

# **Internal Audit Overview - Engagement Management**

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**July 9, 2013**

# Agenda

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- **International Professional Practices Framework (IPPF)**
- **Definition of Internal Auditing**
- **Conducting an Audit Engagement**
  - Key Documents
- **Audit Report Structure**
- **Audit Report Writing**
  - 5 Elements of an Observation
- **An example of an Observation with 5 Elements**

# International Professional Practices Framework (IPPF)

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- Authoritative guidance on the internal audit profession
- Current, relevant, internationally consistent information required by internal audit professionals worldwide.

# IPPF

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- Mandatory Guidance
  - Definition of Internal Auditing
  - Code of Ethics
  - Standards
- Strongly Recommended Guidance
  - Practice Advisories
  - Practice Guides
  - Position Papers



# Definition of Internal Auditing

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- Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

# Conducting an Audit Engagement

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## Key Documents

- **Planning Memo**
- **Risk and Controls Matrix**
- **Kick off Presentation**
- **Closing Meeting Presentation**
- **Closing Memo**
- **Audit Report**

# Planning Memorandum

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- **Initial operational plan for a scheduled internal audit**
- **Planning memo Identifies:**
  - **The objectives of the project**
  - **Areas to be audited / reviewed (i.e., scope of planned work)**
  - **Deliverables**
  - **Key milestones and deadlines**
  - **Project resources**
- **Requires Internal Audit Department management approval**

# **Risk and Controls Matrix**

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- **Establishes control objectives based on planning stage**
- **Identifies risks associated with not meeting control objectives including the fraud risks.**
- **Includes expected controls and audit approach**



# Kick off Presentation

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- **Introduces the IA Organization/Team**
  - **Provides an overview of the engagement**
    - **Background**
    - **Objective/Scope of the Audit**
    - **Audit Timeline**
  - **Establishes Audit Reporting expectations**
    - **Report structure**
    - **Report qualifier**
    - **Observations ratings**
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# Closing Meeting Presentation

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- **Audit Team**
- **Audit Process**
- **Audit Scope**
- **Potential Findings**
- **Other Comments**
- **Next Steps**

# Closing Memo

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- **Documents the closure of an internal audit project**
- **Summarizes the results (findings/recommendations) and the final scope of the project**
- **Provides a record of any subsequent agreed upon follow-up**
- **Requires Internal Audit Department management approval**

# Audit Report

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- **Structure**
  - Executive Summary
  - Detail Report
  
- **Content of Audit Reports**
  
- **Audit Report Writing**
  - Five Elements of an Observation

# Audit Report Structure

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- **Executive Summary**
  - Includes high risk issues
  - 2 pages or less
  
- **Detail Report**
  - Full report
  - Indicates responsibility for the action plan

# Content of Audit Reports

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- **Tone – use unbiased language; create desired tone by projecting positive or negative consequences**
- **Boldface font to call attention to information**
- **Conciseness and Readability**
  - **Concise sentences convey ideas fully in the fewest words possible; Eliminate redundant or unnecessary words**
  - **Readability: a) length of the sentence; b) difficulty of the words**

# Audit Report Writing

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## Five Elements of an Observation

- Condition
  - Criteria
  - Cause
  - Effect / Risk
  - Recommendation(s)
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# Condition

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**Answers the question: “What are the facts?”**



# Condition

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## Writing the condition:

- **Clear and concise**
- **Does the condition answer: What are the facts?**
- **Report the condition factually, completely, accurately and precisely**
- **Quantify whenever possible**
- **Focus on the present not the future or the past**

# Example of a Condition

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**Twenty-five electronic wire transfers averaging \$400,000 a day are executed by the Treasury Clerk. The Clerk has two fund transfer system passwords that allows for the input and release of wire transfers.**

# Criteria

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**Answers the question: “What ought to be?”**

# Criteria

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- **What should exist**
- **Standard established by management, industry practice, common sense, accounting principles or other governing body such as:**
  - a) **internal – policy & procedures manual, employee handbooks, authoritative literature**
  - b) **governmental regulations and law**
- **Cite pertinent policy, procedure, or general principle to give the observation an authoritative tone**

# Example Criteria

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**Sales figures from the stores must be reported accurately to meet corporate policy and governmental regulations**

# Cause

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**Answers the question, “Why?”**

# Cause

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- **The cause explains the discrepancy between the condition and the criteria**
- **Determine why the condition does not agree with the criteria**
  - **The root cause is the primary cause of the condition**
  - **Contributing causes are additional causes that result in noncompliance with the criteria**

# Examples of Cause

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- **The system did not have adequate controls to prevent multiple persons from using the same password**
- **The Supervisor has not enforced the policy for one password per employee**



# Effect

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**Answers the question, “So what?”**

# Effect

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- **The degree of risk the organization is exposed to or could be exposed to if the cause is not addressed**
- **The most critical of the five in persuading the client to take action. Selling point of the observation**
- **Persuasively explain the risks and benefits by stating supportable facts**
- **Quantify the effect (frequency, size, likelihood)**

## **Example of Effect**

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**Due to the dollar amounts of the transactions, the volume and speed, the Company could lose up to \$X amount through errors and irregularities. Wire transfer amounts are in the range of \$5,000 and \$70,000 per transaction.**

# Recommendations

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**Answers the question, “What is to be done?”**

# Recommendation

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- **Suggestions for corrective actions. What must be done to address the cause and to correct the existing condition. The condition can be prevented from recurring**
- **When writing a recommendation, focus on addressing and eliminating the cause(s)**
- **Describe what needs to be done, not how to do it. Go beyond repeating the criteria**
- **Make recommendations that are practical, logical and cost effective**

# Examples of Recommendations

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- **Have management monitor password use through a monthly report, and limit all users to one system password**
- **Evaluate the risks in the wire transfer process and segregate duties accordingly**

# **Example of the Elements of an Observation**

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**From Sample Inc. Treasury Report**

# Example #1 of the Elements of an Observation

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- ***Condition:*** Wire transfers documentation and authorization is not always appropriate.
- ***Criteria:*** According to the Treasury Department's Wire Transfer Guidelines, free form wire transfers should be originated and approved at the requesting department. The original signed request should then be sent to the Cash Management Specialist via interoffice communication with the requisite supporting documentation attached. All wire requests should be signed at the appropriate authorization level in accordance with the Sample Inc. Expenditure Authorization Policy (Bulletin #12).



# Example #1 of the Elements of an Observation

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- ***Cause:*** Treasury does not validate vendor information for recurring wires. There are also no established policies and procedures for verifying vendor information before processing recurring payments.
- ***Effect:*** Wire transfers without appropriate back-up and/or appropriate approvals may result in unauthorized spending. Wire transfers made outside the AP system without validation or setup in the vendor master file, increase the susceptibility to fraud.

## Example #1 of the Elements of an Observation

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- ***Recommendation:*** Treasury should not process any wire requests that lack required supporting documentation or adequate approval. Email wire requests should be regarded as secure due to Lightweight Directory Access Protocol (LDAP) log in and should be accompanied by a scanned copy of the original supporting documents. When a fax wire request is not accompanied by original documentation, Treasury should request scanned copies of originals via email.

Management should ensure that all wire transfers have appropriate back up and approvals at the proper level as prescribed by company policy. Management should review the departmental Wire Transfer Guidelines and ensure that they comply with the Sample Inc. Expenditure Authorization Policy.

# Contact Information

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