

# AUDIT AND INVESTIGATION (ACC 312)

**Module 6: Audit Tests and Procedures**

**Module 7: Audit Sampling**

**Lecturer- Mrs Adebisi .I.M.**

# AUDIT TESTS AND PROCEDURES

- It is a procedure carried out by either an external or internal auditor to assess the accuracy of various financial statement assertions.
- The purpose of these tests or procedures is to enable the auditor collect sufficient appropriate audit evidence to be able to conclude with reasonable assurance that the financial statements are free of material misstatement.

# TYPES OF TESTS

Audit tests are generally divided into two types:

- Compliance Tests
- Substantive Tests
- **Compliance Tests;** are tests designed to provide evidence as to whether internal controls are being operated as prescribed by management. These are also known as tests of control.
  - Internal control procedures are carried out to provide reasonable assurance to the auditor on the controls in place in order to determine the nature, extent and timing of substantive tests.

# TYPES OF TESTS

- **Substantive Tests;** are tests designed to obtain evidence as to the completeness, accuracy and validity of transactions in the financial statements and related ones.
  - Substantive testing procedures represent the final stage of the audit leading to the expression of an audit opinion. They contain direct tests of account balances and other procedures such as analysis of fluctuations and trends in the financial statement.

# AUDIT SAMPLING

- The auditor may decide to carry out audit testing on the whole item he intends to draw conclusion on or decide to pick some representative among the whole item, test them and form his opinion on such.
- Audit sampling is the application of audit procedures to less than 100% of the items within an account balance or class of transactions to enable the auditors obtain and evaluate evidence useful in forming a conclusion concerning the whole population.

# REASONS FOR AUDIT SAMPLING

- It is often impracticable to carry out 100% audit testing.
- In order to meet auditor reporting deadline.
- 100% testing may be time consuming and uneconomical.
- It is possible to still reach conclusion by way of sampling instead of conducting 100% testing.

# CIRCUMSTANCES WHERE AUDIT SAMPLING MAY NOT BE APPROPRIATE

- Where the auditor is put upon inquiry.
- Where the transactions under review is one-off and is material.
- Where items are unusual or extraordinary.
- Where the items are specifically required to be disclosed in the financial statements.
- Where the internal control procedures are weak.

# STAGES INVOLVED IN AUDIT SAMPLING

- **Planning the Sample:** In planning the auditor needs to consider matters as the audit objective, the population, sample size, sampling unit, tolerable error or deviation rate, expected error or deviation rate etc.
- **Selecting the items to be tested:** items selected should be representatives of the population. Samples can be selected using several methods as random selection, cluster selection, systematic selection, stratified selection etc.

# STAGES INVOLVED IN AUDIT SAMPLING

- **Testing the Sample:** It involves conducting compliance or substantive procedures as appropriate on the sample selected. Techniques such as inspection, observation, enquiry etc. can be used during this testing.
- **Evaluating the Sample Results:** The auditor should ensure proper review of results obtained from the audit test process in order to check for error, compliance or otherwise and the possibility of an audit risk.

# AUDIT SAMPLING METHODS OR TECHNIQUES

- Audit sampling can be applied to a class of transactions or account balances using the Non-statistical (Judgemental) and Statistical sampling methods.
- Non-statistical sampling methods; the auditor relies on his judgement in determining the sample size, selecting sample items, and evaluating test results.
- Statistical sampling methods; the auditor applies mathematical principles or probability in determining the sample size, selecting sample items and evaluating test results.

# ADVANTAGES OF STATISTICAL SAMPLING METHODS

- Bias in selecting sample units is eliminated to a large extent.
- Accurate size of the sample can be estimated scientifically.
- Results of test can be expressed in precise mathematical terms.
- It can be used by lower grade staff who have the inability to apply judgement needed during sampling.

# DISADVANTAGES OF STATISTICAL SAMPLING METHODS

- It is inflexible.
- The procedures can be lengthy.
- Knowledge of statistical techniques is needed.
- Limits the use of the auditors' initiative.
- Time spent on mathematics will be better spent on auditing.

# ADVANTAGES OF NON-STATISTICAL SAMPLING METHODS

- They are well understood and refined by experience.
- Does not require special skill or knowledge in statistics.
- The auditor can bring his expertise into play when selecting samples.
- No time wasted with mathematics, it is rather devoted to auditing.

# DISADVANTAGES OF NON-STATISTICAL SAMPLING METHODS

- It is unscientific, hence inability to quantify results.
- Sample size are usually too large, thus uneconomical.
- Personal bias in sample selection is present.
- The auditor may not consider all relevant factors during the sampling process due to the absence of a systematic approach.

# REVIEW QUESTIONS

- Explain the term 'Audit Tests'.
- Explain Compliance and Substantive Audit Test and procedures.
- Define the term 'Audit Sampling'
- Why is a 100% check no longer usual in auditing?

# REVIEW QUESTIONS

- What are the circumstances where audit sampling may not be appropriate?
- Explain the stages involved in audit sampling.
- Audit sampling methods are statistical and non-statistical, explain them and state the advantages and disadvantages of each.

# AUDIT AND INVESTIGATION (ACC 312)

## **Module 8:**

## Auditing in a Computerized Environment

# INTRODUCTION

- Information Technology (IT) is an important aspect of accounting and management information systems. Hence, it is imperative that auditors should be fully aware of the impact of IT on the audit of a client's financial statements.

# ASPECTS OF AUDITING IN A COMPUTER BASED ENVIRONMENT

- **Internal controls in a computer based environment:** Application controls, comprising of input, processing, output and master file controls established by an audit client, over its computer based accounting system.

# APPLICATION CONTROLS

- These are those controls (manual and automated procedure) that help to ensure the completeness and accuracy of the accounting records and the validity of entries made in those records.
- They relate to procedures used to initiate, record, process and report transactions and other financial data
- An effective computer-based system will ensure that there are adequate controls existing at the point of input, processing and output stages of the processing cycle and for data contained in the master file.

# APPLICATION CONTROLS

- Application controls need to be ascertained, recorded and evaluated by the auditor as part of the process of determining the risk of material misstatement in the audit client's financial statements.

# Input Controls

- These are control activities designed to ensure that **input is authorised, complete, accurate and timely**. They are mainly used to check the integrity of data entered into a business application.
- Specific input validation checks by the software may include among others:
  - **Format checks:** it ensures that information is input in the correct form. E.g. a the date of a sales invoice be input in numeric format only not numeric and alpha numeric.

# Input Controls

- **Range checks:** ensures that data input is reasonable in line with expectations. Where an organisation rarely makes a bulk purchase with a value in excess of 50,000, an occurrence of this will require a review and follow up.
- **Compatibility checks:** they ensure that data input from two or more fields is compatible. E.g. sales invoice value should be compatible with the amount of sales tax charged on the invoice.

# Input Controls

- **Exception checks:** that an exception report is produced highlighting unusual situations that have arisen following the input of a specific item. For example, a negative value for inventory available.
- **Check digit verification:** Helps to ensure accuracy of data input. For example, a supplier numerical code should be formatted in such a way that purchase invoices with an incorrect code input in the system is automatically rejected.
- **Existence check:** that a supplier account exists.

# Processing Controls

- It exists to ensure that all data input is processed correctly and that data files are updated accurately in a timely manner and that they are authorized. Processing controls for an application program should be designed and then tested prior to 'live' running with real data.

# Output Controls

- They exist to ensure that all data is processed and that output is distributed only to prescribed authorised users. It will vary from organisation to organisation depending on the confidentiality of information and the size of the organisation.
- Examples include follow up on exception report, resubmission of rejected transactions, ongoing monitoring by a responsible official to ensure that output is distributed in accordance with authorised policy.

# Master File Controls

- Master file contains relatively permanent records about particular items or entries. It can contain information about its customers, vendors etc.
- The purpose is to ensure ongoing integrity of information held in the master files. It is important that strict security controls should be exercised over all master files. Some of these include:
  - Use of passwords to restrict access to master file data.
  - Appropriate segregation of duties and authority to amend data restricted to appropriate responsible individuals etc.

# COMPUTER ASSISTED AUDIT TECHNIQUES (CAATS)

- Computer Assisted Audit Techniques or Tools (CAATs) is a technique that allows the performance of audit work with the use of computers. It allows auditors to test and conclude on the integrity of a client's computer based accounting system.
- The auditor can either use the client's system or another computer to perform their audit work.
- This tool facilitates them to make search from the irregularities from the given data.

# COMPUTER ASSISTED AUDIT TECHNIQUES (CAATS)

- With the help of this CAAT, the internal accounting department of any firm will be able to provide more analytical results. It includes basic office productivity software such as spreadsheet, word processors, editing, more advanced software packages and more dedicated specialized software such as ACL, arbutus.

# COMPUTER ASSISTED AUDIT TECHNIQUES (CAATS)

- The use of either CAATs or manual techniques on a specific audit engagement depends on the following factors:
  - The practicality of carrying out manual testing
  - The cost effectiveness of using CAATs
  - The availability of the audit client's computer facility
  - The level of audit experience and expertise in using a specified CAAT

# COMPUTER ASSISTED AUDIT TECHNIQUES (CAATS)

- Computer-Assisted Audit Techniques is also known as Computer-Aided Audit Tools.
- The two major categories are:
  - Use of Audit Software
  - Use of Test Data

# CLASSIFICATION OF CAATS

- Audit Software can be off-the-shelf or can be purpose written to work on a client's system. It can be used to scrutinize large volume of data, which it would be inefficient to do manually. They can be used to perform specific procedures as check arithmetic accuracy, prepare reports, produce letters to send to customers and suppliers, analyse, summarise, risk assessment etc.

# CLASSIFICATION OF CAATS

- Test data involves the auditor submitting 'dummy' data into the client's computer system to ensure that the system correctly processes it and that it prevents or detects and corrects material misstatements.
- The principle is to test the operation of application controls within the system.
- The auditor will arrange dummy data to be processed; that includes many error conditions, to ensure that the client's application controls can identify particular problems.

# CLASSIFICATION OF CAATS

- Data without errors will also be processed to ensure it is processed correctly
- Examples include: codes that do not exist e.g. customer, supplier etc., invoices with arithmetical errors.

# Advantages of CAATs

- Speed and Accuracy.
- It lessens the level of human error in testing.
- The application of CAATs frees up expensive human capital.
- It facilitate the auditors to test a huge volume of data.

# Disadvantages of CAATs

- They are too costly to set up and necessitate the support of the client.
- Major changes in the client systems could cause changes in CAATs which can be costly.
- Potential incompatibility with the client's computer system.
- It requires sufficient level of IT expertise in understanding results.
- Data may be lost or corrupted.

# AUDIT AND INVESTIGATION (ACC 312)

## **Module 9:**

Report Writing and Types of Audit Report.

**Lecturer- Mrs Adebisi .I.M.**

# INTRODUCTION

- The auditor should review and assess the conclusions drawn from the audit evidence as the basis for the expression of an opinion on the financial statements.
- The auditor's report should contain a clear written expression of opinion on the financial statements as a whole.
- A report is an account in which a given problem is examined for the purpose of conveying information, findings, or facts of a situation.

# CHARACTERISTICS OF A GOOD REPORT

- A good report should have the following characteristics among others:
  - Have a term of reference.
  - Be factual, convincing and unbiased.
  - Be presented in a clear, simple and unambiguous in language and tone.
  - Well punctuated, rid of spelling mistakes.
  - Neatly and attractively presented in paragraph and numbering.

# ELEMENTS OF THE AUDITOR'S REPORT

- Title
- Addressee
- Opening or introductory paragraph
- A scope paragraph
- Opinion paragraph
- Date of the report
- Auditor's address
- Auditor's signature

# ELEMENTS OF THE AUDITOR'S REPORT

- **Title:** An appropriate title such as “Audit report to members of ABC Plc” should be used in the audit report so as to distinguish the report from reports issued by some other persons outside the auditing profession.
- **Addressee:** It should be properly addressed. In this context, it is usually addressed to the shareholders of the company whose financial statements are being audited.

# ELEMENTS OF THE AUDITOR'S REPORT

- **Opening or Introductory Paragraph:** It should identify the financial statements of the entity been audited, including the date of and period covered by the financial statements. It should state that the financial statements are the responsibility of the management and a statement that the responsibility of the auditor is to express an opinion on the financial statements.

# ELEMENTS OF THE AUDITOR'S REPORT

- **Scope Paragraph:** The auditor needs to state that the audit was conducted in accordance with relevant national standards or practices as appropriate. It should describe the work performed by the auditor and include a statement that the audit was planned and performed to obtain reasonable assurance about whether the financial statements are free of material misstatement.

# ELEMENTS OF THE AUDITOR'S REPORT

- **Opinion Paragraph:** This clearly states the auditor's opinion as to whether the financial statements give a true and fair view in accordance with financial reporting framework and whether they comply with statutory requirements.

# ELEMENTS OF THE AUDITOR'S REPORT

- **Date of Report:** The report should be dated as of the completion date of the audit.
- **Auditor's Address:** The report should state a specific location. It is usually the city where the auditor maintains office for carrying out audit.
- **Auditor's Signature:** It should be signed in the name of the audit firm, the personal name of the auditor or both as appropriate.

*\*Check online resources for audit report sample*

# TYPES OF AUDIT REPORTS

- The auditors' report is the statutory final product of the audit process and it contains the auditor's opinion as to whether the financial statements show a true and fair view.
- The two main types of Audit reports are:
  - Unqualified audit report or a clean report
  - Qualified report

# TYPES OF AUDIT REPORTS

- **An unqualified audit report:** Here the auditor does not find material error, omission, fraud or other matters that will make him issue a qualified audit report. An unqualified opinion should be expressed when the auditor concludes that the financial statements give a true and fair view.

# TYPES OF AUDIT REPORTS

- **A qualified report:** In this report, the auditor concludes that most matters have been dealt with adequately, except for few issues. A report is qualified when there is either a limitation of scope in the auditor's work, or when there is a disagreement with management regarding application, acceptability or adequacy of accounting policies. For an auditor, an issue must be material or financially worth consideration to qualify a report.

# QUALIFICATION MATRIX

- In qualifying a report, the auditing standard requires the following forms of qualification to be used in the different circumstances below.

<b>Nature of circumstances</b>	<b>Material but not fundamental</b>	<b>Fundamental or Pervasive</b>
Uncertainties	Except for opinion	Disclaimer opinion
Disagreement	Except for opinion	Adverse opinion

# CIRCUMSTANCES LEADING TO A QUALIFIED OPINION

- The circumstances leading to a qualified opinion are uncertainties and disagreements.
  - **Uncertainty:** This is due to limitations in the scope of the audit. It arises where the auditor is unable to obtain all the information and explanations considered necessary for the purpose of the audit arising from:
    - Absence of proper accounting records.
    - Inability to carry out procedures considered necessary.

# CIRCUMSTANCES LEADING TO A QUALIFIED OPINION

- **Disagreement:** The auditor may disagree with management about matters such as acceptability of accounting policies selected, method of their application, also disagreements as to the facts or amounts included in the financial statements, failure to comply with relevant legislation or other requirements.

# MATERIALITY AND FUNDAMENTALITY

- **Materiality:** An item is said to be material if its omission or misstatement could influence the economic decisions of users of the financial statements.
- **Fundamentality:** when an item is material as to undermine the view given by the financial statement i.e. render it meaningless or misleading totally, it is said to be fundamental.
- While writing the report, the auditor considers whether uncorrected and undetected misstatements have material and fundamental or pervasive effect or just material but not pervasive.

# MATERIALITY AND FUNDAMENTALITY

- Uncertainties becomes fundamental when its impact on the financial statement is so great to render it as a whole totally meaningless.
- Disagreement becomes fundamental when its impact on the financial statements is so great to render it totally misleading.

# QUALIFICATION OF AN AUDIT REPORT

- This qualification can be Except for, Disclaimer and Adverse.
- **Except for:** The auditor expresses an except for opinion on a particular matter which is material but not fundamental. He states that the financial statements give a true and fair view except for the matter referred to (e.g. due to inability to audit certain areas of the company operations due to factors as restrictions by management etc. Give example, check note beside...

# QUALIFICATION OF AN AUDIT REPORT

- **Disclaimer Opinion:** it is expressed when the possible effect of the uncertainty or disagreement is so material and pervasive (fundamental) that the auditor is unable to form an opinion as to whether the financial statements show a true and fair view. A disclaimer opinion implies that the auditor is unable to form an opinion because sufficient evidence could not be obtained.

# QUALIFICATION OF AN AUDIT REPORT

- **Adverse Opinion:** it is expressed when the effect of the disagreement is so material and pervasive to the financial statements. The auditor states that in his opinion the financial statements do not show a true and fair view.
- The disclaimer and adverse opinions are the extreme forms of the categories of qualification of opinion arising from uncertainty and disagreement.

# REVIEW QUESTIONS

- Define a report and an auditor's report.
- Itemize some characteristics of a good report.
- List and explain the elements of an audit report.
- Explain the main types of audit report. i.e. 'Qualified and Unqualified audit reports'
- Explain the two circumstances leading to the expression of a qualified opinion or the issuing of a qualified report.
- In what situations are this opinion expressed? Except for, Disclaimer, Adverse. Explain each of the opinions.

# AUDIT AND INVESTIGATION (ACC 312)

## **Module 10:**

Conducting Investigations; General Approach to Investigative work

**Lecturer- Mrs Adebisi .I.M.**

# INTRODUCTION

- Investigation implies the examination of accounts for some special purpose. It is different from auditing which is carried out primarily to ascertain whether or not the financial statements prepared show a true and fair view.
- Investigation is an act of examining, searching and inquiring into a matter with adequate care and accuracy for the purpose of obtaining information of particular or specific nature.

# INTRODUCTION

- Investigations consist of various non-auditing tasks carried out by accountants, who usually have served as auditors to the organisation.
- An auditor conducting an investigation is seen as an expert and should therefore exercise great skill and care.
- The scope of work could be wider or narrower than auditing depending on the type of investigation being conducted.

# SCOPE OF INVESTIGATIONS

- The following are some of the investigations commonly met with in practice.
  - Investigation on behalf of an individual or firm proposing to buy a business or for investment purpose.
  - Investigation on behalf of a bank for credit purpose.
  - Investigation for the purpose of business re-organisation and reconstruction or for merger and acquisition.
  - Investigation on behalf of a business where fraud is suspected or known to have taken place etc.

# GENERAL APPROACH TO INVESTIGATIVE WORK

- In carrying out investigations, the following stages can be considered.
  - **Preparation:** This stage involves preliminary review, obtaining written instructions from the client and planning the investigation. The auditor will need to be familiar with the business and understand the client's instructions so that he can plan his programme in accordance with the instructions.
  - **Field work:** It involves conducting the investigation proper by ascertaining the facts and obtaining information from relevant people. Information obtained will be verified and analysed.

# GENERAL APPROACH TO INVESTIGATIVE WORK

- **Reporting:** At this stage the evidence is interpreted and next is the writing of the report of the assignment. A draft report can be prepared for discussion with the client to incorporate further work where required by the client before the preparation of the final report and its submission to the client.

# DIFFERENCES BETWEEN INVESTIGATIONS AND CONVENTIONAL AUDIT

- Although both could have similar techniques and procedures, investigations differ in certain important aspects from conventional audits. Some of the differences are:
  - **Objective:** The objective of conventional audit is to primarily report on the truth and fairness of the financial statement presented by the entity. That of investigation varies and it is as specified by the client.

# DIFFERENCES BETWEEN INVESTIGATIONS AND CONVENTIONAL AUDIT

- **Scope:** The scope of conventional audit is as laid down by statutes and generally accepted auditing practice and covers the financial statements, while investigation is as agreed by the client.
- **Timing/Regularity:** Conventional audits are carried out on an annual basis. Investigations are carried out as at and when required.
- **Expected standard of care:** Since the needs of the client are usually well defined, the degree of care that the investigating accountant must exercise may be higher than that of the auditor.

# DIFFERENCES BETWEEN INVESTIGATIONS AND CONVENTIONAL AUDIT

- **Extent of Regulations:** Conventional audits are governed by companies regulations, which sets out the rights, duties and responsibilities of the auditor. On the other hand, investigations are governed by the terms of reference which is mutually agreed between the client and the accountant.
- **Depth of Examination:** Investigations involve in-depth enquiry into specific areas of the entity's financial affairs. Conventional audits require the auditor to carry out reasonable enquiry into each aspects of the entity's financial information, sufficient to enable him report on whether it presents a true and fair view.

# REVIEW QUESTIONS

- Define and Explain the term 'Investigation'.
- Identify some investigations commonly conducted in practice.
- Enumerate and Explain the stages involved in the conduct of investigations.
- Itemize and Explain some differences that exist between conventional audits and investigations .