



Risk Based Auditing

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Group: Bahamas Internal Auditors Association

DEFINITIONS

- **Risk** - The uncertainty that is inherent in the range of possible outcomes (losses or gains) which occur as a result of the choices and decisions required throughout an extended enterprise.
- **Internal control** - A process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives e.g. effectiveness & efficiency of operations; compliance with applicable laws & regulations; reliability of financial reporting.
- **Audit** - The performance of defined procedures to express an opinion on whether financial statements are prepared in all material respects, in accordance with an identified financial reporting framework and gives a true and fair view of the entity's operations.
- **Internal auditing** - This is an appraisal activity established within an entity as a service to the entity. Its functions include amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of the accounting and internal control systems.

RISK BASED AUDITING

Risk based auditing incorporates the assessment of risks that an organization faces as a result of its activities ,and the design and execution of specific procedures to address and obtain assurance about the effective management of these risks.

- Once assessment is done then resources will be focused on the areas of critical risk and concern.
- Non risky areas will be minimally addressed.

* *Internal Control – Integrated Framework, Committee of Sponsoring Organizations (COSO) of the Treadway Commission*

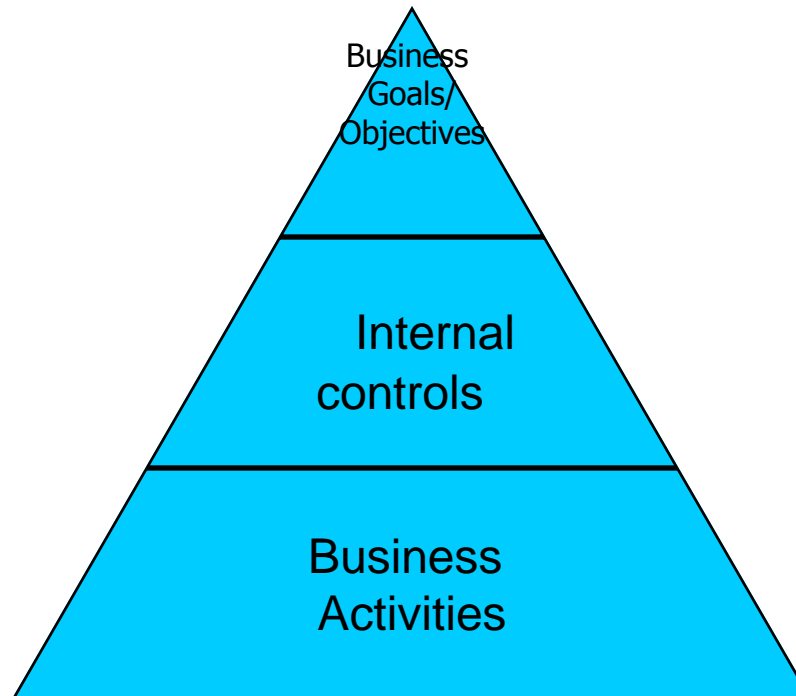
ISA 400

- ISA 400 states that “ the auditor should obtain an understanding of the accounting and internal control systems sufficient to plan the audit and develop an effective audit approach. The auditor should use professional judgment to assess audit risk and to design audit procedures to ensure it is reduced to an acceptably low level”.

AUDIT APPROACH CYCLE



RISK ASSESSMENT



QUESTIONS TO ASK

- What could go wrong?
- How could the organization fail?
- What assets are to be protected?
- How could someone disrupt operations?
- On what information does the company rely?

- How is billing done and revenue collected?
- What decisions require most judgment?
- What activities are most complex?
- What activities are regulated?
- What activities give rise to legal exposure?

APPLICATIONS

- Once risk has been identified, controls to mitigate and manage those risks should be identified.
- Approach should then entail getting a thorough understanding (Internal audit level) of these controls and their operations.

TESTING

- Tests will then be designed to test various control functions throughout these control activities to ascertain whether the control objectives are being met.

ASSERTIONS

- VALIDITY
- COMPLETENESS
- RECORDING
- CUT OFF
- PRESENTATION
- VALUATION

TYPES OF CONTROL TESTS

- OBSERVATION
- EXAMINATION OF DOCUMENTATION
- REPERFORMANCE OF ACTIVITY

EXAMPLES OF HIGH RISK BALANCES

- CASH
- ACCOUNTS RECEIVABLE/LOANS RECEIVABLE
- INVENTORY
- ACCOUNTS PAYABLE

CASH - RISKS

- Validity/Completeness
 - Fraud
 - Security risks
- Recording
 - Inaccurate balances

PROCEDURES - CASH

- Identify and test controls relating to:
 - Segregation of duties for handling of cash
 - Reconciliation procedures
 - Authorization for expenditures
 - Security around cash on hand
 - Investment of funds

A/CS RECEIVABLE & LOANS RECEIVABLES - RISKS

- Validity
 - Unauthorized advances
 - Fictitious customers
- Valuation (Credit Risk)
 - Inadequate security for loans/impairment
 - Loan loss/accounts receivable provision

A/CS RECEIVABLE & LOANS RECEIVABLES - PROCEDURES

- Identify and test procedures relating to:
 - Loan approval policies
 - Credit limit increases
 - Master file maintenance and access
 - Collateral adequacy assessment
 - Loss provisions
 - Reconciliations (sub ledger to G/L)

INVENTORY- RISKS

- Completeness
 - Theft
 - Omission from listing
- Validity
 - Duplication of quantities
- Recording
- Valuation

INVENTORY - PROCEDURES

- Identify and test procedures relating to:
 - Inventory counts and recording
 - Receiving of inventory into stores
 - Issues of inventory from stores
 - Recording of inventory in G/L
 - Assessment and provision for obsolete and damaged goods

ACCOUNTS PAYABLE- RISKS

- Completeness
 - Omission of vendors/balances
 - Validity
 - Fictitious Vendors

ACCOUNTS PAYABLE - PROCEDURES

- Identify and test procedures relating to:
 - Segregation of duties for purchasing, receiving and recording of inventory
 - Identification and Reconciliation of vendor balances
 - Access to master files.

CONCLUSION

Proper use of risk based auditing can increase efficiency and ensures maximum use of available resources to achieve comfort on whether risks faced by an organization are being appropriately managed



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