Audit Planning & Sampling

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01

AUDIT PLANNING

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- **Standard on Internal Audit (SIA) 310**, deals with “Planning of Internal Audit Assignments” for a particular part of the entity.
- **IPPF** – International Standards of Professional Practice of Internal Auditing – **Performance Standard 2010** on **Planning**
- The **Objectives** of an Overall Internal Audit (Engagement) Plan are to:

01

Ensure that the planned internal audits are in line with the objectives of the internal audit function, as per the internal audit charter and also in line with the overall objectives of the organization .

02

Align the organization’s risk assessment with the effectiveness of the risk mitigation implemented.

03

Confirm the broad scope, methodology and depth of coverage of the internal audit work.

04

Ensure that overall resources are adequate, skilled and deployed with focus in areas of importance.

REQUIRMENT OF STANDARD

- The planning exercise shall follow a laid down process, the outcome of which shall be a written document containing essential elements.

01 Internal audit plan shall be reviewed and approved by the highest governing body responsible for internal audits.

02 A discussion with management and other stakeholders shall be undertaken to understand the intricacies of each auditable unit subject to audit.

03 An Audit Universe shall be prepared prior to establishing the scope of the overall internal audit plan

04 A risk- based planning exercise shall form the basis of the overall internal audit plan

05 The Audit Universe and the overall internal audit plan shall be continuously monitored during the execution phase.

STEPS IN AUDIT PLANNING

STEP 6

Documentation

STEP 5

Technology Deployment & Resource allocation

STEP 4

Risk Assessment

STEP 1

Obtaining knowledge of the business and its environment

STEP 2

Discussion with Management & Stakeholders

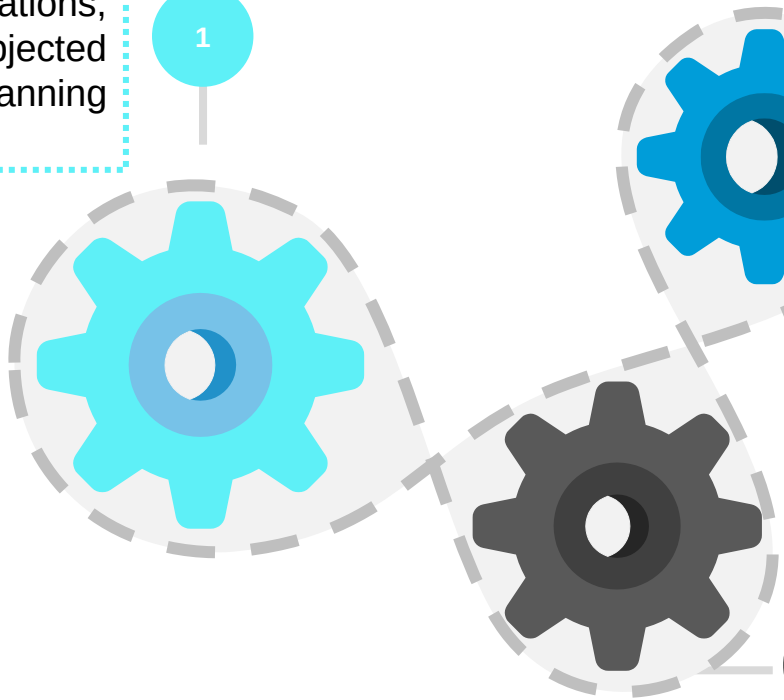
STEP 3

Audit Universe and Scope of coverage

AUDIT UNIVERSE

Audit universe comprises of the activities, operations, units , etc., to be subjected to audit during the planning period.

1



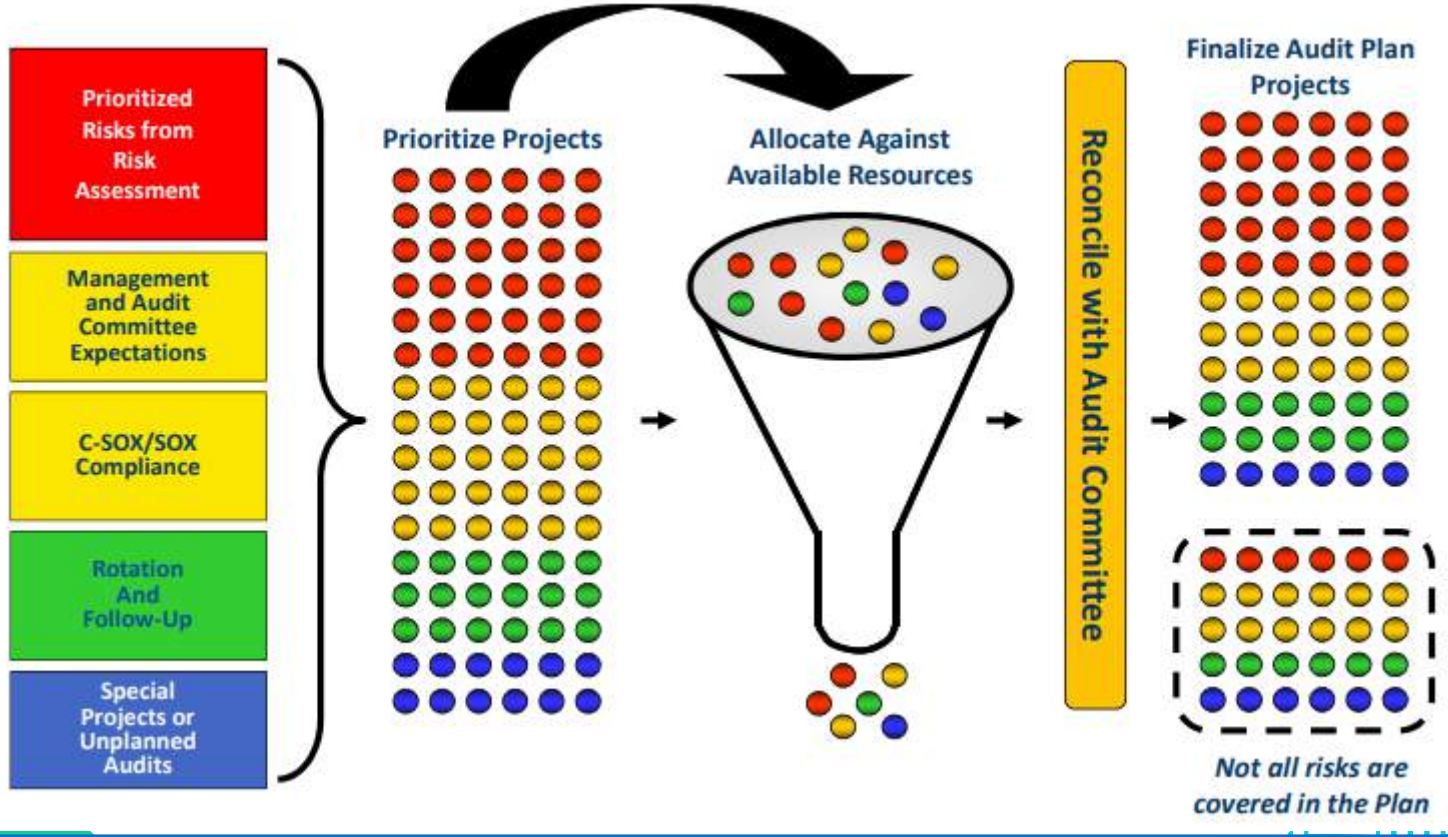
The audit universe and the related audit plan should also reflect the overall business objective, changes in the managements' course of action, corporate objectives, etc.

2

The internal auditor should periodically, say half yearly, review the audit universe to identify any changes.

3

INTERNAL AUDIT PLANNING PROCESS



VED APPLIED TO INTER AUDIT PLANNING

- Categorization of processes in audit universe into **Vital, Essential & Desirable** based on criticality, risk and materiality.
- Vital process audited every year, Essential – once in two years and Desirable – one in three years.
- Based on process controls, risk assessment and audits done in the past three years, audits areas for the year are selected.

PROCESS IMPACT
- Impact of strategic objectives
- Financial impact of process

RISK MATRIX
- Risk score
- Fraud risk score
- Compliance score
- process scores

=

Vital process (A)
Essential process (B)
Desirable process (C)
A+B+C=100%

AUDIT PLANNING AREAS - Selection considerations

Criticality of processes - VED

Focus areas

Spot Audits

Themes

Locations

Stakeholder feedback

Audit Holiday

Exclusions

RISK ASSESSMENT

- Auditor must analyze the key risks, mitigating governance, risk management and control.
- Risk assessments should be: Both qualitative and quantitative.
- Formally documented with written analysis/rationale to support assumptions
- Approved by the audit committee at least annually / upon material changes

Internal factors

Organisational strategies

Governance issues

External factors

Macro economic conditions

Changing market conditions

Changes to law/regulation

Changes to systems, processes or business model

Risk appetite/tolerance levels

Date of last audit

INTERNAL AUDIT PLANNING PROCESS

PLANNING

- Engagement Letter
- Initial Meeting
- Preliminary survey
- Internal control review
- Audit Program

FIELD WORK

- Transaction testing
- Advice & Informal communication
- Audit summary
- Working papers

AUDIT REPORT

- Discussion draft
- Final draft
- Final report
- Client response & comments

AUDIT FOLLOW-UP

- Follow up review
- Follow up report
- Reporting to the board.

02

AUDIT SAMPLING

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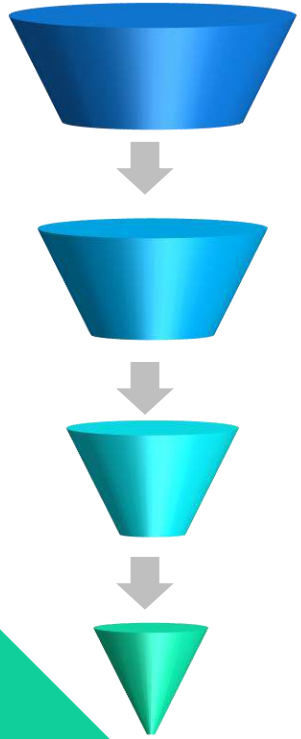
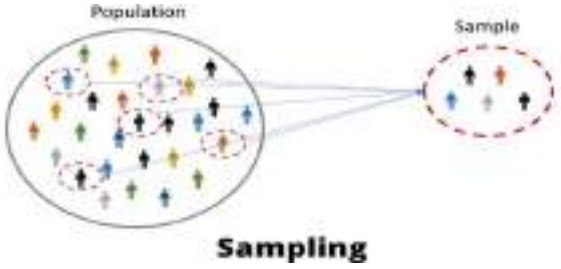
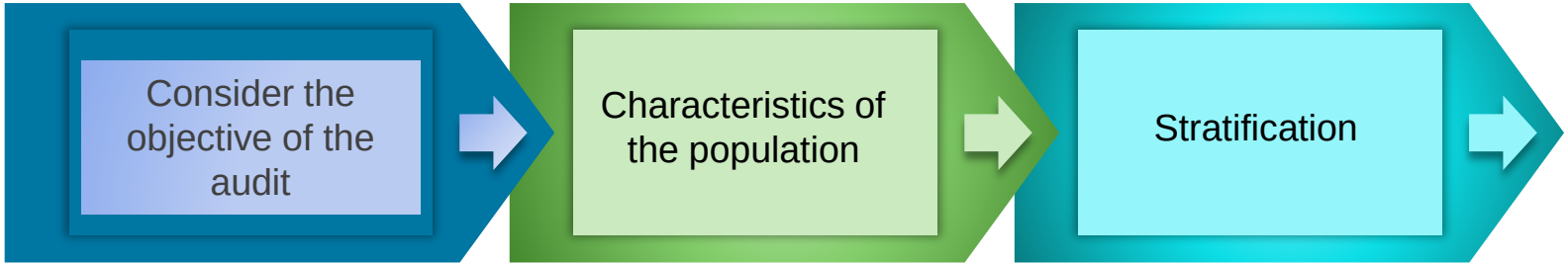


- Applying audit procedure to **< 100% of the population**
- Based on objective of the audit
  - Sufficient understanding of internal control structure to plan the audit & determine nature, timing & extent of tests to be performed.
  - **Standards on Internal Audit (SIA) 5, Sampling** deals with the design and selection of an audit sample and provide guidance on the use of audit sampling in internal audit engagements.
  - Refer professional standards of IIA IPPF
  - Deals with auditor's use of statistical & non selecting the audit sample.



SELECTION OF AUDIT SAMPLE



Auditor should select sample items in such a way that the sample can be expected to be representative of the population.

KEY POINTS – AUDIT SAMPLING

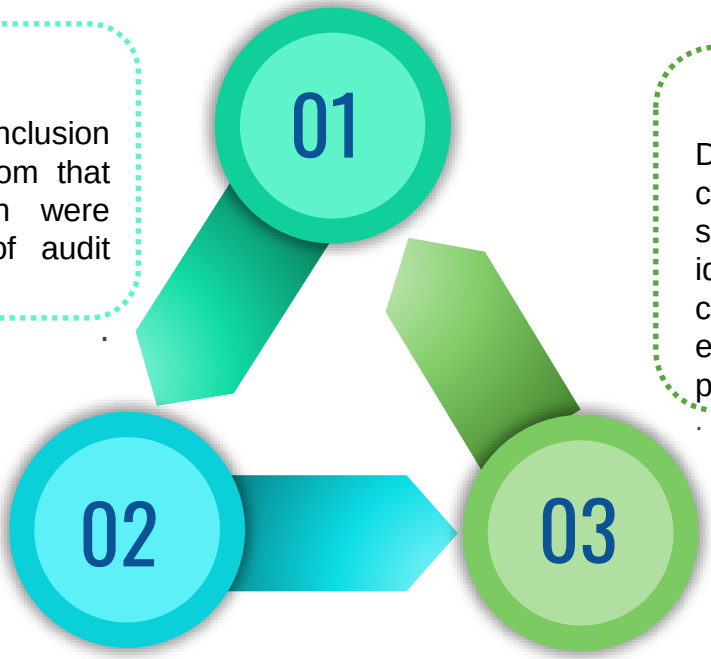
When determining sample size, auditor should consider-

SAMPLING RISK

Possibility that an auditor's conclusion based on a sample is different from that reached if the entire population were subject to audit (Inherent part of audit sampling).

EXPECTED ERROR

Determining expected error considers matters such as - the size & frequency of errors identified in previous audit, changes in Entity's procedures & evidence available from other procedures.



TOLERABLE ERROR

The maximum error in the population that the auditor would be willing to accept.

The lower the risk the auditor is willing to accept, the greater the same size needs to be

FACTORS AFFECTING THE SAMPLE SIZE

Population size

- The lower the rate of deviation that the internal auditor is willing to accept, the larger the sample size needs to be

Confidence level

- The higher the degree of confidence that the internal auditor requires that the results of the sample are indicative of the actual incidence of errors in the population, the larger the sample size needs to be

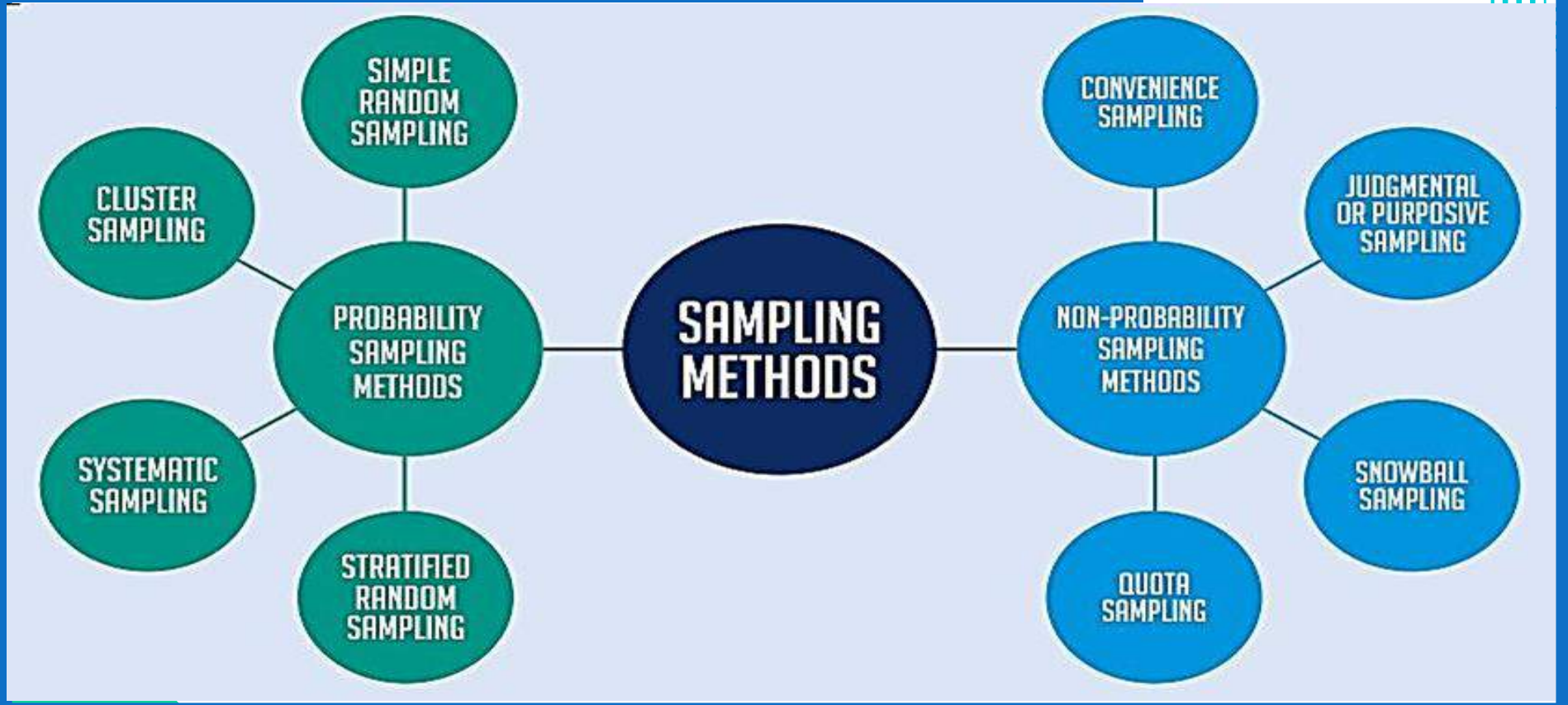
Risk

- In high-risk areas, a large sample will be desirable because high confidence levels and narrow precision intervals are required.

Rate of Deviation

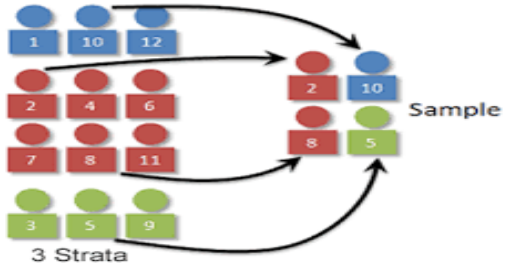
- The higher the rate of deviation that the internal auditor expects, the larger the sample size needs to be so as to make a reasonable estimate of the actual rate of deviation. The lower the rate of deviation that the internal auditor is willing to accept, the larger the sample size needs to be

METHODS OF AUDIT SAMPLING



STATISTICAL AUDIT SAMPLING

- Statistical audit sampling involves a sampling approach where the auditor utilizes statistical methods such as random sampling to select items to be verified. Random sampling is used when there are many items or transactions on record.
- Consider a company with more than 100 inventory transactions on its records. Using statistical sampling is recommended due to the high number of transactions.
- For example, with statistical sampling, ten items are selected from the total population randomly. Every single item within the 100 has an equal probability of being selected and tested for accuracy as a result. Again, it benefits auditors since they can still make an audit opinion but do not have to check all 100 transactions.
- Statistical selection includes two possible techniques:
  - Random selection
  - Systematic selection



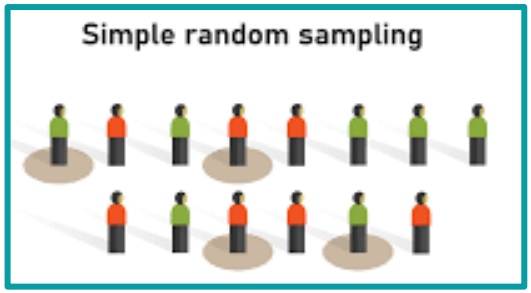
NON- STATISTICAL AUDIT SAMPLING

- In contrast to statistical audit sampling, non-statistical audit sampling items are not chosen randomly. Instead, they are chosen based on the auditor's judgment, and the result of the testing from the selections is not used to infer the conclusion for the entire population.
- In the example earlier, ten inventory transactions can be used to infer the opinion on all 100 transactions. In non-statistical audit sampling, the auditors may choose to select items based on criteria such as:
  - The value of items (e.g., items greater than Rs.100,000)
  - Items with specific information (e.g., items related to a certain company)
- Non-statistical selection covers the following possibilities (among others):

1. Haphazard selection 2. Block selection 3. Judgement selection 4. Risk based sampling combining elements of the three possibilities above

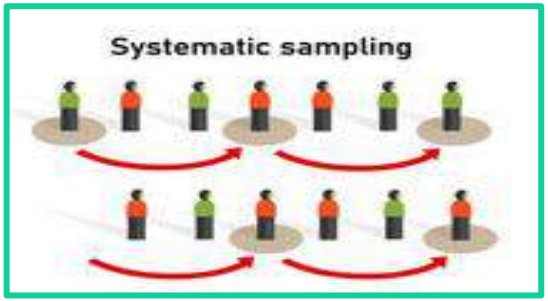
SIMPLE RANDOM SAMPLING

- A simple random sample takes a small, random portion of the entire population to represent the entire data set, where each member has an equal probability of being chosen.
- An example of a simple random sample would be the names of 25 employees being chosen out of a hat from a company of 250 employees. In this case, the population is all 250 employees, and the sample is random because each employee has an equal chance of being chosen. Random sampling is used to conduct randomized control tests or for blinded experiments.
- The example in which the names of 25 employees out of 250 are chosen out of a hat is an example of the lottery method at work. Each of the 250 employees would be assigned a number between 1 and 250, after which 25 of those numbers would be chosen at random.



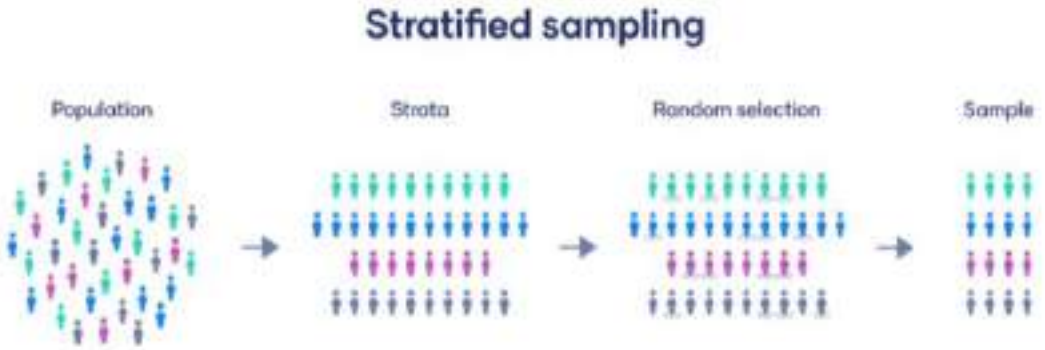
SYSTEMATIC SAMPLING

- Systematic sampling uses a random starting point and then applies a systematic rule to select the additional items (e.g., each 20th item after the random starting point)
- For example, you want to survey customers at a store but don’t have a complete list of all customers. Instead, you can use systematic sampling and administer the survey to every 20th customer who exits the store. This method works because the customers leave randomly.
- When you use systematic sampling in this manner, you must carefully understand the behavior of your population. For example, you might have different types of customers in the store at separate times. The store might have more retirees during daytime hours on weekdays, teenagers after school, and working people in the evening and on weekends.



STRATIFIED SAMPLING

- Stratified random sampling involves dividing the entire population into homogeneous groups called **Strata**.
- In Stratified random sampling, or stratification, the strata are formed based on shared attributes or characteristics such as income or educational attainment.
- For example, analysis of manual purchase orders would require classification of population based on document type to form strata from which samples are drawn and analyzed.



SAMPLING - Advantage & Disadvantage

ADVANTAGE	DISADVANTAGE
• To sketch conclusions about a population without testing all of the transactions or balances in the population as a whole.	• There is always a risk that the auditor's sample is not representative of the population as a whole. Auditor determine and accept the risk, and carry out other procedures to recompense for it, but it always remains as a risk.
• To focus on high risk or high value items, and to distinguish between elements of a population which may be subject to differing internal controls.	• Sampling relies on the use of judgement in relation to exceptions, materiality and in drawing conclusions.

DATA ANALYTICS IN INTERNAL AUDIT

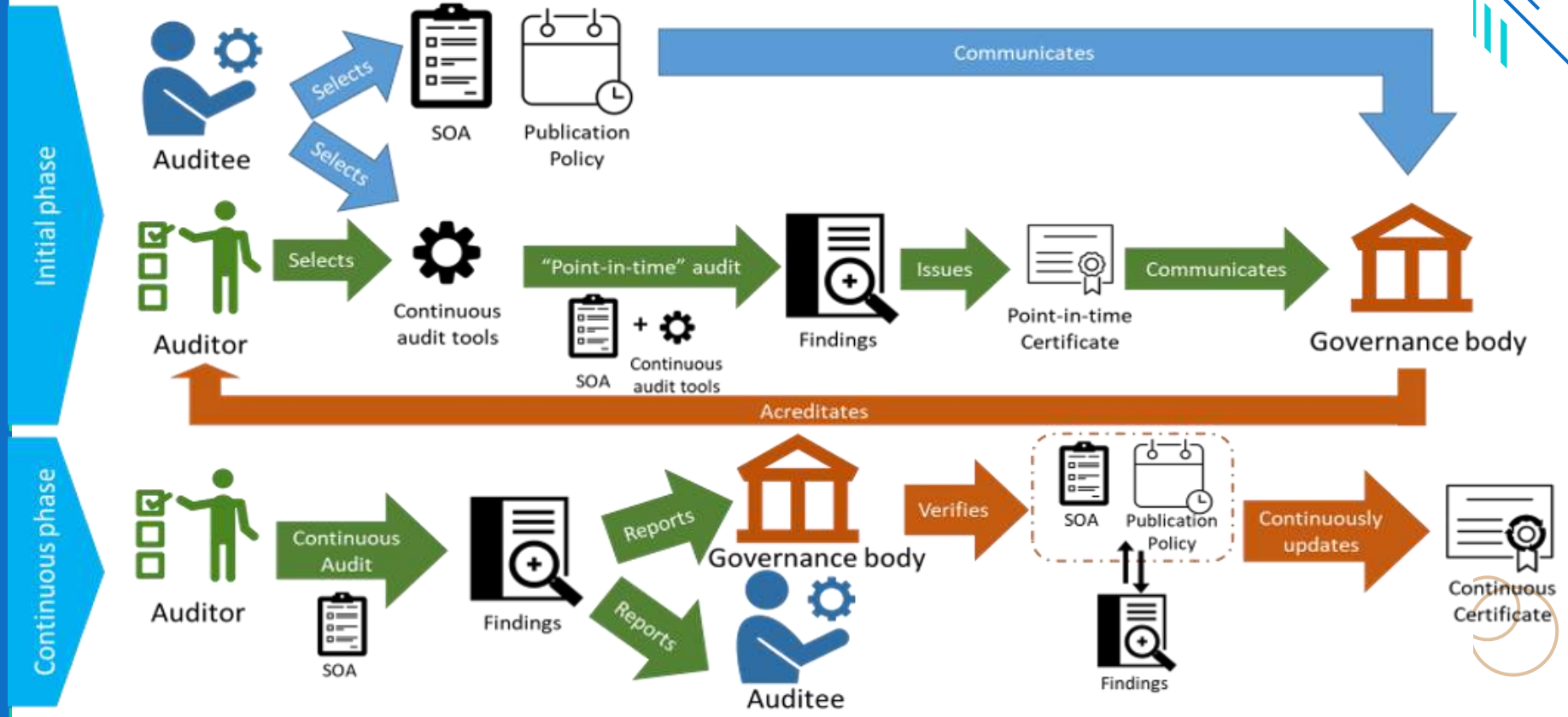
AREAS WHERE DATA ANALYTICS ADDS THE MOST VALUE

- Accounts Payable & Accounts Receivable
- Duplicate detection
- Sampling
- Analysis of large data sets
- Continuous auditing & monitoring
- Fraud detection & Forensic Analysis
- Analysis of Purchases
- Payroll & Time sheets
- Joins & Comparisons
- Inventory audits

CONTINIOUS AUDIT

- “Continuous" aspect refers to the real-time or near real-time capability for financial information to be checked & shared.
- Indicates integrity of information to be evaluated at any given point of time.
- Information verified constantly for errors, fraud & inefficiency.
- Automatic method used to perform auditing activities- control & risk assessments on a more frequent basis.
- Technology - key role helping automate identification of exceptions or anomalies.
- Analyze patterns within the digits of key numeric fields, review trends & test controls.
- Most detailed audit

CONTINIOUS AUDIT



CONTINIOUS AUDIT- Advantages & Challenges

ADVANTAGES

- Detailed analyses of data
- Minimal Audit risk
- No sampling risk
- Detection of error and fraud at an early stage

CHALLENGES

- Accessing complex, diverse system environment
- Reluctance to expand the use of technology
- Overwhelming results
- Training

ADVANTAGES OF CONTINIOUS CONTROL MONITORING

01 Set of technologies to reduce business losses through continuous monitoring

02 Reducing the cost of audits through continuous auditing of the controls in financial & other transactional applications

03 100% real time monitoring.

04 Deviations / Exceptions highlighted.

05 Entry not allowed to be processed

CONCLUSION

- Audit planning is a critical part of audit works and performing the correct audit plan could be the factors that lead to the success of audit engagement.
- The use of sampling is widely adopted in auditing because it offers the opportunity for the auditor to obtain the minimum amount of audit evidence, which is both sufficient and appropriate, in order to form valid conclusions on the population.
- “Audit sampling is also widely known to reduce the risk of ‘over-auditing’ in certain areas and enables a much more efficient review of the working papers at the review stage of the audit.”

THANK YOU