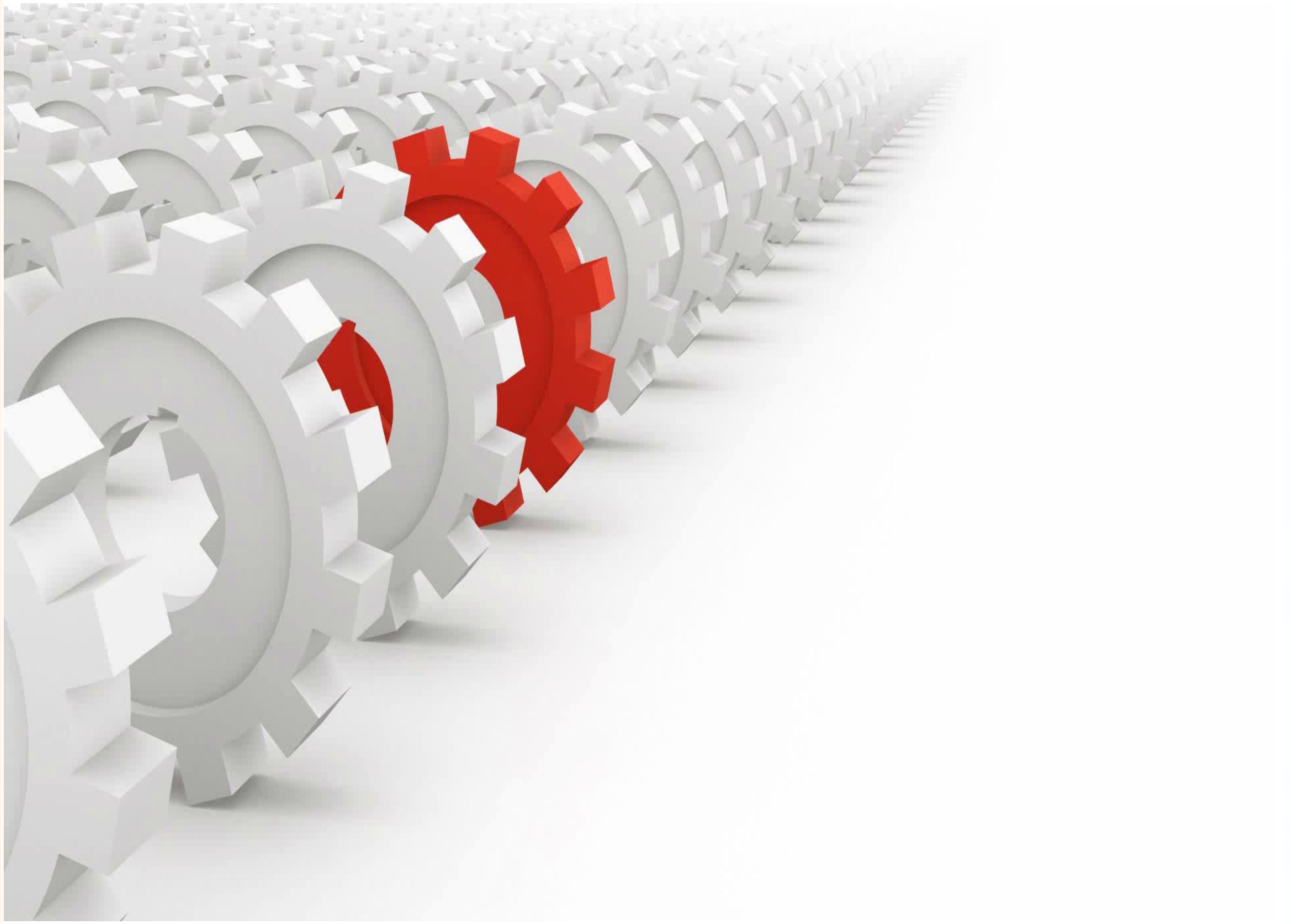

Overview of Audit Risks & Control Methodologies

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Outline

- Introduction
- Auditor Generals' Responsibilities
- Audit Tests Tools and Working Papers
- Audit and Its Purpose
- What is Audit Risks
- Risk assessment
- Fraud, Fraud Risk & Fraud Risk Management
- Measures that minimizes Audit Risks
- Audit Failures
- Conclusion

Introduction

- Audit of public or private sector entities are statutory requirement to provide assurance to owners on the level of accountability of management of such entities. This assurance is provided by the auditor by issuing opinion on whether the financial affairs of the entity show a true and fair view
- In carrying out the audit therefore, the auditor should plan his work and examine the strength of internal control to assure himself that there is no material misstatement in the financial statement (audit risks)
- Wrong opinion by the auditor has negative consequences not only to the auditor but users of the financial statements. While risk is unavoidable, it can be minimised
- The objective of the presentation is to provide insight into the subject matter and mitigating factors.

Auditor General of the Federations' Responsibilities

S.85 (2) States that 'the public accounts of the Federation shall be audited and reported on by the Auditor General who shall submit his reports to the National Assembly'. S.85 (3) authorises him to provide list of auditors to be appointed by statutory corporations, commissions, authorities, agencies, etc; to comment on their annual accounts and auditor's reports thereon and S85 (4)- power to conduct periodic checks of these bodies.

5.85 (5) reguire the Auditor General to submit his report on the Accountant General Financial Statements within 90 days of receipt to the National Assembly (Public Accounts Committee).

FR 108 further provides that the AuGF shall examine and ascertain in such a manner as he may deem fit the accounts relating to public funds and property and shall ascertain whether in his opinion:

Auditor General of the Federations' Responsibilities

The accounts have been properly kept

- All public monies have been fully accounted for, and the rules and procedures applied are sufficient to secure an effective check on the assessment, collection and proper allocation of revenue;
- Monies have been expended for the purposes they were appropriated and the expenditure made as authorised and
- Essential records are maintained and the rules and procedures applied are sufficient to safeguard and control public property and funds

Audit Objectives

ISA 200 states there are two overall objectives of the auditor.

(i) 'To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.'

(ii) where reasonable assurance cannot be obtained, in which case the auditor, depending on the circumstances, may qualify the audit opinion, or disclaim an opinion, or withdraw from the assignment.

Professional Scepticism

'The auditor shall plan and perform an audit with professional scepticism, recognising that circumstances may exist which cause the financial statements to be materially misstated.'

Professional scepticism is defined as an attitude that includes a questioning mind and a critical assessment of evidence.

Audit Test Tools

- The use of audit Tools and Techniques (TTs) are essential to any Audit Function
- There exist various Audit Tools that could help auditors achieve their engagement objective. These include:

- Risk-based audit planning
- Control Self-Assessment (CSA)
- Electronic Working Papers
- Statistical Sampling
- Analytical Reviews
- Quality Assessment Review Tools and
- Benchmarking
- Computer Assisted Audit Techniques (CAATs)
- Electronic communication and other computer audit tools.

Control Self Assessment (CSA)

- This is a process of evaluating and improving the prevalent internal controls carried out by management itself
- The main idea behind control self assessment is to visit or revisit an function or process to ensure that the controls are either satisfactory, as per management's intentions and design
- It also involves documenting a process or function, risk identification and then evaluation of the internal controls that are in place as risk mitigation measures so that risk is mitigated to a level that is acceptable to the management
- It may also be used as a tool to identify if any new internal controls are required.
- The CSA process is similar to an audit in its approach, though being different from audit

Computer Assisted Audit Techniques (CAATS)

- Information the Auditor deals with has become digital, therefore, auditors need to adapt their system to incorporate this information
- Computer-Assisted Audit Techniques refer to the use of technology in auditing
- Auditors can assess several aspects of their audit engagement using these tools
- They are applicable in evaluating the client's internal controls or extracting specific information and are applicable to large and small size data
- These tools allow auditors to receive data in any form and analyze it better and assist auditors to identify trends or single out anomalies in the provided information
- CAATS have become highly beneficial in all audit fields and are common in forensic audits for complex analysis

Audit Working Papers

What are Audit Working papers?

- Material that auditor prepares in connection with performance of the audit
- Record of Audit Procedures Performed
- Relevant Audit Evidence Obtained
- Conclusions the Auditor Reached
- Also termed as “Audit Documentation”
- Contains various procedures that he applies to indicate that the audit is performed by him
- May be in a number of forms such as checklist, questionnaire, flowchart, summary of client’s nature of business, business process flow, audit program or procedure, documents or information obtained, and audit tests applied, etc.

Audit Working Papers

- ISA 230, Audit Documentation states that the objectives of the auditor is to prepare documentation that provides:
- A sufficient and appropriate record of the basis for the auditor's report, and
- Evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements.
- This objective is crucial in quality control and reviews.
- The auditor should prepare the audit documentation on a timely basis and in such a way so as to enable an experienced auditor, having no previous connection with the audit, to understand:
- The nature, timing, and extent of the audit procedures performed to comply with ISAs and applicable legal and regulatory requirements
- The results of the audit procedures and the audit evidence obtained, and Significant matters arising during the audit, the conclusions reached and significant judgments made in reaching those conclusions.

Audit File

- **Audit File**
  - One or more folders or other storage media
  - Physical or Electronic Form.

Section (4) of Audit Regulation 2020 states the Auditor shall:

- create an Audit file for each statutory Audit;
- keep records that are considered appropriate to support their Audit report in accordance with ISA;
- close Audit file not later than 60 days after the date of signing of the Audit report; and
- keep records of any complaint made in writing about the performance of the statutory Audits carried out.

Permanent & Current Audit File

- **Permanent Audit File:** contains information which is of continuous interest and is relevant in future audits - Intended to include data of historical or continuing nature pertinent to current examination like, Client incorporation documents & Business Profile
- **Current Audit File:** contains information regarding audit conducted for the current period - Scope of Work Performed, Evidence and Findings Obtained, Audit Judgment Exercised, Conclusions reached
- **Correspondence File -** Significant correspondence with senior management, Copies of Engagement Letters and Significant representations

Qualities of a Good Audit Working Paper

- Have a proper subject
- Objective
- Name of the client
- Date of the working paper
- Audit period
- Sources of evidences
- Names and signature of staff who prepare
- Names and signatures of Staff who review
- Properly cross-referenced to relevance working papers. The working paper should properly sign by the preparer and reviewer
- Easy to review and understood.

Importance of Audit Working Papers

- Provide evidence of the audit work performed to support the auditor's opinion
- Aid in planning & performance of an audit
- Aid in the supervision & review of the audit work
- Record & demonstrate the audit work from one tear to another
- Plan the timing & extent of audit procedures to be performed
- Draw conclusions from the evidence obtained
- Standardize the working papers to improve the efficiency of the audit
- Facilitate the delegation of work as a means to control its quality
- Provide guidance to the audit staff with regard to the manner of checking schedules
- Fix responsibility on the staff members
- Act as evidence in Court of law when a charge of negligence is brought against the auditor.

Audit Procedures

Audit Testing Tools and Methods

Steps to Build Effective Internal Control Testing Program

- Create an Inventory of Controls
- Prioritize Controls Testing
- Design an Appropriate Test for Each Control
- Document and Follow Up on Identified Issues.
- Audit report writing

Examination of Records

- Examination of records or documents is the process of gathering evidence by examining the records or documents
- While verifying various transactions, the auditor examines the supporting documents and records. This technique is otherwise called vouching
- Audit assertions such as occurrence, accuracy, and cut-off are usually tested by inspecting the documents to support the accounting transactions in the company's records (vouching).
- Completeness assertion is usually tested by selecting documents and trace them back to the company's records (tracing).
- For example, auditor may use the inspection procedure to test the occurrence assertion of expense transactions by vouching them to receiving reports, supplier's invoice and purchase orders

Purpose of Examination of Records

- To confirm the authenticity (genuineness) of the transaction
- To find whether the transactions and the supporting document are appropriate
- To ensure whether the transactions are authorized (approved)
- To ensure whether the classification of the transaction is proper.

What is Audit Risk?

According to the IASB, audit risk is defined as 'The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated'.

- Audit risk is a function of material misstatement and detection risk.' Material misstatements consists of inherent and control risks

- It is the risk that auditors give a clean opinion on financial statements that contain material misstatements – which means that the auditor's report, conclusion or opinion may be inappropriate.

- The implication is that the information that is given to the intended user is not correct/misleading

Types of Audit Risk

They are in three categories:

▶**Inherent risk** is the risk that financial statements contain material misstatement before consideration of any related controls. This risk occurs before putting any internal control in place and already exist before any audit work is performed.

▶**Control risk** is the risk that the internal control fails to prevent or detect material misstatements in the financial statements. Control is usually put in place to reduce the chance of error or fraud that are inherent in the business and its environment.

▶**Detection risk** is the risk that auditors fail to detect the material misstatement that exists in the financial statements. This type of audit risk occurs when audit procedures performed by the audit team could not locate the existed material misstatement.

▶In practice, audit risk is unavoidable. "The biggest risk is not taking any risk. In a world that's changing really quickly, the only strategy that is guaranteed to fail is not taking risks - Mark Zuckerberg, founder of Facebook

Audit Risk Model

- Audit risk The audit risk model helps auditors to determine how comprehensive the audit work must be so as to attain the desired assurance for their conclusions.

- **Audit Risk (AR)**= Inherent risk (IR) x Control risk (CR) x Detection risk (DR)

Audit Risk Assessment

“Audit risk assessments are those carefully designed actions that auditors take in order to be compliant with the provision of ISA 315

- The standard requires auditors to identify and assess risks of misstatements through gaining understanding of entity and its environment
- Risk analysis and assessment is one of the most important stages in auditing
- Audit risk assessment is the process that is performed in the planning stage of the audit by identifying the risks of material misstatement and responding to such risks with suitable procedures.
- The assessment is performed after obtaining an understanding of the client’s business and control environment.
- Audit risk assessment procedures are performed to obtain an understanding of the entity and its environment, including internal control to identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error
- The assessment of risks is a matter of professional judgement

How to Conduct An Audit Risk Assessment

During the initial planning phase of an audit, an auditor should do the following:

- Understand the entity and its environment.
- Understand entity-level controls.
- Understand the transaction level controls.
- Use preliminary analytical procedures to identify risk.
- Perform fraud risk analysis.
- Assess the identified risk.

- **(AR)**= Inherent risk (IR) x Control risk (CR) x Detection risk (DR)

How to Conduct An Audit Risk Assessment

Risk assessment enables:

- ✓ The identification and classification of the risks
- ✓ The evaluation of the likelihood and impact of the risk scales - To determine the severity of the risk scales and calculate the weighted risk number
- ✓ The classification of the risk scales (low-medium-high) - To determine the activities which will be controlled according to the risk scales and report by specifying the suggestions
- ✓ The ranking of the auditable areas by comparing the risks belonging to each auditable area
- ✓ the audit approach and procedures that need to be performed on an audit.
- ✓ the level of substantive audit testing that needs to be performed
- ✓ Appropriate documentation by the auditor

Common Pitfalls in Documenting Risk Assessments

- **Not documenting the inherent risk assessment considerations:** Auditors are always able to explain the reasons for the determination of the inherent risks assessed on the entity being audited but those considerations are not always documented appropriately.

- **Sufficiently test the Controls:** Testing of the actual controls that are in place must be performed, and the details of those tests must be documented to support the control risk assessment

- **Non use of the relevant Assertion Level**: When documenting risk assessments, an auditor needs to make an assessment for each relevant assertion, regardless of whether an auditor has identified any specific risks related to that assertion.

- These includes:

  - Existence or occurrence
  - Completeness
  - Rights or obligations
  - Accuracy or classification
  - Valuation or allocation
  - Cutoff

Common Pitfalls in Document Risk Assessments

- **Not assessing risk on all significant audit areas:** It is important to perform a risk assessment on all the audit areas considered significant in order to be able to develop an appropriate audit approach and procedures for that area.

- **Non provision of proper Documentation:** The risk assessments are developed at planning but can change throughout the audit process.

- These changes should be documented, and the risk assessments should be updated during the audit.

Internal Control Framework

Components of an internal control framework includes:

- control environment,
- risk assessment,
- control activities,
- information and communication, and
- monitoring.

Principles of Internal Control procedures are:

- separation of duties,
- access controls,
- physical audits,
- standardized documentation,
- trial balances,
- periodic reconciliations,
- and approval authority.,

Entity-Level Controls

- Entity Level Controls (ELCs) are “controls that operate pervasively across and throughout the organization to mitigate risks threatening the organization as a whole and to provide assurance that organizational objectives are achieved
- In general, they may also be considered as higher-level controls that are more general in nature or impact a broader audience versus designed for a specific division or operation such as specifically for finance, manufacturing, research & development, etc.
- Entity-level controls are the overriding controls for overseeing that management directives pertaining to the organization as a whole are implemented and enforced.
- These controls define an organization’s corporate culture and values. They also relate to internal values as well as external forces such as laws, regulations, and professional standards.
- The entity-level controls impact the way in which personnel operate and operational processes are designed and implemented.
- **Entity-level controls have a general meaning for the various types of audit engagements and can also be more specific to a type of audit engagement.**

Risks Associated with Weak Entity Level Controls

- Entity Level Controls Risk #1: Management Override of Controls
- Entity Level Controls Risk #2: Limited Segregation of Duties
- Entity Level Controls Risk #3: Over-reliance on Detective Controls vs. Preventative Controls
- Entity Level Controls Risk #4: Informal vs. Formal Controls
- Entity Level Controls Risk #5: Poor Tone at the Top

Fraud, Fraud Risk & Fraud Risk Management

- Fraud is any illegal act characterized by deceit, concealment, or violation of trust
- Frauds are perpetrated by parties and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage
- Any responsibility for auditors in the detection of Fraud? ISA 240 provides guidelines. Generally, fraud can simply be defined as an intentional act of misrepresentation
- Misrepresentation may arise due to number of reasons; but the auditor is interested in those fraudulent activities that have the potential of causing material misstatements in the financial statements.
- Hence, the following two acts are considered by auditors:

✓ Misstatements in the financial statements arising out of fraudulent reporting.

✓ Misstatements in the financial statements arising out of misappropriation of assets.

Are misstatements always caused by fraud?

Fraud, Fraud Risk & Fraud Risk Management

- Fraud is nothing new in the business world (corporate scandals like Enron) and even in government.
- It is primarily the responsibility of both management and those charged with governance to prevent fraud by eradicating possibilities of fraud by creating an entity-wide culture of strong ethics and honesty.
- Auditor’s responsibility is to express an opinion on the financial statements for which he is required to obtain reasonable assurance.
- Reasonable assurance means that in order to express an opinion that financial statements are giving true and fair view, he must be reasonably sure that financial statements are free from material misstatement.
- An auditor is required to: Identify and assess the risks of material misstatements due to fraud
- Design further audit procedures to obtain sufficient appropriate audit evidence against assessed risk
- Design appropriate responses to detected or suspected fraud

Fraud, Fraud Risk & Fraud Risk Management

Fraud Risk:

▶Risk is the "effect of uncertainty on objectives".

▶The effect may be positive, negative or a deviation from the expected.

▶Risk is often described by an event, a change in circumstances or a consequence.

▶For an organisation, risks are potential events that could influence the achievement of the organisation's objectives.

▶***Fraud is a major risk that threatens the achievement of the objectives to which organisation's are set out to meet.***

Risk Management

▶Risk management is about understanding the nature of such events and, where they represent threats, making positive plans to mitigate them.

▶Risk management is the 'process of understanding and managing risks that an entity is inevitably subjected to in attempting to achieve its corporate objectives.

Fraud Prevention Measures & Built-in Controls

- Fraud awareness;
- Building fraud prevention into programme and project design;
- Management of the risk of fraud and corruption;
- Fraud risk assessment;
- Internal control system;
- Integrity and other best practices;
- Application and adherence to standards and codes of conduct;
- Financial Rules or Codes, General Financial Rules.
- Accounts Codes
- Legislative Acts
- Audit trail is visible indicating the line of command and the accountability for various decisions taken.

Expectations from Auditors on Fraud Detection

- Identify red flags indicating fraud may have been committed
- Understand the characteristics of fraud and the techniques used to commit fraud, and the various fraud schemes and scenarios
- Evaluate the indicators of fraud and decide whether further action is necessary or whether an investigation should be recommended
- Evaluate the effectiveness of controls to prevent or detect fraud
- Internal audit should support the organization's anti-fraud management efforts by providing necessary assurance services over internal controls designed to detect and prevent fraud

Measures that Minimises Audit Risks - Planning

- In order to reduce Audit Risk to a desirable level, Auditors must plan the nature, timing and extent of audit procedures carefully
- In the planning stage, the Auditor must consider the likelihood of error in the light of inherent risk and the system of internal control
- The likelihood of errors determines the extent of work required by the Auditor to satisfy themselves that the risk of error in the financial statements is sufficiently low
- Audit failure cannot occur unless there is serious auditors' error or misjudgment
- Poor audit planning and quality may also lead to audit failure where the auditors fail to exercise professional skepticism and material misstatements championed by creative accounting practices that goes undetected
- The cost of accounting and audit failures is immense in terms of skepticism about the auditors and the companies, in terms of litigation against the auditors and the companies and in terms of the survival of the auditors and the companies.

Measures that Minimises Audit Risks - Corporate Governance

- Governance is the term used to describe the role of persons entrusted with the supervision, control, and direction of an entity
- Corporate governance is the system by which organisations are directed and controlled
- It encompasses the relationship between the board of directors, shareholders and other stakeholders, and the effects on corporate strategy and performance
- Corporate governance looks at how these decision makers act, how they can or should be monitored, and how they can be held to account for their decisions and actions
- The Nigerian Code of Corporate Governance Code was unveiled by the Financial Reporting Council (FRC) in 2018
- The Code is intended to institutionalize corporate governance best practices and promote public awareness of essential corporate values and ethical practices

Measures that Minimises Audit Risks - Corporate Governance

- Auditors must express, to the board, their view on the appropriateness – not just the acceptability – of the accounting principles used or proposed to be used, and on the transparency and completeness of the disclosures
- Corporate governance involves decision making, accountability, and monitoring
- Decisions require relevant and reliable information, accountability involves measuring, reporting, and transparency whilst monitoring involves systems and feedback
- The Auditor's primary role is to check whether the financial information given to users is reliable.
- An effective audit committee is a vital component of an effective corporate governance system
- The Audit Committee and the Auditors need to maintain an ongoing dialogue independent of management and the rest of the board
- To meet its obligations to shareholders, the board must ensure that it receives relevant and reliable information and Auditor should assists the board in achieving that goal
- There must be open and frank dialogue between the auditors and the board

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Conclusion

- Audit risks are death traps that auditors need to continuously assess and monitor in every audit engagement so as not to fall into the trapped. The cost to the auditor is monumental including fines, loss of clients and regulator sanctions.
- Adequate planning, diligent and professional conduct of the audit supported by sound internal controls and good governance are germane to minimizing audit risks

Questions?