INTERNAL AUDIT MANUAL

TECHNICAL ASSISTANCE TO THE MINISTRY OF FINANCE FOR DEVELOPMENT OF INTERNAL AUDIT
PROJECT FINANCED BY EU AND MANAGED BY EUROPEAN AGENCY FOR RECONSTRUCTION
Audit manual

PART ONE
REGULATION

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1. INTRODUCTION

The internal audit in the public sector in the Republic of Macedonia is implemented in compliance with:

- Law on internal audit in the public sector (“Official Gazette of RM”, no. 69/04);
- Rulebook for the basic elements of the manual for work, charter, annual plan and programme for internal audit (“Official Gazette of RM”, no. 38/05); and
- Rulebook on the manner for performing internal audit operations (“Official Gazette of RM”, no. 72/03), when are adopted International standards for professional performing internal audit, issued by the Institute for Internal Auditors from USA.

Performance of the internal audit and the rights of the internal auditors in the internal audit unit are defined with Charter for internal audit, brought by the Head i.e. by the official who manages with the subject from the public sector.

2. LAW ON INTERNAL AUDIT OF PUBLIC SECTOR

Chapter 1

GENERAL PROVISIONS

Article 1

(1) This Law shall regulate the internal audit system based on the international standards for internal audit, objectives, principles, organization, functioning and responsibilities of the internal audit at organizations in the public sector in the Republic of Macedonia.

(2) The provisions of the Law shall apply to the following public sector entities (hereinafter: organizations): budget users from the Republic of Macedonia, Pension & Disability Insurance Fund, Health Insurance Fund of the Republic of Macedonia, Road Fund, Employment Bureau of the Republic of Macedonia, municipalities and the City of Skopje, agencies and other institutions established by law, public enterprises, such as legal entities where the state is dominant shareholder.

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1 The Law for Internal Audit in the public sector is published in the “Official Gazette of RM”, no. 69/04.
Chapter 2

DEFINITIONS

Article 2

In the present Law, the following terms shall mean:

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

b) Compliance/regularity audit: the auditor assesses whether the operations and activities of particular organization are in compliance with the existing legal provisions, bylaws and internal acts.

c) System-based audit is an in-depth evaluation of the internal control systems, aiming to assess whether such systems are functioning properly.

d) Performance/value for money audit: the auditor assesses the economy, efficiency, and effectiveness of the operations and the use of resources at a well-defined area of the activities or programmes; and

e) Financial audit covers the examination of accuracy and completeness of the accounting records and financial statements.

Chapter 3

STANDARDS, OBJECTIVES, BASIC FUNCTIONS, PRINCIPLES AND TYPES OF INTERNAL AUDIT

Internal Audit Standards

Article 3

(1) Internal Auditors will perform the Internal Audit in the entities referred to in Article 1, paragraph 2 of this Law.

(2) Internal Auditors shall work in accordance with the accepted professional standards based on internationally accepted internal audit standards.

(3) In line with the international standards on internal audit, the Minister of Finance shall prescribe the Standards for professional performing of internal audit.

Objectives, Basic Functions and Principles of Internal Audit

Article 4
The objective of the internal audit is to provide to the head of organization an independent, objective assurance to improve the operations of the organization and the effectiveness of internal control systems.

**Article 5**

The main functions of the internal audit activity shall include:

- a) evaluating significant exposures to risk factors and advising the head of the organization on the reduction of risk factors;
- b) assessing and evaluating the economy, efficiency and effectiveness of the operations of FMC systems, and giving recommendations to the head of the organization to improve system operations;
- c) examination of assurance and completeness of accounting records and financial statements;
- d) assessing and evaluating the compliance of the operations with laws, bylaws and internal acts;
- e) monitoring the implementation of measures taken by the head of organization on the basis of the audit reports.

**Article 6**

Internal audit shall be exercised in line with the principles of lawfulness, independence, impartiality, confidentiality and professionalism.

**Types of Internal Audit**

**Article 7**

Types of internal audit shall be:

- a) internal control systems audit;
- b) compliance/regularity audit;
- c) performance (execution) audit;
- d) financial audit.

**Chapter 4**

**ORGANIZATION, HARMONIZATION AND INDEPENDENCE OF INTERNAL AUDIT**

**Organization and Harmonization of Internal Audit System**

**Article 8**

The Ministry of Finance shall be responsible for regulation, development, coordination and harmonization of the internal audit system in the public sector and shall collaborate with the relevant international institutions in the field of internal audit.
**Article 9**

The performance of the internal audit function shall be done by:

a) Central Internal Audit in the Ministry of Finance; and  
b) organizational units for internal audit (hereinafter: Internal Audit Units) established in the organizations referred to in Article 1 paragraph 2 in this Law.

**Central Internal Audit**

**Article 10**

(1) Central Internal Audit shall be established as a part of the Ministry of Finance.

(2) Central Internal Audit in the Ministry of Finance shall perform the following activities:

- regulation, development and harmonization of the internal audit system in the public sector;  
- internal audit in the organizations where internal audit units have not been established yet, until establishment of such units, and internal audit in the organizations which have established internal audit units, but such units fail to perform internal audit in accordance with this law and with the acts deriving from this law, until such irregularities are eliminated.

**Article 11**

In order to regulate, develop and harmonize the internal audit system, the Central Internal Audit in the Ministry of Finance shall:

a) prepare draft laws and secondary legislation on internal audit;  
b) give proposals for development and harmonization of internal audit system;  
c) monitor the implementation of the laws, bylaws and internal acts, the accepted professional standards and the Code of Ethics, the internal audit guidelines and methods;  
d) develop training system for internal auditors;  
e) prepare summary quarterly and annual reports on internal audit;  
f) collaborate with the State Audit Office and other professional organizations in the field of audit and accounting.

**Establishment and Operations of Internal Audit Units**

**Article 12**

(1) The organization shall establish internal audit unit in the organization and shall ensure the necessary resources for its functioning.
(2) The operations and tasks of the internal audit units shall be stipulated in this law and in the organization acts of the organization.

(3) The internal audit units in the entities referred to in Article 1, paragraph 2 of this Law, which have second-line budget users, shall also be responsible for performing internal audit tasks at the second-line budget users.

(4) The organizational structure and the number of internal auditors employed in the internal audit unit shall be determined on the basis of the volume and complexity of tasks of the organization and the amount of funds it has on disposal.

Organizational Independence

**Article 13**

Central Internal Audit and Internal Audit Units shall be organized in the way which ensures independence in performing their tasks.

Functional Independence

**Article 14**

(1) The head of the organization shall be responsible for ensuring functional independence of the internal audit activity.

(2) The Internal Audit Unit shall report directly to the head of the organization.

(3) The Head of the Internal Audit Unit and the internal auditors shall not carry out other tasks in the organization not related to the internal audit function.

**Article 15**

(1) The internal auditor shall perform his/her activity in compliance with the law, the bylaws, the standards and the Code of Ethics, as well as in compliance with the operational guidelines and the charter of every Internal Audit Unit.

(2) The Minister of Finance shall regulate the basic elements of the operational guidelines and the charter of internal audit units.

**Chapter 5**

**PROFESSIONAL REQUIREMENTS OF THE INTERNAL AUDITOR**

**Article 16**

The internal auditor, besides general employment requirements determined by law, shall also fulfil the following requirements:
- university or college degree in the fields of economics, law or equivalent, if it is in compliance with the systematisation act.
- minimum two years of working experience in internal audit, external audit or finance.

Chapter 6

COMPETENCIES OF THE HEAD OF INTERNAL AUDIT UNIT

Article 17

The Head of the Internal Audit Unit shall:

a) prepare the operational guidelines of the unit and the Charter of Internal Audit;

b) prepare annual audit plans on the basis of risk assessment, and after their approval by the head of the organization, ensure the implementation and monitoring of their execution;

c) organise and coordinate the internal audit activities and supervise their implementation;

d) inform the head of the organization about existing of the conflict of interests referring to his/her task;

e) inform the head of the organization should suspicion arise about irregularities and/or frauds that may result in criminal, infringement or disciplinary procedure;

f) send the audit report to the head of the organization, and if the audited organization is a second-line budget user, to its head as well;

g) prepare quarterly and annual reports on audit operations;

h) ensure high-quality internal audit operations and application of the guidelines given by the Minister of Finance;

i) register the audit activities and keep audit-related documents;

j) ensure training of internal auditors, prepare and submit annual training plans to the head of the organization for approval and ensure their implementation;

k) annually assess the capacities and resources of the internal audit unit and submit recommendations to the head of the organization regarding their compliance with the annual audit plan;

l) report to the head of organization on the implementation of the annual audit plan and explain any changes in the audit plan;

m) monitor the implementation of the action plans, prepared on the basis of the internal audit recommendations.

Chapter 7

RIGHTS AND RESPONSIBILITIES OF THE INTERNAL AUDITOR

Article 18
The internal auditor shall have the following rights:

a) to enter the premises of the audited organization, taking into account the security rules and the rules of good conduct;
b) to have access to the appropriate audit-related documents in the audited organization, containing state, professional or business secrets and to other documents and data stored electronically by adhering to the provisions on data and secrets protection defined in the relevant laws, bylaws and internal acts. To ask for copies, extracts or certificates of the aforesaid documents, and in certain cases, to take the original documents, leaving a copy behind, with a note of receipt;
c) to request oral or written information from any employee or head of the auditee;
d) to request information from other institutions in connection with the operations and management of the audited organization;
e) to initiate engagement of external experts.

Article 19

The internal auditor shall have the following obligations:

a) to implement the audit programme during the audit activity;
b) to inform the head of the audited organization about the start of the audit and to present his/her letter of appointment;
c) to study the documents and conditions indispensable for formulating an objective opinion;
d) to elaborate his/her findings objectively and truthfully in writing and support them with evidence;
e) to inform the Head of the Internal Audit Unit immediately if during the audit suspicion of irregularity and/or fraud arises that may result in a criminal, infringement or disciplinary procedure;
f) to draft an audit report and consider and harmonize it with the relevant persons at the audited organization;
g) to send the draft and final audit report to the Head of the Internal Audit Unit;
h) to inform the chief internal auditor immediately in case of conflict of interests regarding the audit;
i) hand back the original documents in full at the completion of the audit or if in the course of the audit activity, suspicion of an act, negligence or deficiency arises, which may result in a criminal, infringement, liability or disciplinary procedure, give back the documents to the head of the budget user against acknowledgement of receipt, in order for him/her to take the necessary measures;
j) to keep any state, professional or business secret he/she has disclosed in the course of the audit,
k) to keep all working papers in an internal audit file.
Conflict of Interests

Article 20

The Head of the Internal Audit Unit or the internal auditor shall not participate in the audit if any of the following types of conflict of interests exists:

a) During the last three years the auditor has been employed in the audited organization;

b) Over the last three years, the auditor, the spouse, relatives of up to the second degree have been employed on a managing position in the audited organization;

c) The auditor, the spouse or relatives of up to the second degree have stocks or shares in the audited organization;

d) Other circumstances exist that may bring potential conflict of interests, when deemed as such and reasoned in writing by the Head of the Internal Audit Unit.

Chapter 8

RIGHTS AND RESPONSIBILITIES OF THE AUDITED ORGANIZATION

Article 21

The responsible person in the audited organization shall have the right to:

a) request personal identification document and a letter of authorization of the auditor, otherwise, he/she can refuse to cooperate;

b) be invited to make comments and discuss the draft audit report.

Article 22

The responsible person and the employees of the audited organization shall have the following obligation:

a) to assist and cooperate during the audit;

b) to provide oral or written information, declaration requested by the auditor, provide access to documents, submit signed copies of requested documents and submit the requested original documents by the set deadline, with a note of receipt thereof;

c) upon the request by the auditor, to provide declaration on the completeness of the documents and data;
d) on the basis of the audit findings and recommendations, to prepare an action plan determining the responsible persons and the deadlines for undertaking the necessary measures within their competences and inform the head of the organization and the Head of the Internal Audit Unit on the implementation of the action plan;
e) to provide adequate working conditions for the auditors.

Chapter 9
IMPLEMENTATION OF THE INTERNAL AUDIT ACTIVITY

Planning of the Internal Audit Activity

Article 23
(1) In order to plan the audit work, the Head of the Internal Audit Unit shall prepare annual audit plan, which shall be approved by the head of the organization.

(2) The Minister of Finance shall regulate the content of the annual audit plan.

Article 24
The Head of the Internal Audit Unit of the organization shall send the annual audit plan for the next year to the Minister of Finance no later than December 15th of the current year.

Audit Programme

Article 25
(1) The Head of the Internal Audit Unit or an auditor appointed by him/her shall develop an audit programme for each audit activity and shall assign the internal auditors for the respective audit activity.

(2) The Minister of Finance shall regulate the contents of the audit programme from paragraph 1 from this article.

Letter of Authorization

Article 26
(1) The internal auditor shall be provided with a letter of authorization (appointment), signed by the Head of the Internal Audit Unit.

(2) The letter of authorization of the Head of the Internal Audit Unit shall be signed by the head of the organization.
(3) The letter of authorization of the external expert engaged by the head of the organization shall be signed by the Head of the Internal Audit Unit.

Audit Report

Article 27

The auditor shall prepare an audit report containing the subject, findings, conclusions and recommendations of the audit.

Quarterly and Annual Audit Report

Article 28

(1) The Head of the Internal Audit Unit and the Head of the organization shall be responsible for preparation of quarterly and annual audit report.

(2) The quarterly and annual report shall contain:
   a) summary report on the internal audit activity performed in the respective period;
   b) report on the realization of the audit findings and recommendations.

(3) The head of the organization shall send the quarterly audit reports to the Head of the Central Internal Audit in the Ministry of Finance upon his/her request.

(4) The head of the organization shall send the annual audit report to the Minister of Finance no later than 15th April of the next year.

Chapter 10

TRANSITIONAL AND FINAL PROVISIONS

Article 29

The Minister of Finance, within six months from the date of effectiveness of this Law, shall issue the secondary legislation in line with Articles 3, 15, 23 and 25 of this Law.

Article 30

The provision referred to in Article 20, paragraph 1, item a) of this Law shall apply after the expiry of three years from the day this Law comes into force, i.e. from the date of the first appointment of internal auditor.

Article 31

**Article 32**

The bylaws applicable until this law enters into force shall continue to be applied until the adoption of bylaws under provisions of this law.

**Article 33**

This Law shall come into force on the eighth day from the day it is published in the "Official Gazette of the Republic of Macedonia".
3. RULEBOOK ON THE BASIC ELEMENTS OF THE MANUAL FOR THE PERFORMANCE, CHARTER, ANNUAL PLAN AND PROGRAMME OF THE INTERNAL AUDIT

I. GENERAL PROVISIONS

Article 1

(1) The present Rulebook shall stipulate the basic elements of the Internal Audit Guidelines, Charter, Annual Plan and Programme of Public Sector Institutions.

Article 2

(1) Internal Auditors shall perform audit and prepare audit report based on the Annual Audit Plan and Audit Programme for each individual audit, in line with: International Standards for Professional Performance of the Internal Audit prepared by the Institute of Internal Audit (IIA) and the best practices of the EU member countries.

Manner of performing Central Internal Audit Activities

Article 3

(1) The Central Internal Audit Department (hereinafter: CIAD) shall regulate, develop and harmonize the Internal Audit system in the public sector institutions through the following activities:
- Drafting Internal Audit legislations and by-laws;
- Developing and updating an Internal Audit Manual and Technical Guide;
- Determining the form and elements of the Quarterly and Annual Internal Audit Reports;
- Providing assistance to all Internal Audit units in developing and updating their internal regulations for internal audit;
- Supervision of the performance of all Internal Audit units and providing recommendations for the improvement of their work;
- Development and enhancement of training curricula and plans for internal auditors in the public sector;
- Organization, realization, enhancement and monitoring of training of internal auditors in the public sector;

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2 The Rulebook for the basic elements of the manual for performance, charter, annual plan and programme of the internal audit is published in “Official Gazette of RM”, no.38/05.
- Evaluation and verification of knowledge, skills and other capacities of internal auditors required for performing the Internal Audit function;
- Preparation of the consolidated Quarterly Internal Audit Reports;
- Preparation of an Annual Report on the execution of Annual Plans of the Internal Audit units, which should be submitted to the Government of the Republic of Macedonia by June 15 of the following year at the latest;
- Exchange of information with the State Audit Office relevant to the functioning of the Internal Audit in the public sector; and
- Collaboration with other professional organizations in the areas of auditing and accounting.

**Manner of performing Internal Audit Unit Operations**

**Article 4**

(1) Internal Audit unit shall be an organizational unit of the subject of the audited institution, and fall under direct authority of the management of the audited institution.

(2) Internal Auditors shall be appointed by the management of the audited institution and fall under the authority of the Head of the institution.

**Functional independence of the Internal Audit unit**

**Article 5**

(1) Functional independence of the Internal Audit unit shall be secured through the following:
- Placing the Internal Audit unit as high in the organizational structure of the institution as possible;
- Authorization given to the Internal Audit Head to directly report to the Head of the institution;
- Application of International Internal Audit Standards and Internal Audit Charter in the course of performing internal audits;
- Application of instructions and basic documents issued by the Central Internal Audit Department (CIAD);
- Preparation of the Annual Internal Audit Plan based on the risk assessment and 3-year outlook;
- Submission of the Annual Internal Audit Plan signed by the Head of the institution to the CIAD;
- Reporting to the CIAD once a year on the execution of the Internal Audit Plan;
- Possibility to directly report to CIAD on the course of action in case of inadequately addressed issue of huge or serious irregularities or corruption.
Functional independence of the Internal Auditor

Article 6

Functional independence of an Internal Auditor shall be secured through the following:

- His/her appointment as an Internal Auditor in the Internal Audit unit in line with the legal regulations;
- Adequate training for the professional performance of activities relevant to the Internal Audit;
- Application of International Internal Audit Standards and Internal Audit Charter in performing of any internal audit;
- Application of methodology and basic guidelines prepared by CIAD at the national level;
- Possibility directly to report to the CIAD if the Unit Head should fail to undertake adequate measures in case of serious and huge irregularities or corruption; and
- Possibility directly to report to the State Audit Office in case of emergency or in case CIAD fails to undertake adequate measures.

II. BASIC ELEMENTS OF THE OPERATIONAL GUIDELINES

Internal Audit Planning

Article 7

(1) Internal Audit planning shall consist of the preparation of:
- Annual Internal Audit plan; and
- Audit Programme for each individual internal audit.

Annual Internal Audit Plan

Article 8

(1) The Internal Audit unit Head shall prepare an Annual Internal Audit Plan based on the Risk Assessment and in line with the institution’s objectives and International Internal Audit Standards.
(2) The Annual Internal Audit Plan shall be signed by the Head of the institution.
(3) The Internal Audit unit Head shall inform in writing the audited organizational units on the sections of the Plan relating to them.
Preparation and content of the Internal Audit Plan
Article 9

(1) Based on the list of systems and processes identified in the course of risk assessment in a three-year perspective an Annual Internal Audit Plan shall be prepared in line with the readily available and potential resources of the Internal Audit unit in the course of one year.

(2) The Annual Internal Audit Plan shall consist of:
   - List of systems and processes that are planned to be audited;
   - Clear, achievable and measurable objectives for each individual audit;
   - All available indicators in the sense of time-frame, available resources and possible engagement of external experts.

(3) Engagement of external experts shall be envisaged for performance of certain forms of internal audit depending on volume, complexity, required qualifications and readily available home resources. The budget shall be planned in line with the requirements for engagement of external experts.

(4) In planning the Internal Audit unit activities considered shall be time necessary for preparation of Internal Audit Reports, as well as Annual and Quarterly Report as required by law.

Modification of the Annual Audit Plan
Article 10

(1) The Annual Internal Audit Plan may be modified if there should occur a significant change in the assessed risk or planned resources during the preparation of the Annual Plan.

(2) The modifications of the Annual Plan shall be approved by the Head of the institution.

(3) The modifications of the Annual Plan shall be reported to the Central Internal Audit Department.

Preparation and contents of the Internal Audit Programme
Article 11

(1) The Internal Audit Programme shall be prepared by auditors and its content shall be communicated to the Head of the audited organizational unit at least one week prior to the commencement of field work.

(2) The Audit Programme shall specify the following basic elements:
   - Planned dates for preliminary analysis, field work, period for preparation of draft report, reporting on the preliminary audit results, submission of draft report and distribution of the final report;
   - Objectives set before the audit of systems and processes that are the subject to the audit;
   - Objectives in terms of internal controls that are subject to internal audit analysis;
- Scope and level of the testing required for the accomplishment of objectives;
- Procedures pertaining to collection, analyses, interpretation and corroboration of data;
- List of persons to be interviewed;
- Division of tasks among team members down to the level of individual auditors;
- Specific and strictly limited tasks distributed to external experts if such are engaged;

(3) If necessary, the Audit programme may be modified during the course of the audit with the approval of the Head of the Internal Audit unit.

Letter of Authorization
Article 12

(1) The Letter of Authorization of Internal Auditors and external experts shall be signed by the person in charge of the Internal Audit unit, whereas the appointment of the Head of the Internal Audit unit is signed by the person in charge of the institution prior to the performance of any of the audits within the Annual Plan.

(2) The Letter of Authorization shall specify:
- Systems and procedures subject to the audit;
- Objectives of the audit set out in the Annual Internal Audit Plan;
- Audit team and Team Leader; and
- Time-frame and deadline for submission of Final Internal Audit Report.

Preliminary Investigation
Article 13

(1) Prior to the commencement of the audit, the Head of the Internal Audit unit shall send a letter to the audited organizational units asking for information on the systems and processes that are the subject of the audit.

(2) The Internal Audit Team shall organize an initial meeting with heads of organizational units pertaining to the audited subject, in order for the auditors to acquire additional information on:
- Envisaged objectives of the audit;
- Objectives of analysis of audited systems and procedures;
- Key controls and control objectives;
- Data on activities, financial reports etc.
- Other available documentation;
- System or work objectives/risks;
- Previous audit reports and implementation of the received recommendations;
Key persons to be interviewed.

(3) A copy of the Internal Audit Charter shall be handed to all persons present at the meeting.

(4) Based on the information received at the meeting, the Internal Audit Team shall complete the Internal Audit Programme in line with Article 11 of the present Rulebook.

Field work

Article 14

(1) Field work shall be a systematic process of objective collection of evidence for passing professional assessment on the systems and processes subject to the audit. It shall contain percentage assessment of the strong and weak points of the systems and processes and their relation to the identified risks and objectives.

(2) The objective of the field work shall be to perform all audit procedures specified in the Audit Programme in order to accomplish the audit objectives.

(3) In performance of field work, applied shall be the following audit methodology in line with the International standards and the best international professional practice:

- Monitoring;
- Confirming;
- Verifying;
- Research;
- Analysis; and
- Evaluation.

(4) The evidence should corroborate the claims about the audited processes. Special attention shall be paid to the efficiency of processes in line with the objectives set out in the Audit Programme.

(5) The internal auditor shall also assess the quality and efficiency of controls implemented by the management in order to keep the audited process under ongoing control. The evaluation will be based on the comparison between the control objectives described in the opening statement and the reality discovered through testing and inquiries. The economic effects of over-control shall also be highlighted.

(6) The existing system shall be objectively described with prorating the use of flowcharts.

Preparation and content of the Internal Audit Report

Article 15

(1) The Internal Audit shall prepare audit reports providing the management of the institution with the expert assessment of the audited systems and processes,
as well as financial management and control systems, listing all irregularities, inconsistencies and weak points.

(2) Apart from the professional assessment, the Internal Audit shall also provide the Head of the audited institution with the recommendations for improvement of the existing situation, minimalization of weaknesses and strengthening of efficiency.

(3) Recommendations will be based on existing legal framework, professional experience, and best practices of the EU member countries in order to help the management of the public institution to:
- Reduce risks;
- Increase efficiency;
- Improve the quality of financial management system and controls.

(4) The Internal Audit report shall contain the following:
- Introduction usually including brief description of the specificities of the audit methodology used in the particular case, audited scope and Names of Auditees, objectives and Scope of Audit, eventual limitations (lack of documentation available for review or staff for interview);
- Draft executive summary which would be followed up for the final report;
- Description of findings with clear evidences and testing results;
- Recommendations and timetable for their implementation;
- All necessary appendices usually containing:
  - Flow charts of processes;
  - Interview schedules and summaries;
  - Tables and graphs;
  - Abstracts from legal framework; and
  - Draft proposal of Implementation and Follow Up timetable of Recommendations.

(5) Preparation of the Report shall follow the three-stage path:
- Interim report;
- Draft report; and
- Final report.

**Interim Internal Audit Report**

**Article 16**

(1) Interim Internal Audit Report shall be the first draft of the Internal Audit Report which is presented to the audited unit at the final meeting with the aim of achieving agreement on the content of the report and acceptance of the Auditors’ recommendations.

(2) The Interim Internal Audit Report shall contain all elements provided in Article 15, paragraph 1 of the present Rulebook, except the executive summary that is finalized at a later stage. At the final meeting, the recommendations shall be communicated with the aim to give the Management the opportunity to take part and enhance the plan for implementations of the recommendations.

(3) The objectives of the final meetings shall be:
- To keep faith with Internal Audit’s promise to be transparent and consultive at all times and maintain a professional approach;
- To achieve agreement on the facts of the Audit findings. In case of any disagreement remains, Internal auditors shall have the last word;
- To achieve agreement for recommendations and explain the expected implementation;
- To give Management opportunity to challenge Internal Audit opinion before the final report issue; and
- To achieve agreement on the composition of the timetable for implementation of the recommendations.

Draft Internal Audit Report
Article 17

(1) Draft Internal Audit Report shall be the first official version of the Internal Audit Report including the conclusions reached at the final meeting as well as executive summary.
(2) The Head of the Internal Audit unit shall send the Draft Audit Report to the management of the audited unit with the obligation to receive a reply within 10 working days.
(3) The reply to the Draft Audit Report from the head of the audited unit shall include comments on the contents of the draft report and plan for the implementation of the recommendations with a detailed schedule.

Final Internal Audit Report
Article 18

(1) The Final Internal Audit Report shall contain the final version of the executive summary modified in line with the accepted comments from the Auditee, reply from the Auditee and final schedule for the implementation of the recommendations.
(2) Head of the Internal Audit unit shall send the Final Report to the Head of the audited public institution as well as the Head of the audited organizational unit.

Article 19

(1) Internal Audit unit shall keep track of all issued recommendations with the aim of always having complete and timely information.
(2) Head of the audited organizational unit shall submit a quarterly report to the to the Head of the institution and also to the Head of the Audit unit with the aim of monitoring the progress on the implementation of recommendations in relation to the envisaged time frame. The quarterly report should be used to adjust the deadlines for the implementation of recommendations if necessary.
(3) In the course of the following audits the Internal Auditors shall assess the implementation of the recommendations by the audited organizational units.
Article 20

(1) The Internal Auditor suspecting an intentional irregularity or misrepresentation of facts shall immediately abort further audit and report to the Head of the Internal Audit unit without delay.

(2) Corruption is defined as intentional irregularity or intentional misrepresentation of facts with the aim of obtaining advancement, material or intangible benefit or money. Corruption includes:
- Forging or altering of evidence or documents;
- Covering or avoiding to present transactions in the evidence or documentation;
- Entering into evidence false transactions;
- Theft of premeditated destruction of assets;
- Irregular implementation of accounting procedures, other regulations or policies.

(3) The Head of the Internal Audit unit shall inform the person in charge of the public institution or otherwise relevant authority responsible for undertaking measures in case of irregularities.

(4) Head of the institution and relevant authority shall undertake adequate measures against parties involved in activities referred to under (2) and shall set up adequate controls for elimination of such activities.

(5) Initial reporting on the serious irregularities or corruption shall be oral. The Internal Auditor may be requested to provide a written version of the report when the Head of the institution or the relevant authority initiates the investigation.

(6) Upon reporting on the serious irregularity or corruption, the Internal Auditor and the Head of the Internal Audit unit shall not discuss the irregularity of corruption with any person other than the person in charge of the institution or the relevant authority.

(7) In case of emergency and/or absence of the relevant person or authority the Internal Auditor shall report to the head of the CIAD and demand that adequate measures be undertaken without delay.

Article 21

(1) Internal Audit reports shall be submitted to the State Audit Office (SAO) on its request.

Article 22

(1) The Internal Audit unit monitors the implementation of the audit recommendations issued by the State Audit Office.
(2) The Internal Auditors perform assessment of implementation of recommendations issued by the State Audit Office in the field that was the subject of the audit and include the findings in their report.
III. WORKING AUDIT TOOLS

(1) In the course of their activities Internal Auditors shall use as their working tools the following: Internal Audit Charter, Internal Audit Technical Instruction and other aids prepared by CIAD for the purpose of effective performance of Internal Audit.
(2) The Internal Audit Charter shall define the performance of internal audit and the rights of the Internal Auditors.
(3) A copy of the Charter shall be distributed to the participants of the initial meeting. This document should be made readily available and accessible on the internet page of the Internal Audit.
(4) CIAD shall prepare a Technical Instruction for the performance of the Internal Audit containing a detailed description of the Internal Audit methodology to be applied by every Internal Audit unit.
(5) The Instruction shall be used as the basis for the training of Internal Auditors. The Instruction is to be periodically updated in order to incorporate the most recent tendencies and experiences obtained in the course of performance of Internal Audit of the public sector institutions in the Republic of Macedonia.
(6) The Technical Instruction shall be published on the Internet page of the Ministry of Finance within six months of the publication of the present Rulebook.

IV. CONTENT OF THE INTERNAL AUDIT CHARTER

Article 24

1. MAIN OBJECTIVE

To help the management to maintain and enhance internal control in line with working risks.

2. SPECIFIC OBJECTIVES

To provide for the adequacy of controls within the framework of activities and systems within the public sector institutions, i.e.: to provide comments and propose amendments to the mechanisms set up by the management aimed at realization of the aims of the activities and systems; to monitor implementation of the agreed measures; to draw attention of the executive management and in the last instance to the Head of the institution to the discovered weaknesses.

To undertake annual risk analysis and to provide aid to the financial sector management in the process of financial management and control reporting.

To perform audit, research and review separately from the institution Head.
To communicate with the External Auditors with the aim of finding the most economical manner of applying Internal and External Audit resources.

To advise the Management on the most economical controls to be implemented in the now systems and activities.

To point to the possible ways of decreasing costs and economical and efficient manner of operating the systems and performing activities.

To examine the current situation.

3. SCOPE OF AUDIT

The audit should include all systems and activities in all organizational units and locations of the institution, current as well as those in the development phase. This is performed based on the list of priorities based on risk assessment, assessment of the Internal Audit unit Head and the approval of the Head of the institution. The Audit includes performance all needed types of audit.

4. INDEPENDENCE

The Internal Audit Head is directly responsible to the Head of the institution.

5. APPROACH

A person in possession of classified information has the right to request to be accessed solely by the Internal Audit unit Head.

Internal Audit has the right to access all members of the council and management board, management, staff, executives, supplier, clients and External Auditors.

Closing provisions

Article 25

(1) The present Rulebook comes into effect on the following day from its publication in the “Official Gazette of the Republic of Macedonia“.
4. RULEBOOK ON THE MANNER OF PERFORMING INTERNAL AUDIT OPERATIONS

Article 1

This Rulebook shall regulate the manner of performing internal audit operations pursuant to the standards on professional execution of internal audit.

Article 2

Standards on professional execution of internal audit of the Institute of Internal Auditors (IIA) shall be an integral part of this Rulebook.

Article 3

This Rulebook shall enter into force on the day it is published in the "Official Gazette of the Republic of Macedonia".

INTERNATIONAL STANDARDS FOR THE PROFESSIONAL PRACTICE OF INTERNAL AUDITING

ATTRIBUTE STANDARDS

1000 – Purpose, Authority, and Responsibility
The purpose, authority, and responsibility of the internal audit activity should be formally defined in a charter, consistent with the Standards, and approved by the board.

1000.A1 - The nature of assurance services provided to the organization should be defined in the audit charter. If assurances are to be provided to parties outside the organization, the nature of these assurances should also be defined in the charter

1000.K1 - The nature of consulting services should be defined in the audit charter.

3 The Rulebook for the manner of performing internal audit operations is published in “Official Gazette of RM”, no. 72/03.
1100 – Independence and Objectivity
The internal audit activity should be independent, and internal auditors should be objective in performing their work.

1110 – Organizational Independence
The chief audit executive should report to a level within the organization that allows the internal audit activity to fulfil its responsibilities.

1110.A1 - The internal audit activity should be free from interference in determining the scope of internal auditing, performing work, and communicating results.

1120 – Individual Objectivity
Internal auditors should have an impartial, unbiased attitude and avoid conflicts of interest.

1130 – Impairments to Independence or Objectivity
If independence or objectivity is impaired in fact or appearance, the details of the impairment should be disclosed to appropriate parties. The nature of the disclosure will depend upon the impairment.

1130.A1 – Internal auditors should refrain from assessing specific operations for which they were previously responsible. Objectivity is presumed to be impaired if an auditor provides assurance services for an activity for which the auditor had responsibility within the previous year.

1130.A2 – Assurance engagements for functions over which the chief audit executive has responsibility should be overseen by a party outside the internal audit activity.

1130.K1 - Internal auditors may provide consulting services relating to operations for which they had previous responsibilities.

1130.K2 - If internal auditors have potential impairments to independence or objectivity relating to proposed consulting services, disclosure should be made to the engagement client prior to accepting the engagement.

1200 – Proficiency and Due Professional Care
Engagements should be performed with proficiency and due professional care.

1210 – Proficiency
Internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.

1210.A1 - The chief audit executive should obtain competent advice and assistance if the internal audit staff lacks the knowledge, skills, or other competencies needed to perform all or part of the engagement.

1210.A2 – The internal auditor should have sufficient knowledge to identify the indicators of fraud but is not expected to have the expertise of a person whose primary responsibility is detecting and investigating fraud.
1210.K1 - The chief audit executive should decline the consulting engagement or obtain competent advice and assistance if the internal audit staff lacks the knowledge, skills, or other competencies needed to perform all or part of the engagement.

1220 - Due Professional Care
Internal auditors should apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility.

1220.A1 - The internal auditor should exercise due professional care by considering the:

- Extent of work needed to achieve the engagement’s objectives.
- Relative complexity, materiality, or significance of matters to which assurance procedures are applied.
- Adequacy and effectiveness of risk management, control, and governance processes.
- Probability of significant errors, irregularities, or non-compliance.
- Cost of assurance in relation to potential benefits.

1220.A2 – The internal auditor should be alert to the significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

1220.K1 - The internal auditor should exercise due professional care during a consulting engagement by considering the:

- Needs and expectations of clients, including the nature, timing, and communication of engagement results.
- Relative complexity and extent of work needed to achieve the engagement’s objectives.
- Cost of the consulting engagement in relation to potential benefits.

1230 – Continuing Professional Development
Internal auditors should enhance their knowledge, skills, and other competencies through continuing professional development.

1300 – Quality Assurance and Improvement Program
The chief audit executive should develop and maintain a quality assurance and improvement program that covers all aspects of the internal audit activity and continuously monitors its effectiveness. The program should be designed to help the internal auditing activity add value and improve the organization’s operations and to provide assurance that the internal audit activity is in conformity with the Standards and the Code of Ethics.

1310 – Quality Program Assessments
The internal audit activity should adopt a process to monitor and assess the overall
effectiveness of the quality program. The process should include both internal and external assessments.

**1311 – Internal Assessments**
Internal assessments should include:

- Ongoing reviews of the performance of the internal audit activity; and
- Periodic reviews performed through self-assessment or by other persons within the organization, with knowledge of internal auditing practices and the *Standards*.

**1312 – External Assessments**
External assessments, such as quality assurance reviews, should be conducted at least once every five years by a qualified, independent reviewer or review team from outside the organization.

**1320 – Reporting on the Quality Program**
The chief audit executive should communicate the results of external assessments to the board.

**1330 – Use of "Conducted in Accordance with the Standards"**
Internal auditors are encouraged to report that their activities are "conducted in accordance with the *Standards for the Professional Practice of Internal Auditing*." However, internal auditors may use the statement only if assessments of the quality improvement program demonstrate that the internal audit activity is in compliance with the *Standards*.

**1340 – Disclosure of Non-compliance**
Although the internal audit activity should achieve full compliance with the *Standards* and internal auditors with the *Code of Ethics*, there may be instances in which full compliance is not achieved. When non-compliance impacts the overall scope or operation of the internal audit activity, disclosure should be made to senior management and the board.

**PERFORMANCE STANDARDS**

**2000 – Managing the Internal Audit Activity**
The chief audit executive should effectively manage the internal audit activity to ensure it adds value to the organization.

**2010 – Planning**
The chief audit executive should establish risk-based plans to determine the priorities of the internal audit activity, consistent with the organization's goals.

- **2010.A1** - The internal audit activity’s plan of engagements should be based on a risk assessment, undertaken at least annually. The input of senior management and the board should be considered in this process.

- **2010.K1** - The chief audit executive should consider accepting proposed consulting engagements based on the engagement’s potential to improve
management of risks, add value, and improve the organization’s operations. Those engagements that have been accepted should be included in the plan.

2020 – Communication and Approval
The chief audit executive should communicate the internal audit activity’s plans and resource requirements, including significant interim changes, to senior management and to the board for review and approval. The chief audit executive should also communicate the impact of resource limitations.

2030 – Resource Management
The chief audit executive should ensure that internal audit resources are appropriate, sufficient, and effectively deployed to achieve the approved plan.

2040 – Policies and Procedures
The chief audit executive should establish policies and procedures to guide the internal audit activity.

2050 – Coordination
The chief audit executive should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts.

2060 – Reporting to the Board and Senior Management
The chief audit executive should report periodically to the board and senior management on the internal audit activity’s purpose, authority, responsibility, and performance relative to its plan. Reporting should also include significant risk exposures and control issues, corporate governance issues, and other matters needed or requested by the board and senior management.

2100 – Nature of Work
The internal audit activity evaluates and contributes to the improvement of risk management, control and governance systems.

2110 – Risk Management
The internal audit activity should assist the organization by identifying and evaluating significant exposures to risk and contributing to the improvement of risk management and control systems.

2110.A1 - The internal audit activity should monitor and evaluate the effectiveness of the organization's risk management system.

2110.A2 - The internal audit activity should evaluate risk exposures relating to the organization's governance, operations, and information systems regarding the

- Reliability and integrity of financial and operational information.
- Effectiveness and efficiency of operations.
- Safeguarding of assets.
- Compliance with laws, regulations, and contracts.
2110.K1 - During consulting engagements, internal auditors should address risk consistent with the engagement’s objectives and should be alert to the existence of other significant risks.

2110.K2 – Internal auditors should incorporate knowledge of risks gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the organization.

2120 – Control
The internal audit activity should assist the organization in maintaining effective controls by evaluating their effectiveness and efficiency and by promoting continuous improvement.

2120.A1 - Based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization's governance, operations, and information systems. This should include:

- Reliability and integrity of financial and operational information.
- Effectiveness and efficiency of operations.
- Safeguarding of assets.
- Compliance with laws, regulations, and contracts.

2120.A2 - Internal auditors should ascertain the extent to which operating and program goals and objectives have been established and conform to those of the organization.

2120.A3 - Internal auditors should review operations and programs to ascertain the extent to which results are consistent with established goals and objectives to determine whether operations and programs are being implemented or performed as intended.

2120.A4 - Adequate criteria are needed to evaluate controls. Internal auditors should ascertain the extent to which management has established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, internal auditors should use such criteria in their evaluation. If inadequate, internal auditors should work with management to develop appropriate evaluation criteria.

2120.K1 - During consulting engagements, internal auditors should address controls consistent with the engagement’s objectives and should be alert to the existence of any significant control weaknesses.

2120.K2 – Internal auditors should incorporate knowledge of controls gained from consulting engagements into the process of identifying and evaluating significant risk exposures of the organization.

2130 – Governance
The internal audit activity should contribute to the organization's governance
process by evaluating and improving the process through which (1) values and goals are established and communicated, (2) the accomplishment of goals is monitored, (3) accountability is ensured, and (4) values are preserved.

2130.A1
Internal auditors should review operations and programs to ensure consistency with organizational values.

2130.K1 – Consulting engagement objectives should be consistent with the overall values and goals of the organization.

2200 – Engagement Planning
Internal auditors should develop and record a plan for each engagement.

2201 - Planning Considerations
In planning the engagement, internal auditors should consider:

- The objectives of the activity being reviewed and the means by which the activity controls its performance.
- The significant risks to the activity, its objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level.
- The adequacy and effectiveness of the activity’s risk management and control systems compared to a relevant control framework or model.
- The opportunities for making significant improvements to the activity’s risk management and control systems.

2201.K1 - Internal auditors should establish an understanding with consulting engagement clients about objectives, scope, respective responsibilities, and other client expectations. For significant engagements, this understanding should be documented.

2210 – Engagement Objectives
The engagement’s objectives should address the risks, controls, and governance processes associated with the activities under review.

2210.A1 - When planning the engagement, the internal auditor should identify and assess risks relevant to the activity under review. The engagement objectives should reflect the results of the risk assessment.

2210.A2 - The internal auditor should consider the probability of significant errors, irregularities, non-compliance, and other exposures when developing the engagement objectives.

2210.K1 – Consulting engagement objectives should address risks, controls, and governance processes to the extent agreed upon with the client.

2220 – Engagement Scope
The established scope should be sufficient to satisfy the objectives of the engagement.
2220.A1 - The scope of the engagement should include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties.

2220.K1 – In performing consulting engagements, internal auditors should ensure that the scope of the engagement is sufficient to address the agreed-upon objectives. If internal auditors develop reservations about the scope during the engagement, these reservations should be discussed with the client to determine whether to continue with the engagement.

2230 – Engagement Resource Allocation
Internal auditors should determine appropriate resources to achieve engagement objectives. Staffing should be based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources.

2240 – Engagement Work Program
Internal auditors should develop work programs that achieve the engagement objectives. These work programs should be recorded.

2240.A1 - Work programs should establish the procedures for identifying, analyzing, evaluating, and recording information during the engagement. The work program should be approved prior to the commencement of work, and any adjustments approved promptly.

2240.K1 - Work programs for consulting engagements may vary in form and content depending upon the nature of the engagement.

2300 – Performing the Engagement
Internal auditors should identify, analyze, evaluate, and record sufficient information to achieve the engagement's objectives.

2310 – Identifying Information
Internal auditors should identify sufficient, reliable, relevant, and useful information to achieve the engagement’s objectives.

2320 – Analysis and Evaluation
Internal auditors should base conclusions and engagement results on appropriate analyses and evaluations.

2330 – Recording Information
Internal auditors should record relevant information to support the conclusions and engagement results.

2330.A1 - The chief audit executive should control access to engagement records. The chief audit executive should obtain the approval of senior management and/or legal counsel prior to releasing such records to external parties, as appropriate.

2330.A2 - The chief audit executive should develop retention requirements for engagement records. These retention requirements should be consistent with the organization’s guidelines and any pertinent regulatory or other requirements.
2330.K1 - The chief audit executive should develop policies governing the custody and retention of engagement records, as well as their release to internal and external parties. These policies should be consistent with the organization’s guidelines and any pertinent regulatory or other requirements.

2340 – Engagement Supervision
Engagements should be properly supervised to ensure objectives are achieved, quality is assured, and staff is developed.

2400 – Communicating Results
Internal auditors should communicate the engagement results promptly.

2410 – Criteria for Communicating
Communications should include the engagement’s objectives and scope as well as applicable conclusions, recommendations, and action plans.

2410.A1 - The final communication of results should, where appropriate, contain the internal auditor’s overall opinion.

2410.A2 - Engagement communications should acknowledge satisfactory performance.

2410.K1 – Communication of the progress and results of consulting engagements will vary in form and content depending upon the nature of the engagement and the needs of the client.

2420 – Quality of Communications
Communications should be accurate, objective, clear, concise, constructive, complete, and timely.

2421 – Errors and Omissions
If a final communication contains a significant error or omission, the chief audit executive should communicate corrected information to all individuals who received the original communication.

2430 – Engagement Disclosure of Non-compliance with the Standards
When non-compliance with the Standards impacts a specific engagement, communication of the results should disclose the:

- Standard(s) with which full compliance was not achieved,
- Reason(s) for non-compliance, and
- Impact of non-compliance on the engagement.

2440 – Disseminating Results
The chief audit executive should disseminate results to the appropriate individuals.

2440.A1 - The chief audit executive is responsible for communicating the final results to individuals who can ensure that the results are given due consideration.
2440.K1 - The chief audit executive is responsible for communicating the final results of consulting engagements to clients.

2440.K2 – During consulting engagements, risk management, control, and governance issues may be identified. Whenever these issues are significant to the organization, they should be communicated to senior management and the board.

2500 – Monitoring Progress
The chief audit executive should establish and maintain a system to monitor the disposition of results communicated to management.

2500.A1 - The chief audit executive should establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action.

2500.K1 – The internal audit activity should monitor the disposition of results of consulting engagements to the extent agreed upon with the client.

2600 – Management’s Acceptance of Risks
When the chief audit executive believes that senior management has accepted a level of residual risk that is unacceptable to the organization, the chief audit executive should discuss the matter with senior management. If the decision regarding residual risk is not resolved, the chief audit executive and senior management should report the matter to the board for resolution.

Glossary

Add Value – Organizations exist to create value or benefit to their owners, other stakeholders, customers, and clients. This concept provides purpose for their existence. Value is provided through their development of products and services and their use of resources to promote those products and services. In the process of gathering data to understand and assess risk, internal auditors develop significant insight into operations and opportunities for improvement that can be extremely beneficial to their organization. This valuable information can be in the form of consultation, advice, written communications, or through other products all of which should be properly communicated to the appropriate management or operating personnel.

Adequate Control – Present if management has planned and organized (designed) in a manner that provides reasonable assurance that the organization's risks have been managed effectively and that the organization's goals and objectives will be achieved efficiently and economically.

Assurance Services – An objective examination of evidence for the purpose of providing an independent assessment on risk management, control, or governance processes for the organization. Examples may include financial, performance, compliance, system security, and due diligence engagements.
Board – A board of directors, audit committee of such boards, head of an agency or legislative body to whom internal auditors report, board of governors or trustees of a nonprofit organization, or any other designated governing bodies of organizations.

Charter – The charter of the internal audit activity is a formal written document that defines the activity’s purpose, authority, and responsibility. The charter should (a) establish the internal audit activity’s position within the organization; (b) authorize access to records, personnel, and physical properties relevant to the performance of engagements; and (c) define the scope of internal audit activities.

Chief Audit Executive – Top position within the organization responsible for internal audit activities. In a traditional internal audit activity, this would be the internal audit director. In the case where internal audit activities are obtained from outside service providers, the chief audit executive is the person responsible for overseeing the service contract and the overall quality assurance of these activities, reporting to senior management and the board regarding internal audit activities, and follow-up of engagement results. The term also includes such titles as general auditor, chief internal auditor, and inspector general.

Code of Ethics – The purpose of the Code of Ethics of The Institute of Internal Auditors (IIA) is to promote an ethical culture in the global profession of internal auditing. A code of ethics is necessary and appropriate for the profession of internal auditing, founded as it is on the trust placed in its objective assurance about risk, control, and governance. The Code of Ethics applies to both individuals and entities that provide internal audit services.

Compliance – The ability to reasonably ensure conformity and adherence to organization policies, plans, procedures, laws, regulations, and contracts.

Conflict of Interest – Any relationship that is or appears to be not in the best interest of the organization. A conflict of interest would prejudice an individual’s ability to perform his or her duties and responsibilities objectively.

Consulting Services – Advisory and related client service activities, the nature and scope of which are agreed upon with the client and which are intended to add value and improve an organization’s operations. Examples include counsel, advice, facilitation, process design, and training.

Control – Any action taken by management, the board, and other parties to enhance risk management and increase the likelihood that established objectives and goals will be achieved. Management plans, organizes, and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved.

Control Environment – The attitude and actions of the board and management regarding the significance of control within the organization. The control environment provides the discipline and structure for the achievement of the primary objectives of the system of internal control. The control environment includes the following elements:

- Integrity and ethical values.
- Management’s philosophy and operating style.
- Organizational structure.
• Assignment of authority and responsibility.
• Human resource policies and practices.
• Competence of personnel.

**Control Processes** – The policies, procedures, and activities that are part of a control framework, designed to ensure that risks are contained within the risk tolerances established by the risk management process.

**Engagement** – A specific internal audit assignment, task, or review activity, such as an internal audit, Control Self-assessment review, fraud examination, or consultancy. An engagement may include multiple tasks or activities designed to accomplish a specific set of related objectives.

**Engagement Objectives** – Broad statements developed by internal auditors that define intended engagement accomplishments.

**Engagement Work Program** – A document that lists the procedures to be followed during an engagement, designed to achieve the engagement plan.

**External Service Provider** – A person or firm, independent of the organization, who has special knowledge, skill, and experience in a particular discipline. Outside service providers include, among others, actuaries, accountants, appraisers, environmental specialists, fraud investigators, lawyers, engineers, geologists, security specialists, statisticians, information technology specialists, external auditors, and other auditing organizations. The board, senior management, or the chief audit executive may engage an outside service provider.

**Fraud** – Any illegal acts characterized by deceit, concealment, or violation of trust. These acts are not dependent upon the application of threat of violence or of physical force. Frauds are perpetrated by individuals and organizations to obtain money, property, or services; to avoid payment or loss of services; or to secure personal or business advantage.

**Governance Process** – The procedures utilized by the representatives of the organization’s stakeholders (e.g., shareholders, etc.) to provide oversight of risk and control processes administered by management.

**Impairments** – Impairments to individual objectivity and organizational independence may include personal conflicts of interest, scope limitations, restrictions on access to records, personnel, and properties, and resource limitations (funding).

**Internal Audit Activity** – A department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity 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.
Objectivity – An unbiased mental attitude that requires internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made. Objectivity requires internal auditors not to subordinate their judgment on audit matters to that of others.

Risk – The uncertainty of an event occurring that could have an impact on the achievement of objectives. Risk is measured in terms of consequences and likelihood.

Thankful note

The Institute of Internal Auditors (IIA) is thanking to those governmental institutions, professional organizations, internal and external auditors, and members of the management, boards of directors and academic people who guided us for the development and exemplification of the Standards. IIA owes a lot to those individuals who worked in the Board of internal audit standards and its sub commissions all these years.

The Institute of Internal Auditors

Code of Ethics *

INTRODUCTION
The purpose of The Institute's Code of Ethics is to promote an ethical culture in the profession of internal auditing.
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.

A code of ethics is necessary and appropriate for the profession of internal auditing, founded as it is on the trust placed in its objective assurance about risk management, control, and governance. The Institute's Code of Ethics extends beyond the definition of internal auditing to include two essential components:

1. Principles that are relevant to the profession and practice of internal auditing;
2. Rules of Conduct that describe behavior norms expected of internal auditors. These rules are an aid to interpreting the Principles into practical applications and are intended to guide the ethical conduct of internal auditors.

The Code of Ethics together with The Institute's Professional Practices Framework and other relevant Institute pronouncements provide guidance to internal auditors serving others. "Internal auditors" refers to Institute members, recipients of or candidates for IIA professional certifications, and those who provide internal auditing services within the definition of internal auditing.

Applicability and Enforcement

This Code of Ethics applies to both individuals and entities that provide internal auditing services.

For Institute members and recipients of or candidates for IIA professional certifications, breaches of the Code of Ethics will be evaluated and administered according to The Institute's Bylaws and Administrative Guidelines. The fact that a particular conduct is not mentioned in the Rules of Conduct does not prevent it from being unacceptable or discreditable, and therefore, the member, certification holder, or candidate can be liable for disciplinary action.

Principles

Internal auditors are expected to apply and uphold the following principles:

Integrity
The integrity of internal auditors establishes trust and thus provides the basis for reliance on their judgment.

Objectivity
Internal auditors exhibit the highest level of professional objectivity in gathering, evaluating, and communicating information about the activity or process being examined. Internal auditors make a balanced assessment of all the relevant circumstances and are not unduly influenced by their own interests or by others in forming judgments.
Confidentiality

Internal auditors respect the value and ownership of information they receive and do not disclose information without appropriate authority unless there is a legal or professional obligation to do so.

Competency

Internal auditors apply the knowledge, skills, and experience needed in the performance of internal auditing services.

Rules of Conduct

1. Integrity

Internal auditors:
1.1. Shall perform their work with honesty, diligence, and responsibility.
1.2. Shall observe the law and make disclosures expected by the law and the profession.
1.3. Shall not knowingly be a party to any illegal activity, or engage in acts that are discreditable to the profession of internal auditing or to the organization.
1.4. Shall respect and contribute to the legitimate and ethical objectives of the organization.

2. Objectivity

Internal auditors:
2.1. Shall not participate in any activity or relationship that may impair or be presumed to impair their unbiased assessment. This participation includes those activities or relationships that may be in conflict with the interests of the organization.
2.2 Shall not accept anything that may impair or be presumed to impair their professional judgment.
2.3 Shall disclose all material facts known to them that, if not disclosed, may distort the reporting of activities under review.

3. Confidentiality

Internal auditors:
3.1 Shall be prudent in the use and protection of information acquired in the course of their duties.
3.2 Shall not use information for any personal gain or in any manner that would be contrary to the law or detrimental to the legitimate and ethical objectives of the organization.

4. Competency

Internal auditors:
4.1. Shall engage only in those services for which they have the necessary knowledge, skills, and experience.
4.2 Shall perform internal auditing services in accordance with the *International Standards for the Professional Practice of Internal Auditing*. 
4.3 Shall continually improve their proficiency and the effectiveness and quality of their services.

Adopted by the IIA Board of Directors, June 17, 2000
5. INTERNAL AUDIT CHARTER

In continuance is given model of the Internal Audit Charter that should be adjusted for every specific subject from the public sector.

______________________________________________________________

Internal Audit Charter

1. The charter

This charter establishes the authority and responsibility transferred by the Minister of _____________ to ________________ (name of the Internal Audit Unit) within _________________ (name of the subject in the public sector).

2. Nature of internal audit

Internal auditing is the independent appraisal of the various operations and systems of control within the Ministry of ____________ to determine whether acceptable policies and procedures are followed, legislative requirements and established standards are met, resources are used efficiently and economically, and the objectives of the Ministry of _____________ are being achieved.

3. Role and objective of internal audit

The internal audit function is established to assist the Minister and management of the Ministry of ____________ to attest to its governance role and achieve sound managerial control over all aspects of the operations of the Ministry of ____________ including accounting, asset management, information management and control systems, and for such other activities for which they are responsible.

The overall objective of the plan of Internal Audit is to assist all levels of management in the effective discharge of their responsibilities by providing independent analysis, appraisals, advice and recommendations concerning the activities reviewed.

The attainment of the overall objective may involve:

- reviewing and appraising the adequacy and effectiveness of the system of internal control;
- appraising the relevance, reliability and integrity of management, financial and operating data and reports;
- reviewing the systems established to ensure compliance with those policies, plans, procedures, statutory requirements and regulations which could have a significant impact on operations;
- reviewing the means of safeguarding assets and, as appropriate, verifying the existence of such assets;
• appraising the economy, efficiency and effectiveness with which resources are employed;
• reviewing operations or programs to ascertain whether results are consistent with Ministry of ________ established objectives and goals and whether the operations or programs are being carried out as planned;
• assessing the adequacy of established systems and procedures; and
• conducting special assignments and investigations on behalf of the Minister into any matter or activity affecting the probity, interests and operating efficiency of the Ministry.

4. Independence

Internal auditing is an advisory function having independent status within the Ministry ________. The Head of Internal Audit:

• shall be directly responsible to the Minister and be independent of any other section, branch or officer, and shall have direct access to the Minister if required;
• shall have no executive or managerial powers, functions or duties except those relating to the management of ________ (name of the Internal Audit Unit);
• shall not be involved in the day to day operation of the Ministry of ________; and
• shall not be responsible for the detailed development and or implementation of new systems but should be consulted during the system development process on the control measures to be incorporated in new or amended systems, and be advised of approved variations or new developments.

5. Authority

The authority of the Head of the Internal Audit has authorizations in compliance with article 17 from the Law on Internal Audit in the public sector to establish an effective internal audit function.

Internal auditors, in compliance with article 18 from the Law on Internal Audit in the public sector shall:

• have access at all reasonable times to all books, documents, accounts, property, records, correspondence and other data of the Ministry of ________ which are necessary for the proper performance of the internal audit function; and
• have the right at reasonable times to enter any premises of the Ministry of ________ and to request any officer to furnish all information and such explanations deemed necessary for them to form an opinion on the probity of action, adequacy of systems and or of controls. The officer concerned shall respond promptly to such inquiries.
All employees in the Ministry of ____________ have responsibility to render every assistance to the Internal Auditors in carrying out their audit duties.

6. Responsibilities

The Head of ____________ (name of the Internal Audit Unit) shall be responsible to the Minister for the functional control of audit activities in relation to:

- development, implementation and oversight of Internal Audit methods and procedures;
- development and control of an efficient Internal Audit program;
- scope and boundaries of audits;
- fulfilling the objectives of Internal Audit;
- utilising the Internal Audit resources to maximise the efficiency and effectiveness of the Internal Audit function; and
- maintenance of appropriate auditing standards.

7. Scope of internal audit

The scope of Internal Audit shall be sufficiently comprehensive to enable the effective and regular review of all operational, financial and related activities.

The Internal Audit coverage may extend to all areas of the Ministry of ____________ and following subjects: ________________ (state the subjects where the unit will perform an audit) and to include financial, accounting, administrative, computing and other operational activities.

The extent and frequency of internal audits will depend upon varying circumstances such as results of previous audits, relative risk associated with activities, materiality, the adequacy of the system of internal control, and resources available to the Internal Audit Unit.

8. Audit plan

A strategic audit plan providing for the review of significant operations of the Ministry of ____________ based on an assessment of risk pertaining to the achievement of Ministry of ____________’s objectives, shall be prepared for the approval of the Minister.

An annual Internal Audit plan consistent with the long term strategic plan shall be prepared, in consultation with the Secretary for the approval by the Minister, if practicable, prior to commencement of each calendar year.

9. Audit Methodology

For all audit projects, the person responsible for the activity under review shall be advised and given the opportunity to discuss:
• the objectives and scope of the audit to be conducted, prior to the commencement of such audit; and
• findings and proposed recommendations on the completion of an audit, and where appropriate make comment.

10. Audit Reports

A written report will be prepared and issued by Internal Audit at the conclusion of each audit, and will be distributed to the Minister and where else as considered appropriate. Quarterly audit reports will be submitted to the Head of CHU within the Ministry of Finance and the annual report to the Minister of Finance.

Audit reports will normally explain the scope and objectives of the audit, present findings and conclusions in an objective manner relevant to the specific user's needs and make recommendations where appropriate.

11. Liaison with external auditor

The Head of Internal Audit shall liaise with the ____________ SAO to:

• foster a cooperative working relationship;
• reduce the incidence of duplication of effort;
• ensure appropriate sharing of information; and
• ensure coordination of the overall audit effort.

The Head of Internal Audit shall make available to the ____________ SAO all Internal Audit working papers, programs, flow charts, and reports.

12. Audit Standards

Internal auditing standards shall be consistent with the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors. Staff is expected to abide by the Institute of Internal Auditors Code of Ethics.

13. Quality Assurance

In order to ensure that the quality of the Internal Audit work is consistently at a high standard, the Head of Internal Audit in conjunction with the CIAD / CHU:

• maintain a regular review of audit plans, reports and working papers; and
• provide for staff training as appropriate.
# Audit Manual – PART TWO

## SISTEM BASED AUDIT

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1. Introduction

This Section of the Audit Manual provides guidance on the Systems Audit approach which is one of the main audit methodologies applied by internal audit in the public sector in Macedonia.

All audit staff are expected to familiarise themselves with the procedures set out in the manual and to apply them in the course of their work. In some cases it may be necessary to adapt the procedures to reflect the situation in a particular organisation. Any such changes will be the responsibility of the relevant Chief Internal Auditor who will arrange for local guidance to be prepared and distributed.
2. Systems based audit

A systems based audit comprises the following stages:

2.1. Preparing for & planning the audit assignment
2.2. Ascertaining and recording the system
2.3. Identifying system objectives
2.4. Identifying risks and evaluating controls against risks
2.5. Testing controls
2.6. Arriving at conclusions
2.7. Audit reports and Audit Files
2.1. **Preparing for & planning the audit assignment**

The preparing for & planning the audit assignment consists of: preliminary survey, organizing kick-off meeting and preparing an audit plan.

2.1.1. **Preliminary survey**

In a reasonable time limit before the audit is scheduled to take place a fact-finding exercise (preliminary survey) should be undertaken in order to get an overview of the area to be audited. This preliminary survey should provide the basis for planning the audit, and for determining:

a) The objectives of the audit;

b) The scope of the audit and any specific areas that are to be given emphasis because they are high risk, are of critical importance to the system and/or suffer from weaknesses which are already known;

c) Target dates for completion of each stage of the audit work;

d) Which auditors are to be employed on the audit and who is responsible for supervising the audit team and ensuring the quality of the audit work.

The preliminary survey will also establish the boundaries of the systems under review and identify any interfaces with other systems and any other audits which are planned. This provides the basis for drafting the Audit plan.

The preliminary survey should involve:

a) Review of the permanent audit file and previous audit reports, including reports from the State Audit Office;

b) Review of the strategic and operational plans of the area to be audited;

c) Current organisation charts;

d) Review of budget and management information;

e) Initial discussions with management of the organizational units to establish their objectives in the area to be audited;

f) Review of relevant legislation, regulations, instructions etc.

At this stage it is also useful to identify the goals and objectives of the area(s) under review and the key risks relating to those goals and objectives.

The review of previous audit reports is an important part of the preliminary survey. The reports provide an insight into the level of control at the time of the last audit, and an opportunity to establish whether or not agreed recommendations have been implemented by management.
2.1.2. Kick-off meeting

Prior to the Kick-off meeting a Letter of Authorization should be obtained, according to art. 12 of the Rulebook of the basic elements of the Internal Audit Guidelines, Charter, Annual Plan and Programme of Internal Audit (published in the "Official Gazete Nmb. 38/05) (further in the text: the Rulebook). The template detailing the contents of that letter is provided in Annex 4.2 to this section of the Manual.

Prior to the Kick-off meeting the internal auditors and external experts are required to have a Letter of Authorization, signed by of the Head of the Internal Audit unit, whereas the appointment of the Head of the Internal Audit unit, signed by the person in charge of the institution, prior to the performance of any of the audits within the Annual Plan.

The Letter of Authorization shall specify:

- Systems and procedures subject to the audit;
- Objectives of the audit set out in the Annual Internal Audit Plan;
- Audit team and Team Leader; and
- Time-frame and deadline for submission of Final Internal Audit Report.

The formal start of the audit is the Kick-off meeting which should be held between the Head of the department to be audited and the Chief Internal Auditor accompanied by the Team Leader/Auditor carrying out the work. This meeting is intended to:

- Introduce the audit team to the management of the department to be audited;
- Outline the objective of the audit and give a brief overview of the methodology to be used – if this is the first audit of the department it will be necessary to give a more detailed explanation of the approach;
- Ask management to suggest particular areas which they think should be examined;
- Discuss areas which internal auditors consider on the focus of the audit;
- Explain that internal audit will keep them informed of the progress of the audit, and that management's assistance will be welcomed throughout the audit.
- Request additional information\(^1\) about the business process under audit and agree on the list of documents required from the auditee;
- Distribute a copy of the Internal Audit Charter to all present on the Kick-off meeting (Form of the Charter in Part 1 from this Manual).

Some guidance on how to handle the kick-off meeting with management is given in Part 3 of the Audit Manual.

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\(^1\) According art. 13, paragraph 2 of the Rulebook
2.1.3. Audit Plan

After the preliminary survey and the kick-off meeting, an Audit Plan should be prepared. Template of the Audit Plan is given in Annex 4.1 of this section of the Manual.

2.2. Ascertainning and recording the system

2.2.1. Purpose for describing the system

The main reasons for describing the system are:
- To confirm the auditor's understanding of the system formulating clear process / system objectives;
- To establish any interfaces between systems;
- To establish how the system fits within the Organisation;
- To provide a basis for assessing the extent to which internal controls prevent or detect and correct errors.

The description of the system forms the basis for the auditor's judgement, conclusions and recommendations. It also should provide basis for the evaluation of the strengths and weaknesses in internal control.

Because “describing” the system takes up a lot of time, exclude anything which is not significant to the audit.

The auditor should decide which technique or combination of techniques for recording systems (text and/or flowchart) is most appropriate, taking into account the nature and complexity of the system, the audit objectives and any audit work done earlier.

Sources of information can include:
- Files and papers from earlier audits;
- Organisational and procedural rulebooks, manuals, guidelines and other acts used in the organisation;
- Interviews and informal discussions with managers and staff (detailed guidance on interview techniques is contained in Part 3 of the Audit Manual);
- Observation of the physical environment and the working methods used. It is particularly useful where no physical evidence that something has happened remains after the event. Remember that the presence of the auditor may influence the behaviour of staff and the practices observed may not, therefore, be typical. It may also be difficult to substantiate the evidence.

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2 The Audit Plan means the audit program according article 11 of the Rulebook.
- Documents and records used in the system;
- Reports prepared by any Control and Inspection Units;
- Any other reports relating to the area under audit;
- Management information.

2.2.2. Steps required in documenting systems

This section presents all the steps which are required in documenting system. If the system has previously been documented far less time will have to be spent in discussion with managers and staff. Similarly, if the system has not significantly changed. The steps are as follows:

1. Establish an outline of the system to enable you to decide on whether to use narrative or flowcharting to document the system, and also to decide which of the main sub-systems it will be appropriate to describe separately;

2. Obtain a detailed description of the systems and internal control features from discussions with departmental personnel. This should include a record of:
   - Which processes and procedures are carried out and by whom;
   - Any changes in procedures for different types or groups of transactions – eg those of high value;
   - Measures taken to maintain the continuity of the working process (lunch hours, holidays, vacations or peak flows of operations);
   - All documents used in the process;
   - All computer reports along with their purpose and the way they are used.

3. Record information on rough flowcharts or notes. If possible compare with acts describing internal procedures.

4. Perform walk-through tests (see below) to ensure that the system actually does operate in the manner which has been described.

5. Prepare documentation describing the system – narrative and/or flowchart.

6. Cross reference documents and reports of the system to the narrative and/or flowchart.

When documenting system, the internal auditor should remember that the volume of documentation should be limited to what is needed to identify and record the internal controls.

2.2.3. Extent of the systems description

This should be detailed enough to allow the user and the person reviewing the audit to understand how the system works and how internal controls are achieved. Depending on the objectives of the audit in some cases it may be necessary to record the complete system, and in others it may only be necessary to record key areas of the system.
When recording the system it is important to:

• Record the system as it actually operates;
• Identify and record all types of procedures and transactions covered by the system under audit (including exceptions such as national holidays, staff holiday periods, unusual overtime working hours etc);
• Look carefully for identifying controls - they may not always be clearly indicated;
• Record only the elements of the system essential to the audit;
• Copy only essential documents. Unnecessary copying of documentation can be wasteful and tends to make it difficult to review audit files;
• Remember that the description of the system found in such documentation may be out of date and incomplete.

If they provide adequate explanation, copies of standard documentation and significant reports or summaries may become part of the audit record. System records should also show the sources of information e.g. rulebooks, manuals, interviews.

2.2.4. Documentation of the system

Systems documentation normally takes the form of narrative descriptions, flowcharts or a combination of the two.

2.2.4.1. Narrative Descriptions

A narrative description helps to give a complete picture of the system. It provides a detailed record of the system under audit and, taken together with other forms of system records, it should cover:

• System objectives and targets;
• Links and interfaces with other systems;
• The environment in which the system operates;
• The allocation of authority and responsibility;
• All key controls and systems processes;
• Exceptional situations or cases that may need to be dealt with by the system;
• Ad hoc controls such as management reviews.

Narratives may cover detailed descriptions of transaction flows but in some cases these can be better recorded through flowcharts (see next chapter). It is often useful to use a combination of narratives and flowcharts – using flowcharts to describe more complex parts of the system. If flowcharts are used as well they and the narrative descriptions should be cross-referenced to each other.

Narrative descriptions may be usefully divided into:

• A summary overview of the system; and
• Separate detailed descriptions of the main constituent parts of the system.

Full use should be made of headings and they should be organised in a logical way in order to give a clear picture and make handling and updating easier. Wherever possible the source of the information and the names and titles of people interviewed should be recorded. A clear concise record of the system should be prepared. Annex 4.3 of this section of the Manual.
2.2.4.2. Flowcharts

Flowcharting is a diagrammatic method of recording and describing a system, which shows the flow of documents or information and the related internal controls within a system. Flowcharts can help:

- To obtain a perspective on the whole system;
- Gain an understanding of the auditee’s objectives;
- Identify segregation of duties;
- Help the person supervising the audit to identify areas which are not being covered by the audit.

Flowcharting is likely to be most effective if a logical, top-down approach is taken by starting with an overview or summary flowchart, followed by detailed flowcharts of specific processes if necessary.

There are various methods of, and symbols for, flowcharting. Annex 4.4 of this section of the Manual sets out the symbols which should be adopted by all Internal Audit Units. Microsoft Visio (MS Excel or Word is also possible to use) provides a flowcharting facility and there are also a number of software packages available for producing flowcharts (examples of flowcharts are shown in Annex 4.5 of this section of the Manual).

⚠️ When preparing flowcharts remember:

a. Flowcharts are primarily designed to show document flows rather than operations – although other operations can be explained by means of narrative notes if necessary;

b. Try to avoid mixing up the ‘regular’ process and exceptional processes (two or three transactions per period) on the same flowchart. Prepare separate charts for the regular and the exceptional processes;

c. To consider whether it is better to record the system by preparing one or more basic flowcharts which show the main flows in the system - supplemented by narrative description where necessary;

d. To flowchart the actual system. In some cases it may be necessary to record the ‘official’ system, and in those cases the charts must be labelled clearly to show whether it is the official (prescribed) or the actual (real functioning) system;

e. To work in pencil. This will save time redrawing the flowchart when you make a mistake;

f. That each flowchart should have a title, the date of creation and of any amendments to it and the name of the person who drafted it;

g. To make sure that all documents (and every copy of each document) on the flowchart are fully dealt with;

h. To think carefully before preparing a flowchart. Ask yourself whether it’s really necessary or whether narrative description will be just as effective and less time-consuming.

Flowcharting can be a very effective way of recording document flows in a system. Advantages of flowcharting are:

- Information can be easily communicated and assimilated;
- Flowcharts highlight the relationship between different parts of the system;
• The auditor can see the whole flow of documents; potential bottlenecks can be identified easily;
• Flowcharts offer a consistent method of recording;
• The auditor has to obtain a clear understanding of information flow in order to draw up a flowchart of a complex system;
• Cross-referencing between systems is made easier.

There are a number of disadvantages to using flowcharts. The most important is the time they can take to prepare. It is very easy for auditors to spend a lot of time preparing a flowchart when it would have been more efficient and useful to do a narrative description instead. Other disadvantages are:

• They are limited in scope and may not identify managerial and organisational controls;
• The technique and conventions have to be learned and practised;
• Complex flowcharts may confuse rather than clarify;
• The auditor usually needs some training and experience to be fluent in preparing them.

2.2.5. Other points to consider

2.2.5.1. Organisation Charts

The organisational structure relating to the system under audit should be recorded. A copy of an existing organisation chart will suffice, as long as it is accurate and up to date.

An up-to-date organisation chart will show details of the information flow, relationships in the organization and responsibilities. It is also useful in identifying staff and deciding where audit testing needs to be done. The date the chart was prepared should be recorded.

The chart may include:
• Main department/units with a description of their functions;
• Job titles, grades and names of staff together with lines of responsibility;
• All reporting lines.

2.2.5.2. Minimum Contents of System Documentation

Whichever method is used for documenting the procedures in each system there are certain items, which should be included on every system file. These are:
• Examples of documents describing their purpose and use. These documents and reports should be filed in the order in which they are used in the system, and cross-referenced to the narrative note or flowchart.
• Examples of reports (whether computerised or manually prepared) describing their purpose and use;
• Details of the number of transactions passing through the system. These are essential to a full understanding of the context of the system in relation to the overall activities of the entity. It is therefore necessary to summarise data such as:
  - Number of transactions;
  - Value of transactions;
  - Seasonal fluctuations.
• Forms used to evaluate the system.
It may also be useful for the auditor to know the number of employees or a stratification of the transactions by value or age to assist in the evaluation of risk when a weakness is highlighted.

2.2.6. Checking if the system is recorded correctly

It is important to ensure that the system is recorded accurately because it provides the basis for an evaluation of internal controls and for preparing a programme of audit tests.

If there is a lack of written procedures about processes in the public sector, please ask for confirmation of your narrative or flowchart, by signed from the manager of the audited unit.

2.2.6.1. Walk-through testing

In conducting ‘walk through’ tests, the auditor looks primarily for evidence of the existence of controls. This may involve examining a small number of different transactions at each stage of the process or following one transaction through from start to finish. The aim of this type of testing is to make sure that the system works in the way it is described in the systems narrative or flowcharts and to confirm the controls in place at each stage.

Normally transactions are followed from start to finish (final processing). However, sometimes it is more convenient and practical to start from completion of processing. It is important to consider documents, which pass through other minor systems and sub-systems outside the main system, and to look carefully at each file of documents and confirm where and why they are kept.

What to do with differences between the systems record and the walk-through tests?

When this happens there are two possible reasons:

- The system record you have prepared is mistaken, or
- The system record is correct but the system is not working properly.

If there is a difference, or any other information is identified which is inconsistent with the flowchart, you should refer back to the original source of the information before doing any more work. This is important because, if the system record has to be amended, the paths for walk-through test also may have to be changed.

When the difference is the result of an incidental breakdown in the system, you will normally need only to record this fact on your working papers. This information will then be taken into account in the evaluation of internal control.

2.2.7. Developing an Audit Programme

Once you have identified and confirmed the system/process or activity objectives the audit manager should start developing the Audit Programme (Annex 4.7 in this section of the Manual). First step is to record the process objectives in column 1.
The purpose of this chart for the Audit Programme is to guide the auditor through the audit. It represents the main phases of the audit and gives frame to the internal auditor’s professional activities, decisions and conclusions. In case of complex process, or multiply audit objectives or control objectives, the auditor should prepare several charts or the main Audit Programme should be separated for each process, audit or control objective, as appropriate.

This chart is also an instrument for the management and quality control. Its content shows how well did the auditor understand the operations and process objectives; his capability to identify controls; risk awareness; level of knowledge to assess controls vs. risks and process objectives; ability to determent the extent of substantive and compliance tests, as well to create and carry out tests. The last column with Conclusions and Recommendation contains information about the results of the audit as a whole or specific step of the audit or procedure.

This chart is also useful for following the audit activities, so that anyone who is interested could become familiar with the audit process and check if the audit is carried out in compliance with the professional standards.

### 2.3. Identifying system objectives

<table>
<thead>
<tr>
<th>System objectives</th>
<th>Controls</th>
<th>Risk identification</th>
<th>Controls assessment vs. risks</th>
<th>Compliance test</th>
<th>Substantive test</th>
<th>Conclusions and recommendation</th>
</tr>
</thead>
</table>

The key to an effective system based audit is to identify the system objectives that determine the control objectives against which controls in the system can be audited.

A system has five main elements:

Each of these elements is explained in more detail in **Annex 4.6** of this section of the Manual. A systems based audit is concerned particularly with establishing the link between controls and objectives in order to gather evidence to support the auditor’s professional opinion on the adequacy and effectiveness of internal control in that system.
The first step is to identify the objectives laid down by management for the system. For example in a procurement system the objectives set by management might include:

- ‘To ensure that the national law and legislation and EU requirements are met in placing procurement contracts’
- ‘To reduce the cost of procurement by 5% each year for the next three years’
- ‘To pay all valid invoices on time’.

System objectives such as these can be either, formal and written down, or informal. When you are trying to find out what they are, you should remember that in every system there will be a hierarchy of objectives - starting with those objectives set by senior management and working down to the objectives of the people involved in the detailed operation of the system.

By obtaining an understanding of what the objectives of the system are, it will help you to identify what the control objectives should be. The control objectives you set need to be consistent with the objectives of management in the organization, and should be discussed and agreed with management before you start any evaluation of controls.

### 2.3.1. Establishing control objectives

<table>
<thead>
<tr>
<th>System objectives</th>
<th>Controls</th>
<th>Risk identification</th>
<th>Controls assessment vs. risks</th>
<th>Compliance test</th>
<th>Substantive test</th>
<th>Conclusions and recommendation</th>
</tr>
</thead>
</table>

One useful way of thinking about this is to think about the organizational structure relating to the area you are auditing. This involves:

- identifying the main activities;
- determining the objectives of those activities or processes, and
- developing the control objectives which will help ensure the achievement of the objectives of the main activities or processes.

As a simple guide it may be useful to work on the basis of one control objective for each activity – although this rule should not be applied too rigidly.

For example with procurement the main sections/units involved could be: the department(s) requesting the supplies, services or works; the purchasing/contracts section; the department(s) receiving the goods or services and the accounts department.

For each of those sections or units you can then establish the activities which they carry out and this will help you to decide on the control objectives. So, for procurement:

- the *department requesting the supply* will be concerned with purchase requisitioning and (in many cases) receiving the supplies, services or works
- *purchasing/contracts section* will be involved in: purchase requisitioning; ordering; tendering and contracting; supplier database etc
- accounts department will be receiving invoices; validating and paying invoices; supplier payment files etc

Control objectives should include general control requirements such as:

- economy and efficiency
- prevention and detection of fraud and abuse
- reliability and adequacy of management information
- compliance with laws, legislation, management policies and rules
- security of assets, intellectual property and data
- the completeness and accuracy of the records and accounts of the organization.

An alternative approach to identifying control objectives is described by considering control objectives under the following categories:

- Organisation
- Authority
- Transaction recording and processing
- Asset recording and processing
- Security
- Verification

The following framework can be used to establish control objectives for most systems and processes which exist in each organization. For each area the framework lists a series of control elements. Against each of those control elements are suggestions for the possible focus of control objectives.

The framework needs to be used carefully and is intended for use as an aid to identifying control objectives. It is important to remember that different control objectives will apply in different systems. **It should not be regarded as a comprehensive list of control objectives** and auditors should be constantly thinking about additional control objectives to reflect the particular context in which a system is operating, and any specific problems facing the system or process under review.

**Framework for control objectives**

### 2.3.1.1. Organisation

<table>
<thead>
<tr>
<th>Control element</th>
<th>Possible coverage of control objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guidance and direction</td>
<td>- services, total number of employees and by departments/units, are in accordance with the organisation’s policies</td>
</tr>
<tr>
<td>Rules and procedures</td>
<td>- Rules and procedures for incurring expenditure, collecting income and the custody and disposal of assets are in accordance with the organisation policies.</td>
</tr>
<tr>
<td>Relevant &amp; subject to review</td>
<td>- Acts for systematization are regularly reviewed and approved by the appropriate level of management.</td>
</tr>
</tbody>
</table>

### 2.3.1.2. Authority

<table>
<thead>
<tr>
<th>Control element</th>
<th>Possible coverage of control objective</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statutory authority</td>
<td>- services and transactions are in accordance with legislation and other legal requirements</td>
</tr>
</tbody>
</table>
Professional authority - Quality of service provision is in accordance with professionally recommended standards.

Organisation authority - scales of charges for services etc are regularly reviewed and approved by the Governing board / Municipal Council or the appropriate level of management.

2.3.1.3. Transaction recording and processing

Control element Possible coverage of control objective
Occurrence - recorded income and expenditure did in fact occur.
Completeness - all transactions have been processed and recorded in the accounts or permanent records as appropriate.
Measurement - transactions have been valued in accordance with the laid down accounting policies.
Timeliness - transactions were initiated or recorded within a reasonable timescale.
Regularity - transactions and activities have been carried out in accordance with appropriate regulatory authority.
Propriety - Fairness, integrity and transparency have been observed in the negotiation of the contract for the services or supply.
Presentation and disclosure and - each transaction is coded correctly. (On completion of the annual financial statements, that the form and content of the statements are in accordance with appropriate accounting standards and regulations)

2.3.1.4. Asset recording and processing

Control element Possible coverage of control objective
Ownership - recorded assets are owned by or attributable to the organisation.
Completeness - all assets are recorded in accordance with standing orders and financial regulations.
Valuation - recorded assets have been valued in accordance with the organisation's policies.

2.3.1.5. Security

Control element Possible coverage of control objective
Assets - access to prime documents is properly authorised.
- all assets are secure and custody clearly stated.
- access to assets and asset utilisation is properly authorised.
Permanent records - permanent records are secure and custody clearly stated.

2.3.1.6. Verification

Control element Possible coverage of control objective
Permanent records - recorded assets are physically checked and the need for write off provisions assessed.
Control objectives should relate to the particular nature and operation of the activities which are needed to meet the specific objectives of the system. They should also be specific and show the purpose of control - and not the control itself. For example:

- in a purchasing system one control objective might be ‘to ensure that invoices are paid only for goods or services which have been received’
- in a payroll system a control objective could be: ‘to ensure that payments are made only to valid employees of the organization’
- in a security audit a control objective could be ‘to make sure that only accredited staff and visitors are permitted to enter the building’.

Some examples of control objectives for some common systems audits are provided in Annex 4.9 of this Manual.

### 2.3.2. Recording control objectives

<table>
<thead>
<tr>
<th>Process objectives</th>
<th>Control objectives</th>
<th>Risks</th>
<th>Controls</th>
<th>Control evaluation</th>
<th>Compliance Test</th>
<th>Substantive Test</th>
<th>Working Paper</th>
<th>Conclusion Comments</th>
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<td>1</td>
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</table>

Once the auditor has determined the control objectives they should be recorded in Audit program (column 2). This Audit program will be filled gradually for each step of the audit.
2.4. Identifying risks & evaluating controls against risks

<table>
<thead>
<tr>
<th>System objectives</th>
<th>Controls</th>
<th>Risk identification</th>
<th>Controls vs. risk assessment</th>
<th>Compliance test</th>
<th>Substantive test</th>
<th>Conclusions and recommendation</th>
</tr>
</thead>
</table>

### 2.4.1. Headline risks

It is often very useful to identify the ‘headline’ risk(s) associated with each control objective and to record them. This ensures that the auditor is clear about the context in which the control objective is set, and that the record of the system or activity remains within the parameters of the control objective. It can also help to reduce the amount of time spent on the systems description. Some examples of ‘headline’ risks include:

- damage to the reputation of the organisation or a particular department within the organisation
- a major security breach through unauthorised access to computer facilities
- fraud

The next stage of a Systems Based Audit is to identify and evaluate controls which exist to lessen the risk of failing to achieve a particular control objective. The key elements of this are:
- deciding on the risks relating to each control objective
- identifying the actual controls which exist in the system
- evaluating the effectiveness of those controls.

### 2.4.2. Identification of risks

Once you have identified the system it is useful to consider whether you need to add in further control objectives to those you identified at the start of the audit. As before, these should be recorded. Risks should be identified and recorded for each control objective (column 3 in Audit program). This will make it easier to decide the type of testing and how much testing needs to be done.

<table>
<thead>
<tr>
<th>Process objectives</th>
<th>Control objectives</th>
<th>Risks</th>
<th>Controls</th>
<th>Control evaluation</th>
<th>Compliance Test</th>
<th>Substantive Test</th>
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</table>

The risk endangers the achievement of the objectives defined for the process. During the execution of the processes many errors may emerge. These may be unintentional errors (misunderstandings, confusions, lack of competence etc.) but also intentional errors (varying from deliberate wrong application of rules to abuse like forgery and misappropriation usage of means). Such risk can be identified on the basis of the information collected at an earlier stage. The auditor shall estimate the risk at the planning stage and during the audit itself.
Risks are classified according to two criteria:

1. the probability for a certain risk to appear in reality;
2. its impact, which can be identified by the following table:

<table>
<thead>
<tr>
<th>Probability</th>
<th>LOW</th>
<th>MEDIUM</th>
<th>HIGH</th>
</tr>
</thead>
<tbody>
<tr>
<td>HIGH</td>
<td>Medium</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>MEDIUM</td>
<td>Low</td>
<td>Medium</td>
<td>High</td>
</tr>
<tr>
<td>LOW</td>
<td>Low</td>
<td>Low</td>
<td>Medium</td>
</tr>
</tbody>
</table>

Risk shall be classified as:

- **Low** – there is a low probability that the identified risks will have a negative impact on the audited body;
- **Medium** – there is a medium probability that the identified risks will have a negative impact on the audited body;
- **High** – it is probable that the identified risks have a negative impact on the audited body.

The answer to the question whether the impact of a given risk should be qualified as low, medium or high, is based on a competent opinion formed by the auditor. The possible factors (characteristics, features, qualities) having a role here are the established priorities and the implementation of the policy, the potential image risk and the financial interest related to them. The calculation whether the manifestation of a certain risk is probable or not, is a result of the professional judgement of the auditor. The complexity of the audited process and the leadership and administrative framework in which the process develops are the significant factors in calculating the likelihood impact of a given risk.

It is recommendable that the auditor discuss with the management of the audited body the risks identified by him and their classification, so that no risk factors are left out and to avoid unnecessary differences between the auditor and the management with regard to the process. The auditor should predominantly concentrate on the high risk areas.

Some typical risk categories are:
• **Error** – is there a possibility an error could occur during the process in question or that information held in a key data file or store (ex. details of supplier; employee records) could contain errors.

• **Fraud** – could the process or information be deliberately manipulated for personal gain which might go undetected.

• **Theft** – in the delivery of the systems objectives and the performance of the activity under review are there physical assets which someone could remove for personal benefit.

• **Regulatory** – could the process or system not be compatible to international, European and national and any rules and regulations laid down by the central government or the municipality.

• **Disclosure** – is there a possibility of unauthorized disclosure of information or of the way in which the system or process operates which might lead to loss, embarrassment or other disadvantage.

• **Disruption** – is there a possibility of loss or disruption which would make it difficult or impossible to operate the system or process or could lead to the loss or corruption of data.

• **Value for Money (VFM)** – is there the possibility of uneconomic, inefficient or ineffective use of resources in the performance of the process or system.

Example for identification and risk assessment in the public sector is given in **Annex 4.8** of this section of the Manual.

### 2.4.3. Identification of key controls

For each risk, using the description of the system you prepared, you should then identify the control or controls which are intended to manage that risk. Full details of the control should be recorded in column 4 in Audit program. It is important that you record the actual controls in existence, and not the ideal controls for the situation, or the controls that management would like to have in place. Details should also be included of who (grade and position) performs the control, and where.

<table>
<thead>
<tr>
<th>Process objectives</th>
<th>Control objectives</th>
<th>Risks</th>
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</table>

Controls are actions and procedures established by the auditee to ensure that the objectives of a system are met. Even if objectives are met without controls, reliance cannot be placed on any system which functions without adequate controls.

More information on the different types of control is provided in **Annex 4.9** to this part of the Manual.
2.4.4. Evaluation of controls

Evaluating controls involves two stages:

- evaluating the system design to establish the **adequacy of control**, and
- evaluating the operation of the system to establish the **effectiveness of control**

### 2.4.4.1. Evaluation of the system design (adequacy of control)

This is done after the system is recorded. The auditor must consider whether the control objectives will be achieved by the identified controls. This requires the use of audit judgement. This preliminary evaluation of the adequacy of the existing controls involves:

- starting at the higher level controls (e.g. planning and risk management) and working down to lower level controls over individual transactions
- considering the probability that something will go wrong and the significance (materiality) to the organization if it does go wrong
- looking for compensating controls which may enable the control objective to be met
- looking for unnecessary controls, or ones which cost too much to apply.

It is necessary to establish whether the controls will, under reasonable circumstances, prevent and/or detect and manage risks/errors. If they will prevent and/or detect risks/errors, the auditor should record this conclusion in column 5 of Audit program. It will then be necessary to test the actual operation of the controls. Column 6 and 7 is for the reference to the relevant Audit Test Record.

<table>
<thead>
<tr>
<th>Process objectives</th>
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</table>

If the control will not prevent and/or detect errors etc, or if there is no control at all this should be recorded in column 9 on Audit program (comments on the nature of errors or weaknesses). The auditor will not normally test those controls which are considered to be inadequate, but may - in extreme cases - conduct substantive tests to identify and quantify the extent of any errors. Internal Control Questionnaires can be used to aid the identification of strengths and weaknesses of controls.

### 2.4.4.2. Evaluation of the operation (effectiveness) of the system

This involves testing to ensure that the controls which have been identified have been operated as intended and that they are achieving the control objective. This is dealt with in next chapter of this manual.
2.5. **Testing controls**

<table>
<thead>
<tr>
<th>System objectives</th>
<th>Controls</th>
<th>Risk identification</th>
<th>Controls vs. risk assessment</th>
<th>Compliance test</th>
<th>Substantive test</th>
<th>Conclusions and recommendation</th>
</tr>
</thead>
</table>

### 2.5.1. Why is it necessary to test?

It is management's responsibility to ensure that the systems of control are adequate and that they are being complied with. This means it is for management to carry out appropriate checking or testing procedures to ensure that laid down procedures are being complied with, assets are safeguarded, financial records are maintained etc. Under no circumstances should internal audit be seen as part of this internal check system.

Audit testing is a supplement to management's own testing, and is an essential part of the independent appraisal of internal control carried out by internal audit. This testing:

- confirms that management has been carrying out checking and testing, and
- detects violations which management may not have identified.

Audit testing can be a very substantial part of the audit process, sometimes taking up to half the time available for the audit. This means it is important to ensure:

- audit tests are carefully planned
- there is adequate evidence of the testing which has been done
- conclusions can be fully supported by the testing done.

Internal auditors use testing to evaluate the operation of the system and to form or corroborate an opinion about the adequacy or otherwise of control. This is done by measuring particular characteristics of selected transactions or processes and comparing the results with those expected. For example, the control should assure that in the financial report for some specific year are included only data for transactions performed that year, and not for transactions from previous or future years.

There are two main types of testing: test of controls or compliance test and substantive testing.

### 2.5.2. Compliance testing

Compliance tests aim at collecting evidence whether the control procedures are correctly implemented and are reliable. Compliance tests are performed to guarantee the effectiveness of the functioning of internal control measures throughout the control period (here the control shall be also oriented towards finding the existence of the respective control measures). These activities shall provide evidence for the auditor to affirm the functioning of the control measures. The purpose of compliance tests (i.e. testing the control mechanisms and procedures) is to confirm that the existing control procedures are correctly applied and are reliable.

The main purpose of compliance tests is not to identify errors, deviations or potential fraud, but to identify the control procedures, which are not performed correctly. The reasons for the
omissions and deviations are more important to the auditors than the omissions and deviations themselves.

To find out the performance of internal control measures, you should carry out compliance tests through partial observation of selected cases, events or items. In practice this usually is a combination of compliance tests and detailed tests.

The number of compliance tests carried out depends on two factors:
- the size of the information flow related to the respective process;
- the nature of the control measures.

You should estimate whether the control procedures were adequately performed during the audited period. The planned tests shall be evenly distributed in time.

If one or more similar deviations are found, you should trace out the risk of these deviations and whether this risk is sufficiently covered. If the measures are insufficient to cover a certain risk found, this has a reflection upon the identification of the residual risk. Of course, a considerable number of deviations will make you adapt your opinion of the quality of the internal control system. In such case the planned number of detailed tests shall be increased.

Further information on how to plan, design and evaluate tests of controls is provided in Annex 4.11. to this part of the Manual.

2.5.3. Substantive Tests

Where it has been determined, through compliance testing that they are weak or inadequate controls you may decide to conduct some direct substantive testing. The purpose of this is two fold:
- to determine if any significant losses have occurred, and
- to contribute towards internal audit’s assessment of the organisation’s overall control environment.

The results of this work will either:
- provide assurance to management that there has not been any significant losses to the organisation as a result of a weak control environment, or
- provide evidence to management that the weak control environment has lead to significant losses, and thus prompt management to take appropriate action.

The objective of substantive testing is to evaluate the adequacy and completeness of outputs rather than the operation of controls. For example, checking the amount actually paid to a supplier is the same as the amount on the invoice and on the purchase order.

It is thus more detailed in its nature, more time consuming, and requires larger samples to gain the same level of assurance. However, errors discovered in substantive testing are more significant, as they usually represent a loss to the organisation, where as errors from
controls test demonstrate a control failed to operate – but not necessarily that an error occurred.

**Annex 4.10.** to this part of the Manual presents the steps in the decision making process when deciding on the type and extend of Compliance and Substantive testing.

### 2.5.4. The test program

Before starting any testing you need to decide:
- what to test
- what each test is for, and
- how to test.

When designing the test it is very useful to try to structure one test to cover a number of different control mechanisms and risks. For example:

- when testing the controls over purchase orders you could structure a test to allow you to verify several controls, including the authorisation of purchase orders (signatories etc); changes to purchase orders; and the controls over the receipt of goods and services purchased (details on purchase orders of quantities, prices, delivery dates etc)

- when testing controls over the authorisation of changes to standing payroll data you might structure a test to cover the addition of new employees (including verification of pay rates) and changes in pay rates for current employees (ex. on promotion).

Examples of Compliance and substantive tests are given in **Part 4** of this manual.

The following steps are to be performed in the field work (testing) phase:
- The detail of each test carried out should be recorded on a separate working paper (Annex 4.12. to this part of the Manual).
- Test results should be used for the Record of Audit Findings (**Annex 4.13.** to this part of the Manual).
- All tests and record of audit findings should be referenced in column 8 of the Audit Programme.
- Finally the most important findings, conclusions and recommendations should be summarised in the Audit Findings Summery Form (**Annex 4.14.** to this part of the Manual).
2.5.5. Sampling techniques

In order to reach a judgement on the effectiveness of the internal control system adequate tests need to be performed on the system. If the review of the system and the walk-through tests indicate a weakness in the system, then further tests may be conducted to determine whether that weakness has been exploited and to what extent. The review of the system will also highlight a number of critical controls which appear to be operating effectively, but which need to be tested to ensure that they can be relied upon.

In order to carry out these tests on these controls it is necessary to use sampling techniques to determine a sample from the population of the system being audited (ex. purchase invoices in a procurement system). Clearly if you want to establish the adequacy of controls in that system the ideal approach is to test every purchase invoice, but this is nearly always impossible to do and it can be prohibitively time-consuming and expensive. Some guidance on different sampling methods and when to use them is given in Part 3 of the Audit Manual.
2.6. Arriving at conclusions

This is the stage of a system-based audit where the auditor considers the results of previous work before reporting to audit management and to the management of the area audited. It is important that you think about your findings and conclusions throughout the evaluation and testing processes.

2.6.1. Audit findings form

The Record of Audit Findings Form (see Annex 4.13. to this part of the Manual) provides a useful structure for handling the information you have obtained and to think things through in a logical way when writing the audit report. It is designed to help the auditor to establish the causes of the issues or weaknesses which have been identified from the evaluation of the system of control, and to develop suitable recommendations.

It should be completed as testing is being done and the nature and significance of control weaknesses are established. Wherever possible try to group related weaknesses together on the Audit Findings Summary Form (see Annex 4.14. to this part of the Manual). This will make it easier to plan your audit report.

2.7. Audit reports and action plans

See Part 3 of the Manual
2.8. Audit Files

The working papers and any other documentation related to each audit assignment should be held on dedicated audit files. Those files should be structured in a clear and logical way in order to make it easy for anyone to find what they need and to understand what has been done, and why. The files can be held in electronic or paper form.

Appropriate use of indexes and of cross-referencing between documents and sections of the files is vital if documentation is to be accessible and assist the auditor to carry out the audit efficiently. This will also help anyone using or reviewing the files to follow the steps taken during the audit and to understand how conclusions were reached.

Maintaining well organized and structured audit files:
- enables the audit to be conducted in a logical manner
- helps ensure comprehensive coverage
- aids understanding
- makes it easier to identify weaknesses and draw the correct conclusions
- enables progress and findings to be readily reviewed
- makes report drafting easier
- facilitates the location of papers
- provides a formal record of the work undertaken.

Two types of file should be maintained for each audit - the Permanent File and the Current File.

The Permanent Audit File - contains all the ongoing information about the system, unit or department under review. The permanent audit file should be reviewed by the Auditor at the start of each new audit of that system etc. It should also be updated at the end of the audit.

The Current Audit File – contains all documents or information that refers to the current audit. It contains a detailed history of the current audit from determining the scope and objectives through to the completed Action Plan. It is advisable to create this file at the start of the audit and, as far as possible, to build it up during the course of the audit.

A suggested structure for each of these files is given at Annex 4.15 to this part of the Manual.
3. Supervising audit assignments

3.1. Responsibilities of the Chief Internal Auditor

The Chief Internal Auditor (CIA) is responsible for ensuring that individual audits are adequately resourced and properly supervised throughout. When considering resources care should be taken to ensure that the appropriate range of knowledge, skills and experience are allocated, and that the necessary level of supervision is provided. The level of supervision needed will depend on the proficiency and experience of each auditor and the difficulty and sensitivity of each assignment.

Other key areas on which the Chief of the Internal Audit Unit (CIA) should focus include:
- providing suitable instructions at the outset of an audit and approving audit objectives and work programmes
- making sure that work programmes are carried out, unless changes are both justified and approved
- making sure that audit reports are accurate, objective, clear, concise, constructive and timely
- ensuring that audit objectives are being met within allocated resource budgets and by agreed target dates as far as possible
- ensuring that laid down standards and procedures are being applied and that appropriate audit techniques are used.

3.2. Audit preparation

At the start of every audit the CIA and the Auditor or the audit team should discuss and agree;
- the scope and objectives of the audit - and whether any preliminary work is needed before the audit can start
- audit approach and techniques to be used
- the staffing of the audit
- a time plan for responsibilities of Auditors indicating duration, completion of the audit, etc
- administrative arrangements, security procedures, travel time, subsistence, locations, etc.

The CIA should brief the auditor or audit team before the audit starts to ensure that audit objectives are understood by the team and make sure that all relevant documentation and background material is assembled. The briefing should include approach and techniques, allocation of tasks to individual auditors, liaison with line management, reporting and administrative arrangements. Details of the briefing should be recorded in the Current Audit File.
3.3. **Arrangements for the audit**

The CIA should inform line management of the purpose of the audit and the timing and duration. If part of the audit testing strategy requires an unannounced visit (e.g., a surprise cash count) the Head of Department should normally be informed on arrival.

At the start of the audit, the CIA and the Auditor should arrange an Opening Meeting with the line managers responsible for the work to be audited, and explain the audit task and the systems or activities to be examined.

Any requests for audit to look at matters not covered in the work plan should be referred to the CIA for decision. A provisional timetable and a final discussion date should be agreed. Periodic meetings may be arranged as the audit progresses, particularly where it is a long or complex audit.

3.4. **Supervision of the audit**

Supervision involves monitoring staff on assignments, reviewing their work, developing their skills and making sure that performance is in line with standards and work plans. More supervision is needed where a trainee is being used or if an auditor has a low level of skills in, or experience of, the type of assignment to which he or she has been allocated. The CIA should:

- review performance and progress periodically. This should include regular meetings with the Auditor(s). Failure to exercise control may result in objectives not being achieved or loss of direction and efficiency
- consider the actual man days spent on each audit and determine reasons for variances. The implications for future plans should be considered and any necessary action taken
- pay scheduled and unscheduled visits to see the auditor/audit team at work to assess the way in which the audit is being carried-out and the expertise which is being applied. They should note any training needs arising during the audit.

3.5. **Review**

This is an integral and continuous part of the audit process. All work should be reviewed by the CIA on an ongoing basis throughout the audit. Completed working papers should be inspected to ensure that they meet laid down standards and are relevant to audit findings and conclusions. It is also important to ensure that evaluation and testing are appropriate to the system which is being audited.

The extent of review will vary with the experience of staff and the nature of the assignment but it should be such that the CIA can be satisfied that the conclusions are sound and are demonstrably supported by relevant, reliable and sufficient audit evidence. There should also be evidence that all elements of the plan have been satisfactorily achieved and that the audit file has been reviewed by the CIA.
3.6. Continuous improvement

On completion of each audit the CIA should sit down with the auditor/audit team to assess the way the audit has been done and how effective it has been. This review is to establish ‘lessons learned’. The review should ask:

- what was done well?
- what did we do badly/less well?
- what improvements could be made?

In the light of these reviews the CIA should consider whether there is a need for additional guidance on future audits, whether there are any implications for other audits and the effect on audit plans. Possible solutions to the problems identified could include staff training, better planning, the use of other audit techniques, a different approach to the audit etc.

3.7. Audit review record

A record of the reviews carried out should be prepared and held on the audit file. This record should show:

- the main stages in the audit and the major documents reviewed
- the results of the reviews
- who carried out the reviews
- the dates of the reviews
- lessons learned for the next audit

The review record should be signed by the CIA or other person reviewing the audit on completion of each stage of the audit. The exact timing of each review will depend upon the nature, complexity and length of the audit.

A sample of an Audit Review Record is in Annex 4.16 to this part of the Manual.
4. Annexes

1. Audit assignment plan
2. Form – Authorization letter
3. Narrative description template
4. Flowchart symbols
5. Flowchart example - (vertical and horizontal type)
6. Key elements of systems
7. Audit program
8. Methods of identifying risks
9. Types of control
10. Decision points in a system based audit
11. Planning and performing tests of control (compliance tests)
12. Test record
13. Record of Audit Findings
14. Audit findings summary form
15. Structure of audit files
16. Audit review report
4.1. **Audit assignment plan**

<table>
<thead>
<tr>
<th>Audit assignment plan</th>
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<tbody>
<tr>
<td>Number and name of the audit according to the Annual Audit Plan</td>
</tr>
<tr>
<td>Chief of audit team</td>
</tr>
<tr>
<td>Revised organization</td>
</tr>
<tr>
<td>Chief of the revised organization</td>
</tr>
<tr>
<td>Revised systems or processes</td>
</tr>
<tr>
<td>Key Business/System Objectives</td>
</tr>
<tr>
<td>2.</td>
</tr>
<tr>
<td>3.</td>
</tr>
<tr>
<td>Short description of the system/process</td>
</tr>
<tr>
<td>Important findings for the revised system/process from previous audits</td>
</tr>
<tr>
<td>Key contacts</td>
</tr>
<tr>
<td>(list of people that will be contacted/interviewed)</td>
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<tr>
<td>1.</td>
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<td>3.</td>
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<tr>
<td>Audit Objective</td>
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<td>2.</td>
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<td>3.</td>
</tr>
<tr>
<td>Audit Scope</td>
</tr>
<tr>
<td>Priorities / key issues &amp; possible problems</td>
</tr>
<tr>
<td>Approach &amp; audit techniques</td>
</tr>
<tr>
<td>Audit team members (including outside experts and their tasks)</td>
</tr>
<tr>
<td>Target Completion Date: (Broken down into key stages)</td>
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Prepared by: ______________________ Approved by: ______________________
4.2. Form – Authorization letter

Based on Article 26, point 1, from the Law for Internal Audit in the Public Sector ("Official Gazette of RM", Nr.69/04) and Article 12 from the Rulebook for basic elements of the Work Manual, charter, annual plan and program for internal audit ("Official Gazette of RM", Nr.38/05), chief of __________________, issues the following

A U T H O R I Z A T I O N

Authorized is/are:

_______________________________, ______________________ - Chief of Audit team;
    (name and surname)      (title)

____________________________, ___________________ - Member of Audit team; and
    (name and surname)     (title)

____________________________, ___________________ - Member of Audit team;
    (name and surname)     (title)

to perform audit of __________________________________________________________.
    (systems and processes that will be subject of the audit)

Audit goals are ________________________________________________________________.

The audit should be performed in the period from ______ 200_ year until ______ 200_ year, and the final audit report to be performed latest by ______ 200_ year.

CHIEF OF __________________,
    __________________
    (signature)

(Stamp)
### 4.3. Narrative description of system

The table shown below is only as model for text description. Internal auditor has to use format that will be easy to understand for the user, through increasing the space for writing or using blank form. Main rule that should be followed is: simply, shortly and clearly without unnecessary information.

**Description of System / Process**

<table>
<thead>
<tr>
<th>Name of the system / process:</th>
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<tbody>
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</table>

<table>
<thead>
<tr>
<th>Name of activity (step of the process):</th>
</tr>
</thead>
<tbody>
<tr>
<td>Description of the activity and related connected to it</td>
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<tr>
<td>Name of the responsible person for the activity:</td>
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<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Name of activity (step of the process):</th>
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<tbody>
<tr>
<td>Description of the activity and related connected to it</td>
</tr>
<tr>
<td>Name of the responsible person for the activity:</td>
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<tr>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Name of activity (step of the process):</th>
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</thead>
<tbody>
<tr>
<td>Description of the activity and controls connected to it</td>
</tr>
<tr>
<td>Name of the responsible person for the activity:</td>
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</tbody>
</table>

Date: ……………………… Pre pared: ……………………………

Supervisor: ………………………
4.4. Flowchart symbols

Flowcharts are used as a visual method of both manual and computer process analysis. Through visualisation, flowcharts can make it easier to understand how the system works than a detailed description would do.

Internal audit uses flowcharts mainly in preliminary studies and when scrutinising an internal control system. They can also be useful in developing new systems and for assessing whether your recommendations to improve procedures and systems are appropriate.

Flowcharts consist of symbols, each with a specified meaning, a brief explanatory text and connecting lines. The extent of any explanatory text depends primarily on the complexity of the processes and on who is going to use the flowchart.

Various levels of flowcharts may be used depending on how detailed they are; the number of levels corresponds to the complexity of the systems and/or procedures depicted. The number of levels of a flowchart should be adequate so as to clearly and precisely depict the individual parts of the flowchart and their corresponding links in their complexity. As a rule, at the top of the hierarchy the flowcharts depict the system as a whole. Each following level below depicts in greater detail one or more parts depicted on the level above.

4.4.1. There are two main types of flowchart:
1. **Horizontal flowcharts** (system flowcharts) describing the horizontal distribution of responsibilities (units, positions) rendered using columns
2. **Vertical flowcharts** depict the hierarchical sequence of measures.

When carrying out your audit you need to decide which is the most appropriate type to use.

Standard flowchart symbols are given and easy to be used in Word, Excel (Draw-AutoShapes-Flowchart). Most often used program for drawing flowcharts is Microsoft Visio.

The following diagram shows the principal symbols which should be used.
4.5. **Flowchart example (vertical type and horizontal type)**

4.5.1. Vertical flowchart

![Vertical Flowchart Diagram]
4.5.2. Horizontal flowchart

<table>
<thead>
<tr>
<th>UNIT 1</th>
<th>CONTROL UNIT</th>
</tr>
</thead>
<tbody>
<tr>
<td>START</td>
<td></td>
</tr>
<tr>
<td>PROCESS 1</td>
<td>NO</td>
</tr>
<tr>
<td>PROPOSAL DOCUMENT</td>
<td>CONTROL</td>
</tr>
<tr>
<td>PROCESS 2</td>
<td>YES</td>
</tr>
<tr>
<td>FINAL DOCUMENT</td>
<td>END</td>
</tr>
</tbody>
</table>

4.6. Key elements of systems

Every system has a number of key elements which are:

- objectives/targets
- inputs (resources)
- processes
- controls
- outputs (results)
OBJECTIVES
They are key to any system. They set out what the unit, department or process is trying to achieve. At the highest level they set out the aims of the organization (e.g. to increase tax collection rates by x%); at a lower level they should relate to individual activities or processes (to raise revenues from excise duties on alcohol by x% by end 2005). Good objectives generally should have the following characteristics:

- Specific
- Measurable
- Achievable
- Realistic
- Timescales

INPUTS
These are the resources which feed the system either for conversion during processing or as aids to conversion. They may include funds, materials, staff, time, information or know-how.

PROCESSING
This is the manipulation or conversion of resources within the system.

CONTROLS
These are the checks, reviews, organization structures, training and other procedures which management apply to ensure that objectives are achieved.

OUTPUTS
These are the products, effects and achievements which result from processing in the system.
4.7. **Audit programme**

System / Process / Activity\(^3\) ........................................................................................................................................................................

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
<th>9</th>
</tr>
</thead>
<tbody>
<tr>
<td>Process objectives</td>
<td>Control objectives</td>
<td>Risks</td>
<td>Controls</td>
<td>Controls evaluation</td>
<td>Compliance Test of controls</td>
<td>Substantive Test</td>
<td>Working Paper ref.</td>
<td>Conclusions Comments</td>
</tr>
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</tr>
</tbody>
</table>

Date: ......................

Prepared by: ......................

Supervisor: ......................

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\(^3\) Audit program should be prepared for each system / process/ activity audited
4.8. **Methods of identifying risks**

In recent years there has been a considerable amount of study into the various types of risk which affect organisations and to the ways of categorising them. This section of the technical manual provides an overview of some of the main ways of identifying the risks (or threats) to achieving an objective.

The Business Risk is defined as:

> "the threat that an event or action will adversely affect an organization’s ability to achieve its business objectives and execute its strategies successfully."

There are a number of ways of identifying the risks to an objective being achieved. Options include:

- Considering sources of risk
- Considering types or categories of risk
- Using historical experience as a manual to develop a list (i.e. know sources of problems)
- Using a control model to consider areas where risks can be created.

4.8.1. **Sources of risk**

The sources of risk and possible areas for the risk effect are represented in the following table:

<table>
<thead>
<tr>
<th>Possible Sources of Risk</th>
<th>Possible Areas of Risk Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>commercial/legal relationships</td>
<td>assets and resources</td>
</tr>
<tr>
<td>economic</td>
<td>cost: both direct and indirect</td>
</tr>
<tr>
<td>socio-political/legal</td>
<td>people</td>
</tr>
<tr>
<td>personnel/human behaviour</td>
<td>community</td>
</tr>
<tr>
<td>financial/market</td>
<td>performance of activities: how well the activity is performed</td>
</tr>
<tr>
<td>management activities and controls</td>
<td>timeliness of activities</td>
</tr>
<tr>
<td>technology/technical</td>
<td>organizational behaviour</td>
</tr>
<tr>
<td>the activity itself/operational</td>
<td>environment</td>
</tr>
<tr>
<td>business interruptions</td>
<td>intangibles</td>
</tr>
<tr>
<td>occupational health and safety</td>
<td></td>
</tr>
<tr>
<td>property/assets</td>
<td></td>
</tr>
<tr>
<td>security</td>
<td></td>
</tr>
<tr>
<td>natural events</td>
<td></td>
</tr>
<tr>
<td>public/professional/product</td>
<td></td>
</tr>
<tr>
<td>liability</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Every source of risk can have one or several effects.
4.8.2. Types or categories of risk

Some public sector organizations consider risk under the following six categories scoring them on a scale of 1 to 5 under each relevant category. This is a more precise approach when making risk assessment. The aim of scoring risks is more precisely defining the risk as low, middle or high. You should specify what do you understand under low, middle and high risk compared to assessment conditions, as explained in point 2.4. Identifying risks to this part of the Manual.

Management control environment

<table>
<thead>
<tr>
<th>Score</th>
<th>Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>High confidence in control environment; well run organization; good reputation; efficient and effective operations; sound system of internal control; recently audited with good results</td>
</tr>
<tr>
<td>2</td>
<td>Good confidence in control environment; audited within the last three years with reasonable results</td>
</tr>
<tr>
<td>3</td>
<td>Reasonable confidence in control environment; audited with significant issues within the last five years, but follow-up completed and corrective action implemented</td>
</tr>
<tr>
<td>4</td>
<td>Limited confidence in control environment; not audited within the last five years</td>
</tr>
<tr>
<td>5</td>
<td>Limited or no confidence in control environment; no prior audit coverage or fairly recent audit with significant unresolved issues or material cash losses; poor governmental reputation; high whistleblower or grievance activity</td>
</tr>
</tbody>
</table>

Riskiness of the nature of the work

<table>
<thead>
<tr>
<th>Score</th>
<th>Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Low probability of loss</td>
</tr>
<tr>
<td>2</td>
<td>Exposure potential is relatively immaterial</td>
</tr>
<tr>
<td>3</td>
<td>Exposure represents a relatively low percentage of general budget operations</td>
</tr>
<tr>
<td>4</td>
<td>Exposure represents a relatively moderate percentage of general budget operations</td>
</tr>
<tr>
<td>5</td>
<td>Exposure represents a relatively significant percentage of general budget operations</td>
</tr>
</tbody>
</table>

Public and political sensitivity

<table>
<thead>
<tr>
<th>Score</th>
<th>Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>No press or local interest in generic topic</td>
</tr>
<tr>
<td>2</td>
<td>Exposure potential is relatively immaterial</td>
</tr>
<tr>
<td>3</td>
<td>Somewhat politically sensitive, but interest is narrowly focused to a limited audience</td>
</tr>
<tr>
<td>4</td>
<td>High public interest</td>
</tr>
<tr>
<td>5</td>
<td>Loss of funding, extreme public interest</td>
</tr>
</tbody>
</table>
## Compliance requirements

<table>
<thead>
<tr>
<th>Score</th>
<th>Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Few regulations; clear and simple policies, procedures and guidance</td>
</tr>
<tr>
<td>2</td>
<td>Limited regulations; flexibility permitted in meeting policies, procedures and regulations</td>
</tr>
<tr>
<td>3</td>
<td>Moderate or significant percentage of transactions subject to policies, procedures and regulations; effective and efficient business processes</td>
</tr>
<tr>
<td>4</td>
<td>Significant or high percentage of transactions subject to complex policies, regulations and heavy fines; unallowable cost; somewhat inefficient or ineffective processes</td>
</tr>
<tr>
<td>5</td>
<td>Significant or high percentage of transactions subject to complex and changing policies and regulations heavy fines; unallowable cost; somewhat inefficient or ineffective processes. High probability of monetary or funding source loss</td>
</tr>
</tbody>
</table>
Information and reporting

<table>
<thead>
<tr>
<th>Score</th>
<th>Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>High degree of accuracy, availability, timeliness and usefulness of information; associated information systems or applications are simple, stable or low criticality; loss of access to system generated information or reporting capability would have low budget spending unit, process or entity impact</td>
</tr>
<tr>
<td>2</td>
<td>Some minor issues of accuracy, timeliness or usefulness of information; Automated system with some complexity; Most reporting needs are met and any loss of access to system or reporting would have minor impact to budget spending unit process or entity</td>
</tr>
<tr>
<td>3</td>
<td>Some potential for information to be not timely, useful or meaningful; automated system may require some special training or expertise; system in the mid-life of implementation cycle; associated information system or application has a medium critical impacts on more than one entity, system or process</td>
</tr>
<tr>
<td>4</td>
<td>Uncertain reliability of data, timeliness of information or usefulness; associated information system or application are fairly complex or potentially unstable; Loss of access to system reporting will have fairly major budget spending unit processes or entity impact. Automated system may be older, with inability to provide necessary data, or newly implemented system not been fully tested; system is complex, Impacts other processes or entities or may support health &amp; safety process</td>
</tr>
<tr>
<td>5</td>
<td>Low degree of information accuracy, availability, timeliness and usefulness; Information system is manual outdated or new and untested; system is highly complex, has budget spending unit wide impact, mission critical or supports life processes or activities; Computing risks have not been adequately addressed or controlled</td>
</tr>
</tbody>
</table>

Organizational change/growth

<table>
<thead>
<tr>
<th>Score</th>
<th>Factor</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Stable organization; no increase or decline in the budget</td>
</tr>
<tr>
<td>2</td>
<td>Limited management change or personnel turnover</td>
</tr>
<tr>
<td>3</td>
<td>Average turnover in key personnel, average change in prior year budget</td>
</tr>
<tr>
<td>4</td>
<td>Significant change in processes; downsizing; early retirements; turnover in key personnel</td>
</tr>
<tr>
<td>5</td>
<td>High turnover; major system changes; significant reengineering; significant change in prior year budget</td>
</tr>
</tbody>
</table>

4.9. **Types of control**

There are four basic types of control:

- **preventive** - designed to prevent the occurrence of inefficiencies, errors or irregularities. They cannot guarantee that inefficiencies will not occur, nor errors or irregularities, but they decrease the probability of their occurrence. Some
examples for this are the division of duties and setting up levels for approval depending of the amount to be paid.

- **detective** - designed to detect and correct inefficiencies, errors or irregularities. They may not give absolute assurance since they operate after an event has occurred or an output has been produced. Still, they should reduce the risk of undesirable consequences as they enable remedial action to be taken. Detective controls are most effective when they form part of a feedback loop in which their results are monitored and used to improve procedures or preventive controls. Examples include post-payment checks, stock verification and bank reconciliations.

- **directive** - designed to cause or encourage events necessary to the achievement of objectives. Examples include clear definition of policies and procedures, the setting of targets, and adequate training and staffing.

- **corrective** - to identify and evaluate alternative courses of action, to implement appropriate measures to remedy the situation and minimize damage. Examples for these controls are correcting errors during computer calculation of salaries or correcting errors when entering data in software database for the quantities of goods on stock in warehouse.

In practice the above categories may not be clearly distinguished and a single control may operate to cover two or more functions. Supervision, for example, covers three categories – detective, directive and corrective.

### 4.9.1. Some examples of internal controls

These examples start with the higher level controls, followed by intermediate and then low level controls. They are relevant to both manual and computer-based systems.

**High level controls**

*Planning*

This involves establishing aims, objectives and targets and the means by which they are to be achieved. Good planning includes:

- clear definitions of objectives and targets
- forecasting of activity, operational requirements and external factors which may affect the achievement of objectives
- specifying desired levels of control taking account of risk
- setting standards of performance
- defining, wherever possible, the outputs of a system and criteria for measuring them
- evaluating different options for achieving objectives
- anticipating contingencies, and devising suitable action to take in response
- indications of the relative priorities of objectives, targets and their related activities.
- budgetary constraints
Written guidance

Management’s policies and procedures should be documented to ensure that all staff is aware of them and work together to achieve objectives. Written guidance and procedures manuals should be:

- clear, unambiguous and easy to refer to
- accessible to all relevant staff
- subject to checks by management to ensure that they are read and understood
- reviewed regularly, and any changes brought to the attention of staff and implemented promptly.

Organizational controls

Involves allocating responsibility to individuals or groups so that they work together to achieve objectives in the most efficient manner. Accountability and authority should be allocated to match responsibility. Major principles of good organization include:

- providing clear and documented definition of the responsibilities of individuals and groups for resources, activities, objectives and targets
- establishing clear reporting lines
- finding the most efficient balance of duties between different organizational groups
- establishing the most effective spans of command without creating more levels in the management chain than necessary
- establishing effective means of communication throughout the organization
- separating duties to avoid conflicts of interest or opportunities for abuse
- avoiding undue reliance on any one individual, particularly for internal control.

Intermediate level controls

Monitoring performance

Management needs to monitor performance to ensure that operations are conducted to achieve the optimum economy, efficiency and effectiveness. Quality control of the work should be built in to systems.

Management should establish its needs for, and use of, information about activities. Relevant information may be in the form of numbers, accounts, analyses or reports. It may be produced on a regular schedule, at management’s discretion, or only when predetermined exceptional conditions are met. Management information should be reviewed regularly to ensure that it is relevant to needs and is being effectively used.

Management information should include measures and indicators of performance in respect of efficiency, effectiveness, economy and quality of service. This involves identification of inputs, including costs, and outputs and relating them to objectives.

The results of monitoring provide the basis for future action and should be linked to procedures for correcting or adjusting activities accordingly.
Evaluation
Policies and activities should be evaluated periodically for economy, efficiency and effectiveness. They should:
- be planned from the beginning of the operation
- have well-defined objectives and scope
- establish yardsticks or standards with which to make comparisons
- consider measures and indicators of performance
- identify outcomes
- identify follow-up action and provide the input for reappraisal of future options.

Staffing
Adequate staffing of management functions and operations is essential for a system to function to its full capability. Weaknesses in staffing can lead to mismanagement, error and abuse which can negate the effect of other controls. The major aspects of staffing which have control implications are:
- identifying and reviewing the staffing needs: numbers, grades, experience and expertise levels
- recruiting and selecting staff to meet the needs
- monitoring performance of individuals and groups
- arranging training and other staff development measures to achieve the full potential of staff capability.

Supervision
Supervision is the function by which managers scrutinize the work and performance of their staff. It provides a check that staff are performing to meet standards and in accordance with instructions. It includes checks over the operation of controls by staff at lower levels. Good supervision can raise motivation, enhance quality and assist with staff development. Poor or heavy-handed supervision can lead to de-motivated staff, which has little freedom for innovation and flexibility of response and fail to meet required standards.

Budgetary and other financial controls
The management is fully accountable for achievement of their objectives and targets. For that purpose, it is necessary to provide appropriate resources and level of expenditures. Budgetary control matches realization of objectives and achieving results with used resources and costs. Comparison between resources and costs with outputs should be applied wherever possible and be incorporated within the frames of the overall budget control system. It can be applied easily to most administrative functions, but may prove difficult in areas where costs or outputs cannot easily be quantified or where responsibilities are unclear.

Budgets should be realistic to allow for essential expenditure to achieve objectives, but should be sufficiently tight to encourage the economic and efficient use of resources. They also should be closely linked to planning and review procedures to ensure that any proposed expenditure is essential.
Accounting controls
Organizations must keep adequate financial and other information to allow the accounts to be produced in the form prescribed. Internal auditors should understand the financial reporting requirements and the relevance of accounting standards and recommended practices. There should be adequate controls to ensure that requirements of regularity and propriety of expenditure are met.

Systems development
Controls over the development of new systems and modifications to existing systems or procedures are essential to ensure that:
- new or revised systems meet their objectives
- the effect of changes on systems and controls is properly assessed at an early stage before implementation
- systems modifications are approved and authorized
- adequate plans are made for a change from one system to another
- the implementation and application of new or revised systems and procedures are in accordance with plans.

Low level controls
Authorization
This is the approval or sanction of specified activities or transactions by a manager or other responsible person before they are undertaken. It ensures that proper responsibility is taken for the controlled activities. Key features are:
- defining the authorization requirements for activities and transactions
- allocating authority to appropriate individuals or groups
- separating responsibility for authorization from involvement in other activities which could lead to a conflict of interest
- checking that relevant activities and transactions have been properly authorized

Documentation
This involves recording information and transactions used in an organisation’s business. Good standards of documentation should be established to assist and support activities and to help ensure the continuity of operations in the event of disruption. This includes the retention of information in electronic or other forms. Information must be accessible and good filing and search facilities are essential.

The work of the organization should be sufficiently well documented to enable management, external auditors or other reviewers to follow the course of operations and transactions and to identify errors, abuse or poor performance. Decisions, authorizations, transactions, checks and other information should be clearly recorded and the records safeguarded.
Standard documentation and forms can help to enforce conformity with procedures and legal requirements. They are often used to control transactions or the movement of valuables. Such documentation should be carefully designed to meet its objectives.

**Completeness and accuracy**
- transactions should be recorded as close to their origin as possible
- transactions should be checked at appropriate times in the processing cycle
- checks should be carried out by staff independent of those performing the activities checked.

Typical controls to ensure completeness and accuracy include sequence checking, comparison with related documents, control totals, arithmetic checks, and re-performance.

**Physical controls**
These are concerned with the custody and safety of assets and information. They cover the whole physical environment in which systems operate. The major categories are:
- access controls (such as guards, identity cards, passwords, computer logging)
- physical checks on assets and records (such as stock takes, security inspections)
- environmental controls (such as thermostats, health and safety inspections)
- the geographical location or situation within a building of activities, and the secure custody of assets and records.
4.10. **Decision points in a system based audit**

Start

Audit plan

Ascertain and record system

System record not confirmed

Walk through tests

System records confirmed

Preliminary evaluation

Strong control

Tests of control

No errors

Evaluation of results

Control operating

No substantive tests

End

Weak control

Weakness tests

Errors

Evaluation of results

Control not operating

Substantive tests

Major findings

Investigation ?

Report results
1. Preparing Audit Plan
   
   2. Evidencing and confirming of the functioning of the system through walk through test. If the evidencing of the system is confirmed, then preliminary assessment of controls is making. If you can not confirm the functioning of the system through walk through test, return back and gather additional information, until your report for the system is not identical with the system that is subject of the audit.

   3. If you have an opinion that controls are strong, make control tests. If controls are weak, make tests for weaknesses.

   4. Assess the test results. a) If there are no mistakes bring conclusion: controls are established well and are functioning good. There is no need of comprehensive tests. Inform about the results.

   5. If you find mistakes at the functioning of controls, make comprehensive tests in order to determine the mistake and to assess the results.

   6. Procure findings for main mistakes, omissions or unsuccessful controls.

   7. If it is necessary, for your findings inform the head of internal audit unit, DCIA or the head of the organization with aim to assess whether it is needed further investigation.

   8. Perform the audit report and stated the results.

In the text below are given additional explanations.
4.11. Planning and performing tests of control (compliance tests)

Once the objective of testing has been decided then the method of selection and sample size should be considered. Guidance on sampling is provided in Part 3 of the Manual.

The objective of the test of control is to analye controls and design tests which are appropriate to obtaining a reasonable degree of assurance about the operation of those controls.

The procedures required at this stage are as follows:

- record the control objective to be achieved e.g. regularity;
- record the controls in the system which purport to meet the objective;
- record the population of transactions, operations or other records to be tested;
- design tests to confirm that controls are being operated as intended.

When designing tests you should consider that the controls are analysed into different ways, thus:

- controls where there is no documentary evidence after the fact as to their execution, for instance division of duties, physical safeguarding of assets
- controls evidenced by a completed accounting routine, for instance reconciliation of control accounts, preparation of bank reconciliation, stocktaking and evaluation of stock balances
- controls evidenced by a signature, initials or by the completion of some other operation, for instance initialling boxes on a payment slip, authorising an order, matching of delivery notes and invoices and stapling them together, ticking a calculation on an invoice when it has been checked.
- controls in computer programs e.g. pricing, parameter check which can be relied on because there is good control over program development, maintenance and operations.
- supervisory controls where it is implicit that they have been carried out for instance preparing clear instructions for all operations, follow up of exception reports in management information.

4.11.1. Testing

When you are using the Test record form (Annex 4.12. from this part of the Rulebook) you should clearly list the transactions tested (for example invoices) in column 1 and could be located again if necessary. The tests applied are shown in the column 2 and 3. “Yes” means that the control was operated as intended, “No” means it did not and “N/A” means that the control was not applicable to that particular transaction. For every ‘No’ answer the auditor should record the reasons for this in column 4 and / or on a working paper if needed.

A “No” entry is not necessarily an error. You need to consider why the control has not been applied on this transaction.
4.11.2. Additional tests of control - rules, regulations and policies

In addition to confirming that control procedures have been operated as intended, tests of control are carried out to confirm that all internal rules, regulations and policies have been adhered to. The rule, regulation or policy should be entered in the column headed "test objective".

4.11.3. Evaluation of test results and design weakness tests if necessary

Test results are evaluated to ensure that identified controls are being operated as intended thereby reducing the risk of errors and irregularities associated with the specific audit objective and if not, to design tests to provide evidence as to whether weaknesses have been exploited by an employee or significant errors have occurred in transaction streams.

You should analyse all the errors occurred in the testing procedure and consider the implications of the errors in relation to the effectiveness of controls. When you can obtain a reasonable explanation for an error, if this does not have continuing implications on the adequacy of an individual control, you may decide to accept the error and therefore the control. Typical examples of this are as follows:

- a delay in the performance of an accounting reconciliation - if this was caused by the responsible officer being absent on sick leave in that period and normally reconciliations were completed on time, this could be acceptable;
- an arithmetic error in a transaction - if this occurred when the person normally performing the arithmetic check was on holiday, this may restrict the auditors conclusion and further testing to that period;
- invoices issued went out with an incorrect value - if this occurred soon after the change of scales of charge and was noticed soon after and corrected this would restrict the auditors tests to the period after that time.

It can be seen from these examples that it is important for the auditor to understand the reason for the error and analyse the reason carefully because this has a significant effect on the procedures which follow. Typical possibilities after the completion of tests of control are as follows:

- the auditor finds no error - the auditor would accept that the control was operating as intended;
- the auditor finds one error - the auditor would decide whether to extend the test of control, or perform weakness tests;
- the auditor finds two errors or more which cannot be adequately explained; in this case the auditor would design weakness tests.
4.11.4. Design of weakness tests

The purpose of the weakness test is to narrow down the points of system weakness and the likely sources of error. It is these potential sources of error which the auditor now sets out to explore. You need to identify:

- the type of transaction at risk;
- specific sources of a transaction at risk from inside or outside the institution;
- specific points within the institution when the transaction is more at risk than another.

To be able to define these factors properly you need to understand the underlying reasons for the errors. To some extent these will have been highlighted when you have enquired into the causes of the errors already discovered. Furthermore when testing weakness of the control extend of tested cases (sample size, period etc) should be broaden and the focus should be on quantifying the error rate.

You should endeavour to specify tests which provide direct evidence about the extent of error for each weakness.

4.11.5. Evaluation of weakness test results

The purpose of the evaluation is to consider the evidence available about the operation of control procedures and the error rate, and decide on the further action to be taken.

At this stage the auditor should have clear evidence that:

- controls have failed because officers have not been operating controls which have been laid down by management;
- there is a high error rate in the transaction stream or specific parts of it.

There are two main alternatives at this stage:

- plan an investigation (further collection of information within the legal duties and responsibilities of the IA) because errors appear to have been caused by deliberate action;
- report matters to management for rectification.

In any case it may be necessary to carry out substantive tests which will assess the extent of any loss with a view to advising management to recover a loss by whatever means seems appropriate.
4.12. **Test record**

Test No
For examination ........................................................................................................ of the process........................................................................................................ for the period from year ........................... to ............................

**Objective of the test:**
........................................................................................................................................
........................................................................................................................................
........................................................................................................................................

Examined documents / data:
........................................................................................................................................
........................................................................................................................................
........................................................................................................................................

Sample selection method and sample size
........................................................................................................................................
........................................................................................................................................
........................................................................................................................................

**Detailed procedure**

<table>
<thead>
<tr>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
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<tr>
<td>Checks of data or documents</td>
<td>Yes</td>
<td>No</td>
<td>Comment</td>
<td>Reference</td>
</tr>
<tr>
<td></td>
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</table>

**Test Conclusion:**
........................................................................................................................................
........................................................................................................................................
........................................................................................................................................

Auditor .......... Date:.............

Supervisor:......... Date:.............
### 4.13. Record of Audit Findings

<table>
<thead>
<tr>
<th>Organisation</th>
<th>WP</th>
<th>Condition</th>
<th>Standards</th>
<th>Same finding last examination: Yes</th>
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<tr>
<td>Procedures or practices</td>
<td></td>
<td>Reference to the tests</td>
<td>Causes</td>
<td>Effect</td>
<td>Recommendation</td>
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<td>Discussions:</td>
<td>Name</td>
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<td>Department</td>
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</tr>
<tr>
<td>Comments</td>
<td></td>
<td></td>
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</tbody>
</table>

Auditor | Date  
Supervisor | Date
### 4.14. Audit findings summary form

WP Ref:

Audit: .................................  Financial year: .........................

Prepared by: .........................  Date: ................
Reviewed by: .........................  Date: ................

<table>
<thead>
<tr>
<th>Issues/Weaknesses</th>
<th>Causes</th>
<th>Effects</th>
<th>Audit File Ref</th>
<th>Conclusions</th>
<th>Recommendations</th>
</tr>
</thead>
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<td></td>
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</tr>
</tbody>
</table>
4.14.1. Fulfilling the cumulative Audit Findings Form

4.14.1.1. Issue/Weakness
This should reflect issues or weaknesses identified by audit tests. It is not necessary to provide a lot of detail - a description of one or two sentences will normally be enough.

4.14.1.2. Causes
It is important to identify the real underlying cause, and not the symptom, of each weakness. If you don’t do this it is unlikely that your recommendation will result in improved control. When completing this section of the form you should ask yourself:

- *Why is this happening or not happening?*

It is also worth considering
- what is the effect on performance, control, efficiency etc.?
- why do management need to know this?’

4.14.1.3. Effects
Here you should record the actual or potential impact of the weaknesses you have identified. Your audit tests will provide you with information to do this. If possible, try to quantify what the effect might be. This will allow you to make a stronger case and help to convince management of the need to implement your recommendation.

4.14.1.4. Audit file reference
Here you should record working papers which provide the detail and supporting evidence for the weakness.

4.14.1.5. Conclusion
A brief conclusion related to the weaknesses. Usually it is one or two sentences which sum up the situation. This can also be helpful when writing the audit report.

4.14.1.6. Recommendations
You should note down the main elements of your recommendations. Keep in mind the causes of the weakness and make sure that your recommendation will deal adequately with each of them.

Using this form will help you in your exit meeting with management (further guidance on handling exit meetings is given in Part 3 in this Manual) and provide you with a good basis for discussing your conclusions and recommendations. It will also aid discussion of any alternative solutions to issues and weaknesses which may be suggested by the auditee.
### 4.15. Structure for audit files

#### 4.15.1. The Permanent Audit File

<table>
<thead>
<tr>
<th>SECTION</th>
<th>TITLE</th>
<th>CONTENT</th>
</tr>
</thead>
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<tr>
<td>1</td>
<td>General background information</td>
<td>To include:</td>
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<tr>
<td></td>
<td></td>
<td>• Regulation</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Strategies and plans</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Organization charts</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Expenditure and budgets</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Volume of transactions</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Other data and documents – copies or references where is the information</td>
</tr>
<tr>
<td>2</td>
<td>Reports to management</td>
<td>Copies of executive resume and action plan from all audit reports</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(Correspondence and other documentation to be held on relevant current audit files)</td>
</tr>
<tr>
<td>3</td>
<td>Copies of other relevant reports</td>
<td>External audit reports</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Consultancy reports</td>
</tr>
<tr>
<td>4</td>
<td>Outline of policies and procedures in operation</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Relevant job descriptions and authority limits</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Sample documentation</td>
<td>Any relevant forms and extracts from office instructions etc.</td>
</tr>
</tbody>
</table>
### 4.15.2. The Current Audit File

<table>
<thead>
<tr>
<th>SECTION</th>
<th>TITLE</th>
<th>CONTENT</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Audit supervision and review papers</td>
<td>Completed Audit Review Record and check lists</td>
</tr>
<tr>
<td>2</td>
<td>Audit planning documents</td>
<td>Audit Assignment Plan, Letter of authorisation, Notes of the initial discussions with the auditee, Projected and actual time budgets</td>
</tr>
<tr>
<td>3</td>
<td>Previous audit report</td>
<td>Copies of the previous Internal Audit report, including relevant correspondence and action plans</td>
</tr>
<tr>
<td>4</td>
<td>Points forward from previous audit</td>
<td>List of points highlighted for future work by Internal Audit</td>
</tr>
<tr>
<td>5</td>
<td>Current audit report</td>
<td>Draft and final versions, All related correspondence, Action plan, Minutes of exit and final meetings</td>
</tr>
<tr>
<td>6</td>
<td>Follow-up to last audit</td>
<td>Details of tests done to check implementation of recommendations made on previous audit, Summary of implemented and not implemented recommendations</td>
</tr>
<tr>
<td>7</td>
<td>Systems and procedures in operation</td>
<td>To include flowcharts, narrative descriptions and sample documentation, as appropriate</td>
</tr>
<tr>
<td>8</td>
<td>Form for the audit findings</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Audit Findings Form</td>
<td>Evaluation of weaknesses, causes and effects</td>
</tr>
<tr>
<td>10, 11, 12 etc.</td>
<td>Working papers – divided into sections (ex. by sub-system) as appropriate</td>
<td>To include: Headline risks, Risk Identification, Risk/Control evaluation, Audit Test Program, Audit Test Record, Details of tests carried out</td>
</tr>
</tbody>
</table>
## 4.16. Audit review record

Audit:

Financial Year:

<table>
<thead>
<tr>
<th>Audit stage</th>
<th>Auditor</th>
<th>CIA</th>
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</thead>
<tbody>
<tr>
<td>Identification of (Control) Objectives</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Identification &amp; Evaluation of Controls</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Testing of Controls</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Findings Grid</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Draft Report</td>
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</table>

**Date Report Issued:**

**Comments:**

**Points carried forward to next audit:**
Audit manual

PART THREE
AUDIT SKILLS AND TECHNIQUES

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1. INTRODUCTION

This Section of the Audit Manual provides guidance on the specific types of audit skills and techniques that refer to improvement of the communication skills, preparation of audit reports and action plans and implementation of methods for selecting samples in the audit. Guidance that is described in this part of the Manual should be applied by internal auditors in the institutions from the public sector in the Republic of Macedonia.

All audit staff are expected to familiarise themselves with the procedures set out in the guide and to apply them in the course of their work. In some cases it may be necessary to adapt the procedures to reflect the situation in a particular organisation. Any such changes will be the responsibility of the relevant Chief Internal Auditor who will arrange for local guidance to be prepared and distributed.

Suggestions to improve this Part of the Audit Manual should be made to CIAD in Ministry of Finance.
2. COMMUNICATION SKILLS AND TECHNIQUES

2.1. THE OPENING MEETING WITH MANAGEMENT

2.1.1. Purpose of the meeting

The opening meeting with management is very important. It sets the tone for the entire audit and provides the opportunity to establish the proper atmosphere and to begin building effective working relationships.

At the opening meeting you should:

- explain the role of internal audit (only if it is the first time an audit has been done in the organisation), and to emphasise that the main objective is to provide constructive help and advice to the management

- discuss and agree the scope and objectives of the audit – making it clear that you welcome any questions and also the views and suggestions of management

- ask for the views of management on any problems which may exist in the activities which fall within the scope of the audit. This helps to demonstrate that you welcome their input and that you are not just looking to be critical of what they are doing

- discuss the timing of the audit – and any difficulties which could arise from it (eg the absence of key personnel, new systems development etc). You need to beware of the danger of management raising timing difficulties as a way of having the audit postponed

- establish who are the main people you need to see at the start of the audit. It is also important to agree with management that you can make direct contact with staff, rather than clearing all meetings etc with the line manager

- set out the procedures that will be adopted for:
  - confirming audit findings
  - discussing the draft report
  - issuing the previous and the final report

- explain that all information will be treated in confidence

- establish the normal working hours of staff in the department, where they are located (particularly if some work is done outside of the organisation’s offices) and any other office routines – to make it easier to arrange meetings, locate people etc

- make it clear that you will need access to all relevant files and documents

- ask for the use of an office/desk during the course of the audit – if necessary.

A well-conducted opening meeting can ensure that the audit is conducted in a friendly and positive atmosphere. It can make the difference between active cooperation and open hostility.

A record of the opening meeting should be made and filed on the current audit file.
2.2. **THE EXIT MEETING**

**Purpose**
The purpose of an exit meeting with the auditee is to develop a mutual understanding of the content of the draft report and of any other audit concerns that are not set out in the report. It is intended to avoid any misunderstandings or misinterpretations of fact by providing the opportunity for the auditee to clarify specific items and to express views on the significant audit concerns, recommendations and other information presented in the draft report.

This meeting should also ensure that the formal response from the auditee does not contain any surprises for the auditor. Additionally, the exit meeting should serve as an opportunity to develop a feeling that the report is offered in a spirit of working together to improve the way things are being done.

**Timing**
The Chief Internal Auditor should contact management to determine a suitable time and location for the exit meeting.

**Attendees**
Attendees should include anyone who may be able to object to the validity of the report's contents and anyone having responsibility for the area or the situation needing corrective action - whether or not they personally would take the action or would be affected by the action.

**Discussion**
The exit meeting can be either a difficult confrontation or an open and courteous discussion. The discussion topics at each exit meeting will vary depending upon the specific audit concerns identified and who is attending the meeting. At a minimum, the auditor should:

- summarize the audit including what was done (objectives, scope, procedures)
- give justification for used approach when ascertaining findings, conclusions and recommendations from the audit
- outline the risks identified
- outline the significant audit concerns and the recommendations for dealing with the associated risk
- indicate the significant audit concerns which have already been corrected, and
- refer to any less significant concerns identified in the audit.

The auditor should be willing and able to discuss all matters in whatever detail is necessary. It is also important to make it clear that all significant audit concerns have been discussed with management and that the report contains no surprises. You may also want to thank them for the cooperation obtained during the audit - if that is appropriate.

**Avoiding Confrontation**
The auditor should be prepared for the possibility of conflict when presenting the concerns in the audit report and should be able to retrieve information, support facts and amplify findings without difficulty or delay. To encourage the avoidance of confrontation during the exit meeting, the auditor should:

Be polite throughout the meeting
Avoid the use of non-personal phrases (e.g., try not to start a sentence with "you" when disagreeing),
Make efforts to get on common ground,
Avoid backing the auditee into “a corner” and
Distinguish the expression of different postures from disagreements.

**Addressing Confrontation**

First, it is important not to mistake the airing of views with disagreement. Often all that is necessary is to let the auditees express their views. Perhaps they do not really disagree but merely want a chance to justify their position or to explain the reasons for the conditions the auditor found. After they have made their point, they may be perfectly willing to let the wording of the draft stand as written. In some situations, offering to quote the auditee may end the disagreement.

Auditors must react and adjust their approach according to the discussions and facts presented. The auditor must maintain a state of fairness and objectivity, and be concerned only with what is factual and significant. To that end, the auditor should be open to changes that make for more understandable and more accurate reports and do not compromise the audit findings, conclusions and recommendations.

**Draft Revisions**

The auditor should be willing to accept wording changes or other suggested revisions that they believe are appropriate - as long as the changes do not alter the audit opinion or the focus of the significant audit concern or corrective action. When there is an irreconcilable disagreement and there is no misinterpretation of fact (the facts must be agreed upon), the auditor may then point out that they must report matters as they see them and that they are willing to incorporate the auditee’s views, or response, as well.
2.3. **INTERVIEW TECHNIQUES & EFFECTIVE COMMUNICATION**

2.3.1. **Introduction**

Interviews are a key part of the audit process. They are an important way of obtaining and confirming information and facts about the way systems and controls are being operated. At the same time they represent an opportunity to create and maintain good relations between the audit department and its clients, and to impress the client with the professionalism of internal audit.

There are two types of interview – directive and non-directive. The directive interview is intended to obtain specific information about verifiable facts – for example the procedure for paying purchase invoices. In this type of meeting the auditor plans the meeting to establish what information is needed and determines questions which will provide that information. The auditor controls the meeting throughout, setting the tone and pace and keeping the discussion in line with the planned objectives. The advantage of directive interviews is that they give the auditor exactly what he/she wants to know. The disadvantage is that they discover very little else.

In contrast the non-directive interview is intended to achieve understanding and build confidence with the auditee. Direct questions are avoided and the interview is structured only to the extent that the auditor identifies and opens up broad areas of discussion. This approach has the potential to uncover new areas for audit, but they have to be well controlled or they can be very long and time-consuming.

There is no ‘best’ method of interviewing. The approach depends on the person being interviewed, the nature of the audit, the type of information needed and the time available. In many cases interviews are a combination of the two approaches, starting with a directive approach to get the information needed and ending with a non-directive approach to allow the interviewee to broaden out the discussion.

Whichever approach you take there are a number of things you need to do to maximise the benefit gained from your interviews. The main steps are set out in the following sections.

2.3.2. **Planning the interview**

If you have a good relationship with the interviewee, or have already met him/her several times, then it may be possible to call in casually and unexpectedly. If not then it is normally best to plan the interview and to make a proper appointment in advance.

In planning for the interview you should:

- decide what the purpose of the meeting is
- decide what information you want from the interviewee
- give adequate notice of the interview – wherever possible. Try to take account of peak workloads in the department when scheduling the interview
- always carry out the interview in the interviewee’s office (unless he/she insists otherwise). It is important that the setting for the interview should put the interviewee
at ease and preferably be free from interruptions. It should also allow the auditee to talk without being overheard

- tell the interviewee what the purpose of the meeting is
- give advance notice of any specific information you need
- prepare any files or documents you need to take with you
- write down the questions you want to ask.

When you are arranging interviews try not to schedule them one after the other. Allow some time in between so that you can review your notes while the points are still fresh in your mind.

### 2.3.3. Opening the interview

Resist the temptation to rush straight into the interview. Instead start by making an effort to put the interviewee at ease and establish rapport with him/her. Devote time to some general conversation in order to get the interviewee talking easily. For example, if it's the first time you have met it may be useful to comment on the interviewee's office or the office building in general – but make sure that what you say is sincere. This is particularly important when the interviewee appears apprehensive, or is a junior member of staff.

If, however, the auditee appears pressed for time, general talk may be irritating to them. Open the interview according to the mood of the auditee - but always try to be informal, friendly and natural.

It is a matter of judgement when it is the right time to start the interview proper. The main thing is to do this when the interviewee is relaxed enough and in the right mood. This switch needs to be done tactfully – eg you could say: “I'm concerned that I may be taking up too much of your time, perhaps I could ask you ……..”

Before starting the main part of the interview it is useful to check how much time the interviewee has available. This allows you to adjust your approach, speed and focus if necessary.

### 2.3.4. The interview

It is important not to conduct the interview like an interrogation. Keep in mind at all times that the auditee should do most of the talking and that you need to listen carefully.

During the interview it is worth remembering:

- that you should not talk down to the interviewee no matter how junior the person is
- to maintain a helpful, pleasant and interested manner – even if the interviewee is unpleasant and uncooperative
- to look at the interviewee when he/she is talking and when you are asking questions. Avoid staring, which can cause embarrassment or tension, by looking away briefly from time to time
- to smile, nod your head in agreement etc whilst the interviewee is talking to show attention, interest and agreement
- to avoid doing anything that may indicate you disagree with, disapprove of or don’t believe anything said
• not to comment unfavourably or challenge anything said. However, you should ask for clarification and explanation where necessary
• not to get involved in an argument
• to be alert for reactions which may indicate that he/she is unsure of or doesn’t understand what has been said
• to think carefully about the answers you are given. First, to decide what is fact and what is opinion, and second to decide the future direction of your questioning.

**Keeping the discussion on the right track**

You need to be prepared to accept that a certain amount of time will be wasted in any interview – mainly because interviewees will not keep to the point. Some are more likely to wander off the point than others. It is essential that you try not to introduce any digressions into the interview or encourage the interviewee to make any digressions.

When you need to get the interviewee back onto the point it is important to try to do so tactfully. Controlling such digressions can be a major problem. If you do it too obviously you run the risk of upsetting the interviewee and losing their cooperation. If you don’t control them you will waste time and probably not get all the information you need. Try at all times to show a keen interest in what is being said and avoid all signs of frustration or impatience.

**Closing the interview**

Once you have achieved everything you want of the interview, then you need to take the initiative in bringing it to an end. However, if the interviewee is obviously willing to talk and is giving you useful information do not stop just because you have taken up the scheduled time – useful information can sometimes be lost that way.

In closing the interview follow the normal rules of courtesy and common sense. Always:
• thank the interviewee for their time and their help
• ask them to tell you if after the meeting they think of anything else which is important or relevant
• confirm any action points agreed during the interview – eg agreement to provide documents, further information etc
• leave yourself the opportunity to go back for further information or clarification by saying something like: “It’s possible that I may need to clarify something when I go through my notes. If so would you mind if I called you or came to see you again for a few minutes?”

**2.3.5. After the interview**

Try to read through your notes as soon as possible after the interview. Make any amendments to the notes and identify any additional information or clarification needed.

If you have agreed to do something or to provide something to the interviewee make sure you do this as soon as possible. If you don’t do so it will damage your credibility and your relationship with the interviewee.
2.3.6. Things to remember about effective communication

Verbal communication

You will only get the information you need if both you and the interviewee attach the same meaning to the questions you ask and to the answers he/she gives. It is very easy to interpret words and phrases in a different way from that intended by the speaker. In order to reduce the risk of misunderstandings it may be helpful:

- to think carefully about each question you ask, and try to phrase them in a clear and unambiguous way
- to keep each question as short as possible
- to use short, simple, familiar words to maximise the chance that the interviewee will interpret them correctly
- to avoid the use of jargon and technical terms that the interviewee may not understand
- to avoid the use of vague, general or imprecise words (such as quickly or often) or abstract words (such as successful) which can be interpreted in a number of different ways
- to avoid asking questions which could produce an emotional reaction from the interviewee (eg “what do you think is causing the poor performance of your department?”).

Non-verbal communication

Non-verbal communication is an important part of the communication process, and interviewers often forget to watch for and respond to non-verbal messages which are given out by the interviewee.

Examples of things to look out for are:
- the head nodding to signify understanding and acceptance
- the frown that signifies lack of understanding or confusion
- the set expression of the face or mouth that indicates disagreement
- the flickering of the eyes that signifies uncertainty about how to answer – or unwillingness to answer.

Don’t forget that you too send out non-verbal messages, and you can make use of them to help the interview to run smoothly and effectively. For example, you can use facial expressions, your eyes, movements of the head and body, smiles and hand gestures to show enthusiasm for the audit and agreement with the points being made by the interviewee. Non-verbal messages can help to make what you are saying more acceptable to the interviewee (eg if you ask a question in a rather forceful way which could cause offence, a smile at the end of the question can help to make it more acceptable). You can also try to encourage and compliment the interviewee – for example, nodding your head slowly whilst the interviewee is talking shows that you are both listening to and understanding what is being said.

The most important thing to remember is to make sure that your facial expressions, eyes, body movements and gestures cannot be interpreted as indicating a lack of interest in,
disagreement with or disapproval of what the interviewee is saying. Also, smiling is an effective way of creating a pleasant, friendly atmosphere and of encouraging the interviewee.

**Asking questions the right way**

First, remember not to talk too much, this is one of the biggest mistakes made by auditors when they are interviewing.

There are two kinds of questions, the ‘open’ question and the ‘closed’ question.

**Open** questions usually force the interviewee to think about the answer, and give the freedom to reply in the way he/she thinks best. They can produce a wide variety of possible answers. Open questions often begin with words like: “why”, “how”, “what” and “which”.

**Closed** questions allow the interviewee much less choice in his/her reply, often resulting in a “yes” or “no” answer. They have a tendency to produce an answer the interviewee thinks the auditor wants to hear and not the true situation. They allow little room for discussion and make it difficult for the interviewee to develop his/her own ideas. However, they are useful to get specific items of information or to confirm basic facts and figures.

When asking questions it is useful to remember:

- to be as friendly and pleasant as possible, and to smile
- to watch the interviewee’s facial expressions to check for understanding or confusion
- not to rush the interviewee to give an answer – keep quiet and glance away if necessary
- if the interviewee is unable to answer the question after a reasonable time, suggest you move on to the next point and come back to it later

When it comes to the questions themselves:

- try to think them out in advance as part of the planning for the meeting
- keep each question clear and concise and limit it to a single point or issue
- use words and language which the interviewee will understand and can relate to
- don’t ask too many questions which cover any aspect too broadly
- try to ask your questions in a logical order, but be prepared to follow up points of interest as they arise

**The importance of listening**

Most people find listening very hard. It is very difficult to listen attentively for more than about 30 minutes, after that our concentration drops. There are many reasons why people don’t listen well, including:
• getting distracted by something the interviewee says or does, or the way he/she appears. This could include annoying mannerisms or ways of speaking, their physical appearance or the way they dress
• the temperature of the room, an uncomfortable chair etc
• failing to listen because you are tired or have other things on your mind
• failing to look at the interviewee and losing the benefit of any non-verbal communication.

To improve your listening skills you should:
• look at the interviewee when he/she is talking
• sit up – to increase your mental alertness
• pay full attention and concentrate on trying to understand what is being said
• try not to let yourself get diverted.

Most importantly, don’t talk too much. Too often internal auditors waste valuable time by interrupting the interviewee and expressing their own views and opinions at great length. Remember, your main role in these meetings is to get the interviewee to talk.

Taking notes
There are many ways of taking notes and you need to develop an approach which works for you. Some things to consider are:
• asking the interviewer at the start whether they mind if you take notes
• don’t make your note-taking too obvious, as it can put the interviewee off
• keep note-taking to the minimum, but making sure you record the key points
• don’t look at your notepad except when you are writing
• try to keep your notes intelligible and legible so that you can make sense of them after the meeting
• review your notes as soon after the meeting as possible, and clarify and amplify them wherever necessary
3. AUDIT REPORTING SKILLS

3.1. **Introduction**

This section of the Audit Manual is concerned with reports on individual audit assignments. It covers:

- the purpose and function of an audit report
- the types of audit reports and alternatives to them
- some guidance on the structure and content of audit reports

Audit reports should provide an assurance on the system under review; and form the basis of the overall assurance on the internal control system to be provided in reports to the head of the organisation.

It is vital to remember that the audit report is the only tangible product of an audit and, as such, is Internal Audit’s ‘shop window’. It is the culmination of the planning, time and effort which goes into an audit, and reflects the quality and thoroughness of the audit. The quality of the report will have an important influence on the view of internal audit held by senior management of the organisation. An inadequate audit report may negate the best audit work and finest conclusions. It may also damage the reputation and status of Internal Audit.

3.2. **Purpose and functions of an audit report**

The principal objectives of audit reports are:

- to communicate the problems identified and the causes of those problems
- to explain the effects and repercussions of those problems and quantify them where necessary
- to measure performance - by providing analyses and appraisals - and to highlight areas in which greater efficiency and effectiveness may be achieved, and waste eliminated
- to convince management of the need for change
- to suggest practical and cost effective solutions
- to provide a basis for follow up to ensure that appropriate action has been taken.

There are three main functions of an audit report. First, it is an *action document* - unless the report achieves action it will have been a waste of time for everyone involved in the audit. To achieve action the report should provide the client with a brief, objective assessment of control in the area under review and highlight any significant weaknesses identified. It should also bring out the impact of those weaknesses on the level of control and demonstrate to management that they need to do something about it:

- by explaining the risks involved, and
- by quantifying, where possible, those risks and any potential benefits.

Second, it acts as a *formal, permanent record* of: the audit work undertaken and the conclusions
drawn from it, and the level of control which exists in a particular area at a specific point in time. Finally, a good report - by communicating professionalism and competence - demonstrates Internal Audit’s objectivity and independence and shows that auditors can help to improve efficiency and effectiveness.

3.3. **Types of Audit Report**

A written report should be issued after each audit to provide a formal record of the results of the audit. There are basically two types of audit report which can be considered - a Standard Report and an Audit Memoranda.

*The Standard Report* is the type most frequently used. It comprises three main sections - the Executive Summary, the Action Plan and the Detailed Report.

*Audit Memoranda* are normally shorter than Standard Reports and are used:
- for quick and special reviews carried out at the request of management to report the results of follow-up audits
- where only relatively minor points arise from the audit
- as an interim report on longer audits.

An alternative to an audit report is a *Presentation* or oral report. This involves a formal verbal presentation of the audit findings and discussion of the action to be taken by management. The advantages and disadvantages of reports and presentations are set out in the table below.
Advantages

- Interactive
- Flexible
- Can help gain acceptance
- Aid discussion of complex issues and solutions
- May increase chance of action
- Can focus on high priority issues
- Internal Audit can influence action

Disadvantages

- Can’t put across all the evidence
- Can be difficult to communicate complex data leading to misunderstandings
- Need facilitation skills and two people
- Need to be well prepared
- May be dominated by one individual or issue

Presentation

Standard reports

- Good for detailed evidence and complex data
- Can provide background and context
- Evidence is readily available to reader
- Some auditees prefer them - more ‘authoritative’

- Can be time-consuming to produce
- Long reports may not be read in full
- Sometimes too much to assimilate
- Can be untimely due to delays in preparation

3.4. THE STRUCTURE OF AUDIT REPORTS

The precise structure of audit reports should be decided by the Chief Internal Auditor. The important thing is for every audit report in each organisation to have the same ‘house style’. This makes it easier for line management to use and understand them and helps to build up an image for the internal audit unit.
Standard audit reports – typically should contain:

- Report Cover
- Contents page
- Executive Summary
- Detailed Report
- Action Plan
- Appendices/annexes

Audit Memoranda - will comprise:

- Introduction
- Conclusion
- A series of separate paragraphs, with appropriate headings for the detailed findings and recommendations.

Guidance on the detailed content of each of the sections in standard audit reports is given in the following sections.

3.4.1. Standard audit reports

The Report Cover

This should set out the report title, date of issue and report number. Some audit units adopt logos which are printed on the cover. It may also be worth considering the use of different colour covers for different types of audit review (systems, VFM etc)

Contents Page

This should include the report title, details of each of the main sections of the report and a list of all appendices.

The Executive Summary

The Executive Summary should stand alone and convey the main points to the reader without the need for them to refer to the Detailed Report. It should enable senior management to establish quickly and easily:

- the scope and main objectives of the audit
- why it was done
- the nature and scale of the system or activity reviewed
- the main conclusions of the audit, and
- the principal recommendations.

This is the most important part of the report. It is the main opportunity to encourage the reader to look at the Detailed Report and either take action, or ensure that appropriate action is taken. It should not normally be more than three typed pages in length and should include the following sections.
Introduction and background - covering
- appropriate details of the area under review, including an indication of the significance or value of the topic/system and any significant or unusual aspects of which the reader should be aware
- the scope and principal objectives of the audit
- any important areas excluded from the review, and why
- when and why it has been audited.

Main Conclusions - which should paraphrase the most important conclusions reached in the Detailed Report. These are often set out on a section by section basis, but sometimes it can be more effective to identify any common ‘themes’ which run through the report. Any overall opinion must reflect accurately the findings and comments in the Detailed Report. Keep to the major issues arising and try to avoid raising any minor conclusions in this section.

Principal recommendations - this should list only the key (high priority) recommendations that feature in the Action Plan and each of them should relate to one or more of the main conclusions.

The key thing to remember is that the Executive Summary should stimulate interest which will lead to action.

The Implementation Plan - this lists all the recommendations contained in the Detailed Report

3.4.2. The Detailed Report

Format
The main body of the report should be divided into suitable sections, each clearly headed. The order of the sections will be determined during the report planning process. It may reflect the relative significance of the audit findings, a chronological sequence or simply follow the order in which events occur in the system.

Normally recommendations should be placed at the end of each section. However, if a section is particularly long, and/or deals with a variety of issues, recommendations can be inserted at appropriate points in the section. Recommendations should be placed in a separate paragraph(s) preceded by the subheading "Recommendations" in bold type.

Content
Each section should contain details of the relevant findings. It is important to highlight the underlying causes of weaknesses and their impact on performance or the level of control. Failure to do so is one of the biggest single weaknesses of audit reports. Ask yourself:

- ‘why is this happening or not happening?’
- ‘what is the effect on performance, control, efficiency etc.?'
- ‘why do management need to know this?’
Recommendations should be included which deal with those underlying weaknesses.

Descriptive material should be restricted to what is needed to establish the nature and extent of any weaknesses identified. It is not necessary to provide full and detailed descriptions of every part of the system under review.

It is often useful to include graphs, tables and charts to quantify and illustrate facts and data. Beware of overusing graphs etc, as this can obscure the message and sometimes irritate the reader.

The report must be factual. Subjective comments are not acceptable. Where it is necessary to make value judgements or assumptions, their basis should be clearly stated.

Avoid the use of long paragraphs wherever possible.

Don’t be afraid to say when something is being done well, or to refer to good points you have found. Be careful you don’t overdo this.

**Recommendations**

In developing your recommendations there are some simple things that you should try to remember. They should:

- be based on reliable information
- deal with the underlying cause of the problem, and not just the symptoms
- describe precisely what needs to be done
- suggest who should be responsible for taking action
- be clear, concise and simple
- be unambiguous
- be achievable
- refer to a discrete action point - i.e. each recommendation deals with a single point.

Where an auditee has already taken action, or agreed to do so, this should be stated in the report.

### 3.4.3. Paragraph numbering – some simple rules

Reports should adopt a simple one-part numbering system (1; 2; 3 etc) beginning with the Executive Summary and continuing to the end of the report.

Recommendations should be numbered (R1, R2, R3 etc) so that they can be readily identified.

Headings and sub-headings should not be numbered.
3.4.4. Finalising the report

Before finalising your report there are a number of key checks you need to make. At the very least you should ask yourself the following questions:

1) The Executive Summary
   a. Does it motivate the reader to want to read the detailed report?
   b. Do the main conclusions reflect accurately the major issues and conclusions contained in the detailed report?
   c. Does each key recommendation relate to one or more of the main conclusions?

2) The detailed report
   a. Are the conclusions appropriate and meaningful?
   b. Are weaknesses and benefits quantified where appropriate?
   c. Is the need for corrective action sold? Have you explained the effects of the issues you have identified? Use the “so what?” test.
   d. Do your recommendations deal effectively with the underlying causes of the problem?

3) General
   a. Is the tone of the report appropriate?
   b. Where appropriate and possible have you tried to be positive?
   c. Is the report easy to read and understand?
   d. Have you deleted all unnecessary words and phrases?

You could also use the following checklists to help ensure you produce high quality draft and final reports.

3.4.5. Audit report quality assurance checklist

**Report content**

<table>
<thead>
<tr>
<th>Draft</th>
<th>Final</th>
<th>N/A</th>
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<tbody>
<tr>
<td>1</td>
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<td>The audit report includes:</td>
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<td>- transmittal letter</td>
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<td>The audit report contains an executive summary (2/3 pages maximum)</td>
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<td>The detailed report includes:</td>
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<td>The purpose of the audit, including the reason (whether is planned with the annual plan or is exceptional)</td>
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<td>The scope of the audit, time period covered, functions or processes reviewed, and audit techniques used</td>
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<td>Background information describing - the system, process or the activity</td>
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<td>- the audit finding</td>
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<td>- the audit recommendations</td>
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<tr>
<td>3</td>
<td>- the action plan</td>
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<tr>
<td>4</td>
<td>- all the correct appendices</td>
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<tr>
<td>4</td>
<td>A draft report is clearly labelled 'draft'</td>
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</table>
### Report quality, tone, and appearance

<table>
<thead>
<tr>
<th></th>
<th>Draft</th>
<th>Final</th>
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<tbody>
<tr>
<td>1</td>
<td>The report is clear and concise, free of unnecessary detail</td>
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<td>2</td>
<td>The conclusions expressed in executive summary and the body of the report are consistent</td>
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<tr>
<td>3</td>
<td>Report is broken into sections and each is clearly labelled</td>
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<td>4</td>
<td>Descriptions of operating procedures, if required, are kept short and concise</td>
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<td>5</td>
<td>The structure of the report is logical and easy to follow</td>
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<td>6</td>
<td>Jargon, technical language, clichés, and colloquialisms are avoided</td>
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<td>7</td>
<td>Acronyms and abbreviations are defined before being used</td>
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<td>8</td>
<td>Active voice predominates</td>
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<td>9</td>
<td>The report is direct and to the point</td>
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<td>10</td>
<td>Headings are informative and descriptive</td>
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<td>11</td>
<td>Opening sentences are strong and attention-getting</td>
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<td>12</td>
<td>Main points are presented first</td>
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<td>13</td>
<td>The report has a balanced tone</td>
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<td>14</td>
<td>Findings are worded constructively</td>
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<td>15</td>
<td>Recommendations are directed toward achieving desired results without prescribing step by step actions</td>
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<td>16</td>
<td>Report has a professional appearance</td>
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<td>17</td>
<td>Spelling, grammar and punctuation are correct</td>
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3.5. **ACTION PLANS**

Action plans are vital to recording and monitoring the action taken by management on Internal Audit’s recommendations. They make follow-up audits easier and more effective. An Action Plan should be prepared for every standard audit report. It details what management have agreed to.

A template for an Action Plan is shown below. It lists every recommendation contained in the audit report and shows for each of them:
- the comments of management
- who is responsible for action, and
- the date by which action will be taken.
<table>
<thead>
<tr>
<th>Rec No</th>
<th>Recommendation</th>
<th>Priority</th>
<th>Comments of Management</th>
<th>Action Agreed Y/N</th>
<th>Person Responsible</th>
<th>Implementation Date</th>
</tr>
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3.5.1. Completing the action plan

Internal Audit is responsible for completing the parts of the action plan before the report is issued to the auditee, as:

**Recommendation number (RecNo)** - This is the number given to each recommendation in the Detailed Report (R1, R2, etc). The Action Plan should include every recommendation made in the audit report and the recommendations should be listed in the order in which they appear in the Detailed Report.

**Recommendation** - Each recommendation is included here, worded exactly as it appears in the Detailed Report.

**Priority** - This indicates the level of importance of the recommendation - high/medium/low.

The remaining sections are normally completed by the auditee, as follows:

**Comments of management** - This is to enable management to record their views on the recommendation. These could be simply to accept the recommendation; to accept it with minor amendments; or to propose an alternative solution to the problem. Unless the recommendation is accepted without change, the reasons for any changes or for rejecting it should be recorded here.

**Action agreed** - A simple ‘yes’ or ‘no’ is to be recorded here.

**Person responsible** - This should record the name and title of the person who is to take responsibility for implementing the recommendation. Depending upon the nature of the recommendation, this could be either the person who will actually be making the changes, or the manager who is responsible for the unit, department or sector to which the recommendation relates.

**Implementation date** - The date by which management intend to make the recommended changes.

3.5.2. Dealing with the completed action plan

The Action Plan should be sent out with the draft audit report and the Chief Internal Auditor should ensure that it is completed and returned –together with any other management comments within ten working days. The completed Action Plan should be reviewed to ensure that:

- recommendations have been accepted
- any alternative proposals by management are acceptable
- An appropriate person has been made responsible for implementing each recommendation
- suitable dates for implementation are proposed.

The completed Action Plan should be inserted as Appendix 1 in the final report and a copy of it placed on the Permanent Audit File. Based on the action plan the Chief Internal Auditor should schedule a follow-up audit – if necessary before the next planned audit.
3.6. **AUDIT FOR FOLLOW-UP OF RECOMMENDATIONS**

The audit for follow-up of the recommendations is one of the most important stages of any audit, that should not be neglected or incorrectly implemented. If internal audit fails to make sure that its recommendations are implemented, then all of the investment in doing the audit may be wasted.

The timing of the follow-up should be determined in relation to the significance and impact of the recommendations and the criticality of the system which has been audited. It should also take account of the implementation dates given in the Action Plan. It is important that time for follow-up audits is provided in the short term (annual) plan and that any specific follow-up audits are scheduled upon completion of each audit.

There are three main ways of following-up an audit, these are:

**3.6.1. By letter asking the auditee to confirm action has been taken**

In many cases, and certainly for those audits containing minor audit findings, this will be the most appropriate approach. Checks should then be made at the next scheduled audit to ensure appropriate action had actually been taken and that the controls had been implemented properly.

**3.6.2. Scheduling a specific follow-up audit**

This may involve either:

- an interim review of the systems and controls which have been introduced, discussions with management to determine how they are operating and a limited programme of testing to ensure they are working as intended, or

- a full systems audit to establish that the correct action has been taken and controls are working effectively or, where no action has been taken by management, to determine the impact of the lack of control.

In deciding whether to do an interim review or a full systems audit some things to consider are:

- the risk, importance and materiality of the system
- known changes in organisational objectives or priorities since the audit was done
- the stability of the system (systems which are subject to frequent change are less likely to be suitable for interim reviews)
- the extent of the changes recommended in the audit report
- any indication that significant changes or new systems developments may have taken place.
3.6.3. Follow-up as part of the next audit

It should be standard practice on any scheduled audit to carry out a follow up to establish the extent of implementation of the recommendations made at the last audit. This should be done at the start of the audit so that audit testing can be adjusted appropriately. The audit report should highlight clearly any further action which needs to be taken in relation to the last audit.
4. SAMPLING

4.1. INTRODUCTION

For the CIAD, internal audit consists of obtaining evidence to form a view and provide recommendations for improvement regarding the soundness and application of accounting, financial and operational controls of an organisation. The evidence has to be sufficient, relevant and reliable. This chapter is concerned primarily with the sufficiency of evidence and the use of audit sampling.

Sufficient evidence is the quantity of evidence necessary to provide the auditor with reasonable assurance that the systems of internal control being audited do not contain material weaknesses. The auditing profession accepts that absolute certainty cannot be assured. For most audits the required level of assurance is obtained from a number of audit procedures including the evaluation of controls and the selection and examination of a sample of items.

Audit tests may be carried out using various techniques and the auditor may apply such tests to an entire set of data (100% testing). This can be very time-consuming and costly to do. Alternatively the auditor may choose to draw conclusions about the entire set of data (population) by testing a representative sample of items selected from it; this latter procedure is "audit sampling".

Main objectives of the audit procedures that include samples are:

- To substantiate the accuracy and regularity of transactions, permanent records, accounting records or financial statements, (substantive tests);
- To confirm that the system described to the auditor and recorded in the auditor's system documentation actually works as it has been described (walk-through tests);
- To ascertain the extent of errors or losses in a population of transactions where previous testing has disclosed a high error rate, (weakness tests).

If it is systems based audit, the objective of audit procedures is to confirm that internal controls operate as intended by management and if the answer is yes, assessing whether the auditor can rely on the system to limit errors and losses (tests of control).

Each of these decisions will have an impact on both the size of the sample and the method of selection and consequently on the amount of work planned by the auditor. In general the following apply:

- Higher sample sizes when adopting a substantive approach (when you can not reply on the internal controls in the system);
- Lower sample sizes when relying on the system to prevent or detect errors;
• Lower sample sizes where the auditor assesses that the risk of error or loss is low.

Further decision points occur when the auditor is considering the results of the sample. Generally the results of procedures are the discovery of no error or some errors. Different errors have different consequences and the auditor’s subsequent action depends on the type of error discovered.

Before selecting a sample the auditor must decide the amount of evidence that will be sufficient. This requires a judgement about the materiality level - materiality is the significance of undesirable events occurring, and in the context of systems it is concerned with the significance of a failure to achieve management’s objectives.

### 4.2. STAGES OF SAMPLING

Audit sampling involves the following stages:

• Deciding on the sampling approach.
• Determining the sample size.
• Testing the selected items.
• Evaluating the results of the tests.

### 4.3. PLANNING OF SAMPLES

**Judgement sampling based on audit judgement**

Clearly throughout the audit process the auditor is using judgement, and this is particularly true when it comes to selecting items for sampling. Judgement is often applied during the initial evaluation of the system (assessing the nature, appropriateness and extent of controls in place) when a decision could be made to include an item or a group of items in the testing.

Judgement also comes into the identification of those key controls which need to be tested. It is also important when it comes to deciding on the size and method of selection of items for testing. Decisions to test may reflect concern over the way in which a control appears to be operated or a suspicion by the auditor that management is not giving serious attention to particular controls.

These processes are often called ‘judgement sampling’. Statistical sampling, on the other hand, tends to remove bias in selecting items for sampling allowing reliable estimates to be made. However, even with statistical sampling auditors need to use judgement to decide on how reliable estimates need to be of the whole population.
Simple Random Sampling

In simple random sampling, each unit of the target population has the same chance of being selected. It assumes that you know the population and that each item has a known chance of selection. Selection of the items to be tested is done using random number tables – which are particularly suitable where each item has a predetermined number, e.g. purchase orders, payroll listings, goods received notes etc. When using random number tables the starting point in the table should be selected at random by placing a pencil on some place on the table. The tables are printed in groups of numbers and it is up to the auditor to decide how to read off the numbers – the main thing is to make sure this is done in a consistent way. The biggest advantage to a simple random sample is that you get a pretty good, unbiased sample fairly easily. The biggest downside is that you may not get all elements of the population that are of interest.

Interval selection

Where the population is unnumbered random number tables cannot be used. In such cases it will be necessary to select a sample using interval selection. It is important to know the structure of the population to make sure that your sample is being taken from all items and that each item stands a known chance of being selected. It is also important how the first item is to be selected. Once the first item is identified the auditor then works through the population selecting items at a given interval (e.g. every 10th or 20th etc. item). If the selection came up with an item which is not relevant to the test, that item should be ignored. For example, if you are selecting every 20th sales invoice in a population containing both sales invoices and credit notes, and an item you select is a credit note, then you should ignore the credit note. Next item selected should be separated from the credit note by the standard interval you are using, in this case 20. Thus if the credit note is the 60th item in the population, you ignore it and select the 80th item in the population. The precise interval you use is determined by the size of the population and the size of the sample required. See below for guidance on sample sizes.

Stratified Random Sampling

This is a way of reducing the sample size in a population which displays considerable variety. A stratified random sample is one in which the population is classified into "strata" or subgroups and then a random sample is pulled from each subgroup. For example, if we were looking at contract tendering procedures in an organization, the contracts could be divided into (a) contracts over MKD 22.5million, (b) contracts between MKD 2.25million and MKD 22.5million and (c) contracts under MKD 2.25million. Similarly, if we are auditing stocks (e.g. medical supplies in a hospital) we could divide them into (a) small quantity, high value items, (b) medium quantity, middle value items and (c) large quantity, low value items.

A sample is then taken from each stratum using random number or interval selection techniques. It is necessary to interpret the results separately for each stratum and then draw conclusions for the whole population.

Cluster Sampling

Cluster sampling can be used for more difficult or complex populations. It is particularly useful when it is difficult to sample from the entire population. In this case the selection is made from one or more parts of the population. For instance if you want to test the system for reviewing and approving school budgets by the municipalities, because of the way in
which the files and information are held it may be most practical to restrict the sample to schools in a particular area or district. The important thing is to ensure that all areas and districts have an equal chance of being selected. Cluster sampling generally uses naturally occurring clusters such as business units, categories of school (primary, secondary etc) or asset categories (property, equipment, vehicles etc). Random sampling can then be used to select items within each cluster, or to review all items within a particular cluster if appropriate. Cluster sampling gives reduced reliability because it is difficult to ensure that every item has an equal chance of selection.

**Computer sampling**

In computerised systems it is often possible to carry out 100% checks of the population (ex. of payroll records) against specific criteria. Alternatively the computer can be used to select the sample for more detailed review. This can be done using software such as IDEA. Excel can also be used to select samples based on data input to worksheets prepared by the auditor.

**Attribute sampling**

This deals with the rate of occurrence or frequency of items in a population which have a particular attribute – ex. the number of patients having to wait more than six months for cancer treatment; the number of children who start kindergarten at the age of four. The results are expressed as a simple percentage of the total sample size.

**Variables sampling (Sample according to monetary unit)**

Variables sampling (monetary unit sampling) is designed to determine the value of something that occurs within a population, based on testing sample selected according to ascertained monetary unit (expressed in denars).

The variable sample is used for testing units that can have any value in specific continual interval. Therefore, it is used for comprehensive tests. For example, average annual value of stocks, liabilities, demands, etc.

**4.3.1. Determining the sample size**

The basic information which affects the sufficiency of audit evidence required by the auditor is the:

- size of the population of transactions or properties governed by a system;
- distribution of types of transactions or properties governed by a system;
- attributes of individual transactions or properties within the population;
- acceptable error rate in the records, transactions or properties subject to audit;
- risk that the audit conclusions, based on samples may not be applicable to the whole population.

These factors are discussed in more detail below.
Population size

Basically, the larger the population, the larger the sample size required. However, using probability theory applied to a representative sample, there is a cut-off point where, with a prescribed confidence level, additional testing will not significantly improve the reliability of the result.

Hence the required sample size is affected only to a limited extent by the size of the population from which the sample is chosen. Once the population sizes reaches a certain level, the required sample size to achieve a given level of confidence increases only marginally. As inherent risk falls, so the maximum sample size also falls.

Inherent risk understands risk of the system/process, that is present substantive of the functioning of the internal controls.

Population variability

The distribution of different types of transaction in the population may have an impact on sample size. There are two common distributions:

- a different proportion of high and low value transactions;
- a different volume at certain peak periods.

Guidance on sample sizes for different types of tests are given below.

4.3.2. Size of the sample for walk through tests

If using a SBA approach, auditors should begin by performing a walk through test on between 1-3 items, depending on the complexity of the system.

A walk through test is a process adopted as part of a systems audit. Typical transactions are followed through the system and its controls to enable the auditor to understand how procedures are conducted in practice. The objective of walk through tests is to confirm that the auditor's understanding of the system, which has been documented on file, is correct.

4.3.3. Tests of controls

Guidance on sample sizes for tests of controls depends on the classification of the system, the inherent risk assessment, and the preliminary control risk assessment. Appropriate sample sizes for tests of controls over individual transactions are given in the table below.
Tests of Controls - sample sizes

Tests of controls over individual transactions

<table>
<thead>
<tr>
<th>Inherent Risk</th>
<th>Preliminary Control Risk</th>
<th>System assessed as:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Fundamental</td>
<td>Non-fundamental</td>
</tr>
<tr>
<td>High</td>
<td>Moderate</td>
<td>50</td>
</tr>
<tr>
<td></td>
<td>Low</td>
<td>40</td>
</tr>
<tr>
<td>Moderate</td>
<td>Moderate</td>
<td>40</td>
</tr>
<tr>
<td></td>
<td>Low</td>
<td>30</td>
</tr>
<tr>
<td>Low</td>
<td>Moderate</td>
<td>30</td>
</tr>
<tr>
<td></td>
<td>Low</td>
<td>30</td>
</tr>
</tbody>
</table>

Note: tests of control should not normally cover more than 25% of the transactions in the population.

The sample size in the table refers to big populations. If subject to testing are small populations, the sample size should be decreased respectively.

If preliminary control risk is high, a systems based audit approach should not be used.

Examples for sample size for consolidation tests:

- Where testing relates to controls that are carried out monthly, e.g. bank reconciliations, auditors should review evidence for 2 months and obtain evidence that the process occurred in the other 10 months of the financial year.
- Where testing relates to controls that are carried out weekly, e.g. checks over weekly batch processing, auditors should review evidence for 5 weeks and obtain evidence that the process occurred in the other 47 weeks of the fiscal year.

4.3.4. Extended tests of controls

Where the initial sample of controls yields a low error rate (1 or 2 errors), the auditor may be unsure whether this error rate reflects the whole population or is the result of sampling error. To provide a sound basis for the audit conclusion, it is recommended that the auditor extends the test of controls to seek further evidence. The extent of further audit testing will be subject to the auditor's professional judgement, but should not be larger than the original sample size. If any significant errors are found in the extended testing, the auditor may stop the tests there and conclude the system is not operating effectively.
4.3.5. Substantive testing

Substantive testing should not normally be used by internal audit. However, where controls are not in place or have been assessed as high risk, it may be impossible to gain assurance through controls testing. In that case, it is necessary to implement substantive tests on sample from the population.

4.3.6. Weakness tests

Where tests of control or substantive tests identify a high error rate in a particular type of transaction or group of transactions, the auditor should carry out weakness tests on this sub-population. Tests should be focused on the type of error found and conducted in sufficient quantity to draw a conclusion in order to:

- Report
  - failure to manage
  - failure to follow management instructions
- Direct the auditor to
  - investigate the cause of high error rates
  - conduct an investigation resulting in discovery of an irregularity
  - recommend action to address the weakness

The objective of such tests is to focus on known system weaknesses or sub-populations with a suspected high error rate. Two examples are shown below with suggested responses.

Control (check) not implemented
- Identify the person responsible for the particular control (or check);
- For a statistical conclusion, examine 100 transactions at random
- Otherwise, select transactions known to be at risk (similar to key item selection) and examine closely.

Transactions related to a particular supplier
- Identify the supplier;
- For a statistical conclusion, examine 100 transactions at random and evaluate the findings;
- Otherwise, select transactions known to be at risk and examine closely.
Guidance on Sample Selection for Substantive Tests

4.3.7. Key items

Often when performing substantive testing, there will be items in the sample which cannot be considered as having the same attributes, and therefore the same expected error rates as other items in the population. These are known as key items.

The best example of a key item is one with a value significantly higher than other items in the population. Such an item is important for two reasons. Firstly, due to its value, any deliberate or accidental errors relating to it are likely to be of interest to management. Secondly, due to its value, it may be subject to a different control procedure than other items (e.g. approval by a senior officer for transactions over 100 thousands denars), and hence be less susceptible to error than items under this value.

4.3.8. Sampling options

There are two approaches to sampling for substantive testing. If the auditor has no suggestions for key item selection then stratified sampling should be used as the preferred approach. Otherwise, the auditor should incorporate three stages; a high value selection, key item selection and representative sampling.

The difference between the methods is summarized below.

4.3.9. Preferred option - Stratified sampling

This is a technique of dividing a population into relatively homogeneous subgroups called strata. These strata then may be sampled separately; the sample results may be evaluated separately or combined, to provide an estimate of the characteristics of the total population. Whenever items of extremely high values or low values, or other unusual characteristics, are segregated into separate sub-populations, so that each sub-population becomes more homogeneous.

For example, payment vouchers may be classified in strata or layers of, say, 1,001-10,000 MKD, 10,001-100,000 MKD and over 100,000 MKD. It may then be decided that all vouchers of over MKD 100,000 each should be checked without exception, while a series of progressively declining sample sizes may be picked from the remaining strata in descending order. Such sample sizes should preferably be determined on the basis of the auditor’s professional judgment.

The additional example given below may help the use of stratified sampling. Assume there is a payment account that has a total value of MKD 3,000,000. Using stratified sampling it is split up into the following strata.
<table>
<thead>
<tr>
<th>Strata (MKD)</th>
<th>Number of transactions</th>
<th>Value (MKD)</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Below 10,000</td>
<td>543 transactions</td>
<td>100,000</td>
</tr>
<tr>
<td>(2) 10,001 - 25,000</td>
<td>325 transactions</td>
<td>190,000</td>
</tr>
<tr>
<td>(3) 25,001 - 40,000</td>
<td>200 transactions</td>
<td>490,000</td>
</tr>
<tr>
<td>(4) 40,001 - 55,000</td>
<td>65 transactions</td>
<td>390,000</td>
</tr>
<tr>
<td>(5) 55,001 - 70,000</td>
<td>30 transactions</td>
<td>470,000</td>
</tr>
<tr>
<td>(6) 70,000 - 85,000</td>
<td>20 transactions</td>
<td>400,000</td>
</tr>
<tr>
<td>(7) 85,001 - 100,000</td>
<td>10 transactions</td>
<td>285,000</td>
</tr>
<tr>
<td>(8) Over 100,000</td>
<td>6 transactions</td>
<td>675,000</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td><strong>1200 items</strong></td>
<td><strong>3,000,000</strong></td>
</tr>
</tbody>
</table>

The auditor decided that items (transactions) over MKD 70,000 are to be checked fully and the 36 items valued at 1,360,000 MKD (ordinary number 6, 7 and 8) need to be excluded from the calculation leaving a residual population of 1,640,000 MKD (ordinary number 1 to 5). From the remaining strata a sample size of 113 was calculated according to the following formula:

$$\text{Sample} = \frac{\text{Size of Population} \times \text{Security Factor}}{\text{Material Amount}}$$

The sample to be selected from each strata was calculated in the following manner.
<table>
<thead>
<tr>
<th>Stratum No.</th>
<th>Calculation</th>
<th>Number of units in the sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>100.000 * 113 ( \frac{1}{1.640.000} )</td>
<td>7 units</td>
</tr>
<tr>
<td>2</td>
<td>190.000 * 113 ( \frac{1}{1.640.000} )</td>
<td>13 units</td>
</tr>
<tr>
<td>3</td>
<td>490.000 * 113 ( \frac{1}{1.640.000} )</td>
<td>34 units</td>
</tr>
<tr>
<td>4</td>
<td>390.000 * 113 ( \frac{1}{1.640.000} )</td>
<td>28 units</td>
</tr>
<tr>
<td>5</td>
<td>470.000 * 113 ( \frac{1}{1.640.000} )</td>
<td>31 units</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
<td></td>
<td><strong>113 units</strong></td>
</tr>
</tbody>
</table>

### 4.3.10 Alternative option – Key item selection

This option has been proposed because it has the advantage of using the auditor’s judgment to select key and particularly risky items from the population before selecting the representative sample. It should only be used when auditors are familiar with the application of this approach to the individual account balances that they are auditing.

**High value selection**

All transactions which are individually above a fixed amount should be examined. The maximum amount for this value will be the amount of materiality but the approach to fixing this level may be subject to the auditor’s professional opinion. As a guide, it is common to investigate all items exceeding 3% of the total value of the population. The total value of the high value transactions examined should be calculated and recorded on the audit file along with the percentage this bears to the whole population.

Auditors should bear in mind that the results of this 100% check of part of the population cannot be used to draw conclusions about any other strata of the whole population. However, the auditor obtains assurance about the presentation of a significant value of the population.

**Key item selection**

Transactions from each different type of account balance which are known to be risk prone can be identified. Guidance on the risk prone items for selected account balances is shown in the Table below. It is important to note that this is not an exhaustive list and auditors should put forward their suggestions for key items when they are conducting the audit.

In drawing conclusions about the population of key items auditors should take care to draw conclusions only about the key item population and the specific objective being tested. The results should not be applied to any other part of the audit sample.
4.3.11. **Guidance on key item selection for different account balances**

The object of the key item selection is to choose those items which are risk prone. This may be due to the nature of the transaction, the people incurring it or the system through which it is processed.

<table>
<thead>
<tr>
<th>Account balance</th>
<th>Suggested key item selection</th>
<th>Objective of test</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll</td>
<td>• Starters, leavers, people transferred or retired who may be kept on the payroll as ghosts</td>
<td>• Substantiation of salary payments using a witnessed pay out</td>
</tr>
<tr>
<td></td>
<td>• Pay levels of salaries section, accountants and computer section staff</td>
<td>• Substantiation of salary rates from prime documents of authority</td>
</tr>
<tr>
<td></td>
<td>• Pay rates and amounts of temporarily employed staff particularly on projects</td>
<td>• Both of the above</td>
</tr>
<tr>
<td></td>
<td>• Attendance and time recording</td>
<td>• Confirm that staff are attending for the full paid hours</td>
</tr>
<tr>
<td>Expenditure and payments</td>
<td>• Hand written invoices and small piece meal purchases</td>
<td>• Substantiation of payments to small suppliers</td>
</tr>
<tr>
<td></td>
<td>• Non-recurring creditors</td>
<td>• Substantiation of the reason for use of unofficial suppliers</td>
</tr>
<tr>
<td></td>
<td>• Purchases from abroad</td>
<td>• Substantiation of the item(s) purchased and confirmation of the justification for the purchase</td>
</tr>
<tr>
<td></td>
<td>• Purchases without quotations</td>
<td>• Confirmation that tendering and contracting arrangements for those suppliers were in accordance with financial regulations</td>
</tr>
<tr>
<td>Account balance</td>
<td>Suggested key item selection</td>
<td>Objective of test</td>
</tr>
<tr>
<td>-----------------</td>
<td>-----------------------------</td>
<td>-------------------</td>
</tr>
</tbody>
</table>
| Project payments | • Administrative expenses  
                     • Salaries paid to permanent employees | • Confirm that these are reasonable  
                     • Confirm that the employees are contributing to the project |
| Major contractual payments | • Tendering arrangements for major works  
                               • Payments to contractors  
                               • Major items maintenance and contractual payments | • Confirm that regulations have been followed in the award of contracts  
                     • Confirm that all payments over specified amount have been checked and approved by the authorized person  
                     • Confirm that the work has actually been done |
| Stocks and stores transactions | • Slow moving balances  
                                 • Items with general domestic use  
                                 • Stock shrinkage | • Substantiation of stores value and write off to the operating statement  
                     • Substantiation of regular use of purchases  
                     • Confirm the reason for the losses |
| Transport | • Vehicles and plant with low utilisation  
                  • Private use | • Maintenance of uneconomic plant and vehicles  
                     • Irregular use |
| Revenues | • Taxes levied more than one month after the due date  
                  • Taxes unpaid and in dispute | • Confirm reasonableness of the reason for late billing  
                     • Establish origin of dispute and confirm that it is reasonable |
| Properties including equipment and general inventory | • Old uncollected and/or unpaid balances  
• Services to staff on credit | • Over valuation of assets and under valuation of bad debts reserve  
• Irregular use of discount facilities and poor cash flow | • Attractive items  
• Disposals of properties of any sort | • Substantiation that items exist  
• Confirm that they were no longer useful to the entity  
• Confirm that disposal arrangements were in accordance with financial regulations |
4.3.12. Critical decisions in the chain of audit testing

The key decisions on the type of audit tests to be applied in a particular situation are illustrated in the attached diagram Testing decision tree.
4.4. Types of Error

4.4.1. Substantive error
A physical difference between the transaction or property being examined and what the auditor expects to find. For example, a monetary error on a transaction or a property, this cannot be located.

Such an error might result in the auditor deciding to extend the programme of tests and if fraud is suspected, this might lead to a special investigation.

4.4.2. Walk through error
A failure of a document or process to follow the system described to the auditor. Changes to the audit documentation should only be made after the auditor has confirmed the correctness of the revised system.

Such an error might mean that the person describing the system failed to remember the details of the system operation. In this case, if the error is confirmed, the audit documentation should be amended. If, on the other hand, the error indicates that the person did not understand the system which they are responsible for implementing, then this may have implications on the way controls are performed and hence may affect the auditor’s evaluation of the effectiveness of the system.

4.4.3. Tests of control error
A failure to operate a control in a manner intended by management, a failure to record evidence of the operation of the control or failure to comply with individual rules, regulations or policies which establish or exercise control.

In evaluating these results the auditor should bear in mind that a failure to carry out these operations may not affect the completeness, measurement or regularity of a transaction. Indeed, it is a fair assertion that the majority of transactions are correctly recorded when they occur which is normally before control procedures come into operation.

4.5. Valuation of Sampling Results
Whenever audit work is carried out by sampling methods rather than testing of entire populations, it is necessary to consider how these results should be interpreted. The results of tests on relatively small samples will be used:
• as the basis for reporting conclusions on whole systems and batches of transactions to management
• as the basis for internal audit conclusions on the overall effectiveness of accounting, financial and operating systems
• to guide further preventative and investigative action to be taken by management

It is therefore of critical importance that the conclusions and recommendations drawn from samples reflect the underlying characteristics of the whole population. In practice, the sampling methods used should provide 95% confidence that the conclusions drawn by the auditor from sample testing are reflective of the underlying characteristics of the population.

The method of interpreting sample results depends fundamentally on two things:

• the type of audit test being conducted
• the type of sampling and method of selection

4.5.1. Types of audit tests

Walk through tests

The first and easiest case relates to walk through tests. Discovery of errors on a walk through test usually mean that the auditor has not properly understood the way the system works – either in theory or in practice. Usually it means that the system does not actually work the way it was designed or documented. The auditor therefore needs to update his / her understanding and documentation of the operation of the system.

Occasionally, an error on a walk through test can mean that a planned control or process was omitted for this particular transaction. The auditor should therefore note this as an error and include this item in the future sample. (S)he should also conduct another walk through test on a different item, to confirm the correct operation of the system.

Tests of Controls / Extended Tests of Controls

Tests of controls are designed to assess the practical effectiveness of the internal control framework in place. They provide evidence over the effectiveness of controls in reducing material risks to the organisation, such as the potential for physical loss of resources. Controls are a preventative measure. The absence or poor operation of a control does not imply that a loss has occurred; but it does mean that an error, accidental or otherwise, may not be detected. This increases the risk of an error occurring, and makes the organisation more vulnerable to fraud and corruption. Internal audit focuses on controls rather than transaction testing where possible, because controls are a proactive measure which can prevent loss, while transaction testing identifies losses after they have occurred.
In evaluating the results of tests of controls therefore, it is important to emphasise that weaknesses lead to increased risk, but that tests of controls will not normally identify actual loss. Where controls are weak, the auditor will normally supplement tests of controls with substantive tests, which can provide evidence on the size of losses incurred by an organisation as a result of a poor control framework.

Where extended tests of controls are used, these should be treated in the same way as tests of controls, though possibly applied to a sub-group of the original population.

**Substantive / weakness tests**

Substantive tests over individual transactions can provide evidence on the correctness of the processing of groups of transactions. It can be used as an indirect way of identifying whether controls operated satisfactorily in practice, though it can not differentiate between transactions that were checked as valid and transactions that were valid but not checked. However, the discovery of errors provides evidence that a system of controls was not operating effectively. Thus substantive testing can confirm when a system is not working properly, but is unlikely to provide substantial evidence that a system of control is functioning effectively.

Conclusions relating to substantive testing should therefore emphasise that it does not provide positive evidence on a system of internal controls. However, unlike controls testing, it can be used to provide estimates of losses incurred in a whole population, based on the rates of losses observed in a sample.

Where weakness tests are used, these should be treated in the same way as substantive tests, but applied to the specific sub-group of the original population that exhibits these weaknesses, e.g. all payments processed by a particular individual.

**4.5.2. Type of sampling and method of selection**

Results from different sampling methods require different interpretation.

**Statistical attribute sampling**

This involves random selection of items across a whole population, such that each item has the same probability of being selected, regardless of its value. Errors found in tests selected by this method should be assessed as error rates, e.g. 3/30 or 10% error rate. Assuming there has been no bias in the method of sample selection, it is appropriate to conclude that this error is the best estimate of the error rate in the whole population. So for tests of controls, the auditor could conclude that controls are not applied to 10% of transactions. For substantive tests, for example on the validity of payments, the auditor could conclude that 10% of the payments were not valid. The best estimate would then be that 10% by value of the payments were invalid.
When evaluating errors, the auditor should pay careful attention to the cause of the errors found. If, for example, most errors relate to transactions processed in a particular month or by a particular employee, then it would be appropriate to regard this as a separate population with its own error rate. Interpretation and evaluation of errors in these cases are given below under stratified attribute sampling.

**Stratified attribute sampling**

This involves stratifying the population to be tested according to key attributes which are expected to influence the results of the tests. For example, payments over a certain value may be subject to additional control checks and are therefore less likely to contain errors. Testing a sample of payments which includes payments under and over this value may not be appropriate. Error rates found from testing items under this value could not be applied to transactions over this value. Similarly, payments processed in very busy periods, or by new and inexperienced staff, may not be representative of the population as a whole.

Once a population has been stratified into sub-populations, which have then been tested separately, it is important to evaluate the results separately. The error rates for each test should be applied to that specific sub-population, and the overall error rate will therefore be a weighted average of the individual error rates. The process for calculating the overall error rate is illustrated below.

<table>
<thead>
<tr>
<th>Sub-population (shillings)</th>
<th>Number of errors / sample size</th>
<th>Population value</th>
<th>Sample error rate</th>
<th>Forecast error</th>
<th>Population error rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 - 10,000</td>
<td>20/100</td>
<td>3,500,000</td>
<td>20%</td>
<td>700,000</td>
<td>20%</td>
</tr>
<tr>
<td>10,001 - 100,000</td>
<td>5/50</td>
<td>6,700,000</td>
<td>10%</td>
<td>670,000</td>
<td>10%</td>
</tr>
<tr>
<td>100,001 - 1,000,000</td>
<td>0/3</td>
<td>4,800,000</td>
<td>0%</td>
<td>0</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Total population</strong></td>
<td><strong>25/153</strong></td>
<td><strong>15,000,000</strong></td>
<td></td>
<td><strong>1,370,000</strong></td>
<td><strong>9.1%</strong></td>
</tr>
</tbody>
</table>

Note here that the error rate from the sample is 25/153 = 16.3% but the actual error rate for the whole population would be estimated as 9.1% (1,370,000/15,000,000).

**Alternative sampling approach – selection of high value and key items**

Where a non-statistical approach is used to select a sample, but picking out items over a certain value, and key items (e.g. new employees on a payroll test), it is not valid to consider errors on these key items as representative of the sample as a whole. This is because we have already identified these particular transactions or properties as having different characteristics to the rest of the population.

Key items selected should be regarded as a separate sub-population subject to 100% testing. Therefore the actual value of errors found is the error in the whole sub-population. Testing of key items should always be accompanied by statistical / random testing of the remainder of the
population. Error rates found in the remaining population should then be extrapolated in the usual manner. The overall error rate for the population as a whole should be calculated as in the above example, treating key items as a separate sub-population.

### 4.5.3. Reporting results of sample tests

The purpose of reporting the results of audit tests is to provide information to management on the operation of financial, accounting and operational systems. To aid management, internal audit should make that information as clear and understandable as possible.

It is recommended that reports clearly identify to management:

- the importance of the control or transaction tested
- the nature and purpose of the test conducted
- the results of the test, in a standard form such as percentage compliance
- a firm conclusion, on whether the control was in place or the transactions valid
- the implication of findings for the effective operation of the organisation
- recommendations to management on action to address weaknesses found

An example of the results of an audit test into the authorisation of payments is illustrated below:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Internal audit reviewed the process for authorising payments in the Ministry of Health.</td>
</tr>
<tr>
<td>2.</td>
<td>Effective authorisation of payments is required under financial regulations, and is important to ensure that only valid and necessary payments are made, relating to goods and services received by the Ministry.</td>
</tr>
<tr>
<td>3.</td>
<td>Internal audit reviewed a sample of 120 payments to ensure that the invoice had been matched to a purchase request form, signed by an authorised officer; that the invoice amount had been properly calculated; and that the correct payment had been made.</td>
</tr>
<tr>
<td>4.</td>
<td>In 6 cases (5%), the invoices could not be traced to an appropriate authorised order. After discussion with officers in the Ministry of Health, it was concluded that the payments should not have been made.</td>
</tr>
<tr>
<td>5.</td>
<td>The total loss to the Ministry was 45,000 MKD. Estimates of the potential loss from unauthorised payments for the whole Ministry are around 560,000 MKD.</td>
</tr>
<tr>
<td>6.</td>
<td>Internal audit therefore conclude that there is an ineffective system for ensuring that the validity of payments.</td>
</tr>
<tr>
<td>7.</td>
<td>This lack of effective control represents a significant weakness to the operation of systems of internal control, and poses a fundamental risk to the organisation.</td>
</tr>
<tr>
<td>8.</td>
<td>It is recommended that:</td>
</tr>
<tr>
<td></td>
<td>• management review its system for matching invoices to approved orders</td>
</tr>
<tr>
<td></td>
<td>• managers are reminded of the need to monitor spending against their budgets closely and regularly</td>
</tr>
<tr>
<td></td>
<td>• spot checks are carried out on the authorisation of invoices, to ensure all processing clerks are carrying out their duties effectively.</td>
</tr>
</tbody>
</table>
4.5.4. Forming opinions based on sample results

In order to direct management resources towards the most significant issues, internal audit should categorise any weaknesses found as fundamental, serious or minor. This categorisation should be at the front of auditors’ minds when designing and conducting audit tests.

In order to provide an opinion to management on the results of individual tests and on the overall control framework in the organisation, auditors should therefore bear in mind the following factors:

**Nature of systems and materiality**

Errors on fundamental systems pose a greater risk to the organisation than errors in non-fundamental and minor systems. This should be reflected in internal audit reports. Similarly, when errors are discovered, the projected value of these errors should be compared to the materiality value. Projected errors exceeding materiality represent fundamental weaknesses which need to be investigated and addressed immediately. Projected errors below materiality are serious, but may not compromise the ability of the organisation to achieve its objectives.

**Type and Rate of Error**

Some controls, and therefore some audit tests, are more important than others. For example, a control which safeguards a physical asset or resource may be considered more fundamental than a control which checks the level of authorisation or timeliness of processing of a transaction. Also, an error rate of 5% in the application of a control check may be regarded as acceptable to management (as the majority of transactions to which the control is applied are likely to be satisfactory anyway), whilst an error rate of 50% may be regarded as so high that unauthorised transactions may be processed, and the laxity of controls may actually increase incidents of fraud and corruption.

**Compensating controls**

In many cases, a weak control in one area may not be a significant problem to the organisation if there is a strong control operating elsewhere in the system that would identify any errors missed by the first weak control. Compensating controls may also include the overall budgetary framework and governance arrangements. For example, a weak control of authorisation of payments may be compensated for by a strong budgetary control framework in which all budget holders regularly review details of profiled expenditure against their budgets.

**Combination of System Weaknesses**

Similarly, a minor weakness in one area may be compounded by weaknesses in other areas and a poor overall control framework. Where this is the case, a series of minor but related errors may together pose a significant risk to the organisation. Internal auditors should therefore evaluate the results of individual tests in the context of other audit findings, to provide a picture on the control system of the organisation as a whole.
Adverse Reports to the Manager in charge

Where an individual control weakness or the overall control environment is considered so fundamental that it adversely affects the ability of the organisation to meet its objectives, internal audit should consider issuing an adverse report to the accounting officer. Such action should not be done lightly, but after discussions with the manager in charge and HIA. If internal audit regard every weakness as fundamental, the manager in charge will be less likely to carry out actions suggested by internal audit. However, if this tool is used sparingly it can prompt management to take decisive, corrective action when it is really needed.
Internal Audit Manual

PART 4

DETAILED GUIDANCE ON SPECIFIC ACCOUNT AREAS

Contents

1. INTRODUCTION
2. AUDIT OF THE BUDGET CYCLE
3. REVIEW OF HUMAN RESOURCES MANAGEMENT
4. REVIEW OF CASH COLLECTION AND BANK ARRANGEMENTS
5. REVIEW OF INCOME AND DEBTOR ARRANGEMENTS
6. REVIEW OF PURCHASING AND PAYMENT PRACTICES
7. REVIEW OF PAYROLL AND EXPENSE ARRANGEMENTS
8. REVIEW OF STORES AND PROPERTIES SYSTEMS
9. REVIEW OF THE PUBLIC PROCUREMENT PROCEDURES
1. INTRODUCTION

In this part of the Manual, detailed directions are given for the following specific areas of the audit:
- Audit of the budget cycle;
- Audit of the human resources management;
- Audit of the work with cash/payment means and banks;
- Audit of the work with incomes and demands;
- Audit of the processes for procurement and payments;
- Audit of the systems for stocks and property; and
- Audit of the public procurement procedures.

For each of the specific areas of the audit are explained objectives of: the audit, the area (system) and controls. In the enclosed tables, internal auditors should give conclusions for the accomplishment of the control objectives once they gather enough evidences and information based on received answers from questionnaires and conducted tests. For some areas of the audit are given audit programs with audit tests that should be conducted.

Internal auditors should implement directions and respectively to fulfil the working tables for the conclusions and to implement the audit programs. Also, given directions for the specific areas can be changed and amended depending on the particularities of the regulation, the organization and the scope of the audit. Ascertained control objectives and audit tests should be presented in the audit program for every specific audit.

2. AUDIT OF THE BUDGET CYCLE

Introduction

The budget is the most important tool used by management to plan, control and monitor the activities and performance of the organisation. Within a large organisation, the budget exists at a number of levels of detail.

Within the national budget, there will be an approved expenditure vote for each ministry, agency or department. These vote levels should be supported by detailed budgets for the individual activities of each ministry, which sub-divisional breakdowns used for day to day management and control. Across the whole Government, every line of expenditure should have a clear budget holder responsible and held accountable for controlling that expenditure.

Budgets for each organisation within the Government and LSGUs should also be linked to the strategic plan and targets of that organisation. Budgets and therefore the allocation of scarce resources should be directed constantly to the Government's priorities, rather than being driven on the basis of who received what in the previous year.
The Role of Internal Audit in Budgeting

As a management function, internal audit can usefully assist the management in evaluating and recommending improvements to the organisation’s budgetary arrangements. This section provides guidance to assist internal audit in a review of the budgetary arrangements in one organization.

Overall Budgetary Arrangements

The overall audit objectives of internal audit with respect to an organisation’s budgetary arrangements are to ensure that all income and expenditure is adequately planned, controlled and monitored. Hence, the overall audit objective can be reviewed from point of view of the following three more specific objectives:

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Planning</td>
<td>Appropriate budgets are established that are consistent with the organisation’s strategic plan and financial forecasts</td>
</tr>
<tr>
<td>Control</td>
<td>The budget provides an adequate framework for keeping the organisation’s activities in line with its strategic plan</td>
</tr>
<tr>
<td>Monitoring</td>
<td>Appropriate reports are produced to enable senior managers to effectively monitor the organisation’s financial position and activities against its budget and strategic plan</td>
</tr>
</tbody>
</table>

The attached audit program provides guidance on important issues and tests that internal audit can conduct to assess the planning, controlling and monitoring of the organisation’s activities. However, it remains a matter of judgement for the auditor to assess the overall adequacy of budgetary arrangements in each organisation, dependant on the nature and culture of that organisation.
ANNEX

AUDIT PROGRAM FOR AUDIT OF THE BUDGET CYCLE

CONCLUSIONS¹

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT Satisfactory (Y / N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>System Objective:</strong></td>
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<tr>
<td>All income and expenditure is adequately planned, controlled and monitored</td>
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<tr>
<td><strong>Control objectives:</strong></td>
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</tr>
<tr>
<td>A Appropriate budgets are established that are consistent with the organisation’s strategic plan and financial forecasts</td>
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<tr>
<td>B A suitable budgetary control framework has been developed</td>
<td></td>
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<td></td>
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<tr>
<td>C Managers are provided with suitable expenditure reports</td>
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</tr>
<tr>
<td>D Appropriate management accounts (reporting system) are produced to enable senior managers to effectively monitor the organisation's financial position</td>
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</tbody>
</table>

The organisations overall budgetary arrangements are:

<table>
<thead>
<tr>
<th>GOOD</th>
<th>REASONABLE</th>
<th>POOR</th>
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</thead>
</table>

Auditor in charge: __________________________ Date: ________________

Head of Internal Audit Unit: __________________________ Date: ________________

¹ The table with the conclusions is filled after gathering enough evidences and information based on questionnaires and tests prepared in compliance with direction given in continuance.
A. Appropriate budgets are established that are consistent with the organisation's strategic plan and financial forecasts

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1 Budgets are set as part of the organisation’s planning cycle.</td>
<td></td>
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<tr>
<td>1.1 Budget setting is in compliance with the strategic plans of the organization and the Fiscal strategy of the Ministry of Finance.</td>
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<tr>
<td>1.2 A suitable timetable for budget setting has been developed, which is integrated with the Government’s overall budget formulation process. This has been communicated to all senior management involved in budget setting.</td>
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<tr>
<td>1.3 The Head of Finance produces a draft budget which is line with the expected expenditure vote for the organisation, in compliance with the strategic plans of the organization and the Fiscal strategy of the Ministry of Finance</td>
<td></td>
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<tr>
<td>1.4 Where the expenditure vote finally approved by Parliament is significantly different from that expected, the Head of Finance revises the organisation’s budget accordingly.</td>
<td></td>
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<tr>
<td>1.5 The organisation's annual budget is formally agreed by the Head of the subject before the beginning of the relevant financial year.</td>
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<tr>
<td>A2 Budgets are set on an objective basis and presented in an appropriate format.</td>
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<tr>
<td>2.1 Budgets are based on the resources needed to achieve the operational plan rather than historic budget figures.</td>
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<tr>
<td>2.2 Budgets are linked to organisational objectives and targets outlined in the strategic plan.</td>
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<tr>
<td>2.3 The format of the budget document provides a clear explanation of the rationale for the proposed allocation of resources.</td>
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<tr>
<td>2.4 The budget document provides information</td>
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<td></td>
</tr>
<tr>
<td>OBJECTIVE</td>
<td>RESULT (Y/N)</td>
<td>INITIALS</td>
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<tr>
<td>at the appropriate level of detail to inform stakeholders of the organisation’s activities.</td>
<td>2.5 Where possible, public feedback is taken into account in budget formulation.</td>
<td>2.6 Plans from individual budget holders in the organization (departments, units, branch offices, etc.) are supported by an objective analysis of costs, by expenditure category, e.g. staff expenditure, materials, transport, and capital.</td>
<td>2.7 The analysis of staff expenditure identifies the number of full time equivalent staff, average wages and expected total staff costs.</td>
<td>2.8 Where budgets are set below the previous year’s level of actual expenditure, detailed actions to generate these cost savings are shown.</td>
</tr>
<tr>
<td>OBJECTIVE</td>
<td>RESULT (Y/N)</td>
<td>INITIALS</td>
<td>DATE</td>
<td>WP REF.</td>
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<tr>
<td><strong>A4</strong> Managers are actively involved in the development of their budgets.</td>
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<tr>
<td><strong>4.1</strong> All managers who are going to control the budgets are involved in their development and agree with the final budget or are at least provided with an adequate explanation for the level of budget that is finally agreed.</td>
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</tr>
</tbody>
</table>
B. A suitable budgetary control framework has been developed

<table>
<thead>
<tr>
<th></th>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td>B1</td>
<td>Each area of the budget has one, and only one, budget holder (organizational unit)</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>1.1 All managers are clear which income and costs they are responsible for and what their allocation is.</td>
<td></td>
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</tr>
<tr>
<td>B2</td>
<td>All managers have appropriate written instructions on the setting, use, control and monitoring of their budgets.</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>2.1 There is an appropriate and documented process for virement with suitable rules for the level and authorisation required.</td>
<td></td>
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<td></td>
<td>2.2 Reasonable measures have been taken to account for contingencies in the budget.</td>
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<tr>
<td></td>
<td>2.3 These rules have been agreed by senior management.</td>
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<tr>
<td>B3</td>
<td>Managers are able to control the level of expenditure or income from their budgets.</td>
<td></td>
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<tr>
<td></td>
<td>3.1 Managers are only held financially responsible for the costs of activities they can actually control.</td>
<td></td>
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<tr>
<td></td>
<td>3.2 Budgets are devolved to the managers who actually control the expenditure concerned.</td>
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<tr>
<td></td>
<td>3.3 Managers are expected to identify savings from other budget heads if one budget head overspends.</td>
<td></td>
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</tr>
<tr>
<td>B4</td>
<td>The spend or income from each budget head is adequately planned</td>
<td></td>
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<tr>
<td></td>
<td>4.1 End of year spends are avoided and the spending profile is reasonable over the year.</td>
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<tr>
<td>OBJECTIVE</td>
<td>RESULT (Y/N)</td>
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<td>DATE</td>
<td>WP REF.</td>
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</tr>
<tr>
<td>4.2 Managers are given reasonable incentives to make savings on their budget e.g. being able to spend at least a proportion of any savings or extra income generated.</td>
<td></td>
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<tr>
<td>4.3 Suitable action is taken if, for example, spending is higher than expected or income lower than planned in the first part of the year. Where appropriate savings can be carried over to the next year.</td>
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<tr>
<td>B5 All budgets are periodically reviewed by senior managers.</td>
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<tr>
<td>5.1 Budgets are reviewed at least monthly to ensure they are adequately controlled.</td>
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<tr>
<td>5.2 Senior managers supervise the co-ordination of individual budget holders, promote the efficient use of resources; spot emerging problems; and ensure that suitable action is taken e.g. moving budgets from one area to another if necessary to manage the overall budget.</td>
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</tbody>
</table>
C. Managers are provided with suitable expenditure reports

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>C1</strong> Managers receive suitable budget reports promptly each month.</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>1.1 Managers receive details of actual income and expenditure compared to a suitable profile (i.e. showing the likely seasonal spend) of the annual budget on a monthly basis (with variances).</td>
<td></td>
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<tr>
<td><strong>C2</strong> Managers have access to further information as required.</td>
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<tr>
<td>2.1 On request, budget holders can obtain transaction listings or have on-line access to the information system. This allows individual items of expenditure or income to be identified and checked</td>
<td></td>
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<tr>
<td><strong>C3</strong> Budget reports include details of commitments.</td>
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<tr>
<td>3.1 Budget reports show the value of orders raised but not yet paid in addition to the value of invoices that have been received and paid.</td>
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<tr>
<td><strong>C4</strong> Managers are required to reconcile any records they keep with the central records.</td>
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<tr>
<td>4.1 The system for budget monitoring is integrated with, or uses the same base information set as, the financial accounting system.</td>
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<tr>
<td>4.2 Where managers use their own / subsidiary commitment accounting systems they are required to reconcile their records to the management accounts / budget reports produced on a central level each month.</td>
<td></td>
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</tbody>
</table>
D. Appropriate management accounts (reports) are produced to enable accounting officers and senior managers to effectively monitor the organisation's financial position

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>D1</strong> Senior Management receive and consider detailed management accounts on a monthly basis.</td>
<td></td>
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</tr>
<tr>
<td>1.1 Managers of the budget users in the organization are held to account for any over or under spends in their budgets and where possible over spends in one area are compensated for by under spends in another.</td>
<td></td>
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<tr>
<td><strong>D2</strong> Each quarter the Managers of the budget users receives suitable management accounts (reports).</td>
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<tr>
<td>2.1 Management accounts include:</td>
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<tr>
<td>• income and expenditure account - comparison of actual to profiled / budget (with variances) on a current month and year to date basis, with a forecast out-turn to the year end</td>
<td></td>
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</tr>
<tr>
<td>• balance sheet - comparison of actual to budget, and forecast to year end</td>
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<tr>
<td>• commentary on significant variances and an action plan to manage the effects over the next period.</td>
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<tr>
<td>The management accounts are properly discussed and actions recorded at regular senior management team meetings.</td>
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<tr>
<td><strong>D3</strong> Managers are required to provide explanations for any variances.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>3.1 Managers have to explain differences between their agreed budgetary profile and the actual expenditure in the previous period if these are more than about 10% of the budgeted figures. Explanations should then be provided to senior managers and</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>OBJECTIVE</strong></td>
<td><strong>RESULT (Y/N)</strong></td>
<td><strong>INITIALS</strong></td>
<td><strong>DATE</strong></td>
<td><strong>WP REF.</strong></td>
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</tr>
<tr>
<td>D4 Any amendments to the budget are formally agreed and recorded.</td>
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<tr>
<td>4.1 All transfers of money from one budget head to another, should be suitably authorised by senior managers in line with the formal scheme of delegation. The original budget should still be reported in management accounts even if this is amended during the year.</td>
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<tr>
<td>4.2 Where forecasts suggest it will not be possible to continue to provide the planned level of service for the whole year within the current budget, the accounting officer prepares a proposal for the Manager of the organization, and seeks a suitable supplementary.</td>
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<tr>
<td>4.3 Supplementary votes (budget rebalance) are recorded in the budget by amendments to the original budget, and forecast expenditure is compared to the new profiled budget.</td>
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</tbody>
</table>
3. REVIEW OF HUMAN RESOURCES MANAGEMENT

Introduction

People are the most important resource for any organisation. They usually account for the majority of its expenditure, and are responsible for all its outputs. The way an organisation recruits, trains, manages and rewards its people is fundamental to the performance of an organisation. Recognising the importance of people as a resource leads to the recognition of good human resource management as a key strategic objective. Establishing a human resource department and giving human resource management appropriate status in an organisation is key to achieving the organisation's mission.

The Role of Internal Audit in Reviewing Human Resource Management

In conducting a review of HRM it is important firstly to identify who is responsible for, and who performs, the different aspects of HRM. Once this initial review has been performed, it will be possible to design tailored audit programs for the specific organization in the public sector.

Based on the reports from performed audits of HRM in the subject from the public sector whose employees have status as civil servants, Central Internal Audit within the Ministry of Finance will prepare and submit information for most essential problems to the Government of RM, which resolving is under competency of the Agency for civil servants.
Audit objectives of the audit of the Human Resource Management

The overall audit objectives of internal audit with respect to an organisation's HRM arrangements are to ensure the economy, efficiency, and effectiveness of HRM activities.

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy</td>
<td>all inputs to the process are secured in the most economical manner, with regard to the specifications of cost and quality;</td>
</tr>
<tr>
<td>Efficiency</td>
<td>given inputs to a process are converted into outputs in the most efficient manner possible;</td>
</tr>
<tr>
<td>Effectiveness</td>
<td>the outputs to a process are designed to be as closely aligned to the overall objectives of the organisation as possible</td>
</tr>
</tbody>
</table>

An HRM review can be structured by focusing on five key areas:

- Activities of central departments with responsibility for HRM
- Recruitment
- Training
- People Management
- Performance Management

The attached audit program provides guidance and tests on these five areas, which internal audit can use to evaluate the organisation’s HRM arrangements.
## ANNEX

### AUDIT PROGRAM FOR AUDIT OF THE HUMAN RESOURCE MANAGEMENT

#### CONCLUSIONS

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT Satisfactory (Y / N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>System Objective:</strong></td>
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<tr>
<td>Human resource management is conducted economically, efficiently and effectively.</td>
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<tr>
<td><strong>Control objectives:</strong></td>
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<tr>
<td>A Activities of central departments with responsibility for Human resource management are adequately devised, assigned and carried out.</td>
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</tr>
<tr>
<td>B Recruitment is strategically planned, and conducted in a robust and open manner.</td>
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<tr>
<td>C Comprehensive training needs are assessed; appropriate training is provided and evaluated.</td>
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<tr>
<td>D There are adequate procedures for managing, developing and communicating with the people in the organisation.</td>
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<tr>
<td>E There are adequate procedures for monitoring, improving and rewarding performance in the organisation.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>GOOD</th>
<th>REASONABLE</th>
<th>POOR</th>
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</thead>
<tbody>
<tr>
<td>The organisations overall human resources policies and strategies are:</td>
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</tbody>
</table>

Auditor in charge: __________________________ Date: __________________
Head of Internal Audit Unit: __________________________ Date: __________________

---

2 The table with conclusions is filled after gathering enough evidences and information based on questionnaires and tests prepared in compliance with directions given in continuance.
A. Activities of central departments with responsibility for Human Resource Management are adequately devised, assigned and carried out.

<table>
<thead>
<tr>
<th>A1</th>
<th>Human resource strategies are properly developed and coordinated.</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.1</td>
<td>An HR strategy has been developed within the Government / organisation, and is revised appropriately.</td>
</tr>
<tr>
<td>1.2</td>
<td>The HR strategy links to the organisation’s mission, vision and value statements, and includes a statement on the organisation’s commitment to its employees.</td>
</tr>
<tr>
<td>1.3</td>
<td>The HR strategy has been communicated properly to all organisations and staff. Responsibilities for implementation have been assigned.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>A2</th>
<th>The human resource division has an appropriate status in the organisation</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.1</td>
<td>The head of HR is a member of the senior management team.</td>
</tr>
<tr>
<td>2.2</td>
<td>HR issues are discussed at the highest level in the organisation.</td>
</tr>
<tr>
<td>2.3</td>
<td>HR has its own budget, under the control of the head of HR, which is adequate for it to fulfil its duties.</td>
</tr>
<tr>
<td>2.4</td>
<td>HR has the appropriate number of qualified staff commensurate with its responsibilities and status within the organisation.</td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>A3</th>
<th>Appropriate monitoring of HR's activities and impact is conducted.</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.1</td>
<td>The head of HR is accountable to the manager who is on appropriate high level in the organisation.</td>
</tr>
<tr>
<td>3.2</td>
<td>HR help set, monitor and report performance targets for the organisation,</td>
</tr>
</tbody>
</table>
including for example:
- Staff turnover rates
- Job vacancy rates
- Absenteeism rates
- Significant employee achievements.

3.3 Performance measures are reported and used to drive remedial action. Reporting includes historical trends, analysis across divisions / departments, and comparison to other organisations.

### A4 HR set and monitor appropriate organisational policies.

4.1 HR produces appropriate policies and guidance on the conduct of staff dismissals.

4.2 HR takes the lead in data protection issues and ensures its own employee data meets data protection requirements.

4.3 HR takes the lead in formulating and implementing the organisation’s policies on retrenchment and redundancy.

4.4 The organisation’s retrenchment policy considers all alternatives in retrenchment, including:
- Natural wastage
- Recruitment Bans
- Redeployment
- Voluntary Redundancy
- Compulsory Redundancy.

### A5 HR takes an active role in key staff issues.

5.1 HR has a lead role in helping to plan for and manage any major restructuring or retrenchment exercises.

5.2 HR is proactive in communicating to staff on all personnel issues.

### A6 HR has a proactive approach to managing risk.
6.1 HR identifies the key staffing and personnel risks to the organisation, and produce plans for dealing with these risks.

6.2 HR monitor public perception of the organisation’s staffing and personnel activities, and respond appropriately to press coverage of staffing issues, including:
- Redundancies
- Allegations of corruption
- Allegations of nepotism
- Concerns over salary levels, the award of allowances and expense payments.

A7 HR seeks to maintain the quality of its services.

7.1 The HR department identifies and seeks to maintain best practice in its activities, and seeks external reviews of its activities to confirm this.

7.2 HR adopts a culture of continual learning, and promotes this culture across the organisation.
B. Recruitment is strategically planned, and conducted in a robust and open manner.

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>B1</strong> Appropriate recruitment strategies have been designed and implemented.</td>
<td></td>
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<tr>
<td>1.1 HR conducts formal reviews of staffing needs to meet the strategic plan against current capacity in the organisation.</td>
<td></td>
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<tr>
<td>1.2 The recruitment strategy sets out the organisation's recruitment policy, in terms of using internal and external recruitment.</td>
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<tr>
<td><strong>B2</strong> The recruitment process is robust and open.</td>
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<tr>
<td>2.1 All recruitment needs are driven by the strategic plan.</td>
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<tr>
<td>2.2 For each position to be filled, a formal job or person specification is produced. This is used to design internal or external advertisements for the position.</td>
<td></td>
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<tr>
<td>2.3 Job adverts state the nature, terms and conditions of employment, including grade or salary if appropriate.</td>
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<tr>
<td>2.4 For all vacancies, leading candidates are interviewed in a fair and objective manner.</td>
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<tr>
<td>2.5 The appointment process is conducted in an open and fair manner.</td>
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<tr>
<td>2.6 Formal references and evidence of relevant qualifications are obtained prior to employment.</td>
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<tr>
<td><strong>B3</strong> Appointment procedures and employment contracts are robust.</td>
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<tr>
<td>3.1 All appointments are made using formal conditions of employment, which are legally binding on the employee.</td>
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<tr>
<td>3.2 Conditions of employment include a probationary period during which the</td>
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<tr>
<td>OBJECTIVE</td>
<td>RESULT (Y/N)</td>
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<td>--------------------------------------------------------------------------</td>
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<tr>
<td>employee’s performance is assessed.</td>
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<tr>
<td>3.3 Where relevant, the conditions of employment determine the length of</td>
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<tr>
<td>the appointment and performance measures to be used in monitoring</td>
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<tr>
<td>performance.</td>
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<tr>
<td>3.4 Conditions of employment give the salary level / salary grade of the</td>
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<tr>
<td>position.</td>
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<tr>
<td>B4 Appropriate induction procedures are in place.</td>
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<tr>
<td>4.1 For all new staff, an appropriate induction process is designed.</td>
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<tr>
<td>4.2 Management seeks feedback on the appointment and induction process,</td>
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<tr>
<td>and uses this to make improvements.</td>
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</table>
C. Comprehensive training needs are assessed; appropriate training is provided and evaluated.

<table>
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<tr>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
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</thead>
<tbody>
<tr>
<td>C1 Training needs assessments are linked to the strategic plan.</td>
<td></td>
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<tr>
<td>1.1 Formal comparison of existing capabilities to assessed needs is conducted across the organisation. The results are prioritised and used to produce training plans.</td>
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<tr>
<td>1.2 Training needs assessments make use of staff surveys to identify current skills and perceived needs.</td>
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<tr>
<td>1.3 Training needs are addressed through an appropriate balance of formal training programs and on the job training.</td>
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<tr>
<td>C2 Adequate training records are maintained.</td>
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<tr>
<td>2.1 Adequate records are kept by personnel of employee's qualifications, training records and needs, tailored to current job specifications.</td>
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<tr>
<td>C3 Suitable Training is Provided.</td>
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<tr>
<td>3.1 For specific technical areas, staff are enrolled on formal training programs to give them the skills or qualifications they need.</td>
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<tr>
<td>3.2 Junior staff are assigned mentors who take responsibility for their career development and for organising on the job training.</td>
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<tr>
<td>3.3 Regular assessments are carried out on training provided, including course assessments by delegates as well as external assessments.</td>
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<tr>
<td>3.4 During their career development, staff receive training in management skills, communication and team skills.</td>
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<tr>
<td>3.5 Qualified professional staff are encouraged</td>
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<tr>
<td>OBJECTIVE</td>
<td>RESULT (Y/N)</td>
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<tr>
<td>to participate in relevant Continual Professional Development (CPD) programs.</td>
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</table>

**C4 Training investments are protected.**

4.1 Where the organisation has sponsored professional training of its staff, it has made arrangements to recover the costs of this investment if the employee leaves the organisation within a certain period after qualification.
D. There are adequate procedures for managing, developing and communicating with the people in the organisation.

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<tr>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
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</thead>
<tbody>
<tr>
<td><strong>D1 Adequate procedures exist for management within the organisation</strong></td>
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<tr>
<td>1.1 The organisational structure is appropriate and has been communicated to all staff.</td>
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<tr>
<td>1.2 All staff report to and are responsible to a line manager.</td>
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<tr>
<td>1.3 Managers know which staff and what outputs and budgets they are responsible for.</td>
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<tr>
<td>1.4 Managers receive appropriate training on performance review and performance monitoring.</td>
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<tr>
<td>1.5 HR enables managers to be aware of and promote compliance with corporate policies, such as:</td>
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<tr>
<td>• Whistle blowing policies</td>
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<tr>
<td>• Grievance procedures</td>
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<tr>
<td>• Codes of conduct</td>
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<tr>
<td>• Equal opportunities policies</td>
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<tr>
<td><strong>D2 An appropriate environment exists for staff development.</strong></td>
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<tr>
<td>2.1 HR or senior management take a responsibility for career development of key staff.</td>
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<tr>
<td>2.2 HR identifies key positions within the organisation and utilises succession planning to develop junior staff for their future promotion.</td>
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<tr>
<td>2.3 As part of career development, managers encourage rotation of duties, additional work experience and secondments to other job posts with aim of gathering knowledge that will need in their future roles.</td>
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<tr>
<td>OBJECTIVE</td>
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<tr>
<td>2.4 Management seeks to involve staff in organisational development through input to strategy and working groups to facilitate organisational change.</td>
<td></td>
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<tr>
<td>D3 Adequate communication exists between staff and management.</td>
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</tr>
<tr>
<td>3.1 Appropriate communication channels have been developed to allow management to communicate efficiently and effectively with staff.</td>
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<tr>
<td>3.2 Management seek the opinion of staff regarding job satisfaction, scope for change etc through appropriate feedback mechanisms such as surveys.</td>
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</tbody>
</table>
E. There are adequate procedures for monitoring, improving and rewarding performance in the organisation.

<table>
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<tr>
<th>OBJECTIVE</th>
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<th>INITIALS</th>
<th>DATE</th>
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</thead>
<tbody>
<tr>
<td>E1 Appropriate performance monitoring systems are in place.</td>
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<tr>
<td>1.1 HR have designed a performance review system which is used to set goals and targets for all employees, monitor performance and provide feedback to stimulate improvement.</td>
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<tr>
<td>1.2 Careful attention is paid to aligning and balancing individual and team targets in the performance review system.</td>
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<tr>
<td>1.3 Performance targets are generated through a two way dialogue between staff and management.</td>
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<tr>
<td>1.4 Managers seek staff’s perceptions of the organisation and compare these to the organisation’s value statement.</td>
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<tr>
<td>1.5 Management makes use of focus groups and communication events to assess staff perceptions of the organisation’s internal procedures and culture.</td>
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<tr>
<td>E2 The organisation continually seeks to improve performance.</td>
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</tr>
<tr>
<td>2.1 Management use the performance monitoring system to identify poor performance and seek improvements.</td>
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<tr>
<td>2.2 Appropriate disciplinary procedures are used where poor performance continues.</td>
<td></td>
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<tr>
<td>2.3 The organisation has established mechanisms for implementing demotions, transfers or redundancies if appropriate.</td>
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<tr>
<td>2.4 HR conducts periodic reviews of salaries and conditions against similar organisations and the private sector, in order to improve staff retention rates.</td>
<td></td>
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<tr>
<td>OBJECTIVE</td>
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<tr>
<td>E3 Appropriate incentive schemes are in place to encourage and reward good performance.</td>
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</table>

<table>
<thead>
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<th>RESULT (Y/N)</th>
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</table>

3.1 Promotion decisions are linked to the performance appraisal system.

3.2 Incentives, where appropriate, are used to reward staff / teams for continually achieving their objectives.

3.3 An open and transparent mechanism is in place to reward outstanding performance or innovation, through, for example, enhanced salary payments, financial rewards or formal awards.
4. REVIEW OF CASH COLLECTION AND BANK ARRANGEMENTS

Introduction

Cash management and banking (Treasury) arrangements are one of the most fundamental systems operated by any organisation. Also, cash (and other liquid resources) are an organisation's most important physical asset. The ability to pay wages and pay suppliers depends on the availability of cash.

As an asset, cash is also the asset most at risk from fraud and corruption, as it can be hard to trace and is easy to spend. It is therefore of fundamental importance to any organisation to have good systems for collecting, managing and disbursing cash.

The system objective with respect to cash and banking (Treasury) arrangements is to ensure that all cash income is collected, recorded adequately and promptly banked; and that suitable banking (Treasury) services are obtained.

The Role of Internal Audit in assessing cash and bank arrangements

Internal audit should assist the head of Finance by evaluating and recommending improvements to the control environment surrounding the organisation's cash management and banking arrangements. Types of generic controls for this system are the follows:

- Segregation of duties
- Organisational
- Authorisation and approval
- Physical
- Supervision
- Personnel
- Arithmetical and Accounting
- Management

This part of the manual provides guidance to assist internal audit in a review of the cash management and banking arrangements in one organization.

Audit Objectives of the audit of cash and bank management systems

The overall audit objectives with respect to an organisation's cash management and banking (Treasury) arrangements are to ensure the complete and accurate recording and disclosure of all transactions and assets, and the proper security, substantiation and utilisation of all assets.

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Definition</th>
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</thead>
<tbody>
<tr>
<td>Completeness</td>
<td>All transactions, assets and liabilities relevant to the period of review have been recorded.</td>
</tr>
<tr>
<td>Measurement</td>
<td>The recorded transactions, assets and liabilities have been</td>
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</tbody>
</table>
Internal Audit Manual

valuation correctly and accurately valued or measured.
Disclosure The recorded transactions, assets and liabilities have been properly classified and recorded in the organisation's financial records.
Security All assets are kept securely, custody is clearly stated, and access is properly authorised.
Substantiation Recorded assets and liabilities are periodically compared with independent financial records.
Utilisation All liquid financial assets are utilised efficiently

The attached audit program provides guidance on important issues and tests that internal audit can conduct to evaluate the control environment around the organisation's cash management and banking arrangements, depending on the nature and culture of that organisation.

Substantive Testing

Where it has been determined, either through a weak Preliminary Systems Evaluation or testing of the control environment that adequate controls are not operating in practice, the auditor may decide to conduct some substantive testing. The purpose of this is two fold:

- To determine if any significant losses have occurred, and
- To contribute towards internal audit’s assessment of the organisation’s overall control environment.

The results of this work will either:

- provide assurance to management that there has not been any significant losses to the organisation as a result of a weak control environment, or
- provide evidence to management that the weak control environment has lead to significant losses, and thus prompt management to take appropriate action

The objective of substantive testing is to evaluate the adequacy and completeness of outputs rather than the operation of controls. For example, checking the amount actually paid to a supplier is the same as the amount on the invoice.

It is thus more detailed in its nature, more time consuming, and requires larger samples to gain the same level of assurance. However, errors discovered in substantive testing are more significant, as they usually represent a loss to the organisation, where as errors from controls test demonstrate a control failed to operate – but not necessarily that an error occurred.

The attached DST audit program provides a list of possible substantive tests the auditor may carry out to assess the organisation’s cash management and banking (Treasury) arrangements.
OVERALL SYSTEM OBJECTIVE:
ALL CASH INCOME IS COLLECTED, RECORDED ADEQUATELY AND PROMPTLY BANKED;
SUITABLE BANKING SERVICES ARE OBTAINED.

SYSTEM RISKS:
<table>
<thead>
<tr>
<th>Inherent Risk:</th>
<th>Preliminary Control Risk:</th>
<th>Analytical Review Evidence:</th>
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<tbody>
<tr>
<td>High / Medium / Low</td>
<td>High / Medium / Low</td>
<td>High / Moderate / Low</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Audit Objective. Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMPLETENESS - All transactions, assets and liabilities relevant to the period of review have been recorded.</td>
<td>Income received through the bank and at each cash office is adequately recorded. For each cash payment: an officer is issuing a receiving doc; a cashier is receiving the money, recording it and issuing cash receipt. (principle of two staff, who both check and confirm the total cash and cheques received). Cash and records of receipts are passed promptly to the treasury. Where possible the public is informed to pay at central cashiers etc and to make bank transfers to the organisation. All cash / bank transfers are adequately recorded and witnessed. Receipts are issued for all income received by hand.</td>
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</table>

Part 4.4 - Review of Cash Collection and Banking Arrangements- 3
## AUDIT OBJECTIVE

### Control Objective

#### Key Controls Identified

<table>
<thead>
<tr>
<th>Control Adequate to Meet Objective? (Y / N / n/a)</th>
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<th>Control Operates Adequately in Practice? (Y / N / n/a)</th>
</tr>
</thead>
</table>

### Control Adequate to Meet Objective?

- Cash tills are used properly. Till keys are adequately controlled by supervisors and readings recorded.

### Control Confirmed by Walk Through Test?

- The public can clearly see cash register displays and see that cash taken is rung into the till.

### Control Test to Evaluate Operation of Control

- Comprehensive procedure notes for cash collection are available for all relevant staff, are regularly updated and include action to be taken for attempted theft.

- Staff involved with cash collection do not also maintain debtors records or get involved with debt recovery action.

## MEASUREMENT / VALUATION

- The recorded transactions, assets and liabilities have been correctly and accurately valued or measured.

### Control Operates Adequately in Practice?

- Payments from/to bank accounts are adequately controlled. Bank paying-in slips record each cash payment and cash totals. Bank paying-in slips are reconciled to cash takings and to daily totals on the cash receipting system.

- Actual and expected income is compared regularly. All income streams are reviewed at least quarterly and any significant variations from expected income are investigated.
## TESTS OF CONTROL AUDIT PROGRAM

### Audit Objective, Control Objective

<table>
<thead>
<tr>
<th>Key Controls Identified</th>
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- **Control Adequate to Meet Objective? (Y / N n/a)**
- **Control Confirmed by Walk Through Test? (Y / N / n/a)**
- **Control Test to Evaluate Operation of Control**
- **Sample size for Test of Control**
- **Results of Tests of Controls**
- **Control Operates Adequately in Practice? (Y / N n/a)**

### Key Controls Identified

1. **Income (budgets) is investigated.**
2. **Bank account reconciliations are undertaken regularly. The balance on each of the bank accounts according to the bank statement is independently reconciled to the figure expected from the financial records at least monthly. This may be relaxed for accounts with few transactions.**
3. **The person who reconciles the accounts does not have access to cash or the accounting records. Bank statements are received by and the reconciliations are undertaken by staff who does not work in treasury and who do not have access to any cash.**
4. **Daily reconciliation of cash and records. Collection by each cashier is checked and a cumulative total of all differences is maintained and reviewed regularly each month.**

### DISCLOSURE

- The recorded transactions, assets and liabilities have been properly classified and recorded in the organisation’s financial records.

- **Income received is correctly and accurately recorded in the accounts.**
- **All cash or bank payments received through the bank or at cash offices are promptly recorded and correctly coded according to the established chart of**

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**Part 4.4 - Review of Cash Collection and Banking Arrangements- 5**
## TESTS OF CONTROL AUDIT PROGRAM

### System:
Cash and bank

<table>
<thead>
<tr>
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<tbody>
<tr>
<td><strong>SECURITY</strong> - All assets are kept securely, custody is clearly stated, and access is properly authorised.</td>
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<tr>
<td>Money received at all cash offices is held securely.</td>
<td>All tills are locked when not attended by the till registrar.</td>
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<td></td>
<td>Any money held over night in a cash office is held in a secure safe, and cash offices have adequate security.</td>
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<td>Income is adequately accounted for and banked promptly</td>
<td>There is an established procedure and timetable for daily close down of cashiers’ tills, cashiering, reconciliation and banking. All income is banked intact and promptly each day.</td>
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<td></td>
<td>Promptness of banking is checked periodically by a manager or chief cashier.</td>
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<td>Cash collection is undertaken securely and efficiently.</td>
<td>The organisation has adequate insurance against theft and fraud, including a fidelity guarantee policy.</td>
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</table>

*Accounts.*

Assets and liabilities are properly recorded in the accounts.

Cash, investments and borrowings are properly coded in the accounting according to the established chart of accounts.
### Audit Objective: Control Objective

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<tr>
<td>All staff involved in cash collection have suitable training, personal alarms, and vary routes used for transfer of cash.</td>
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<tr>
<td>Each treasury is maintained as a secure environment with limited staff access and suitable security measures are periodically tested. All cash collection points are secure and clearly sign posted.</td>
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<tr>
<td>Banking facilities are appropriate and efficient</td>
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<tr>
<td>The bank mandate (signatories etc) is up to date. Staff are removed from the mandate as soon as they leave the organisation. Bank accounts are only opened as necessary in the name of the organisation. There is a pool of several senior staff who are signatories.</td>
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<tr>
<td>Banking services are periodically formally reviewed. They are covered by a written agreement and are adequately monitored.</td>
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<td>Bank charges are formally reviewed for reasonableness and significant changes at least once a year.</td>
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<tr>
<td>Orders for payments to regular creditors are issued to the Treasury in compliance with the regulation. There is limited staff access to the system, and printouts</td>
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<tr>
<td></td>
<td>are checked and signed by authorised signatories.</td>
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</tbody>
</table>

**SUBSTANTIATION** - Recorded assets and liabilities are periodically compared with independent financial records.

- Assets held are regularly substantiated.  
  - At least annually (as part of the preparation of the annual accounts) records of all assets and liabilities are compared to independent records of the relevant financial institutions.
  - At least monthly, a reconciliation is performed between cash recorded on the accounting system and amounts recorded on bank statements.

**UTILISATION** - All liquid financial assets are utilised efficiently.

- Loans and investments are appropriate and are reviewed regularly.  
  - The organisation has a coherent investment and borrowing policy, in line with Government policy.
  - Rates of returns and risk profiles of all investments are reviewed periodically.
### Audit Objective: Control Objective

<table>
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</thead>
<tbody>
<tr>
<td>Interest rates on all loans are reviewed periodically and the possibility of early redemption or loan consolidation is considered.</td>
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<tr>
<td>Bank accounts are used efficiently.</td>
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<tr>
<td>The nature and number of bank accounts held is subject to regular review, with a view to consolidating accounts where possible.</td>
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Interest rates on all loans are reviewed periodically and the possibility of early redemption or loan consolidation is considered.

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**OVERALL OBJECTIVE:**
ALL CASH INCOME IS COLLECTED, RECORDED ADEQUATELY AND PROMPTLY BANKED; SUITABLE BANKING SERVICES ARE OBTAINED.

<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
<th>Result Satisfactory (Y / N)</th>
<th>Initials</th>
<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Observe cash collection at a sample of cash offices and ensure all receipts are recorded.</td>
<td></td>
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<tr>
<td>2</td>
<td>Check calculation of daily totals of cash receipts.</td>
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<tr>
<td>3</td>
<td>Check daily totals agree to amounts passed to Treasury/Main cashier office and/or banked.</td>
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<tr>
<td>4</td>
<td>Check that invoices / bills / charges raised instruct the public to pay at the central cashiers’ office, and make bank transfers payable to the organisation.</td>
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<tr>
<td>5</td>
<td>Check that receipts have been used for cash payments received.</td>
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<tr>
<td>6</td>
<td>Check that receipts are sequentially numbered, and that all receipt numbers can be accounted for.</td>
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<tr>
<td>7</td>
<td>Check that all receipt books can be accounted for.</td>
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<tr>
<td>8</td>
<td>Observe staff using cash tills and ensure all monies are rung in to the till.</td>
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<tr>
<td>9</td>
<td>Ensure a daily record of till readings is kept, and test records back to till rolls.</td>
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<tr>
<td>10</td>
<td>Check cash collection procedure notes are complete and adequate.</td>
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</tbody>
</table>
### Test no. | Audit objective and audit procedure | Result Satisfactory (Y / N) | Initials | Date | W.P. Ref. | Errors to SoF
--- | --- | --- | --- | --- | --- | ---
11 | Ascertain whether staff are aware of the procedure notes and correct procedures for recording and safeguarding cash. | | | | |
12 | Ensure that staff responsible for cash collection are not also involved with recovering debts. | | | | |

#### Measurement / valuation: the recorded transactions, assets and liabilities have been correctly and accurately valued or measured.

13 | Reconcile amounts on bank paying in slips to cash totals for the relevant period. | | | | |
14 | For each major source of income, compare actual income to budget for the period and investigate significant differences. | | | | |
15 | Repeat the bank reconciliation for the latest month, and ensure that all reconciling items are bona fide. | | | | |
16 | Ensure that all bank reconciliations have been performed and/or reviewed by appropriate senior accountants, who are not involved in daily cash management. | | | | |
17 | Review the list of differences for a selection of cash offices. Ensure there is no evidence of regular or significant under / over receipt of cash. Investigate any unusual trends. | | | | |

#### Disclosure: The recorded transactions, assets and liabilities have been properly classified and recorded

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Part 4.4 - Review of Cash Collection and Banking Arrangements- 11
### Test no. | Audit objective and audit procedure | Result Satisfactory (Y / N) | Initials | Date | W.P. Ref. | Errors to SoF
--- | --- | --- | --- | --- | --- | ---
18 | Review a list of cash receipts and check the correctness of coding against the chart of accounts. |  |  |  |  |  |
19 | Review a list of investments and borrowings, and ensure all are properly recorded on the accounting system. |  |  |  |  |  |

**Security:** All assets are kept securely, custody is clearly stated, and access is properly authorised.

20 | Observe practices in cash offices and ensure tills are locked when not attended. |  |  |  |  |  |
21 | Observe cashing up at cash offices; ensure this follows a suitable, established procedure; and ensure all monies are properly stored in a secure safe. |  |  |  |  |  |
22 | Inspect physical security of cash offices, including locks, alarms, windows and safes. |  |  |  |  |  |
23 | Ensure that cash is banked on a regular basis, appropriate to the amount of cash taken and security of cash storage systems. |  |  |  |  |  |
24 | Review the number of days between cash being received and cash being credited in the bank. Investigate where significant cash balances are not banked promptly. |  |  |  |  |  |
25 | Check the organisation’s insurance policies to ensure cover against theft of cash and fraud. |  |  |  |  |  |
26 | Check that staff involved in cash collection has received appropriate |  |  |  |  |  |
<table>
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<td>27</td>
<td>Check that officers responsible for handling and transporting cash have alarms and take adequate security precautions when transporting large amounts of cash.</td>
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<td>28</td>
<td>Check that cash collection points are secure and clearly sign posted.</td>
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<td>29</td>
<td>Check that bank mandates are up to date and reviewed regularly.</td>
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<td>30</td>
<td>Check that senior officers who have left the organisation have been removed from the bank mandate.</td>
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<td>31</td>
<td>Check that only appropriate senior members are authorised as signatories for each bank account.</td>
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<td>32</td>
<td>Obtain a list of bank accounts from the organisation’s main banks, check that each one is valid and is included in the organisations financial records.</td>
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<td>33</td>
<td>Review the number of bank accounts in use and consider whether this is appropriate.</td>
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<td>34</td>
<td>Check whether the organisation is periodically reviewing its banking services.</td>
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<td>35</td>
<td>Review the level of bank charges compared to previous periods and similar organisations. Consider whether these appear reasonable.</td>
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<tr>
<td>36</td>
<td>Inspect security arrangements of the supply of receipt books.</td>
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<tr>
<td>37</td>
<td>Review the register of receipt books and ensure that all can be accounted for.</td>
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<tr>
<td>38</td>
<td>Obtain / prepare a list of major supplier payments by the organisation according to type of payment and investigate where there are significant, regular cash payments.</td>
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<tr>
<td>39</td>
<td>Obtain a list of payments done via the Treasury and for a sample of payments, ensure these relate to bona fide goods / services provided.</td>
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<tr>
<td></td>
<td><strong>Substantiation</strong>: Recorded assets and liabilities are periodically compared with independent financial records.</td>
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<tr>
<td>40</td>
<td>Obtain a list of all cash, investments and borrowings from the accounting system, and check whether they are in compliance with the regulation.</td>
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<tr>
<td></td>
<td><strong>Utilisation</strong>: All liquid financial assets are utilised efficiently.</td>
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<tr>
<td>41</td>
<td>Obtain and review the organisations investment and borrowing policy, and check this is in line with government regulations.</td>
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</tr>
<tr>
<td>42</td>
<td>Calculate the annual rate of return on major investments, compared to current interest rates, and investigate where returns are below expectations.</td>
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<tr>
<td>43</td>
<td>Review the interest rates charged on major loans against current interest rates and consider the costs and benefits of early repayment.</td>
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</tbody>
</table>

Auditor in charge: ___________________________ Date: ___________________________  
Head of Internal Audit: ___________________________ Date: ___________________________  
Unit: ___________________________  

Part 4.4 - Review of Cash Collection and Banking Arrangements- 14
### SUBSTANTIVE TESTING AUDIT PROGRAM

<table>
<thead>
<tr>
<th>Organization:</th>
<th>File Reference</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Period Under Review:</th>
<th>Prepared by</th>
<th>Date</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>System:</th>
<th>Reviewed by</th>
<th>Date</th>
</tr>
</thead>
</table>

**Part 4.4 - Review of Cash Collection and Banking Arrangements**
5. REVIEW OF INCOME AND DEBTOR ARRANGEMENTS

Introduction

This section covers the raising and recording of taxes and other charges of the subjects on central and local level on power, as well as the monitoring and collecting of debts due. It thus covers all aspects of income generation and collection except the cash receipting system, which is covered under cash and bank.

Subjects from the public sector on central and local level realize incomes comprises mainly revenue due from different forms of taxation, as well as amounts receivable in exchange for goods and services provided.

The Budget and the budget users presently use a cash accounting system. Under this system, it records in its accounts only cash received in a given period. However, in compliance with the accounting regulations these subjects should also produce a balance sheet. This means that budgets and budget users must record the balance of monies due but not received in a given period. These are known as debtors.

It is appropriate therefore that the budgets and budget users should record all charges raised (income), amounts received, and amounts due but not received (debtors). For the purpose of good management of an organisation, it is important to have robust procedures to monitor, control and collect debts due. It is therefore appropriate that internal audit, as a management function, assists the accounting officer to improve systems of control for income and debtors.

The system objective with respect to income and debtors is to ensure that invoices are raised promptly and accurately for all non-cash income due to the organisation, and this income is collected efficiently.

Income

When referring to revenue of the subjects from the public sector on a central and local level we are referring to the following revenues:

- Domestic direct taxes
- Domestic indirect taxes
- Property taxes
- Charges and fees
- Sales of goods and services
- Revenues from property and government’s investments / units of the local self government
- Other miscellaneous revenues
- Capital revenue (from sale of governments property / units of the local self government)
Taxes are an important source of domestic revenue. To realize the payment of taxes, subjects from the public sector on a central and local level must carry out a tax assessment, which involves four stages:

- filing of returns or documents by the taxpayer, or collection of particulars by the assessing authority;
- investigation of the facts by the assessing authority and application of the relevant law to compute the tax base,
- determination of deductions, exemptions or reliefs admissible, and
- calculation of the tax payable.

Key controls over income

Different types of income require different systems for raising charges and collecting amounts due. These different systems will therefore exhibit different key controls.

Some key control over income from taxes and duties are given below.

- the inspection of goods or books of account for tax purposes, the assessment of taxes and duties, and their collection must be carried out by separate persons independent of each other;
- any reduction, exemption or relief of taxes and duties must be approved by responsible officials other than those who made the assessments;
- employees who inspect goods for tax purposes would not be allowed to fill out the declaration forms by themselves since this could create room for collusion and pave the way to manipulation;
- proper security controls should be operated to ensure that no goods leave the premises of a customs area without being taxed;
- all related documents should be kept in one place in order to facilitate collection of revenue; and
- there should be a continuous follow-up to ensure the prompt and accurate collection of taxes and duties.

Key controls over income from goods and services provided by the subjects from the public sector are shown below.

- there must be approved official rates and lists of charges for all services rendered;
- duties of staff should be segregated between the determination of the appropriate revenue and the actual collection;
- the collection, recording and accounting of revenues should be adequately controlled in order to prevent manipulation;
- in the case of services where customers have to make an initial deposit before receiving the service, controls should exist to prevent receipt without the appropriate prepayment; and proper registers should be maintained of all services provided; and
- amounts due from debtors should be properly accounted for, and proper procedures followed to ensure their speedy collection.
Debtors

At any given time can happen to the subjects from the public sector on a central and local level that taxes and charges for services will have been raised by but not yet paid. This money due represent an asset of the subjects and should be safeguarded in the same manner as any other asset. It is important therefore that an accurate register of all debtors is maintained, that they are collected promptly and efficiently, and that appropriate action is taken to chase outstanding debts, and write off debts that can no longer be paid.

The Role of Internal Audit in assessing income and debtors

Internal audit should assist the CFO by evaluating and recommending improvements to the control environment surrounding the organisation’s systems for income and debtors. Types of generic controls for income and debtor systems are as follows:

- Segregation of duties
- Organisational
- Authorisation and approval
- Physical
- Supervision
- Personnel
- Arithmetical and Accounting
- Management

This section provides guidance to assist internal audit in a review of the income and debtor systems.

Audit Objectives in income and debtor systems

The overall audit objectives with respect to an organisation's income and debtor systems are to ensure the completeness, accuracy, regularity and disclosure of income, and the completeness, existence, valuation, disclosure, security and substantiation of debtors.

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completeness</td>
<td>All income and debtors relevant to the period of review have been recorded.</td>
</tr>
<tr>
<td>Existence</td>
<td>All debtors recorded are valid, exist and are likely to be paid.</td>
</tr>
<tr>
<td>Measurement / valuation</td>
<td>The recorded income and debtors have been correctly and accurately valued or measured. Debtor valuations reflect the likelihood of payment.</td>
</tr>
<tr>
<td>Regularity</td>
<td>All income has been raised in accordance with established laws and regulations.</td>
</tr>
<tr>
<td>Disclosure</td>
<td>Income and debtors have been properly classified and</td>
</tr>
</tbody>
</table>
recorded in the organisation’s financial records.

Security
All debts are pursued appropriately to ensure they remain a valid asset of the government.

Substantiation
Outstanding debtors are periodically verified to source records to ensure the debt remains valid.

The attached audit program for control tests provides guidance on tests that internal audit can conduct to evaluate the control environment for the income and debtor systems. However, it remains a matter of judgement for the auditor to assess the overall adequacy of cash management and banking arrangements in each organisation, dependant on the nature and culture of that organisation.

Direct Substantive Testing
Where it has been determined, either through a weak Preliminary Systems Evaluation or testing of the control environment that adequate controls are not operating in practice, the auditor may decide to conduct some direct substantive testing. The purpose of this is two fold:

- To determine if any significant losses have occurred, and
- To contribute towards internal audit’s assessment of the organisation’s overall control environment.

The results of this work will either:

- provide assurance to management that there has not been any significant losses to the organisation as a result of a weak control environment, or
- provide evidence to management that the weak control environment has lead to significant losses, and thus prompt management to take appropriate action

The objective of substantive testing is to evaluate the adequacy and completeness of outputs rather than the operation of controls. For example, checking the amount actually paid to a supplier is the same as the amount on the invoice and on the purchase order. It is thus more detailed in its nature, more time consuming, and requires larger samples to gain the same level of assurance. However, errors discovered in substantive testing are more significant, as they usually represent a loss to the organisation, where as errors from controls test demonstrate a control failed to operate – but not necessarily that an error occurred.

The attached audit program for substantive tests provides a list of possible substantive tests the auditor may carry out to assess the organisation’s income and debtors systems.
**OVERALL SYSTEM OBJECTIVE:**

Invoices are raised promptly and accurately for all non-cash income due to the organisation, and this income is collected efficiently.

<table>
<thead>
<tr>
<th>SYSTEM RISKS:</th>
<th>Inherent Risk:</th>
<th>Preliminary Control Risk:</th>
<th>Analytical Review Evidence:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High / Medium / Low</td>
<td>High / Medium / Low</td>
<td>High / Moderate / Low</td>
</tr>
</tbody>
</table>

---

**Audit Objective, Control Objective**

<table>
<thead>
<tr>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
</table>

---

**COMPLETENESS** - All income and debtors relevant to the period of review have been recorded.

<table>
<thead>
<tr>
<th>Proper records are kept of all tax payers.</th>
<th>Lists of all tax payers for the organisation are kept up to date and periodically reviewed.</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Appropriate files are kept for all tax payers either in paper or electronic format.</td>
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</tr>
<tr>
<td>Taxes due to the organisation are raised and recorded appropriately.</td>
<td>The number of tax assessments and tax invoices raised is reconciled to the number of tax payers on the list.</td>
<td></td>
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<tr>
<td>All tax payers for whom no assessment or charge is raised are checked to ensure there is a valid reason for this.</td>
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<tr>
<td>Tax assessment notices are sent to taxpayers without delay.</td>
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</tbody>
</table>
### TESTS OF CONTROL AUDIT PROGRAM

**Audit Objective.**

#### Control Objective

**Key Controls Identified**

<table>
<thead>
<tr>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Records of all taxes due are recorded on an adequate computerised system.</td>
<td></td>
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<tr>
<td>Adequate arrangements are made to feed data from the tax recording system to the organisation’s financial management systems.</td>
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</tr>
<tr>
<td>Tax exemptions are valid.</td>
<td>Tax exemptions are only granted in accordance with statutory provisions.</td>
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<tr>
<td>Exemptions are checked (on a sample basis) by officers independent of the assessment and collection process.</td>
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</tr>
<tr>
<td>Tax receipts are compared to budgets.</td>
<td>Budgets for expected tax receipts are based on objective information, such as prior year receipts, changes in tax rates, tax base and collection rates.</td>
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<tr>
<td>Actual tax receipts are compared to budgets, by region, and significant variations investigated.</td>
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<tr>
<td>Percentage tax collection rates are monitored and recorded in management accounts. Poor or falling collection rates are investigated and appropriate action taken.</td>
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</tbody>
</table>

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**Part 4.5 - Review of Income and Debtor Arrangements - 6**
<table>
<thead>
<tr>
<th>Audit Objective, Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax revenues as a percentage of the overall tax base (e.g. VAT as a percentage of sales) are compared to prior years. Significant changes are investigated.</td>
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<tr>
<td>Customs taxes are levied appropriately.</td>
<td>Goods declared as imported are properly inspected.</td>
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<tr>
<td></td>
<td>Declarations are duly signed by the customs officials.</td>
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<tr>
<td></td>
<td>Proper security controls operate to ensure that no goods leave a customs area without being taxed.</td>
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<tr>
<td></td>
<td>There is proper authorisation and checking of duty-free goods.</td>
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</tr>
<tr>
<td>Suitable charges are made for all goods and services provided.</td>
<td>All staff has access to an official, published scale of charges, covering all services and goods provided.</td>
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<tr>
<td></td>
<td>The scale of charges is reviewed and approved each year by the management team / accounting officer or they agree the percentage increase to be applied.</td>
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</tr>
<tr>
<td>Audit Objective. Control Objective</td>
<td>Key Controls Identified</td>
<td>Control Adequate to Meet Objective? (Y / N n/a)</td>
<td>Control Confirmed by Walk Through Test? (Y / N / n/a)</td>
<td>Control Test to Evaluate Operation of Control</td>
<td>Sample size for Test of Control</td>
<td>Results of Tests of Controls</td>
<td>Control Operates Adequately in Practice? (Y / N n/a)</td>
</tr>
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<td>------------------------------------------------------</td>
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</tr>
<tr>
<td>Invoices / Bills are raised promptly and accurately for all goods and services provided.</td>
<td>There is a target for the prompt issue of invoices. The achievement of this target is monitored and revised if necessary.</td>
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<tr>
<td></td>
<td>All invoices / bills are official serially numbered documents. These identify the individual who prepared them and their department. All invoices are periodically accounted for.</td>
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</tr>
<tr>
<td></td>
<td>Segregation of duties exists between staff: • raising invoices, collecting income and undertaking debt recovery • receiving post and raising invoices • raising invoices and those with access to the related goods or services</td>
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</tr>
<tr>
<td></td>
<td>There is a periodic income register, to ensure all recurrent income is invoiced. Amendments are made by staff other than those who raise invoices. Annual increases are checked to scale of charges or other prime documents.</td>
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</tr>
</tbody>
</table>
# TESTS OF CONTROL AUDIT PROGRAM

**Organization:**

**Period Under Review:**

**System:** Income and Debtors

<table>
<thead>
<tr>
<th>Audit Objective, Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
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<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Receipts from goods and services are compared to budgets.</td>
<td>Suitable budgets are set for all potential income sources, based on objective and realistic expectations. These are disaggregated to a suitable level and monitored regularly.</td>
<td></td>
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</tr>
<tr>
<td>Explanations are obtained for any unusually low income levels.</td>
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<td></td>
</tr>
</tbody>
</table>

**EXISTENCE** - All debtors recorded are valid, exist and are likely to be paid.

- Recorded debtors are valid assets of the organisation.
  - All recorded charges and taxes are supported by adequate documentation.
  - An established procedure exists for writing off debts when they are no longer regarded as collectable.
  - Bad debt write-offs are checked and approved by senior officers, and reported in the management accounts.

**MEASUREMENT / VALUATION** - The recorded income and debtors have been correctly and accurately valued or measured. Debtor valuations reflect the likelihood of payment.

- All tax charges raised are calculated appropriately.
  - A tool for electronic calculation of taxes has been designed and is used where appropriate, based on collected information.
### Audit Objective. Control Objective

### Key Controls Identified

<table>
<thead>
<tr>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Manual tax calculations are checked by an independent officer.</td>
<td></td>
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<tr>
<td>Source documents used to carry out tax assessments are checked for authenticity and copies held on file.</td>
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</tr>
<tr>
<td>There is adequate segregation of duties between the inspection of goods or books of account for tax purposes, the assessment of taxes and duties, and their collection.</td>
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<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Taxes due are adequately recorded in the accounts of the organization.</td>
<td>Amounts of taxes due on the tax systems are periodically compared and reconciled to amounts on the organisation’s accounting system.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Charges for goods and services are correctly calculated.</td>
<td>Invoices / Bills are independently checked (at least on a sample basis) to ensure prices and accounting codes are correct.</td>
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<td></td>
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</tr>
<tr>
<td>Staff has access to procedure notes and are aware of their contents.</td>
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</tr>
<tr>
<td>Audit Objective, Control Objective</td>
<td>Key Controls Identified</td>
<td>Control Adequate to Meet Objective? (Y / N n/a)</td>
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<td>Control Test to Evaluate Operation of Control</td>
<td>Sample size for Test of Control</td>
</tr>
<tr>
<td>-----------------------------------</td>
<td>----------------------------------------------------------------------------------------</td>
<td>-----------------------------------------------</td>
<td>------------------------------------------------------</td>
<td>--------------------------------------------</td>
<td>--------------------------------</td>
</tr>
<tr>
<td>Suitable computer access controls are used.</td>
<td>Passwords and user profiles are used to control access to information on the general ledger.</td>
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<td></td>
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</tr>
<tr>
<td></td>
<td>Passwords are changed at least every 6 months. Each member of staff has their own password and has been instructed not to give their passwords to any other person.</td>
<td></td>
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</tr>
<tr>
<td></td>
<td>The computer system administrator should not use the system or have access to any of the finance systems.</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>Suitable bad debt provisions are made.</td>
<td>The organisation periodically reviews its debtors and makes a suitable provision against bad and doubtful debts.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td>Suitable aged debtor analysis is prepared for senior managers each month. Suitable information is produced regarding debt write offs.</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Methods for calculating provisions are reasonable with regard to past collection rates, and are applied consistently.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Suitable computer access controls are used. Passwords and user profiles are used to control access to information on the general ledger.

Passwords are changed at least every 6 months. Each member of staff has their own password and has been instructed not to give their passwords to any other person.

The computer system administrator should not use the system or have access to any of the finance systems.

Suitable bad debt provisions are made. The organisation periodically reviews its debtors and makes a suitable provision against bad and doubtful debts.

Methods for calculating provisions are reasonable with regard to past collection rates, and are applied consistently.
### TESTS OF CONTROL AUDIT PROGRAM

#### Organization:

#### Period Under Review:

#### System:

**Income and Debtors**

<table>
<thead>
<tr>
<th>Audit Objective, Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
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<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>REGULARITY</strong> - All income has been raised in accordance with established laws and regulations.</td>
<td>Tax calculations follow statutory provisions.</td>
<td>Adequate procedure notes have been written for all tax collectors to instruct them on their duties.</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td>Adequate training has been provided in tax calculation and assessment.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td>Administrative instructions issued by the taxing authority are followed.</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Tax assessments are reviewed by a senior officer, at least on a sample basis.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>DISCLOSURE</strong> - Income and debtors have been properly classified and recorded in the organisation’s financial records.</td>
<td>All income is appropriately recorded in the financial records.</td>
<td>The structure of income records in the government’s chart of accounts matches the types of taxes and charges levied.</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td></td>
<td>The coding of tax and other income on the accounting system is checked for accuracy and consistency.</td>
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<tr>
<td></td>
<td>Debtors are properly recorded in the financial records.</td>
<td>Balance sheets show the net debt due. The costs of debt write offs and general provisions are shown against the organisation’s management accounts.</td>
<td></td>
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</tr>
</tbody>
</table>
## Part 4.5 - Review of Income and Debtor Arrangements

### Security

- **All debts are pursued appropriately to ensure they remain a valid asset of the government.**

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective?</th>
<th>Control Confirmed by Walk Through Test?</th>
<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice?</th>
</tr>
</thead>
<tbody>
<tr>
<td>SECURITY</td>
<td>Systems for recording tax charges raised and payments received record due dates appropriately.</td>
<td>(Y / N n/a)</td>
<td>(Y / N / n/a)</td>
<td></td>
<td></td>
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<tr>
<td></td>
<td>Taxpayers are penalised for late payment and penalties are levied according to Revenue Authority regulations or the law.</td>
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<tr>
<td></td>
<td>There is an appropriate debt recovery policy. Procedures are adequately documented including guidance on suitable agreements to pay in instalments. All relevant staff have access to this.</td>
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<tr>
<td></td>
<td>Reminder letters are sent promptly to all debtors in line with policy and are accurately recorded. Automatically reminders are sent for new/small debts.</td>
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<tr>
<td></td>
<td>There is an established procedure and legal provision for pursuing overdue debts through the courts.</td>
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<tr>
<td></td>
<td>Legal action is taken against over due debtors where deemed to be cost efficient.</td>
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<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>
## Audit Objective

<table>
<thead>
<tr>
<th>Audit Objective Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit is only provided to individuals where appropriate.</td>
<td>Goods and services are not provided on credit to individuals with significant debts owed to the organisation. Departments can check the total debt owed by individuals to the organisation.</td>
<td></td>
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<tr>
<td>Debt write off is adequately controlled.</td>
<td>Appropriate authorisation is obtained for the write off of bad debts.</td>
<td></td>
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<tr>
<td>Senior officers receive regular reports on performance of debtor collection against agreed targets, and consider changing debt collection procedures where necessary.</td>
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</tr>
</tbody>
</table>

### SUBSTANTIATION

- Outstanding debtors are periodically verified to source records to ensure the debt remains valid.

- The validity of recorded over due taxes is properly confirmed.
  - Where possible, significant over due taxes are confirmed with tax payers (Note – liaise with external audit, who may carry out this test as part of their audit testing).

- The validity of debtors is properly confirmed.
  - Where possible, significant debts are confirmed with debtors (Note – liaise with external audit, who may carry out this test as part of their audit testing).
OVERALL OBJECTIVE: For all cash income of the organization are issued appropriate documents (invoices/accounts) and these incomes are efficiently obtained.

<table>
<thead>
<tr>
<th>SYSTEM RISKS:</th>
<th>Inherent Risk:</th>
<th>Control Risk:</th>
<th>Analytical Review Evidence:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High / Medium / Low</td>
<td>High / Medium / Low</td>
<td>High / Moderate / Low</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
<th>Result Satisfactory (Y / N)</th>
<th>Initials</th>
<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Completeness:</strong> All income and debtors relevant to the period of review have been recorded.</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Check the list of tax payers / taxable bodies has been updated.</td>
<td></td>
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</tr>
<tr>
<td>2</td>
<td>Check a sample of files for tax payers to ensure adequate documentation is kept.</td>
<td></td>
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</tr>
<tr>
<td>3</td>
<td>Compare and reconcile (where possible) the number of tax payers to the number of tax invoices.</td>
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<tr>
<td>4</td>
<td>Check that there is adequate reason for any tax payers not being sent tax invoices.</td>
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<tr>
<td>5</td>
<td>Check the length of time between tax assessments conducted and tax invoices sent out.</td>
<td></td>
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</tr>
<tr>
<td>6</td>
<td>Check a sample of tax assessments to invoices and records of due amounts. Investigate any discrepancies.</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>7</td>
<td>Compare amounts due on the tax system to amount of taxes due on the financial management system.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>8</td>
<td>Test the validity of tax exemptions in accordance with statutory provisions.</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>9</td>
<td>Compare tax receipts for the period to budget, by region, and obtain explanations for significant variances.</td>
<td></td>
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</tr>
<tr>
<td>Test no.</td>
<td>Audit objective and audit procedure</td>
<td>Result Satisfactory (Y / N)</td>
<td>Initials</td>
<td>Date</td>
<td>W.P. Ref.</td>
<td>Errors to SoF</td>
</tr>
<tr>
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</tr>
<tr>
<td>10</td>
<td>Enquire in to the methods used to estimate the budget for tax income, and consider whether this is reasonable.</td>
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<td></td>
</tr>
<tr>
<td>11</td>
<td>Recalculate the percentage tax collection rates for the period, check these are reported to management, and compare to previous periods.</td>
<td></td>
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</tr>
<tr>
<td>12</td>
<td>Calculate tax revenues as a percentage of the tax base, compare to previous periods and investigate significant changes.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>13</td>
<td>Observe the processes for assessing and levying customs taxes on imports. Ensure goods declared as imports are properly assessed.</td>
<td></td>
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<tr>
<td>14</td>
<td>Inspect security at customs points and ensure goods imported can not leave the area without being inspected and assessed.</td>
<td></td>
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<tr>
<td>15</td>
<td>Check that goods classed as duty free meet the statutory classifications for duty free goods.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>16</td>
<td>Check that prices are published (and annually updated / reviewed) for all services provided by the organisation.</td>
<td></td>
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</tr>
<tr>
<td>17</td>
<td>Calculate the percentage of invoices that are produced within timescales established by management, or within reasonable timescales.</td>
<td></td>
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</tr>
<tr>
<td>18</td>
<td>Check that invoices are consecutively numbered, and that all invoices can be accounted for.</td>
<td></td>
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</tr>
<tr>
<td>19</td>
<td>Check that invoices have been issued for items on the periodic income register.</td>
<td></td>
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</tr>
</tbody>
</table>
### Test No. 20
Enquire into the methods used to estimate the budget for charges for goods and services, and consider whether this is reasonable.

### Test No. 21
Compare revenues for the period to budget, by region, and obtain explanations for significant variances.

**Existence:** All debtors recorded are valid, exist and are likely to be paid.

### Test No. 22
Check a sample of debtor balances to ensure adequate documentation is held to support the debt.

### Test No. 23
Investigate significant write offs for bad debts and ensure there are adequate reasons (e.g. bankruptcy, court judgement, death).

**Measurement / valuation:** The recorded income and debtors have been correctly and accurately valued or measured. Debtor valuations reflect the likelihood of payment.

### Test No. 24
Recalculate a sample of tax charges to ensure accuracy. Investigate any discrepancies.

### Test No. 25
Check the adequacy and authenticity of source documents used for tax calculations.

### Test No. 26
Check the calculation of the bad debt provision is in accordance with established procedures and consistent with prior years.

### Test No. 27
Check the debtors recorded in the accounts is the net debt (total debt less write offs and provisions).
## SUBSTANTIVE TESTING AUDIT PROGRAM

<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
<th>Result Satisfactory (Y / N)</th>
<th>Initials</th>
<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><strong>Regularity:</strong> All income has been raised in accordance with established laws and regulations.</td>
<td></td>
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<tr>
<td>28</td>
<td>Check that taxes and service charges raised are done in accordance with relevant statutory provisions.</td>
<td></td>
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</tr>
<tr>
<td></td>
<td><strong>Disclosure:</strong> Income and debtors have been properly classified and recorded in the organisation’s financial records.</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>29</td>
<td>Check that tax invoices and receipts have been properly coded on the financial ledger.</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>30</td>
<td>Check that the costs of debt write offs and provisions have been reflected in management information showing the cost of the service.</td>
<td></td>
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<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Security:</strong> All debts are pursued appropriately to ensure they remain a valid asset of the government.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>31</td>
<td>Check that the due dates recorded for taxes are in accordance with relevant laws and regulations.</td>
<td></td>
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</tr>
<tr>
<td>32</td>
<td>Check that penalties for late payment have been calculated and applied properly.</td>
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</tr>
<tr>
<td>33</td>
<td>Check that reminder letters for non-payment have been sent at the appropriate time.</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>34</td>
<td>Check that significant overdue debts are being pursued appropriately, and investigate where this does not appear to be the case.</td>
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</tbody>
</table>
### Test no. 35

**Substantiation**: Outstanding debtors are periodically verified to source records to ensure the debt remains valid.

**Audit objective and audit procedure**

Obtain direct confirmation from debtors regarding the validity of overdue debts (Note – liaise with external audit, who may carry out this test as part of their audit testing).

---

<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
<th>Result Satisfactory (Y / N)</th>
<th>Initials</th>
<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td>35</td>
<td><strong>Substantiation</strong>: Outstanding debtors are periodically verified to source records to ensure the debt remains valid.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>35</td>
<td>Obtain direct confirmation from debtors regarding the validity of overdue debts (Note – liaise with external audit, who may carry out this test as part of their audit testing).</td>
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</tbody>
</table>

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**Auditor in charge**: ____________________________ **Date**: ________________

**Head of Internal Audit Unit**: ____________________________ **Date**: ________________
6. REVIEW OF PURCHASING AND PAYMENT PRACTICES

Introduction

This section covers the purchasing, receiving and payments of goods and services by the subjects from the public sector. Hence, it covers all aspects of the system used by Government to acquire goods and services, except for those acquired through the use of public procurement procedures.

The system for acquiring goods and services can be illustrated as follows:

<table>
<thead>
<tr>
<th>Event</th>
<th>Purchase order</th>
<th>Receive goods/services</th>
<th>Receive invoice</th>
<th>Make payment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Records</td>
<td>Commitment</td>
<td>Receipt note</td>
<td>Creditor</td>
<td>Payment</td>
</tr>
</tbody>
</table>

It thus covers the placing of orders, the receiving of goods and invoices and payments made in respect of these goods. It also covers the organisation's records relating to purchase, receiving and payment of goods/services.

One of the biggest problems in financial management in large public sector organisations is managing debts. A major cause of this is the lack of systematic procedures for recording all commitments and liabilities, which makes it harder for the organisation to plan its cash flow and manage its resources. Taken to its extreme, this is evidenced by cupboards full of unrecorded, accruing unpaid invoices; the organisation obtaining a reputation as a bad payer; and eventually companies and other organisations refusing to supply it with goods and services.

The risk of this is exacerbated by the use of a cash accounting system. Under this system, the Government records in its accounts only payments made in a given period. It does not record the value of goods ordered or received which have not yet been paid for. However, the Public Accounting Act also requires from budgets and budget users to produce a balance sheet. This implies the Government must record the value of goods and services received but not yet paid for in a given period. These are known as creditors.

It is appropriate therefore that the Government’s systems record all goods and services received (expenditure), amounts paid, and goods and services received but not paid for (creditors). For the purpose of good management of an organisation, it is important to have robust procedures to record all purchases, commitments and payments due, in order to properly manage cash flow and resources. It is therefore appropriate that internal audit, assists the accounting officer to improve systems of control for purchases and payments.

The system objective with respect to purchases and payments is to ensure all goods and services required by the organisation are received, accounted and paid for efficiently.
Key Controls over Purchase Orders

After expenditure votes have been made and budgets set, the purchase order is the first stage in the process of acquiring goods and services. This stage initiates a transaction and usually commits the organisation to a future liability. If accounting records are not complete and accurate at this stage, it becomes very difficult for the organisation to ensure that:

- all goods and services it requires are received
- only valid payments are made
- accurate records exist of the organisation's liabilities

Some key controls over purchase orders are:

- only authorised staff can place orders on behalf of the organisation
- all orders fall within the approved vote and budgets of the organisation
- adequate resources exist to meet the liabilities created
- all orders are completely and accurately recorded
- orders are matched to goods received and to invoices

Key Controls over Receipt of Goods and Services

There should be an official order for all goods and services received by an organisation. When goods or services are received, the goods received note (GRN) should be matched to a valid, open order to ensure its validity. Goods received which do not relate to a valid, open order should be investigated carefully: accepting such goods may incur an obligation which has not been properly approved.

Ensuring the complete recording of all goods and services is crucial to ensure that payments are only made for goods received. It is advisable to ensure that all goods received are signed for, and that the organisation and the supplier keep a copy of this receipt.

Some key controls over the receipt of goods and services are:

- all goods and services received are accompanied by a goods received note, copies of which are kept by the organisation and supplier
- all goods received are matched to an official order before being accepted; the order is marked as closed on the system
- goods received without an official order are checked for appropriate authorisation before acceptance
- all goods are checked for quality, quantity and specification before being accepted; the goods received note is signed for by an authorised officer
- goods are only delivered to approved locations which have adequate security.
Key Controls over Payments

Payments for goods and services may be made by cash or direct bank transfer (Treasury). Security and efficiency are highest when using bank transfers, then cash. It is therefore recommended that organisations limit the use of cash payments where ever possible. However, for small payments and payments to small suppliers, cash may be the only feasible payment method.

The primary objective in the auditing of payments is to ensure that all payments have been properly authorised, recorded and made to the relevant supplier. In order to achieve this primary objective, it is necessary to ensure that:

- invoices received are matched to approved orders, marked as delivered
- invoices are checked, authorised for payment and stamped as ‘PAID’
- payments are made to the right party for the right amount
- all the proper supporting documents are attached to the payment voucher
- the payment is correctly recorded in the accounting records
- all payments are correctly recorded under the appropriate budgetary heads and expenditure votes

Key controls over cash payments include:

- payments over specified limits are made by bank / treasury only, and imprest systems are used for petty cash payments
- there is proper segregation of duties among personnel e.g., authorising officers, paying officers (cashiers) and recording (accounting) personnel
- payment vouchers and supporting documents are examined before payment and approved by authorised officials
- safes or vaults are used for custody of cash
- there is adequate security over cashiers’ offices
- there are proper procedures for the accurate recording of all cash payments.

Key controls over bank payments include:

- proper procedures for the preparation of payment vouchers, including attachment of supporting documents and deduction of discounts, returns, etc
- adequate procedures for the receiving, recording, custody and issue of cheque books
- adequate rules and regulations governing the preparation of requests for Treasury payments, e.g. machine printed, officials authorised to sign, use of crossings, etc
- appropriate methods for transmission - by direct transfer to the payee's bank account, etc
- adequate procedures for the arrangement, storing and custody of all paid invoices and supporting documents for a specified period
- proper recording of all payments in the cash and bank books, monthly reconciliation with bank statements and follow-up of any uncleared items, all duties being properly segregated amongst staff.
Key Controls over Creditors and Commitments

At any given time, goods and services will have been ordered or received by the organisation, but not yet paid for. Items ordered represent a commitment of the organisation; items received but not paid represent a creditor. The recording of commitments is useful for planning cash flow in an organisation, though commitments fall outside the scope of a normal accounting system. Commitment accounting and monitoring should only be used where the organisation perceives additional control is needed over its expenditure, for example if it has a history of incurring obligations which it can not meet.

Normally, organisations start to record accounting transactions when a good or service is provided. The accounting entry is usually prompted by the receipt of a good or service, or the receipt of an invoice for a good or service provided. At this point, when a good or service has been provided, the organisation has incurred a liability to make a future payment. It is essential for effective management of the organisation that it records, measures and monitors its liabilities, so it can make plans to honour these obligations in the future. It is important therefore that an accurate register of all creditors is maintained, so that they can be paid when due, to the correct party, and at the correct rate.

The Role of Internal Audit in purchase and payment systems

The internal audit should assist the accounting officer by evaluating and recommending improvements to the control environment surrounding the organisation's purchase and payment systems. Types of generic controls for purchase and payment systems are:

- Segregation of duties
- Organisational
- Authorisation and approval
- Physical
- Supervision
- Personnel
- Arithmetical and Accounting
- Management

This section provides guidance to assist internal audit in a review of the purchase and payment systems in the organization.

Audit Objectives in Purchase and Payment Systems

The overall audit objectives with respect to an organisation's purchase and payment systems are to ensure the completeness, occurrence, measurement, regularity and disclosure of purchases and payments, and the completeness, valuation, ownership and disclosure of creditors and/or commitments.
Audit Objective | Definition
--- | ---
Completeness | All purchases, receipts, payments and creditors relevant to the period of review have been recorded.
Occurrence | All recorded orders and receipts actually occurred and were relevant to the period of review.
Measurement / valuation | The recorded purchases, payments and creditors have been correctly and accurately valued or measured.
Ownership | All recorded creditors are properly those of the audited body and arise solely from regular activities.
Regularity | Purchases and payments are in accordance with established laws and regulations that are in force.
Disclosure | Purchases, payments and creditors have been properly classified and recorded in the organisation’s financial records.

The attached audit program provides guidance on tests that internal audit can conduct to evaluate the control environment for the purchase and payment systems. However, it is a matter of judgement for the auditor to assess the overall adequacy of purchase and payment systems in each organisation.

**Direct Substantive Testing**

Where it has been determined, either through a weak Preliminary Systems Evaluation or testing of the control environment, that adequate controls are not operating in practice, the auditor may decide to conduct some direct substantive testing. The purpose of this is two fold:

- To determine if any significant losses have occurred, and
- To contribute towards internal audit’s assessment of the organisation’s overall control environment.

The results of this work will either:

- provide assurance to management that there has not been any significant losses to the organisation as a result of a weak control environment, or
- provide evidence to management that the weak control environment has lead to significant losses, and thus prompt management to take appropriate action

The objective of substantive testing is to evaluate the adequacy and completeness of outputs rather than the operation of controls. For example, checking the amount paid to a supplier is the same as the invoiced amount.

Hence it is more detailed, more time consuming, and requires larger samples to gain the same level of assurance. However, errors discovered in substantive testing are more significant, as they usually represent a loss to the organisation, where as errors from controls test demonstrate a control failed to operate – but not necessarily that an error occurred.

The attached audit program provides a list of possible substantive tests the auditor may carry out to assess the organisation’s purchase and payment systems.
## OVERALL SYSTEM OBJECTIVE:

ALL GOODS AND SERVICES REQUIRED BY THE ORGANISATION ARE RECEIVED, ACCOUNTED AND PAID FOR EFFICIENTLY.

### SYSTEM RISKS:

<table>
<thead>
<tr>
<th>Inherent Risk:</th>
<th>Preliminary Control Risk:</th>
<th>Analytical Review Evidence:</th>
</tr>
</thead>
<tbody>
<tr>
<td>High / Medium / Low</td>
<td>High / Medium / Low</td>
<td>High / Moderate / Low</td>
</tr>
</tbody>
</table>

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<th>Audit Objective, Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
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<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>COMPLETENESS - All purchases, receipts, payments and creditors relevant to the period of review have been recorded.</td>
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<tr>
<td>Appropriate orders are raised for all goods and services.</td>
<td>Official order books are held securely. Only staff authorised to place orders have access to the order records.</td>
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<td></td>
<td>Orders are raised promptly on official order forms.</td>
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<tr>
<td>All goods and services that have been ordered are received and used as required.</td>
<td>Adequate segregation of duties exists between staff authorised to order goods; those who receive them and those who have access to the payments system.</td>
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<td></td>
<td>All goods are checked upon receipt against the official order (or good received note) and their quality is checked; the invoice is then initialled and dated. Queries are documented</td>
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</tbody>
</table>
### Audit Objective, Control Objective

<table>
<thead>
<tr>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N / n/a)</th>
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<th>Control Operates Adequately in Practice? (Y / N / n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>and promptly raised with the supplier.</td>
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<tr>
<td>Goods received are held securely. Where appropriate a secure designated receiving area is used. All orders indicate where the goods should be delivered.</td>
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<tr>
<td>Duplicate payments are avoided.</td>
<td>Checks are made to ensure that duplicate payments are avoided. Invoices are stamped PAID when input for payment; payments are only made from original invoices.</td>
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<tr>
<td>Appropriate computer reports are produced and investigated, e.g. same invoice value or order number paid to same supplier in last three months.</td>
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<tr>
<td>All valid creditors are recorded on the creditors system.</td>
<td>Records of outstanding orders are checked periodically to ensure they are still open. Cancelled orders are marked as such on the order system.</td>
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</tbody>
</table>

### OCCURRENCE - All recorded orders and receipts actually occurred and were relevant to the period of review.

| All goods are received in full and relate to valid | All goods received are checked to official purchase orders before the goods received note is signed. | |

---

**Part 4.6 - Review of Purchasing and Payment Practices- 7**
### Audit Objective: Control Objective

**Key Controls Identified**

<table>
<thead>
<tr>
<th>Control Adequate to Meet Objective? (Y / N / n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
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</thead>
<tbody>
<tr>
<td>Adequate</td>
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<tr>
<td>to Meet Objective</td>
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</tbody>
</table>

**Results of Tests of Controls**

- **Control Operates Adequately in Practice?**
  - Yes
  - No
  - Not Applicable

**Audit Objective: Control Objective**

Orders.

- Goods received are checked and signed for by appropriately authorised staff.

**MEASUREMENT / VALUATION** - The recorded purchases, payments and creditors have been correctly and accurately valued or measured.

- Payments are made accurately and promptly for all goods and services received.
  - Adequate segregation of duties exists between staff who:
    - certify payments
    - account for creditor payments

- All payments are certified. This is documented by initialling and dating the invoice, to confirm checks made on receipt; that received as ordered; and expenditure code is appropriate.

- Lists are maintained of all staff authorised to certify invoices for payment.

- All payments for goods and services are adequately accounted for.
  - All payments give raise to an individual entry in the creditor payments system and can be traced to the relevant invoice.
## Audit Objective

**Control Objective**

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N / n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
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<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N / n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lists of all proposed payments (prepayment reports) are checked, initialled and dated by authorised staff before the payments are made. For at least a sample of these payments, checks are made that the value and payee are the same as on the invoice and the invoice has been properly authorised.</td>
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<tr>
<td>Exception reports are produced of larger payments for particular checks. All payments over a certain value are individually signed or signed by a second person.</td>
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</tbody>
</table>

## OWNERSHIP

- All recorded creditors are properly those of the audited body and arise solely from regular activities.

- All creditors are generated solely from appropriately authorised orders.

- All orders are suitably authorised. Budget holders authorise orders to show that the goods or services are required and that a budget is available within their delegated limits.

- Suitable levels of stocks are maintained. However, these should be minimised and no more than e.g. one month’s supply should be held.
<table>
<thead>
<tr>
<th>Audit Objective, Control Objective</th>
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<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N / n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amendments to standing data on creditors is adequately authorised and checked. Amendments to the creditor payments masterfile are suitably checked and authorised. Summary reports of all changes are periodically checked.</td>
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</tr>
<tr>
<td>Checks are made to ensure no staff are set up as creditors.</td>
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</tr>
<tr>
<td>There are adequate access controls to the ordering and creditors systems.</td>
<td>Passwords and user profiles are used to control access to information on the general ledger.</td>
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</tr>
<tr>
<td>Passwords are changed at least every 6 months. Each member of staff has their own password and they have been clearly instructed not to give / share / tell their password to any other person.</td>
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</tr>
<tr>
<td>The computer system administrator (the person who sets up new staff, changes profiles etc) does not use the system or have access to any of the finance systems.</td>
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</tbody>
</table>
### TESTS OF CONTROL AUDIT PROGRAM

**Audit Objective.**

**Control Objective**

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<th>Key Controls Identified</th>
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<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transactions are in accordance with the appropriate delegated authority</td>
<td>There is an up to date authorised signature list for authorising purchase orders, payments and creditor write offs.</td>
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</tbody>
</table>

**REGULARITY** - Purchases and payments are in accordance with established laws and regulations.

- Payments are made in accordance with payment terms.
  - Payments are made within an appropriate time scale with regard to prompt payment discounts and supplier terms of credit (30 days unless otherwise stated in the contract). Compliance with payment terms is reported to management at least quarterly.
  - All orders are approved by budget holders or managers under delegated authority. Orders indicate the budget head to which the purchase relates.
  - Budget holders review all expenditure charged to their budgets each month to ensure the expenditure falls within the approved vote.

**DISCLOSURE** - Purchases, payments and creditors have been properly classified and recorded in the organisation’s financial records.

- All transactions are properly recoded in the government’s chart of accounts.
### TESTS OF CONTROL AUDIT PROGRAM

**Organization**

**Period Under Review:**

**System:** Purchases and Payments

<table>
<thead>
<tr>
<th>Audit Objective, Control Objective</th>
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<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
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<tbody>
<tr>
<td>the financial records.</td>
<td>allows for the recording of types of expenditure incurred, by organisation and region.</td>
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<tr>
<td></td>
<td>All coding is checked for accuracy and consistency at least on one sample basis.</td>
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</tbody>
</table>
OVERALL OBJECTIVE: ALL GOODS AND SERVICES REQUIRED BY THE ORGANISATION ARE RECEIVED, ACCOUNTED AND PAID FOR EFFICIENTLY.

<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
<th>Result Satisfactory (Y / N)</th>
<th>Initials</th>
<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td><strong>Completeness:</strong> All purchases, receipts, payments and creditors relevant to the period of review have been recorded.</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>
| 2        | For a sample of payments, ensure:  
  • each relates to a bona fide good or service needed by the organisation  
  • the payment is supported by an official invoice  
  • there is evidence (e.g. GRN) of the goods being received  
  • the GRN relates to any appropriately authorised order |                             |          |      |           |               |
<p>| 3        | For any payments tested which cannot be traced back to an authorised order, investigate and check that the payment has been properly authorised and seek evidence of a good or service provided. |                             |          |      |           |               |
| 4        | Observe the receipt of goods in a designated receipting area. Ensure that all goods are being adequately checked and counted before being signed for. |                             |          |      |           |               |
| 5        | Check adequate security facilities exist at designated receipting areas. |                             |          |      |           |               |
|          | Interrogate the computer payments system for evidence of payments made to same supplier for same amount or same order number. Investigate for duplicate payments. |                             |          |      |           |               |</p>
<table>
<thead>
<tr>
<th>Test no.</th>
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<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td>6</td>
<td>Interrogate the purchase order system for old, outstanding orders. Enquire with the person raising the order whether the order is still open or whether it has been cancelled. Ensure cancelled orders are marked cancelled on the system.</td>
<td></td>
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<tr>
<td>7</td>
<td>Check a sample of GRNs back to official orders. Ensure the descriptions, quantities and prices match.</td>
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<tr>
<td>8</td>
<td>Check GRNs are not signed for by the person who authorised the order.</td>
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<tr>
<td>9</td>
<td><strong>Measurement / valuation:</strong> The recorded purchases, payments and creditors have been correctly and accurately valued or measured.</td>
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<tr>
<td>10</td>
<td>Test the pricing calculations on a sample of invoices. Ensure the payments made were for the right amount. Investigate any discrepancies between invoice prices and quoted order prices.</td>
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<tr>
<td>11</td>
<td>Where there are goods returned to suppliers, overpayments or overcharging, ensure that suppliers have issued appropriate credit notes and these have been recorded as debit entries on the creditors system.</td>
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<tr>
<td></td>
<td>Interrogate the system for payments over a certain value, and ensure they are for bona fide goods or services.</td>
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</tr>
<tr>
<td>Test no.</td>
<td>Audit objective and audit procedure</td>
<td>Result Satisfactory (Y / N)</td>
<td>Initials</td>
<td>Date</td>
<td>W.P. Ref.</td>
<td>Errors to SoF</td>
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</tr>
<tr>
<td>Ownership: All recorded creditors are properly those of the audited body and arise solely from regular activities.</td>
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<tr>
<td>12</td>
<td>Obtain the latest budget reports for the organisation and analyse for any (pro-rata) areas of over spending or near overspending on goods and services. Investigate levels of outstanding orders on these budget heads, and consider whether total spending plus commitments is greater than the approved budgets.</td>
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<td>13</td>
<td>For areas of overspending identified, enquire of management about actions taken to rectify overspending.</td>
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<tr>
<td>14</td>
<td>Investigate levels of major stocks held compared to current usage rates. Discuss with management where stock holding does not appear to be in line with usage.</td>
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<tr>
<td>15</td>
<td>Review standing data on the creditors system. Check that recent amendments to data are bona fide and that supporting documents are held to validate new suppliers.</td>
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</tr>
<tr>
<td>Regularity: Purchases and payments are in accordance with established laws and regulations.</td>
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<tr>
<td>16</td>
<td>Review a sample of payments and ensure that payments are made by the due date. Ensure that prompt payments discounts have been taken where appropriate.</td>
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<tr>
<td>17</td>
<td>Review latest budget reports and obtain a breakdown of goods and services under each budget head. Test a sample to ensure the</td>
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</tr>
<tr>
<td>Test no.</td>
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<tr>
<td></td>
<td>expenditure has been charged to the correct budget head and expenditure vote.</td>
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<tr>
<td></td>
<td>Disclosure: Purchases, payments and creditors have been properly classified and recorded in the organisation's financial records.</td>
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<tr>
<td>18</td>
<td>Check a sample of purchases has been properly coded on the financial ledger.</td>
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<td>19</td>
<td>Check that credit notes received have been deducted from the cost of service in management information / budget reports.</td>
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</tr>
</tbody>
</table>

Auditor in charge: __________________________ Date: ________________
Head of Internal Audit Unit: __________________________ Date: ________________
7. REVIEW OF PAYROLL AND EXPENSE ARRANGEMENTS

Introduction

This section of the Manual covers payroll, allowances and expense payments for employees. Payroll usually represents the largest proportion of an organisation’s expenditure, and is an area where good controls are essential to prevent fraud and corruption.

Payroll systems usually incorporate payments that are made direct from employees’ payroll such as personnel income tax and pension contributions. The accuracy of these payments is therefore also covered by internal audit work on payroll systems.

The system objective with respect to payroll and expenses is to ensure that current employees are paid accurately and promptly.

Key controls over payroll and expenses

The most important controls in a payroll system are to ensure segregation of duties between the personnel function (responsible for hiring new staff and setting salary rates) and the payroll function (responsible for administering payroll payments), and to ensure prompt and accurate budget reports are distributed to all budget holders showing the payroll costs charged to their budget.

Payroll is an area where computer based controls checks and computer based audit techniques can usefully be employed. For example, if all payroll payments are processed on a single computer payroll system, it is possible to download the payment file into a database and interrogate it for duplicate names and addresses, payments over particular values, allowances over a particular percentage of salaries etc. It is also possible to run cross checks between the payroll system data and personnel system data, and reconcile the two.

The Role of Internal Audit in assessing payroll and expense systems

Types of generic controls for payroll and expense systems are as follows:

- Segregation of duties
- Organisational
- Authorisation and approval
- Physical
- Supervision
- Personnel
- Arithmetical and Accounting
- Management

This section of the manual provides guidance to assist internal audit in a review of the payroll and expense systems in the institution.
Audit Objectives in Payroll and Expense systems

The overall audit objectives with respect to an organisation's payroll and expense systems are to test the completeness, occurrence, measurement/evaluation, regularity and disclosure of all payments for employees.

<table>
<thead>
<tr>
<th>Audit Objective</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Completeness</td>
<td>all payments relevant to the period of review have been recorded;</td>
</tr>
<tr>
<td>Occurrence</td>
<td>all recorded payments, and transactions to which they relate, actually occurred and were relevant to the period of review;</td>
</tr>
<tr>
<td>Measurement / Evaluation</td>
<td>the recorded payments have been properly calculated;</td>
</tr>
<tr>
<td>Regularity</td>
<td>all payments are in accordance with relevant legislation and other specific requirements’</td>
</tr>
<tr>
<td>Disclosure</td>
<td>all payments have been properly classified and allocated to the appropriate expenditure votes, as they were foreseen with the budget.</td>
</tr>
</tbody>
</table>

The attached audit program provides guidance on tests that internal audit can conduct to evaluate the control environment for the payroll and expense systems. However, it remains a matter of judgement for the auditor to assess the overall adequacy of payroll and expense systems in each organisation, dependant on the nature and culture of that organisation.

Direct Substantive Testing

Where it has been determined, either through a weak Preliminary Systems Evaluation or testing of the control environment that adequate controls are not operating in practice, the auditor may decide to conduct some direct substantive testing. The purpose of this is two fold:

- To determine if any significant losses have occurred, and
- To contribute towards internal audit assessment of the organisations’ overall control environment.

The results of this work will either:

- provide assurance to management that there has not been any significant losses to the organisation as a result of a weak control environment, or
- provide evidence to management that the weak control environment has lead to significant losses, and thus prompt management to take appropriate action.

The objective of substantive testing is to evaluate the adequacy and completeness of outputs rather than the operation of controls. For example, checking the amount actually paid to an employee is the same as the amount stipulated on his / her contract. It is thus more detailed in its nature, more time consuming, and requires larger samples to gain the same level of assurance. However, errors discovered in
Internal Audit Manual

substantive testing are more significant, as they usually represent a loss to the organisation, where as errors from controls test demonstrate a control failed to operate – but not necessarily that an error occurred.

The attached audit program with substantive tests provides a list of possible substantive tests the auditor may carry out to assess the organisation’s payroll and expense systems.
OVERALL SYSTEM
OBJECTIVE:
CURRENT EMPLOYEES ARE PAID ACCURATELY AND PROMPTLY

<table>
<thead>
<tr>
<th>SYSTEM RISKS:</th>
<th>Inherent Risk:</th>
<th>Preliminary Control Risk:</th>
<th>Analytical Review Evidence:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High / Medium / Low</td>
<td>High / Medium / Low</td>
<td>High / Moderate / Low</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Audit Objective. Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
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</thead>
<tbody>
<tr>
<td>COMPLETENESS – All payments relevant to the period of review have been recorded</td>
<td></td>
<td></td>
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<td></td>
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<td></td>
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</tr>
<tr>
<td>All payroll and expense payments made promptly.</td>
<td>A check is made on changes to the number of staff on the payroll compared with the last period. On each payroll / section of payroll the number of staff paid is reconciled with the previous month (or week) and the changes included within authorised data input.</td>
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<td></td>
<td>A register is maintained of all expense claims received. All expense claims are recorded on the system as soon as they are received, and are marked as paid as soon as they are paid.</td>
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<tr>
<td>OCCURRENCE - All recorded payments, and transactions to which they relate, actually occurred and were relevant to the period of review.</td>
<td>Suitable control accounts are used</td>
<td>The output from payroll is reconciled to the input totals in the general ledger</td>
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<tr>
<td>Audit Objective, Control Objective</td>
<td>Key Controls Identified</td>
<td>Control Adequate to Meet Objective? (Y / N n/a)</td>
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<td>Sample size for Test of Control</td>
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<td>Control Operates Adequately in Practice? (Y / N n/a)</td>
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<td>to validate total payments.</td>
<td>through the use of suitable controls.</td>
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<td></td>
<td>The total debits / credits to the payroll system are compared to those posted to the general ledger. If the control account does not balance this is investigated and suitable action taken to ensure that this is corrected. The reconciliation is promptly reviewed. Preparers and reviewers initial and date all reconciliations.</td>
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<tr>
<td>Total payments recorded on the payroll system are reconciled to the payroll payments recorded on the bank statement on a monthly basis. Any discrepancies are investigated.</td>
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<tr>
<td>Payroll payments are checked to independent source records.</td>
<td>A suitable independent list of employees and their salaries is established in the Human Resources Management Unit. The payroll is periodically checked to the payroll establishment.</td>
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<tr>
<td>There is proper over sight of the total expense</td>
<td>The total expenses paid to each member of the staff are reviewed each year. Tabulation is produced of the total value</td>
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**TESTS OF CONTROL AUDIT PROGRAM**

<table>
<thead>
<tr>
<th>Audit Objective. Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
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<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>claims for each body.</td>
<td>of expenses claimed by each member of staff each year and this is reviewed for reasonableness by the head of department. Any potential anomalies are checked carefully.</td>
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</table>

**MEASUREMENT/EVALUATION -** The recorded payments have been properly calculated.

- Variations to payroll input data are accurate and undertaken promptly.
- All starter and leaver records are created by staff in a personnel section that is separate from the payroll section.
- Staff responsible for authorising the creation of new employee records has no involvement in the processing of the payroll.
- All changes to payroll input data are checked and authorised. Staff responsible for authorisation of the following changes are formally agreed:
  a) amendments to standing data (e.g. salary scales, tax rates)
  b) amendments to permanent individual data (e.g. staff salary levels)
  c) data that varies on a monthly basis (e.g. overtime, expenses for food, claims for each body.
<table>
<thead>
<tr>
<th>Audit Objective, Control Objective</th>
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<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
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<td>transportation)</td>
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<tr>
<td>(b) and (c) are only submitted for processing if the relevant documents (e.g. starters/leavers forms, overtime records) are properly authorised by the appropriate persons (copies of whose signatures are held by the payroll section).</td>
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<tr>
<td>Payroll staff receives a copy of the appointment letter and the new starter form and details are checked for consistency.</td>
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<td>Personnel staff checks all leavers are stopped promptly on the correct date.</td>
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<tr>
<td>All tax and pay scales that are held in the computer are checked for accurate input, at least on a sample basis, to prime documents e.g. notification of pay increases or tax rates.</td>
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<tr>
<td>Spot checks are made on payroll items to ensure that input data is accurate. Items within output reports are checked (on sample basis) in comparison with the authorised data submitted and prime documentation, including spot checks</td>
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</tbody>
</table>
### Audit Objective. Control Objective

<table>
<thead>
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<th>Control Operates Adequately in Practice? (Y / N / n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>by staff independent of the original preparation of data for submission.</td>
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<tr>
<td>Access to the computer payroll system is suitably controlled. Only authorised staff has access to the payroll system. Use is made of suitable password protection and user profiles, i.e. staff only have access to those aspects of the system that they need to undertake their work.</td>
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<tr>
<td>Passwords are changed every 6 months. Each member of staff has their own password and has been instructed not to give their passwords to anyone else.</td>
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<tr>
<td>The computer system administrator does not use the system or have access to any of the finance systems.</td>
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<tr>
<td>All payroll data is accurately processed, net pay is properly calculated.</td>
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<tr>
<td>There is clear segregation of duties between staff who account for payroll and those who make payments. Staff responsible for handling payroll data and calculating pay is not required to handle cash or cheques and are not involved in automatic payment systems.</td>
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</tbody>
</table>
### Audit Objective

**Control Objective**

<table>
<thead>
<tr>
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<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Each payroll statement is authorised by senior officers not directly involved in its preparation. Authorisation of payroll payments is restricted to appropriate senior staff independent of the production of the payroll itself.</td>
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<tr>
<td>Checks are made to ensure that individual and total payroll payments do not exceed an agreed amount and unusual payments are investigated. Appropriate payment limits are established for individual bank transactions.</td>
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</tbody>
</table>
| Exception reports are produced showing for example:  
  • gross salary is greater than given percentage of basic pay rate ascertained with the legislation  
  • gross pay greater than a given limit  
  • net pay is greater for some percentage above the previous period  
  • salary above the grade maximum  
  • overtime greater than a given limit  
  • allowances greater than a given limit  
  • cash payments greater than a limit. | | | | | | | |
### REGULARITY - All payments are in accordance with relevant legislation and other specific requirements.

<table>
<thead>
<tr>
<th>Audit Objective, Control Objective</th>
<th>Key Controls Identified</th>
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<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>REGULARITY</td>
<td>Suitable documentary guidance is available to staff.</td>
<td>All relevant staff has access to suitable payroll procedure notes. These are sufficiently detailed to be used for training and reference by new staff and cover all aspects of the payroll function and are updated as necessary with new guidance and regulations.</td>
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<tr>
<td></td>
<td>Staff has access to suitable detailed guidance on e.g. taxation issues. This may be written guidance or access to suitably qualified and experienced advisors.</td>
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<td></td>
<td>All deductions from gross pay are properly calculated, accounted for and paid over to the appropriate organization</td>
<td>Checks are made to ensure that personal income tax is paid accurately and promptly each month. Personnel income tax is deducted where appropriate, paid to the Public Revenue Office by the required date and properly accounted for.</td>
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<td></td>
<td>Appropriate arrangements are made for the deduction of pension contributions. Staff agrees in writing to join and employee and employer contributions are sent to / transferred to the relevant</td>
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<tr>
<td>Audit Objective, Control Objective</td>
<td>Key Controls Identified</td>
<td>Control Adequate to Meet Objective? (Y / N / n/a)</td>
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<tr>
<td>pension fund by the required date.</td>
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<tr>
<td>Other deductions have appropriate written authorisation e.g. Court Orders, maintenance payments etc.</td>
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<tr>
<td>Control accounts are used to ensure deductions are paid accurately.</td>
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<tr>
<td>Voluntary deductions from pay are authorised in writing by the employee.</td>
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<tr>
<td>Appropriate expenses are paid accurately and promptly.</td>
<td>Limits for personal expenses are reviewed and agreed each year. Limits for personal expenses are foreseen in the budget for every institution.</td>
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<tr>
<td>Unless otherwise documented in staff contracts, expenses are only for specific costs that have been incurred and, where possible, are backed up with receipts.</td>
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<tr>
<td>Expenses are only allowed if they are claimed promptly. All expenses are claimed on official forms within two months of the end of the month in which they were incurred. The forms are authorised by approved supervisors. Expenses are paid through payroll.</td>
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## Audit Objective. Control Objective

### Key Controls Identified

- **All foreign travel is reviewed by members each year and the cost compared to likely benefits. All foreign travel is coded separately and the total for each member of staff is reported to senior management each year.**

<table>
<thead>
<tr>
<th>Audit Objective. Control Objective</th>
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<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
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</tr>
</thead>
<tbody>
<tr>
<td>All foreign travel is reviewed by members each year and the cost compared to likely benefits. All foreign travel is coded separately and the total for each member of staff is reported to senior management each year.</td>
<td>All foreign travel is reviewed by members each year and the cost compared to likely benefits. All foreign travel is coded separately and the total for each member of staff is reported to senior management each year.</td>
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</table>

**DISCLOSURE** - all payments have been properly classified and allocated to the appropriate expenditure votes, as they were foreseen within the budget.

- **Payroll, allowances and expense payments are properly recorded.**
  - The structure of expenditure records in the government’s chart of accounts allows for separate recording of payments, types of allowances and expenses, by organisation / region.
  - The coding of payments on the accounting system are checked for accuracy and consistency.
OVERALL OBJECTIVE: Current employees are paid accurately and promptly

<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
<th>Result Satisfactory (Y / N)</th>
<th>Initials</th>
<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Completeness: All payments relevant to the period of review have been recorded</td>
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<tr>
<td>1</td>
<td>Compare and reconcile number of payments made in consecutive periods. Investigate discrepancies.</td>
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<td>2</td>
<td>Check a sample of expense payments have been paid once and only once.</td>
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<tr>
<td></td>
<td>Occurrence: All recorded payments, and transactions to which they relate, actually occurred and were relevant to the period of review</td>
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<tr>
<td>3</td>
<td>Reconcile payroll output totals to general ledger input totals. Investigate any discrepancies.</td>
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<tr>
<td>4</td>
<td>Reconcile payroll output totals to payroll figures recorded on the bank statement.</td>
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<tr>
<td>5</td>
<td>Check a sample of payroll payments to the staffing establishment lists of the employees. Ensure payments are for the correct amount and have been made to the correct employees.</td>
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<tr>
<td>6</td>
<td>Produce / obtain a list of total expense payments for the period by employee. Review the list to assure in the reasonableness and investigate any significant payments made based on higher qualifications</td>
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</table>
**Test no.** | **Audit objective and audit procedure** | **Result Satisfactory (Y / N)** | **Initials** | **Date** | **W.P. Ref.** | **Errors to SoF**
---|---|---|---|---|---|---
and responsibilities.  
**Measurement and evaluation:** The recorded payments have been properly calculated.
7 | Take a sample of starters and leavers, check there is adequate authorisation from the personnel department. Check whether payments start and finish on the correct dates. |  |  |  |  |  
8 | Check amendments to standing data to source records, e.g. changes in salary rates, staff salary levels, expense rates. |  |  |  |  |  
9 | Check a sample of standing data on the payroll system to source documents. |  |  |  |  |  
10 | Where cash payments are used, check a sample of payments to amounts recorded on the payroll system. |  |  |  |  |  
11 | Interrogate the system to produce lists of payments for further investigation, including:  
• gross greater than given percentage of basic pay, as it is ascertained in the legislation  
• gross pay greater than a given limit  
• net pay greater than the given limit  
• salary above the grade maximum  
• overtime greater than a given limit  
• allowances greater than a given limit  
• cash payments greater than a limit. |  |  |  |  |  
12 | Review the budget reports for the organisation and check that the staff costs charged to the budget relate only to bona fide employees. Check |  |  |  |  |  

Part 4.7 - Review of Payroll and Expense Arrangements - 14
<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
<th>Result Satisfactory (Y / N)</th>
<th>Initials</th>
<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>that total staff budget costs are within the approved expenditure vote.</td>
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<tr>
<td></td>
<td><strong>Regularity</strong> - All payments are in accordance with relevant legislation and other specific requirements.</td>
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<tr>
<td>13</td>
<td>Review of sample of deductions from payroll (e.g. income tax, pension payments) and check these have been calculated in accordance with existing legislation.</td>
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<td>14</td>
<td>Check that monthly / annual totals transferred to the tax authorities agree to the tax authority’s records.</td>
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<td>15</td>
<td>Check any other payroll deductions to appropriate source records.</td>
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<tr>
<td>16</td>
<td>Check the rates at which expenses have been paid agree to appropriate legislation.</td>
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<tr>
<td>17</td>
<td>Check a sample of expense claims to appropriate supporting documentation.</td>
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<tr>
<td>18</td>
<td>Check that any foreign travel expenses claimed are supported by adequate documentation and appropriate approval for the trip.</td>
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<tr>
<td></td>
<td><strong>Disclosure</strong> – all payments have been properly classified and allocated to the appropriate expenditure votes as they were foreseen with the budget.</td>
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<tr>
<td>19</td>
<td>Check that a sample of payroll transactions has been coded correctly on the financial ledger.</td>
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</table>

Auditor in charge: __________________________ Date: ________________

Head of Internal Audit Unit: __________________________ Date: ________________
<table>
<thead>
<tr>
<th>Organization:</th>
<th>File Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>Period Under Review:</td>
<td>Prepared by Date</td>
</tr>
<tr>
<td>System: Payroll and Expenses</td>
<td>Reviewed by Date</td>
</tr>
</tbody>
</table>
8. REVIEW OF STORES AND PROPERTIES SYSTEMS

Introduction

This section of the manual covers the recording and management of stores and properties. Stores include all items of stock held by the organisation for resale, distribution or production of other goods and services. Properties include all fixed and movable assets held by the organisation for long term benefit, being mainly: land, buildings, vehicles, machinery, computer equipment, fixtures and fittings.

This section of the manual therefore covers the majority of the Public sector’s non-monetary assets.

The Role of Internal Audit in stores and properties

The responsibilities of internal audit in relation to these assets are to audit the system of internal control in managing stores, stock and properties.

It is appropriate that systems are in place to record all stores and properties of the organisation. For the purpose of good management, it is important to have robust procedures to control and safeguard assets, and to ensure they are utilised effectively. It is therefore appropriate that internal audit, as a management function, assists the accounting officer to improve systems of control for stores and properties.

Based on organisation’s property records, the internal audit should make additional tests with aim to confirm the completeness, existence, valuation, ownership and disclosure of the organisation's property.

Types of generic controls useful for stores and property systems are as follows:

- Segregation of duties
- Organisational
- Authorisation and approval
- Physical
- Supervision
- Personnel
- Arithmetical and Accounting
- Management

This section manual provides guidance to assist internal audit in a review of the stores and property systems in the institution.

Audit Objectives in Stores and Property Systems

For the management of the organisation's stores and property, the system objective is to ensure that all stores and properties are properly safeguarded, verified and utilised effectively.
Audit Objective  | Definition
---|---
Security  | All stores and properties are held securely.
Substantiation  | Stores and properties are periodically verified to ensure they exist and that any impairments are reflected in their valuations.
Utilisation  | All stores and properties are utilised effectively.

The attached audit program of the control tests provides guidance on tests that internal audit can conduct to evaluate the control environment for managing stores and property.

**Direct Substantive Testing**

Where it has been determined, either through a weak Preliminary Systems Evaluation or testing of the control environment that adequate controls are not operating in practice, the auditor may decide to conduct some direct substantive testing. The purpose of this is two fold:

- To determine if any significant losses have occurred, and
- To contribute towards internal audit’s assessment of the organisation’s overall control environment.

The results of this work will either:

- provide assurance to management that there has not been any significant losses to the organisation as a result of a weak control environment, or
- provide evidence to management that the weak control environment has lead to significant losses, and thus prompt management to take appropriate action.

The objective of substantive testing is to evaluate the adequacy and completeness of outputs rather than the operation of controls. For example, checking that all assets recorded on an accounting officer’s statement exist and are effectively utilised by the organisation. It is thus more detailed in its nature, more time consuming, and requires larger samples to gain the same level of assurance. However, errors discovered in substantive testing are more significant, as they usually represent a loss to the organisation, where as errors from controls test demonstrate a control failed to operate – but not necessarily that an error occurred.

The attached audit program for substantive tests provides a list of possible substantive tests the auditor may carry out to assess the organisation’s stores and property systems.
## OVERALL SYSTEM OBJECTIVE:

**ALL STORES AND PROPERTIES ARE PROPERLY SAFEGUARDED, VERIFIED AND UTILISED EFFECTIVELY.**

<table>
<thead>
<tr>
<th>SYSTEM RISKS:</th>
<th>Inherent Risk:</th>
<th>Preliminary Control Risk:</th>
<th>Analytical Review Evidence:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>High / Medium / Low</td>
<td>High / Medium / Low</td>
<td>High / Moderate / Low</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Audit Objective. Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>SECURITY - All stores and properties are held securely.</td>
<td>The list of assets is accurate and up to date.</td>
<td>A designated officer is responsible for maintenance of the fixed asset register. This is kept on a secure computer system and only authorised officers can amend data.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>All purchases and disposals of fixed assets are recorded on the asset register.</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td></td>
<td></td>
<td>Adequate computer systems are used to record the receipt and issue of all stock.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>The list of assets provides sufficient information to assist and enhance security.</td>
<td>All property is assigned an owner (individual for computers, vehicles etc, division for machinery, buildings, land) who is held responsible for the security / substantiation / utilisation of that asset.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## TESTS OF CONTROL AUDIT PROGRAM

### Organization:

#### Period Under Review:

- Prepared by: [Date]
- Reviewed by: [Date]

#### System:

- Stores and Properties

### Audit Objective

#### Control Objective

#### Key Controls Identified

<table>
<thead>
<tr>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
<th>Control Confirmed by Walk Through Test? (Y / N / n/a)</th>
<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
</table>

#### The accounting officer’s list of assets records the location of all non-moveable property.

#### All property is given a unique security reference, marked on the property, and recorded on the asset register.

#### The stock register records the location of all stocks, and each location is under the delegated responsibility of an authorised employee.

#### All fixed assets are held securely.

#### Security arrangements at all locations are appropriate to the value of property held there.

#### Property losses are reported to managers and investigated promptly.

#### All stocks are held securely.

#### There is adequate physical security at storage units, including locks, alarms, security guards and restricted access.

### SUBSTANTIATION

#### Stores and properties are periodically verified to ensure they exist and that any impairments are reflected in their valuations.

#### Stock levels are regularly verified.

#### There are properly controlled, periodic stock takes under taken management. These compare the level of each type of stock in store to the level recorded on the computer systems. Differences are properly investigated.
## Part 4.8 - Review of Stores and Property Systems

### Audit Objective

#### Control Objective

<table>
<thead>
<tr>
<th>Audit Objective. Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
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<th>Control Test to Evaluate Operation of Control</th>
<th>Sample size for Test of Control</th>
<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock takes consider the valuation of stock, and ensure that stock is valued in accordance with the Government’s accounting policy.</td>
<td>Stock takes</td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>For significant stores, an annual stock take is undertaken by an independent body (usually external audit).</td>
<td>For significant stores</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Fixed assets are periodically verified.</td>
<td>Management has implemented a rolling program of asset verification, checking that all assets on the list are still held by the organisation. The frequency of checks takes into account the value of the asset and the risk of misappropriation.</td>
<td>Management</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Asset verification considers the present state and usefulness of the asset against its present value, and ensures the asset’s valuation is in accordance with the legislation.</td>
<td>Asset verification</td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

### UTILISATION

- All stores and properties are utilised effectively.

| Stock holdings are kept at an appropriate level. | Management considers the cost of holding stock, risk of loss and average usage levels, to determine an optimum minimum and maximum stock level. | | | | | | |
### Audit Objective.

<table>
<thead>
<tr>
<th>Audit Objective. Control Objective</th>
<th>Key Controls Identified</th>
<th>Control Adequate to Meet Objective? (Y / N n/a)</th>
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<th>Results of Tests of Controls</th>
<th>Control Operates Adequately in Practice? (Y / N n/a)</th>
</tr>
</thead>
<tbody>
<tr>
<td>All write offs, losses and impairments of assets are charged to the accounts of the appropriate division.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>
OVERALL OBJECTIVE: ALL STORES AND PROPERTIES ARE PROPERLY SAFEGUARDED, VERIFIED AND UTILISED EFFECTIVELY.

<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
<th>Result Satisfactory (Y / N)</th>
<th>Initials</th>
<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Security:</strong> All stores and properties are held securely.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Review the list of fixed assets and check that it is up to date and contains details such as location, owner, security number.</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>2</td>
<td>Check that recent amendments to the register have been made by authorised staff.</td>
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</tr>
<tr>
<td>3</td>
<td>Obtain a list of fixed asset purchases and ensure these have been input on the asset register.</td>
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<td></td>
<td></td>
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</tr>
<tr>
<td>4</td>
<td>Review the asset register for disposals and sale of assets. Ensure there is adequate authorisation and reason for asset disposals.</td>
<td></td>
<td></td>
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<tr>
<td>5</td>
<td>Ensure that proceeds from the sale of assets are appropriate considering the asset’s value, and that the proceeds have been credited to the organisation’s bank account.</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>6</td>
<td>Test that a sample of stock receipts and issues have been correctly recorded on the stock system, with regard to quantity, valuation and location.</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>7</td>
<td>Visit a sample of locations and check that security arrangements for fixed assets are adequate for the value of assets held there.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Part 4.8 - Review of Stores and Property Systems

<table>
<thead>
<tr>
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<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td>8</td>
<td>Enquire in to any cases of property losses and ensure that management investigated and responded appropriately.</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>9</td>
<td>Visit storage facilities and ensure that security arrangements are adequate for the value of stocks held there (e.g. locks, alarms, security guards, restricted access).</td>
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</tr>
<tr>
<td>10</td>
<td>Obtain the list of fixed assets and seek to verify the existence of a sample of assets. Stratify the list into subgroups of assets with high, medium and low risk of loss. Sample from each subgroup separately, focusing on larger value items.</td>
<td></td>
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<tr>
<td>11</td>
<td>Ensure that any impairment in the asset is reflected in its valuation.</td>
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<td></td>
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<tr>
<td>12</td>
<td>Attend a stock take and ensure that stocks are counted and valued appropriately.</td>
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<td></td>
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</tr>
<tr>
<td>13</td>
<td>Review stock taking arrangements to ensure they are robust.</td>
<td></td>
<td></td>
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<tr>
<td>14</td>
<td>Ensure stock is not double counted or incorrectly categorised to cover up losses.</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>15</td>
<td>Obtain stock sheets and recount a sample to ensure accuracy.</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>16</td>
<td>Review the method for valuing stock and ensure this is in line with the legislation.</td>
<td></td>
<td></td>
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<td></td>
<td></td>
</tr>
</tbody>
</table>

**Substantiation:** Stores and properties are periodically verified to ensure they exist and that any impairments are reflected in their valuations.
<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
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<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td>17</td>
<td>Examine any damaged or obsolete stock and ensure these are marked as such on the stock sheets. Ensure these are valued appropriately.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>Compare the level of stocks held at stores to the average usage levels. Where excessive stock appears to be held, consider the value of capital tied up in stock and report the interest cost to management where significant.</td>
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</tr>
</tbody>
</table>

**Utilisation**: All stores and properties are utilised effectively.

---

Auditor in charge: _______________________ Date: _________________

Head of Internal Audit Unit: _______________________ Date: _________________
9. REVIEW OF THE PUBLIC PROCUREMENT PROCEDURES

Introduction

This section of the manual covers the public procurement of goods and services that are regulated with the Law for public procurement and by laws. Very often are made changes in value limits and procurement procedures, so that these directions can be used only after will be consolidated with the current legislation.

Take into consideration that provisions from the Law for public procurement do not refer to the purchase of equipment and stocks for state defence and security (like the Ministry of Defence).

According to the Law for public procurement, procurement procedures should be implemented when buying goods or services for which is expected that will cost more than 3000 euros. It is expected gains to be bigger than the costs of the procedure.

The Law for public procurement forbids the purchase to be separated on parts with aim to avoid the public procurement procedures or other legal limitations.

The rules for procurement should not be considered as a group of rules that must be respected, but as a possibility the organization to get higher value for invested money. For an example, during the year, several suppliers can implement group purchase and all together to procure equipment or office material in value of 10 million denars. Taken as a group, there is significant possibility these suppliers to work together to embody one procurement with much lower price and on that way to save significant resources for own organization.

Audit risk and sampling

Public procurements in the organization usually are characterized with small number of procurements with high amount that are executed every year. The usual method for taking samples that is consisted of the internal audit – attributive sampling – is not suitable for this case, because risks are specific for every purchase. Because of this, usually the whole testing of the procurements should be done through selection of key units – focusing on those purchases that are:

- with high value;
- with strategic importance for the organization;
- politically sensitive;
- with high risk for failure of the purchase.

This will probably direct the focus mainly to purchases that are subject to national or international public tenders.

The procurement process in these cases usually should include the following steps:
Defining the specifications or the procurement conditions
If needed, getting approval
Preparation of tender documentation
Approval of the tender documentation from the Commission for public procurement
Advertisement of the tender
Arrival of offers and tender opening
Offer assessment
Investigation and approval from the Commission for public procurement
Reviews and approvals from authorised person
Reporting for the choice of best bidder
Concluding contract

This table should give directions that will help the auditor to understand the procurement process in the Republic of Macedonia, and the time frame for each separate step in the procedure should be determined in compliance with the regulation, internal act of the organization and specifications of the procurement.

Control objectives

Control objectives for the public procurement procedures are as follows:

• Clear justification for the need of the goods or services;
• Goods or services are procured with lowest prices;
• Goods or services are received when they were needed;
• Procured goods or services are with appropriate quality and accurate specification.

The internal audit should help to the high management through assessment and giving recommendations for improvement of the control environment where is implemented the public procurement process. The types of basic controls that are used in the public procurement system are:

• Segregation of duties;
• Organization;
• Authorization and approval;
• Physically;
• Supervision;
• Personnel;
• Arithmetic and accounting;
Managerial. This part of the manual gives directions to help the internal audit during the audit of the public procurement system in the organization.

Audit objectives of public procurement systems

General audit objectives of the public procurement systems in the organization are to confirm that purchases are done economically, efficiently and effectively.

<table>
<thead>
<tr>
<th>Audit objective</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy</td>
<td>All inputs in the process are provided of the most economy way in relation to the specifications for the cost and the quality;</td>
</tr>
<tr>
<td>Efficiency</td>
<td>Given inputs in the process transfer in results on the most efficient way;</td>
</tr>
<tr>
<td>Effectiveness</td>
<td>Results from the process are designed to be compatible as much as possible with the general goals of the organization.</td>
</tr>
</tbody>
</table>

The attached audit program for audit provides guidance on audit tests that should be done to assess the control environment of the public procurement system. Still remains the auditor to decide for the adequacy of the public procurement system in every organization.

Substantive tests

Where will be decided to be necessary, whether through previous assessment of the systems or through testing of the control environment that adequate controls are not implemented, the auditor can decide to perform several direct substantive tests. The objective of these tests is:

- to determine whether occurred some significant losses, or
- to contribute for the complete appraisal for the whole control environment in the institution.

Results from this will provide:

- assurance for the management that no significant losses happened for the institution as a result of the weak control environment, or
- proofs for the management that the weak control environment brought to significant losses and hence recommends to the management to undertake appropriate activities.

The objective of the substantive tests is to assess the adequacy and the completeness of the results, and not the working of the controls. For example, the check whether detailed regulations for procurements have been implemented for specific procurements. Hence, the more tests are detailed, the more time they need for realization and bigger number of samples for achieving of same level of
assurance. However, errors that are discovered through substantive tests are more important, because mostly they show loss for the institution, than errors discovered through control tests that show that controls are not functioning properly – but not that an error occurred.

The attached audit program for substantive tests provides a list of possible substantive tests that the auditor can make in order to assess the procurement systems in the institution.
## ANNEXES

### AUDIT PROGRAM FOR AUDIT OF PUBLIC PROCUREMENTS

### CONCLUSIONS³

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT Satisfactory (Y / N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td>System Objective:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>All goods and services that are necessarily for the organization are provided economy and timely and they are with adequate specification and quality.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Control objectives:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A</td>
<td>There is clear justification for the need for the goods and services.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B</td>
<td>Goods and services are provided with lowest prices.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C</td>
<td>Goods and services are provided when they are needed.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D</td>
<td>Purchased goods and services are with adequate quality and exact specification.</td>
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</tr>
</tbody>
</table>

### GOOD REASONABLE POOR

The overall procedure for public procurement of the organisation is:

**Auditor in charge:** ________________________ **Date:** ________________________

**Head of Internal Audit Unit:** ________________________ **Date:** ________________________

³ The table with conclusions is filled after will be gathered enough evidences and information based on questionnaires and tests prepared in compliance with directions given in continuance.
A. Clear justification exists for the need for goods and services

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1 Strategic approach exists towards procurements.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 The organization has a strategy for procurements that covers the whole process for purchase of goods and services form other subjects.</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>1.2 The procurement strategy shows clear relation between the objective of the procurements and the organizational objectives.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.3 A written procedure exists that covers the procurements and all employees are familiarized with its content.</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>A2 Bigger procurements are respectively planned.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2.1 The annual process of planning includes prognosis of the need for goods and services, including time frame assessment.</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>2.2 The organization prepares procurement plan for those goods and services for which there is enough money in the adopted budget or they are budgeted for the following years.</td>
<td></td>
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</tr>
<tr>
<td>2.3 For all bigger procurements or services that are given to external companies there is a document (study) for economical justification.</td>
<td></td>
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</tr>
<tr>
<td>2.4 The document for economical justification identifies and assesses the options for achieving the objectives of the activity for which the procurement should be made and reviews different methods for procurements such as common procurements with other organizations.</td>
<td></td>
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</tr>
<tr>
<td>2.5 The document for economical justification is presented and approved by the high management before the procurement is</td>
<td></td>
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</tr>
</tbody>
</table>
### Objective Result

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITIALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td>implemented.</td>
<td></td>
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</tr>
<tr>
<td><strong>A3</strong>  There is respective Commission for public procurements.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.1 In the organization is established a Commission for public procurements. Its members, appointment and procedures are in compliance with the Law for public procurements.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.2 The Commission for public procurements has working manual or document for the conditions for work, where are given the obligations, responsibilities and limitations of the authorizations.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.3 All members of the Commission for public procurement are familiarized with the conditions for work and trained/involved in the procurement process.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
B. Goods and services are purchased with lowest prices.

<table>
<thead>
<tr>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
<th>INITITALS</th>
<th>DATE</th>
<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td>B1 Most appropriate selection procedures are used.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.1 The Commission for public procurement is familiarized with regulations for procurements for the organization and it implements them in tender procedures.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1.2 When is used a procurement from one exclusive source, the institution that makes the procurement also records the reason for that and requires approval from the Bureau for public procurements within the Ministry of Finance.</td>
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<td></td>
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<tr>
<td>B2 Goods and services are provided in most economy quantities.</td>
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<tr>
<td>2.1 The organization reviews the possibility for accepting a contract for shipment in the moment when there is a need with aim not to create excessive stocks.</td>
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<tr>
<td>2.2 The organization made an assessment for the optimal quantity for purchase with aim to get the best prise from suppliers.</td>
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<tr>
<td>B3 The organization is actively using group supplies with other organizations.</td>
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<tr>
<td>3.1 The organization investigated whether some other organization provides similar goods or services and requests procedure for group supply.</td>
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<tr>
<td>OBJECTIVE</td>
<td>RESULT (Y/N)</td>
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<td>WP REF.</td>
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<tr>
<td><strong>B4</strong></td>
<td>The organization has established adequate relations with all bigger suppliers.</td>
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<tr>
<td>4.1</td>
<td>The organization tried to make frame contracts with suppliers from which often purchases similar goods.</td>
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<tr>
<td>4.2</td>
<td>The organization concludes adequate contracts for determination of prices / guarantee for the price stability from suppliers, for example to get a discount if the goods can be found on other place with cheaper prices; or to ascertain prices that are subject of change depending of the season.</td>
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<tr>
<td>4.3</td>
<td>When possible, the organization uses methods for electronic purchases in order to minimize the transaction costs.</td>
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<tr>
<td><strong>B5</strong></td>
<td>The organization has adequate knowledge for the market of own customers.</td>
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<tr>
<td>5.1</td>
<td>The organization / Bureau for public procurements prepared a list of certified suppliers for different types of goods and services. Regularly it reviews the quality of their products and their financial condition.</td>
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<tr>
<td>5.2</td>
<td>The Government actively reviews programs with which can enable to suppliers an access to markets for which is considered that does not have enough choice and competition.</td>
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</tbody>
</table>
C. Goods and services are received when they are needed.

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<tr>
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</tr>
</thead>
<tbody>
<tr>
<td>C1 Needs for procurements should be adequately planned.</td>
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</tr>
<tr>
<td>1.1 Annual plans and documents for economy justification include the time frame for planned distribution of goods and services.</td>
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<tr>
<td>1.2 Plans include adequate costs for execution of procurement procedures.</td>
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<tr>
<td>C2 Big projects / procurements are adequately managed.</td>
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<tr>
<td>2.1 Responsible person is appointed for projects/procurements management.</td>
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<tr>
<td>2.2 Adequate plans exist for managing every bigger contract.</td>
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<tr>
<td>2.3 Project managers are adequately trained / have knowledge for methodology for project management.</td>
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<tr>
<td>2.4 Project plans include time frame for bigger activities, dead lines for the key results and key moments in the project</td>
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<td>2.5 During the project, several adequate controls exist.</td>
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<td>2.6 Project plan identifies all bigger risks and the measures that will be undertaken for decreasing, insuring, transfer or accepting</td>
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<td>OBJECTIVE</td>
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<td>of these risks.</td>
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<tr>
<td>2.7 Adequate external advice is required when the project team does not have the necessary knowledge or experience for project management.</td>
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<tr>
<td><strong>C3</strong> The work of suppliers is reviewed.</td>
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<tr>
<td>3.1 The organization / Government follows the work of the suppliers in relation of timely delivery and accomplishment of dead lines of the projects.</td>
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<tr>
<td>3.2 The organization has adequate plans for unforeseen situations in case if suppliers are not in position to deliver the goods or services that are crucial for the work of the organization.</td>
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<tr>
<td>3.3 Contracts with suppliers include provisions for decreasing the price in cases when the supplier will not deliver in the dead line defined in the contract.</td>
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<tr>
<td><strong>C4</strong> Adequate procedures exist for ordering goods for stock.</td>
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<tr>
<td>4.1 Adequate systems are used for recording and monitoring of the levels of goods on stock.</td>
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<tr>
<td>4.2 Lowest levels for stocks are set up and if they are reached the organization orders new goods for stock. These lowest levels are determined by calculation of costs for order for goods for stock, average rates of use and the time needed for delivery.</td>
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</tbody>
</table>
D. **Purchased goods and services are with adequate quality and accurate specification**

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<thead>
<tr>
<th></th>
<th>OBJECTIVE</th>
<th>RESULT (Y/N)</th>
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<th>WP REF.</th>
</tr>
</thead>
<tbody>
<tr>
<td>D1</td>
<td>Tender specification is adequate.</td>
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<tr>
<td>1.1</td>
<td>Tender specifications are prepared by appropriately trained and qualified staff who is familiarized with goods and services that are procuring.</td>
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<tr>
<td>1.2</td>
<td>When the organization does not have adequate technical experts to prepare procurement specifications then an adequate technical support is requested.</td>
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<td>D2</td>
<td>Before concluding the contract, suppliers are respectively assessed.</td>
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<tr>
<td>2.1</td>
<td>When something like that exists, suppliers are compared with suppliers lists approved by the Government.</td>
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<tr>
<td>2.2</td>
<td>The reputation of the supplier is checked and respective recommendations and proofs for previous realized similar procurements.</td>
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<tr>
<td>D3</td>
<td>Overview on current basis is done.</td>
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<tr>
<td>3.1</td>
<td>Long term projects are regularly checked by the organization / independent experts and not only performing a check at the end of the project.</td>
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<td>3.2</td>
<td>The quality of deliveries from important suppliers is regularly checked comparing it with the specifications.</td>
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<tr>
<td>D4</td>
<td>Payments are related with satisfactory execution.</td>
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<tr>
<td>4.1</td>
<td>Standards of the services are specified in the contracts where it is possible.</td>
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<tr>
<td>4.2</td>
<td>Methods for reviewing of the standards and punishments for not fulfilling the standards are stated in the contracts.</td>
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<tr>
<td>4.3</td>
<td>Observation of the standards is monitored and also decreasing of process is provided.</td>
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### OBJECTIVE

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<thead>
<tr>
<th></th>
<th>OBJECTIVE</th>
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<tbody>
<tr>
<td>4.4</td>
<td>Adequate stimulus activities exist to encourage good, consistent service from suppliers.</td>
</tr>
<tr>
<td>4.5</td>
<td>Procedures for solving disputes and arbitration are foreseen in the contracts.</td>
</tr>
<tr>
<td>4.6</td>
<td>Ascertained are the rights and responsibilities in case of violation of the contract and respective arrangements exist for alternatives in case when the procurement will be terminated from certain reasons.</td>
</tr>
</tbody>
</table>
SUBSTANTIVE TESTS

OVERALL OBJECTIVE: All goods and services that are necessary for the organization are provided economically and timely and all that will appropriate specification and quality.

SYSTEM RISKS:

<table>
<thead>
<tr>
<th>Inherent Risk</th>
<th>Control Risk</th>
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<tbody>
<tr>
<td>High / Medium / Low</td>
<td>High / Medium / Low</td>
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</table>

<table>
<thead>
<tr>
<th>Test no.</th>
<th>Audit objective and audit procedure</th>
<th>Result Satisfactory (Y / N)</th>
<th>Initials</th>
<th>Date</th>
<th>W.P. Ref.</th>
<th>Errors to SoF</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economy:</td>
<td>All inputs are provided on most economy way in relation to costs and quality</td>
<td></td>
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<tr>
<td>1</td>
<td>Overview of the business plans of the organization, budgets and payments that are above the margin for “small procurements”. Provide a list of big payments and procurements where tender procedures should have been used.</td>
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<td>2</td>
<td>Take sample from this list based on the value, strategic importance, political sensitivity and the risk for failure of the project. Require proofs that the tender procedures were implemented as they should.</td>
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<tr>
<td>3</td>
<td>For selective projects review the tender documentation within the Commission for public procurements. Check whether tender methods are in compliance with the procurement regulations, based on the total assessment of the project value.</td>
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<td>4</td>
<td>When procurement is made from one exclusive source, check whether that one is adequately approved and whether the reason for that is appropriately recorded and adequate.</td>
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<td>5</td>
<td>Revise the payment system in order to find the total value of payments for</td>
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<td>6</td>
<td>biggest suppliers during one year. Consider whether there are evidences that some projects are divided on smaller parts in order to avoid the procurement regulations or whether there is scope for establishing contracts for procurements with bigger suppliers.</td>
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<td>7</td>
<td>Check whether international companies that received contracts are registered within the respective professional body.</td>
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<td>8</td>
<td>Check whether tenders are published in adequate newspapers/magazines.</td>
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<td>9</td>
<td>Check whether technical and financial offers are requested and received in separate envelopes and whether technical manuals are publicly opened and reviewed by the Commission for public procurements before opening of the financial offers.</td>
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<td>10</td>
<td>Check whether technical offers that do not correspond with the minimal requests are returned back to the bidder with unopened financial offer.</td>
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<td>11</td>
<td>Check whether the method for assessment and scoring of the technical and financial offers is in compliance with the method stated in the tender documentation.</td>
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<td>12</td>
<td>Check whether the contract is awarded to the best bidder in compliance with provisions from the Law for public procurement.</td>
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<td>When the contract is not awarded to the bidder stated in the provisions from the Law for public procurement, check whether the reason for this is recorded and justified.</td>
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<tr>
<td>Efficiency:</td>
<td>Given inputs are</td>
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<td>13</td>
<td>Check whether for the procurement is prepared adequate tender documentation.</td>
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<td>14</td>
<td>Check whether the tender documentation is approved by the Commission for public procurements before it is given to the suppliers.</td>
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<td>15</td>
<td>Check whether the tender documentation is already sent to all respective suppliers (those that are selected on the tender or those who were interested in and for which is considered that have the necessary knowledge and experience).</td>
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<td>16</td>
<td>Check whether long term projects are regularly assessed by independent experts.</td>
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<td>17</td>
<td>Check whether time situations for construction works are confirmed by respectively qualified professionals.</td>
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<td>18</td>
<td>Check whether signed contracts include:</td>
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<td></td>
<td>• Dead line for finishing the procurement and key phases from the procurement, if it is possible;</td>
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<td></td>
<td>• Standards for services/specifications of the goods;</td>
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<td>• Methods for reviewing the standards;</td>
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<td></td>
<td>• Punishments for not accomplished standards;</td>
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<td></td>
<td>• Procedures for solving disputes;</td>
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<td></td>
<td>• Punishments for violation of the contract.</td>
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<td>19</td>
<td>Check whether there were suppliers did not accomplish the defined standards and/or dead lines, respective punishments/discounts are applied.</td>
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<td>20</td>
<td>Effectiveness: As mush as possible results are consolidated with the general objectives of the organization.</td>
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<td>21</td>
<td>For big procurements for which tender is announced during the year, check whether a procurement has been included in the strategic/annual plan and whether it was respectively approved.</td>
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<td>22</td>
<td>Check whether procurements are implemented only when there is enough money for that in the budget or if there are foreseen means for the next year.</td>
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<td>23</td>
<td>Check whether plans for the procurement are also reviewing the available options for procurement (buying, lizing, partnership contracts, etc.) and whether these options are appropriately assessed and approved.</td>
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<td>24</td>
<td>Review the constitution and appointment of the members of the Commission for public procurements versus requests of the Law for public procurements.</td>
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<td>25</td>
<td>Check whether is required additional approval from competent body when the amount for complete realization of the procurement surpasses the amount that was first approved for the procurement.</td>
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Auditor in charge: ___________________________ Date: ____________________