

A simple approach to developing an audit finding

The following information aims to explain the key elements/factors required for a finding and what each of them means in simple English with a relevant example under each element/factor. The key factors of a finding are as follows:

Criteria:

The criteria is the **must** of what must happen in the company. This usually comes from the policies or procedures of the company, laws and regulations or best practices. For example, the policy of XYZ Limited states that bank reconciliations must be performed on a monthly basis.

Condition:

The condition should state what is **actually happening** in the environment being audited.

For example, it was found during the audit that bank reconciliations are not being conducted by the finance department.

Cause:

The cause indicates the **reason** that the control is not being conducted. Not following policies and procedures is not a cause for a control failure.

An example of a cause would be: Through discussion with the personnel in the finance department, it was noted that they were not trained to complete bank reconciliations and therefore do not know how.

Effect:

The effect is similar to the risk. You need to explain that if the control fails (the one identified as the criteria), what will be the **possible outcome**.

For example, if bank reconciliations are not completed on a monthly basis, it is possible for the company to over or under state the bank account balance in the financial statements which could lead to misrepresentation of the financial status of the company.

Recommendation:

The recommendation should state how to **fix** the problem (corrective action). It is extremely important to remember that the recommendation must talk to the root cause. Any plausible corrective action that addresses the cause of the problem will be accepted.

For example, management should consider sending the current staff for training on how to perform bank reconciliations so that they can complete it on a monthly basis OR management should consider hiring staff with the competency to complete bank reconciliations.

Question

In response to a special request by the financial manager, you are required to briefly review the reasonableness of the accounts receivable (debtors) balance at the end of June 2012. The financial manager is concerned about the collectability of debtors after the debtors' age analysis suddenly worsened in May.

During your review you discover that the debtors' statements were posted two weeks later than usual in May as a result of a problem encountered with the information system. The server that housed all the accounts receivable information was hit by lightning.

Owing to the volume of journals and in an attempt to ensure that the system would be able to go live as soon as possible, the accounts receivable manager gave a blanket approval of all the journals processed to update the system. This was contrary to company policy as the policy requires that journals be approved by the accounts receivable manager on an individual basis.

You have collected the following information during your audit:

The total number of disputed transactions comes to 5% of the monthly turnover.

The total debtors balance was R360 500 in May and R450 300 in June.

Credit sales for May and June amounted to R1 700 000 per month.

You also discovered that some of the payments received from debtors, while the accounts receivable system was down, were not subsequently updated.

You have discussed the matter with the accounts receivable manager, who said that he was aware of some of the problems. Owing to the massive backlog created by the breakdown, his staff has been simply unable to cope with more than their current workload.

REQUIRED

Write an internal audit report on your review of the accounts receivable section. Your report should include recommendations you might have in respect of your audit findings. (15 marks)

(Marks will also be given for the appropriate layout and headings)

Solution

AUDIT REPORT

To: Financial manager (½)

From: Internal Auditor (½)

Date: 31 July 20xx (½)

Review of the accounts receivable section (½)

Introduction (½)

This review was performed in response to a specific request received from the financial manager after the debtors age analysis worsened significantly in June. (1)

Purpose and scope (½)

The purpose and scope of the review was to assess the reasonableness of the accounts receivable balances at the end of June 2012 and to determine the cause of the sudden change in the aging of the debtors age analysis. (1)

Findings and recommendations

Journals were not approved individually. (½)

Criteria: (½)

Policy requires that, as a control measure, the accounts receivable manager should approve each journal individually, online. (1)

Condition: (½)

The updates from the manual system were processed on the computer system by means of journals. (1) This amounted to a high volume of transactions, being too many for the accounts receivable manager to inspect and approve individually. (1)

Cause: (½)

Owing to the massive backlog created by the breakdown and therefore the volume of transactions to be updated, the accounts receivable manager gave a blanket approval to all the journals run in that period. (1)

Effect: (½)

These journals did not follow the normal authorisation process as prescribed by policy. This approach increased the risk of fraudulent transactions. (1) As the authorisation control was not followed, it also increased the risk of errors occurring in the processing of journals. The increase in the total debtors balance and the number of disputed items indicate that it is likely that many errors occurred during the updating process. (1)

Recommendation: (½)

It is recommended that a detailed reconciliation be performed of all the manual transactions with the journals used to update the system. (1) This would include a correction of all the errors identified. (1) Thereafter the internal audit activity can perform a debtors circularisation to identify any unresolved issues. (1)

We trust that this review highlighted the problem areas and that you accept our recommendations. Please do not hesitate to contact us should you require any additional information. (1)

Signed by Internal Auditor (½)

(½ marks for the layout; one mark for each valid reportable fact and recommendation with a maximum of 15 marks in total)