Workshops of the SAI Working Group on Audit Manuals in Tirana, Antalya and Ljubljana

It is with great pleasure that we hereby present this year’s final issue of the Newsletter. In this issue we cover the three workshops: the workshop on IT Audit on 11-13 June was hosted by the Albanian Supreme Audit Office (Kontrolli i Larte i Shtetit); the workshop on Risk Assessment on 23-26 September was hosted by the Turkish Court of Accounts (TC Sayisay Baskanligi); and finally the workshop on Audit Sampling on 17-19 November was hosted by the Slovenian Court of Audit (Racunsko Sodisce). We have again decided to make the information and recommendations, exchanged during the course of the workshops, available to as many of our colleagues as possible. We will also make all documents available on the SIGMA Closed EDG, to be found on our Web site www.sigmaweb.org as well as the Web sites of the hosting SAIs. We will also send to all Presidents, Liaison Officers and participants, past and present, paper copies of all the documents as well as a few extra papers with information about different practices and standards relevant under the theme of the workshop in question.

We hope that you will find the reading interesting and useful in your work as public sector external auditors.

Best wishes from SIGMA

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Conclusions from Tirana, 11-13 June 2003
Workshop on Audit of IT Systems

The objective of the workshop was to facilitate the exchange of knowledge and practical experience between member state, acceding country and candidate country SAIs concerning current practices and standards for IT systems and the audit thereof, so as to encourage the application of better methods and procedures for IT Audit.

In addition, a Board Member of the Information Systems Audit and Control Association (www.itgi.org), presented COBIT (control objectives for information and related technology) explaining its key concepts, practical application and principles. A representative of the Chair of the EUROSAI IT Working Group (Algemene Rekenkamer) also informed the workshop of the new and important activities of this Group.

In essence the workshop encouraged the active and expert audit of IT systems and recommended the following specific actions:

- To carry out audits of significant and material IT systems in their countries.
- To make good use of the modern and effective IT audit tool – COBIT.
- To support and be active in the EUROSAI IT Audit Working Group and support its training and other activities.
- To further exchange practical and useful information between the workshop participants.
- To encourage IT audit training in their SAIs.
- To support staff who wish to train to become specialist IT auditors through the ISACA.
- To substantially revise the EU Implementing Guideline on IT Audit.
More photos from Tirana

Participants and facilitators from Bulgaria, Albania, Slovakia, Belgium, Croatia and the Netherlands

The workshop participants with their host, President Mustafa Kerçuku
Conclusions from Antalya, 23-26 September 2003
Workshop on Risk Assessment

Group work on risk assessment with participants and facilitators

The SAIs of the Acceding and Candidate countries as well as representatives from Albania and Croatia, met for three days in order to exchange experiences and discuss good practices for risk assessments carried out in the planning phase of an audit. Besides the above-mentioned SAIs, representatives from the Danish, Portuguese and UK SAIs also attended the workshop, which was organised by the Turkish Court of Accounts and chaired by SIGMA and the ECA.

The first important task of the workshop was to define the "risk" to be discussed in view of the different definitions that exist. Starting with a more general definition of risk used in the context of social science and the "Risk Management" of an enterprise, the "Audit Risk Model" was discussed in more detail and related to the other two definitions.

The presentations of SAIs in the area of risk assessments showed very different positions. Some SAIs apply risk assessments only in very limited cases because they are obliged to audit all transactions. Most of the SAIs do risk assessments in a general way and only in qualitative terms. The differentiation between inherent and control risk is not often made and criteria for risk assessments are not always clear. One SAI reported on its experience in applying a knowledge-based software to perform qualified risk assessments. All these risk assessments were carried out in financial audits and a new dimension was given by the experience of the UK NAO in performing risk assessments in VFM audits.

All these experiences were of course based on the existing standards in the area of risk assessment.
The presentation of the new IFAC standards that are expected to be adopted late 2003, however, changed the situation. According to this new standard, systematic audit risk assessment will be part of the General Principles governing a financial audit of financial statements and it will place the risk assessment at the planning phase in the core of every single financial audit. This assessment will be necessary and the audit documentation will have to show how the results of the assessment are followed through at each of the following stages of the audit.

Audit risk assessment will be made at two levels – the overall level of the financial statements and the Assertion (or Audit Objective) level. INTOSAI have commented that the list of assertions in draft ISA 500 needs to be expanded to include “regularity” and that direct references to internal audit should be included in the standard.

The risk assessment will be made based on a comprehensive understanding of the entity, covering the five aspects of the control environment and the five elements of internal control framework. Included in these is an assumption that the entity has a risk management programme and a system for the communication of performance results.

The understanding of the entity also extends to an appreciation of events and conditions outside the transaction processing system (the accounting system), that have an impact on the financial statements. It is expected that financial auditors must have an in-depth understanding of wider business risks of the entity, what in the public sector might be interpreted as the equivalent of “value-for-money” risk.

As it is possible that there are some risks that may not be mitigated solely by substantive tests, the draft ISAs appear to rule out the option of setting control risk high, eliminating tests of controls as a source of audit evidence and relying instead on mainly substantive tests.

The audit response to the overall assessment is likely to be strengthening the resources required for the audit, identifying potential difficulties from inherent risks that cannot be mitigated by substantive procedures and setting the overall level of audit risk/audit assurance required from the audit procedures.

The participants agreed that the exposure draft might have a number of implications for SAIs:

- The national audit law of SAIs.
- The financial audit methodology model of an SAI including the need to update audit manuals and guidance and the development of templates to assist implementation.
- Intensified involvement of senior auditors in field work and better documentation of risk assessments and risk assessment decisions.
• The need for additional training and briefing material.
• Intensified co-operation with internal audit services.
• The need of communicating the new approach and the added value to auditees and parliaments.
• The need for additional resources.
• Risks assessed to be clearly linked to audit tests.

In order to better assess the risks associated with business, SAIs might also recommend that auditees introduce "Risk Based Management" in audited institutions. In addition, there is the need to test institutional risk management processes as a key control.

**Conclusions and Recommendations**

Risk Assessment is at present used by SAIs in the planning phase of an audit in order to identify areas on which the audit work should focus. According to the "Audit Risk Model", risks identified refer to risks that the audit institution will give a positive opinion when in fact the area audited is subject of major irregularities, misstatements or weaknesses. The identification of those risks is linked to the system of internal control and the "risk management" in the audited institutions.

Audit techniques to identify risk can be both quantitative and qualitative, although the quantitative approach is not very often used at present. Developments in international standards will require, in the future, that risk assessment will not only be used in the planning phase, but will be a major tool of the audit itself. This will lead to a more important use of risk assessment techniques. Even if the available international audit standards will primarily be applicable for financial audits, risk assessments in performance audits will also become more prominent and necessary. In order to comply with those international standards for financial audits, SAIs should seek to develop specific guidance and tools for risk assessments, both for financial and value for money audits. This guidance should clearly express the link between the risks identified and the audit approach used.
Conclusions from Ljubljana, 17-19 November 2003
Workshop on Audit Sampling

President Vojko Anton Antončič opening the workshop with co-chairs Colin Maynard (ECA) and Nick Treen (SIGMA)

Sampling represents a key tool for auditor to gain information and to draw a conclusion about the population without the need to examine the population in its entirety. Thus, audit sampling is the application of an audit procedure to less than 100% of the total population to obtain audit evidence about certain characteristics of the population.

Although the degree of the implementation of the audit sampling differs among participants’ countries, it was unanimously accepted between participants that this instrument is highly effective and efficient increasing the quality of the audit work carried out by SAIs. Also, it was observed that the approach to audit sampling on the part of SAIs is relatively homogenous, planning being based on the audit risk model and the most used sampling technique being Monetary Unit Sampling (MUS), although it is not appropriate in all circumstances and the limits of this technique have to be taken into account.

There are two general approaches to audit sampling: statistical or non-statistical. Both approaches require the auditor to use professional judgement in planning, performing and evaluating a sample. Either approach to audit sampling, when properly applied, can provide sufficient evidence. The participants in the workshop considered a series of the most important advantages of audit sampling to be the following:

- saves time and money;
- increases consistency and transparency of audit work;
Encourages to apply risk-based approach; is an effective and efficient way of auditing large complex populations; meets the audit objective and provides defendable audit results; encourages dealing with and being familiar with, the data subject to audit; assures harmonisation and compatibility of methods.

All participants agreed that in most cases 100% testing is impracticable on cost grounds. However, in some cases the auditor could test in full a relatively small group of items which are sufficiently important that an error in any one of them would have serious implications for the entire population. Usually, these are high value items or a group of transactions which are particularly risky.

Julio Cabeca from the European Court of Auditors with colleagues from Poland, Latvia, Slovakia, Turkey, Malta, Romania and France during one of the group exercises.

The essential factors to be taken into account when planning an audit sample are the following:

- Audit objectives.
- Resources available and staff knowledge of sampling techniques.
- Population size and characteristics.
- Materiality.
- Risk assessment.
- Confidence level.

The first three of these factors have an impact on selecting the most appropriate sampling method, and the last four on designing the sample size.

For the auditor to draw valid conclusions, it is essential that a sample is representative of the population from which it is drawn. This means that the attribute being tested for should be expected to occur in the sample to the same extent as it appears in the population as a whole.

In designing the sampling strategy the auditor considers if it is necessary to stratify the population before sampling. The participants agreed that if certain types of transactions are more prone to error than other transactions, they should be treated as a separate population.

In the same time the auditor has to be aware of the risk of over-stratification of a population which leads to more audit work rather than simplifying it.

Before extrapolating the results of a test sample the auditor should ensure that the extrapolation will only be made over the (sub-) population from which the sample was selected.
In interpreting the sampling results, the auditor reviews the materiality limit against the projected error and against the upper error limit. The accounts will be acceptable whenever the materiality level is above the upper error limit. However, this is not always the case. A number of other situations can arise. In some cases, the auditor is faced with a situation where the materiality limit is below the upper error limit or the projected error. After debating this concrete issue, participants reached the conclusion that the auditor should always analyse the nature and the causes of the errors. Following this analysis, there are two main actions the auditor could undertake: to try to isolate errors whose effect can be limited to only a part of the population and/or to consider extending the sample size.

In the first case, the auditor determines for which part of the tested population these errors may have had consequences. In doing this, the auditor defines a threshold in terms of risks and controls and may be able to isolate the errors in a relatively small part of the population, providing a rationale for accepting the “good” part in which the error causes are not valid. However, isolation of errors is a very time consuming approach and is not efficient in cases where the auditor finds multiple error causes. It is an efficient tool to reduce the upper error limit of the sampling result.

Extending the sampling size may not be the best solution because it is likely that more errors could appear. Furthermore, sample extension will reduce the original planned confidence level. By expanding the sample size, the auditor will fail to meet the required assurance unless the originally planned sample size incorporated a cushion allowing the auditor to arrive at an acceptable result even if some errors are found. Extending the sample size proves to be an effective solution in cases where the materiality level is only slightly below the upper error limit.

When neither isolation of errors nor extending the sample size are applicable and the materiality level is below the upper error limit, the auditor should consider concluding that the accounts are not reliable and/or the underlying transactions are not, taken as a whole, legal and regular. In these circumstances the auditor should consider drafting an audit report with a qualified or adverse opinion.

The general conclusion of the workshop was that sampling enables the auditor to meet audit objectives in an effective and efficient way. Participants agreed that statistical sampling is usually to be preferred as it should normally be efficient and it provides objective, representative and defendable results. Where non-statistical sampling is used, the approach to planning sample sizes, selecting items for testing and evaluating results, should be rigorous enough to ensure that the results are sufficient and unbiased.

President Vojko Anton Antončič concluding the Workshop with discussions on using the results of audit sampling

*** NEWSFLASH !!!***

If you would like to join the SIGMA restricted Electronic Discussion Group – SIGMA Supporting the Exchange of Experiences – Concerning Public Sector External Audit and European Accession please contact:

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Alida Hyseni and Sali Agaj in Tirana;
Cevad Gurer in Antalya;
Natasa Skrt-Kos in Ljubljana;
and Dieter Boeckem of the ECA for his essential work and support for all three workshops.
Group Photo from Antalya

Group Photo from Ljubljana

Contributions to the next issue of the Newsletter are most welcome and should be sent to: nicolas.john.treen@oecd.org or esther.bright@oecd.org