supervision can raise motivation, enhance quality, and assist with staff development. Poor or heavy-handed supervision can lead to de-motivated staff, who have little freedom for innovation and flexibility of response and fail to meet required standards.

### *Budgetary and other financial controls*

Budgetary control matches resources and costs to responsibilities for objectives and outputs. Managers become fully accountable for the achievement of their objectives and targets. It should be applied wherever possible and incorporated within an overall budgetary control system. It can be applied easily to most administrative functions, but may prove difficult in areas where costs or outputs cannot easily be quantified or where responsibilities are unclear.

Budgets should be realistic to allow for essential expenditure to achieve objectives, but should be sufficiently tight to encourage the economic and efficient use of resources. They also should be closely linked to planning and review procedures to ensure that any proposed expenditure is essential.

### *Accounting controls*

Organisations must keep adequate financial and other information to allow the accounts to be produced in the form prescribed. Internal auditors should understand the financial reporting requirements and the relevance of accounting standards and recommended practices. There should be adequate controls to ensure that requirements of regularity and propriety of expenditure are met.

### *Systems development*

Controls over the development of new systems and modifications to existing systems or procedures are essential to ensure that:

- New or revised systems meet their objectives;
- The effect of changes on systems and controls is properly assessed at an early stage before implementation;
- Systems modifications are approved and authorized;
- Adequate plans are made for a change from one system to another;
- The implementation and application of new or revised systems and procedures are in accordance with plans.

## **Low level controls**

### *Authorization*

This is the approval or sanction of specified activities or transactions by a manager or other responsible person before they are undertaken. It ensures that proper responsibility is taken for the controlled activities. Key features are:

- Defining the authorization requirements for activities and transactions;
- Allocating authority to appropriate individuals or groups;
- Separating responsibility for authorization from involvement in other activities which could lead to a conflict of interest;
- Checking that relevant activities and transactions have been properly authorized.

### *Documentation*

This involves recording information and transactions used in an organisation's business. Good standards of documentation should be established to assist and support activities and to help ensure the continuity of operations in the event of disruption. This includes the retention of information in electronic or other forms. Information must be accessible and good filing and search facilities are essential.

The work of the organization should be sufficiently well documented to enable management, external auditors, or other reviewers to follow the course of operations and transactions and to identify errors, abuse, or poor performance. Decisions, authorizations, transactions, checks, and other information should be clearly recorded and the records safeguarded.

Standard documentation and forms can help to enforce conformity with procedures and legal requirements. They are often used to control transactions or the movement of valuables. Such documentation should be carefully designed to meet its objectives.

### *Completeness and accuracy*

- Transactions should be recorded as close to their origin as possible;
- Transactions should be checked at appropriate times in the processing cycle;
- Checks should be carried out by staff independent of those performing the activities checked.

Typical controls to ensure completeness and accuracy include sequence checking, comparison with related documents, control totals, arithmetic checks, and re-performance.

### *Physical controls*

These are concerned with the custody and safety of assets and information. They cover the whole physical environment in which systems operate. The major categories are:

- Access controls such as guards, identity cards, passwords, computer logging;
- Physical checks on assets and records such as stock takes, security inspections;
- Environmental controls such as thermostats, health and safety inspections;

The geographical location or situation within a building of activities, and the secure custody of assets and records.