Chapter 5
Audit Programs

The audit program. Guide and means of self-control. Telling the what, when, how, and who. The benefits of a proper program. When to prepare programs. Internal auditing responsibilities. Stress on risks, controls, standards. Audit scope — from compliance to effectiveness. Defining economy, efficiency, and effectiveness. Audit objectives and procedures. Comparison with operating objectives and procedures. Examples of varied auditing procedures. How to prepare the audit program. Using background information gained during the preliminary survey. Identifying objectives, risks, and controls. Programs as a defensive tool. Examples of purchasing and marketing audit programs. Comprehensive audit programs: Traffic. Example of a pro forma *program: Safe deposit boxes. Ambiguities in program language. Relationships to the final audit report. Program mechanics. Small audit staffs. Guidelines for preparing audit programs. Criteria for audit programs.*

Introduction

Purpose

The internal audit program is a guide to the auditor and a compact with audit supervision that certain audit steps will be taken. The audit steps are designed (1) to gather audit evidence and (2) to permit internal auditors to express opinions on the efficiency, economy, and effectiveness of the activities to be reviewed. The program lists directions for the examination and evaluation of the information needed to meet audit objectives within the scope of the audit assignment.

In short, the program is designed to tell the internal auditor:

- What is to be done.
- When it is to be done.
- How it is to be done.
- Who will do it.
- How long it will take.

The audit program is the link between the preliminary survey and the field work. In the preliminary survey internal auditors identify operating objectives, risks, operating conditions, and controls. In the field work they gather evidence about the effectiveness of control systems, the efficiency of operations, the accomplishment of objectives, and the effects of risks on the enterprise.

Benefits

Well-constructed audit programs may offer many benefits. These audit programs:

- Set forth a systematic plan for each phase of the audit work, a plan that can be communicated both to audit supervision and to audit staff.
- Provide a basis for assigning work to auditors.
- Provide a means, through time budgets, of controlling and evaluating the progress of the audit work.
- Permit audit supervisors and managers to compare what was performed with what was planned.
- Assist in training inexperienced staff members in the work steps of an audit.
- Provide a summary record of work done.
- Help familiarize subsequent auditors, through programs for past audits, with the kind of audit work carried out and how long it took.
- Benefit supervisors by reducing the amount of direct supervision needed.
- Present appraisers of the internal audit function with a starting point from which to evaluate the audit effort.

These potential benefits should not lead internal auditors into a slavish adherence to specific audit steps — a checklist form of audit. Audit programs should never stifle initiative, imagination, or resourcefulness. The program should tell what is to be accomplished. An ounce of common sense is better than a pound of specific instruction. And the law of the situation will always prevail; when reality differs from what was anticipated, adjustments may have to be made.

This chapter presents traditional audit program development. Audit programs generated through software that are based upon risk evaluation are discussed later in this text. Likewise audit programs generated in a high technology environment are also discussed later.

When to Prepare the Audit Program

Internal auditors should prepare their audit programs immediately after the preliminary survey. Programs prepared too late may have gaps and inadequacies and may fail to establish proper priorities. But even carefully prepared audit programs may omit important matters the auditors are unaware of until they become deeply involved in the field work. So, all audit programs should be considered tentative until the audit is completed. Of course, all changes to the drafted audit program require the same approval as the original program.

The *pro forma* program, used on repeated audits of similar operations, often evolves over a period of years and gradually is accommodated to problems encountered in the field. It should not be so inflexible as to fail to accommodate changes or unusual situations. At other times, the program may be developed in advance to obtain particular information at many localities or to fit new or changing circumstances.

New *pro forma* programs intended for use at many locations should be prepared enough in advance to allow time to purge them of errors, unreasonable demands, and unnecessary steps. What is conceived in the ivory tower often fails in the arena. So new *pro forma* programs should be given trials or pilot runs to prevent confusion. The trials permit defects to surface early and to be corrected before the programs are put to broad use.

Some firms are developing software that prepares audit programs as a direct result of their risk assessment. These programs are based upon past experience, input from management, and seasoned audit judgment.

Audit Responsibilities

Internal auditors should be responsible for planning audit assignments. Planning should be documented and should include:

- .1 Establishing audit objectives and scope of work.
- .2 Obtaining background information about the activities to be audited.
- .3 Determining the resources necessary to perform the audit.
- .4 Communicating with all who need to know about the audit.
- .5 Performing, as appropriate, an on-site survey to become familiar with the activities and controls to be audited, to identify areas for audit emphasis, and to invite client comments and suggestions.
- .6 Writing the audit program.
- .7 Determining how, when, and to whom audit results will be communicated.
- .8 Obtaining approval of the audit work plan.

Currently, Audit Standard 2201, "Planning Considerations," states:

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 activities risk management and control systems.

The related Practice Advisory 2200-1, "Engagement Planning," provides that the internal auditor is responsible for planning and conducting the engagement assignment, subject to supervisory review and approval. The engagement program should:

- Document the internal auditor's procedures for collecting, analyzing, interpreting, and documenting information during the engagement.

- State the objective of the engagement.

- Set forth the scope and degree of testing required to achieve the engagement objectives in each phase of the engagement.

- Identify technical aspects, risks, processes, and transactions that should be examined.

- State the nature and extent of testing required.

- Be prepared prior to the commencement of engagement work and modify, as appropriate, during the course of the engagement.

All those in management who need to know about the engagement should be informed. Meetings should be held with management responsible for the activity being examined. A summary of matters discussed at meetings and any conclusions reached should be prepared, distributed to individuals, as appropriate, and retained in the engagement working papers. Topics of discussion may include:

- Planned engagement objectives and scope of work.
- The timing of engagement work.
- Internal auditors assigned to the engagement.
- The process of communicating throughout the engagement, including the method, time frames, and individuals who will be responsible.
- Business conditions and operations of the activity being reviewed, including recent changes in management or major systems.
- Concerns of any request of management.
- Matters of particular interest or concern to the internal auditor.
- Description of the internal auditing activity's reporting procedures and follow-up process.

Audit Scope

The audit program should indicate the scope of the audit work. It should make clear what is to be covered in the audit and what is not. The audit objectives should govern the scope of the work.

The *Standards* hold professional internal auditors responsible for examining and evaluating the effectiveness of their organization's system of internal control and the quality of performance in carrying out assigned responsibilities. The primary objectives of these internal control systems are to ensure:

.1 The reliability and integrity of information.
.2 Compliance with policies, plans, procedures, laws, and regulations.
.3 The safeguarding of assets.
.4 The economical and efficient use of resources.
.5 The accomplishment of established objectives and goals for operations and programs.

A comprehensive, unrestricted internal audit may cover all these objectives; certainly, internal auditors should prepare their audit programs with these responsibilities in mind. But they should not overlook the audit authority vested in them by their superiors. The audit scope may not exceed what senior management has authorized the auditors to do.

In an audit of an expenditure cycle — the business cycle that runs from the ordering of, to the subsequent receipt of and payment for, goods and services — all primary objectives may be examined. For example:

- Distribution to the appropriate accounts of expenditures for goods and services.
- Compliance by buyers with rules regarding selection of suppliers and approval of purchases, and with relevant government regulations.
- Safeguarding of goods on the receiving docks and in storerooms or warehouses.
- Purchase of economical order quantities and efficient operation of a value engineering program.
- Authorization and accountability controls for access to systems and data.
- System controls for assuring data integrity, availability, and confidentiality.
- Assistance in meeting production goals by obtaining goods and services on time, but also meeting financial and storage objectives by not bringing goods in too early.

Improved audit ability is needed as internal auditors progress from relatively simple financial and compliance audits to the comprehensive audits of the economy, efficiency, and effectiveness of operations.

Defining Economy, Efficiency, and Effectiveness

The terms *economy, efficiency,* and *effectiveness* are often used interchangeably, although there are subtle distinctions among them.

Economy is often used to mean thriftiness; but it can imply more than saving. Its chief implication is "prudent management" or "use to the best advantage without waste" — meanings that can also apply to efficiency. It is more widely applicable than thrifty, which refers only to persons or their expenditures. For example: Sea power is the most mobile and therefore the most economical form of military force. In that sentence, the term *economical* could probably be replaced by *efficient* without doing violence to the intent of the statement. Webster defines *economical* as, "the prudent use of things to their best advantage." At the same time, Webster defines an efficient operation as being, "one which is measured by a comparison of actual results with the energy expended to achieve those results." Not too wide a chasm separates the two terms.

Efficiency implies minimizing the loss or the waste of energy when effecting, producing, or functioning. When referring to people, the term *efficient* suggests exercising skill, taking pains, and keeping vigilance; it often becomes synonymous with capable and competent. In some cases the term *efficient* can be applied to a person or operation that is competent and capable of producing desired results with minimum effort.

Effectiveness emphasizes the actual production of an effect or the power to produce a given effect. Something may be effective without being efficient or economical. Yet a program to make a system more efficient or economical may also turn out to be more effective.

The overlap is there, but with careful writing and reading, one may be able to distinguish among the three terms. A system of processing records may be effective in producing accurate and properly approved documents, but the route the records take from desk to desk may be inefficient because it involves unnecessary backtracking. Besides, the operation may be uneconomical because six copies of the documents are produced when only five are needed.

Since audit programs usually address all three concepts, internal auditors should keep the definitions and differentiations in mind when developing their programs.

Objectives and Procedures

Objectives are what one aims at — a purpose or end. Procedures are the techniques employed to achieve one's objectives. Internal auditors deal with different sets of objectives and different sets of procedures in their work. These include operating objectives and procedures and audit objectives and procedures. They must learn to differentiate among them if they are to carry out their own responsibilities.

Operating Objectives and Procedures

Operating objectives are the ends to be achieved by operating managers and their people. Among the operating objectives of a procurement activity are those of purchasing the right goods or services at the right price at the right time and of the right quality. Each of these objectives is pursued through procedures or techniques. For example, among the procedures used to make sure the right goods are purchased would be the use of requisitions from ordering departments spelling out precisely what goods are to be procured.

Internal auditors are unable to evaluate an operation if they do not understand fully what that operation is designed to achieve — its objectives. Nor would they be able to determine whether the objectives are being met efficiently, economically, and effectively if they did not examine the procedures employed by operating personnel in achieving their ends.

All audit programs, therefore, should identify the operating objectives whose accomplishment auditors seek to evaluate.

Audit Objectives and Procedures

Audit objectives can be general or specific. General audit objectives are pursued in all engagements and are governed by the audit scope that management and the board grants to the chief audit executive. For example, internal auditors may be restricted to accounting and financial matters only. In that event their general audit objectives may be directed solely to determining the reliability and integrity of financial information; compliance with policies, plans, procedures, laws, and regulations; and the safeguarding of assets.

If their audit scope is comprehensive, however, then their general audit objectives would be increased to include reviewing operating reports as well as evaluating the economical and efficient use of resources and the accomplishment of established objectives and goals for operations and programs.

Specific audit objectives are linked to the operating objectives. For example, if the procurement objective is to purchase the right goods, the audit objective is to determine whether systems are designed to see that the operating objective has been achieved and whether the right goods have indeed been purchased.

Audit procedures are the techniques the auditor employs to determine whether operating objectives have been met. For example, the audit program would specify that the auditors would examine a sample of purchase orders and determine whether they are supported by required requisitions.

Determining which operating objectives warrant audit examination, and therefore should become audit objectives and be included in an audit program, becomes a matter of audit judgment based on study and experience. The professional internal auditor usually has a background that permits discrimination between the audit objectives that should be met in evaluating a proposition and those that may be irrelevant or unimportant to that end. The audit program, then, should be designed to tell auditors which audit procedures to perform to meet the audit objectives.

Similarly, experience and logic will determine which audit procedures apply to which audit objectives. Procedures should be relevant to the selected objectives. Irrelevant procedures, no matter how applicable to the audit as a whole, will be useless if they do not produce evidence about the operating objectives selected for review.

Each of the multitude of operating activities in the great variety of entities, both public and private, presents challenges to internal auditors when deciding what to include and what to exclude from an audit program. The same is true for the audit objectives and the audit procedures needed to meet the audit objectives. There is probably no compendium of all the audit procedures needed to meet all audit objectives. Still, an analysis of some audit objectives and procedures, selected at random from CIA examinations, may shed some light on the approach professional internal auditors take.

Advertising. Advertising is usually contracted to an agency. The agency normally bills for the costs it incurs plus a commission based on those costs. The best assurance the auditor has for determining whether the costs are documented and reasonable — the audit objective — is to audit, in the field, the agency's records and operating procedures. Other operating procedures, such as developing the advertising budget, selecting the right media, or establishing financial controls for the agency are clearly outside the audit scope.

Asset disposals. In an audit of controls over the disposal of assets, auditors are generally in over their heads if they try to determine on their own whether particular disposals were made properly. Only reviews of the written approvals of people responsible for the disposals, given in accordance with established procedures, or determining if disposals followed prescribed procedures would satisfy the audit objective.

Employee medical contributions. An audit objective could be to determine the validity of deductions from employee payroll for contributions to medical insurance options. Whether employee contributions cover the cost of the options is a good question, but irrelevant to the audit objective. An audit procedure to determine whether the payroll deductions are supported by written authorization forms is both appropriate and relevant.

Environmental protection and alarm devices. An internal auditor is seeking to determine whether such devices are installed and operating. Audit procedures that might be interesting, but irrelevant, would be reviewing the architect's alarm specification documents, examining invoices for the devices, or interviewing the plant safety officer. The only procedure that would provide assurance of installation and operation would be an observation of the placement of the alarms and of actual testing.

Inventories. An audit objective is to determine whether significant inventories have been correctly stated. Some audit procedures might be relevant but ineffective, such as obtaining statements from management, or flowcharting the inventory cycle, or interviewing personnel. An effective procedure would be to conduct or review physical inventories and obtain expert valuations.

Land acquisitions. The proposition is to verify legal ownership of land considered for acquisition. Examining the existing deed and title documents would be interesting but not conclusive; these might have been superseded. The surest way of determining legal ownership is to inspect the current records at the local courthouse.

Not-for-profit activity. Many audit objectives may enter into the audit of a not-for-profit organization. A management-oriented audit will seek to determine whether the activity is doing the job for which it was established. Hence, appropriate audit procedures would be to determine the mission of the organization, what standards have been established to measure performance toward that mission, and the extent to which the standards were met.

Payables. An audit is being performed of potential overpayments of payables. Under the existing system, payments are made on the basis of matching documents evidencing orders, receipts, and billings. Partial payments occur often. Comparing the records of every payment would be onerous. It is more productive to zero in on potential overpayments. An appropriate procedure, to that end, is to sample and compare amounts paid with the purchase order limits. Working from the purchase order, receiving report, or invoice records would not be conclusive. Automated analyses and comparisons should be used where appropriate.

Payrolls. Assume an audit objective of verifying appropriate payroll cost distributions to specific accounts. Many audit procedures may be perfectly valid in a payroll audit, but not relevant to the objective cited. For example, it would be irrelevant here to reconcile total payroll costs to the payroll cost distribution, to review time cards for supervisory approval, or to compare labor cost distributions to standard labor hours. For the cited objective, the appropriate procedure would be to trace the payroll cost distribution to job time tickets to determine whether the account or contract charged was actually the one on which the employee worked, and to verify that the work performed pertained to the job (for instance, charging costs of fixed price work to time and material contracts).

If the audit objective is to test for payments to unauthorized recipients, the most appropriate audit procedure would be to review and verify by field check the distribution of paychecks. Reviewing authorizations to put new employees on the payroll, calculating payroll payments, or reviewing approvals of hours worked are interesting but not relevant.

An audit objective in a payroll audit may be to make sure that salaried employees are not taking more paid vacation time then that earned. The most effective audit procedure would be to observe physically or from the vacation records which employees were absent because of vacations. Then the internal auditor would be able to trace those absences through the payroll records to deductions from accumulated vacation time.

The question is whether persons on the payroll of a particular department actually work there. Reviewing time cards, observing paycheck deliveries, or discussing the matter with departmental supervision would not be conclusive; but a surprise departmental floor check would.

To find out whether individuals are actual employees, the appropriate procedure would be to cross-reference individual payroll time cards to personnel department records and reports.

Comparing current departmental staffing with industry standards could lead to assessing department performance. The comparisons would provide no information on identifying bogus employees or evaluating internal controls or compliance with laws and regulations.

Pricing. To determine whether the markup applied to an organization's products varies improperly among customers, an appropriate procedure would be to determine that all prices are set objectively and followed. Analyzing costs would be ineffective in this case.

Production. An audit objective is to assist management in its evaluation of the effectiveness and efficiency of the production process. An appropriate procedure would be to compare actual costs with standard costs.

Purchasing. An audit objective is to determine whether an organization is purchasing excess/ raw materials. To decide whether standards are established for the quality, quantity, and sourcing of raw materials would not address the question of excess materials. What could shed light on the subject would be to determine whether production budgets, job orders, standard inventory levels, and economic order quantities are meshed and used in determining the quantities to be purchased. Analyzing surplus account disposals could help.

If an audit objective is to determine whether purchase transactions are authorized, the audit procedures should include verifying that the documentation the purchasing agents received contained signed approvals. Reviewing other documentation, such as receiving memos and vendor invoices, would be irrelevant.

Quality. If an auditor is seeking to learn whether and why excessive rejection rates are being experienced, the audit procedure calculated to bring the matter to light would be to evaluate how well the sales department is communicating on product returns with the production department. Looking into the volume of sales or the credit ratings of customers would be entirely irrelevant. Also, analyzing scrap accounts and accumulations could help.

A reasonable audit objective is to evaluate the propriety of quality control standards. A relevant procedure would be to review the appropriateness and accuracy of the data that management used to document the development of the standards. Determining whether the standards were being met is wholly irrelevant to the given audit objective. That would be another part of the audit and another audit objective.

Rental property. In an audit of an organization that owns, maintains, and operates rental property, an audit objective would be to determine the propriety of recorded maintenance expense. An appropriate audit procedure would be to trace selected entries in the maintenance expense account to their supporting work orders. Other procedures, such as discussions with maintenance people or checking arithmetical accuracy and authorization of work orders might be relevant but not as definitive as an examination of the completed work orders themselves.

Research and development. Research and development projects must be planned like any other project. Such plans should include standards for measuring performance. Without appropriate and quantifiable standards, management has no yardstick by which to measure R & D results. Certainly, internal auditors cannot set standards in such a technical environment. But they can determine whether standards exist and test the validity of the process used for setting them.

Sales. The audit objective may be to determine whether sales commissions are too big. A procedure to determine the accuracy of the recorded commission expense for individual salespersons is best determined by recomputing selected sales commissions. Other techniques, like calculating commission ratios, using analytical procedures, or assessing overall reasonableness, would be of no value for this audit objective.

An auditor wants to determine whether all credit sales are recorded in accounts receivable. An audit procedure would be to trace the records from a sample of shipping documents to the related sales invoices and subsidiary ledger. The only procedure in a case like this must start with the documents showing actual shipments and working backward.

Tax revenues for a state government. An audit objective is to ascertain whether taxpayers are properly reporting their sales taxes. Of the various options available to internal auditors, the most likely procedure for achieving the objective involves field examination of selected taxpayers. Much less definitive would be testing selected sales tax returns for proper computations, confirming sample sales tax receipts with organizations that file returns, comparing the names of organizations filing returns with those who are licensed, and comparing sales tax revenues received with sales tax receipts budgeted.

Preparing the Audit Program

Background Information

The background information gained through the preliminary survey will help dictate the programmed audit coverage. Any broad operation with its many interrelationships and processes could keep an audit team occupied for a long time if it decided to examine every activity being carried out. But effective, economical programs focus on what is essential to meet the operation's key objectives and not on what is merely interesting.

At the same time, internal auditors must look to their professional responsibilities in deciding what to audit and what not to audit. Internal auditors cannot be held responsible for the prevention of fraud, misconduct, or error. These are management's responsibilities. Yet internal auditors are held responsible for identifying those matters that permitted or fomented undesirable actions. When fraud or misconduct surfaces, internal auditors have but one defense: Their methods and procedures were professional and were calculated to identify and explore the risks within the enterprise.

But saying so is not enough. The auditors must be able to produce documentation to that end. And that is one of the functions of a professional internal auditing program: To demonstrate that the program is effective — addressing only what is significant; and to give proof to the fact that significant risks and controls were identified and evaluated.

That is why tailor-made programs will be more relevant to an operation than generalized programs. The latter do not necessarily take into account the variations resulting from changing circumstances, varied conditions, and different people. But a careful analysis — made with the assistance of operating managers — can spell out the operating objectives, identify the actual or potential risks, and determine the controls appropriate to the circumstances. And the assistance of operating management affords protection against any criticism that the auditors were not interested in what interested management.

Analyses such as these can produce thoughtful, relevant, effective, and economical audit programs. Such programs make good sense to an organization or agency executive because they are management-oriented. They also deal with the larger issues — the issues that executives would take into account if they themselves would review their own activities or programs.

Such programs are economical for another reason as well. While they may be time-consuming when first constructed, they will address key, continuing risks that need to be reviewed during every audit. Therefore, follow-on audit programs would only add new risks or delete those that are no longer significant.

Some examples will help explain this approach more clearly than a written description. Let us examine how this analytical approach to objectives, risks, and controls applies to the functions of purchasing and marketing.

Purchasing

The generally accepted management objectives of a purchasing operation are to obtain the right goods or services: (1) at the right price, (2) at the right time, (3) in the right quantity, (4) of the right quality, and (5) in the right place.

These objectives can form the framework of the audit program. Each can head a separate segment of the program. For example, obtaining goods and services at the right price can represent a separate part of the audit program and the audit work. Then the auditor can list any actual or potential risks disclosed during the preliminary survey relating to establishing the right prices for goods and services inherent in any purchasing operation.

Exhibit 5-1 shows part of an audit devoted to prices. It does not list every conceivable risk and control; such a comprehensive audit program could be unnecessarily expensive. Instead, it spells out those risks that are applicable to a particular purchasing organization at the time of audit, as determined by the preliminary survey. For example, assume that the preliminary survey documented close adherence to excellent bidding procedures. To expend an inordinate amount of audit effort on bidding practices would be wasteful. Instead, the program identifies existing and potential problems and concentrates on them.

In any audit of operations, internal auditors must go beyond the six kinds of operating objectives enumerated for the purchasing function. Another significant objective exists in any activity or department: that it be well managed. Accordingly, one segment of a program for procurement would be related to the administration of the activity. The administrative risks revealed during the preliminary survey might be:

- Organization charts for the purchasing department have not been prepared. (May result in confusion as to which buyer is responsible for purchasing particular products or services.)

- Lack of a directive covering the purchasing department's authority and responsibility. (Other organizations [line units] may assume the authority to deal directly with suppliers.)

- Lack of a purchasing department manual. (Buyers may perform in accordance with their personal desires rather than in a consistent, approved fashion.)

- Absence of a procedure by which people are authorized to sign requisitions for supplies and services. (Orders may be issued by people for their own use or for the wrong materials or quantities.)

Exhibit 5-1
Excerpts from an Audit Program for a Purchasing Department

Audit Segment: Costs and goods and service

Objective of Operation: To obtain goods and services at the right price.

Audit Budget: 5 days

*The letters in parentheses indicate the degree of risk, running from high risk (A) to low risk (G).

Risks	Controls	Tests-(Recommendations)	W/P Ref.	Comments
Make or Buy Committee does not have a written charter or set of procedures. (F)*	Committees should include people from Manufacturing, Quality Control, Engineering, and Procurement. They should meet regularly to arrive at make-or-buy decisions on new products and programs. Decisions should be based on plant capacity, continual cost information, and appropriate trade-offs.	Examine records of Committee to determine whether principal procurements have been considered and adequate support has been provided for the decisions.		
Absence of quantitative and qualitative yardsticks on purchasing activities. No information or standards by which management can judge procurement activity. Uncontrolled buying. Higher prices and possible deterioration of buyer discipline. (E)	Monthly commitment reports by each buyer on such matters as: Total dollars committed. Commitments based on competitive bids. Reasons for no competition. Dollars spent on non-competitive buys.	Determine by sample the volume of noncompetitive bids. Ask for reasons. Inquire of buyers the procedures they follow in obtaining reduced prices. (Recommend system of reporting to provide management with such information.)		

Exhibit 5-1 (Cont.)

Risks	Controls	Tests-(Recommendations)	W/P Ref.	Comments
	Savings achieved through competitive bids, negotiation, new supply sources, innovative procedures, and substitute materials.			
Lack of provision for rotation of buyer assignments. Permitting buyers to have long-term dealings with particular suppliers and favoring them. (C)	Provision for periodic rotation of assignments. Requirement that all buyers take vacations. Formal rotation and vacation schedules.	Examine rotation and vacation schedules. Investigate any instances where vacations were not taken or assignments were not rotated.		
Purchasing made aware of new equipment requirements on receipt of completed engineering drawings. Thus, Purchasing does not have time to obtain competitive bids on long lead time items. (D)	A committee, including Purchasing people, to establish schedules for equipment items to deal with long lead time procurements. Purchasing should be party to establishing schedules on such items.	For a sample of long lead time items, determine whether schedules were set, were realistic, and provided ample time for soliciting competitive bids.		
Absence of a value analysis program whereby goods are investigated to relate to function, not cost. (G)	System by which items procured must pass tests as to appropriate form. Is cost proportionate to usefulness? Is there a need for all the features the item has? Availability of standard parts, etc.	Determine who is responsible for value analysis. Review reports on savings. From a sample, determine whether items were subjected to value analysis.		

Exhibit 5-1 (Cont.)

Risks	Controls	Tests-(Recommendations)	W/P Ref.	Comments
Excessive number of confirming orders, meaning that using departments instead of Purchasing are selecting suppliers and ordering goods, thereby evading procurement controls and leading to favoritism and higher prices. (A)	Provision for reports on such orders, determining reasons, and taking appropriate disciplinary action. Management directive giving Purchasing sole authority to commit organization funds for services and supplies obtained from suppliers.	Determine ratio of confirming orders to total orders. Determine what is done to reduce their number. From a sample, inquire of buyers and using departments the reasons for the confirming orders.		
No provision for records showing prior purchases for same products, thereby withholding valuable information from buyers in assessing bids and quotations. (B)	System for recording on cards or on electronic equipment the procurement activity on each individual item on which there are repeated purchases.	For purchase orders sampled, trace prior purchases for same items. Investigate significant variances. (Recommend maintenance of price history records.)		

Risks vary in degree of intensity. Obviously, auditors should be sure to review those risks presenting the greatest danger before dealing with those that are less hazardous. Internal auditors may find it burdensome to prepare a program that lists risks in the order of decreasing perceived intensity. But once the risks, controls, and program steps have been put into the program, auditors should be able to review what they listed and indicate the severity of the risk.

Accordingly, internal auditors may rate the intensity by placing some form of indicator after the listed risk. For example, "A" might indicate the greatest risk, "B" the next, and so forth. In that way, auditors will be alerted to review major risks before they work on minor ones. Thus, they would not put themselves in the unfortunate position of failing to examine a serious risk before the audit budget was exhausted.

Marketing

Some of the more important objectives of a marketing organization might be to (1) determine the market potential for the organization's products and/or services (market research); (2) impart information, develop consumer attitudes, and induce action beneficial to the organization (advertising); and (3) induce distributors to give extra attention to the sales of organization products and persuade customers to buy those products (sales promotion).

Thus, market research, advertising, and sales promotion might each be a separate segment of a marketing function audit. Some of the risks, related controls, and suggested tests associated with an advertising activity are found in Exhibit 5-2.

Both programs illustrated in the exhibits provide a column for reference to the working papers ("W/P Ref."), which are the records of tests and reviews. This reference is extremely important for ready access to the evidence of work done. Audit supervisors, external auditors, and other reviewers will generally use the audit program as a starting point for appraising the adequacy of the audit work accomplished.

The program also provides a column for the auditors' comments. These can be brief statements indicating the results of the audit work, and can be very useful in providing an overview of audit results. The comments should be brief, such as "controls adequate," "no exceptions," "excellent system," "substantially correct," or they should make reference to a record of an audit finding such as "RAF-7" (see Chapter 8).

Exhibit 5-2
Excerpts from an Audit Program for a Marketing Department

Audit Segment: Advertising
Objective of Operation: To impart information, develop consumer attitudes, and induce action beneficial to the organization.
Audit Budget: 10 days
•The letters in parentheses indicate the degree of risk, running from high risk (A) to low risk (G).

Risks	Controls	Tests-(Recommendations)	W/P Ref.	Comments
Organization is advertising in various media but has a single expense account. Hence budgets become useless as a control device. (F)*	Establish separate budgets and accounts for such matters as magazine and newspaper space, television and radio, television talent and production with written descriptions on what should be charged to each account.	Compare budgets and costs. Investigate significant differences. Determine that overruns have been properly approved. (Recommend separate accounts.)		
Complete comparisons between budgets and actual advertising costs are made at the end of a fiscal year. Thus, advertising trends are not identified in time to take corrective action. (G)	Prompt recording of both commitments and expenditures; monthly reports comparing budgets and actuals.	Review reports for accuracy, timeliness, and meaningfulness. Determine what action was taken on adverse trends. (Recommend monthly comparisons.)		
Absence of written agreement with advertising agency. Leads to uncertainty and disputes. No right to review agency records. (A)	Written agreement containing provision as to charges and expenses billable, records to be maintained, and right of audit of systems and records.	Review agency charges for reasonableness and applicability to advertising work. (Recommend written agreement.)		

Exhibit 5-2 (Cont.)

Risks	Controls	Tests-(Recommendations)	W/P Ref.	Comments
Absence of a detailed estimate of charges for each advertising project. Hence, agency may make expenditures exceeding budget. Lack of information on adverse cost trends. (D)	Provision for costs of individual jobs or projects to be itemized on the estimates and subjected to frequent comparisons with actual costs incurred.	Without estimates, tests may be meaningless. Examine whatever means management used to determine propriety of charges. (Recommend provision for written estimates and comparison of charges with the estimates.)		
The same agency employee is responsible for placing advertising orders and also verifying related charges. Hence, excessive authority given to one individual; potential for manipulation. (E)	Separation of duties. It is as important in an advertising agency as it is in the auditor's organization.	Review system. See what supervision the employee receives. Test transaction from ordering to receipt. (Recommend separation of duties.)		
Artwork and organization property left with agency for photographic sets. Hence, possible loss of valuable materials. (C)	Provision for inventory records of all property with sufficient value to warrant control. Insurance coverage for valuable property.	Test system of control exercised by the advertising group. Trace records of items shipped to agency. Compare records and physical items. Question retention by agency of property for unreasonable lengths of time.		

Exhibit 5-2 (Cont.)

Risks	Controls	Tests-(Recommendations)	W/P Ref.	Comments
For non-media purchases, the advertising group deals directly with suppliers and contracts with them for supplies. (B)	Purchasing department must have the responsibility and the authority to make all commitments for supplies. For repetitive purchases of items needed expeditiously, the purchasing department should negotiate blanket orders for the advertising group.	Examine a sample of transactions. Determine whether appropriate bidding, ordering, and receiving practices were used. (Recommend that Advertising deal with Purchasing for all supplies.)		

Comprehensive Audits

Under some circumstances, internal auditors may want to make comprehensive audits of an operation. Perhaps the first audit of an operation may warrant an audit of all activities, whether or not they present serious risks or hazards. Or the auditors may want to document an entire system to determine whether it conforms to the internal accounting control requirements of the U.S. Foreign Corrupt Practices Act of 1977 or other requirements that have been established.

The tailor-made audit program may still be the best course but, in such cases, the focus will be on controls since the risks are not the primary basis for the extent and approach of the audit. The audit will be directed toward determining what controls exist or should exist to see that the operation's objectives will be met. Exhibit 5-3 provides an excerpt from one segment of such a program for a traffic department.

Exhibit 5-3
Excerpts from an Audit Program for a Traffic Department

Audit Segment:	Routine Inbound and Outbound Shipments
Objective of Operation:	To select carriers and routes that will provide the most economical and timely shipments of supplies and finished goods.
Audit Budget:	8 days

Optimum Means of Control	Risks	Audit Tests	W/P Ref.	Comments
Inbound Shipments		Select at random documents covering a representative number of routings and determine whether:		
Provision for close coordination with the purchasing department and for review by traffic personnel of requests to purchase.	Inefficient and uneconomical routings.	Routing was approved by traffic.		
Requirement for special approvals for premium transportation.	Excessive use of more costly transportation.	Premium traffic was properly authorized.		
Provision to consolidate shipments to obtain carload rates.	Unnecessarily expensive shipments.	Items received in large quantities and subject to carload rates, were received in carload lots and not LCL (less than carload).		
Standard time spans for the ordering of goods to allow adequate time for nonpremium routings.	Excessive premium routings to meet production schedules.	Sufficient time was allowed by ordering and purchasing departments between shipping and required dates.		

Exhibit 5-3 (Cont.)

Optimum Means of Control	Risks	Audit Tests	W/P Ref.	Comments
Preparation by traffic for purchasing of information on routings and rates for major suppliers.	Purchase orders providing uneconomical routing instructions.	Suppliers made allowances for transportation costs when purchase orders provided for carload shipments and part of shipment was LCL.		
Outbound Shipments		Determine whether:		
Provision for traffic to specify means of shipment.	Best means of shipment might not be used.	Routing was specified by traffic.		
Maintenance of current routing and rate guides.	Errors in routing.	Routing and rate guides were up to date.		
Provision to charge customers for more expensive routing when such routing is requested.	Customer may not be billed for requested routing.	Customer was billed for more expensive routing requested.		
Provision for adequate support for premium shipments.	Unauthorized premium shipments.	Premium rates were supported by: • Reason for routing. • Authorization for premium shipment. • Appropriate accounting distribution.		
Provision to review and report on the use of premium shipments.	Failure to detect any unfavorable trends. Excessive premium shipments.	Results anticipated by premium transportation were actually gained.		

Pro Forma Programs

Pro forma programs are useful, even essential, when audits will be carried out by inexperienced auditors whose work must be closely monitored. They are also useful if (1) the same kind of audit will be performed at a number of different locations; (2) comparable information is needed for each location; (3) similar reports or consolidated reports will be issued; and (4) operations being audited are relatively similar.

An example of such a program, for the audit of safety deposit boxes in a bank, is shown as Exhibit 5-4. The program focuses on detailed verifications and also provides the auditors with background information that indicates the objectives of the operation and the prescribed system of control. It is a useful audit program, helpful to the auditors and capable of producing all the information needed for a comprehensive evaluation of the activity under review.

Exhibit 5-4
Excerpts From Audit Program for Safe Deposit Department

General Information
Boxes are rented to customers for the safekeeping of personal property. Each safe deposit box has two separate locks. The box can be opened only when the key to each of these locks is used at the same time. When a box is rented, two keys to one of these locks are given to the customer. There are no duplicates available. The keys to the other lock, which are called "Guard Keys," are kept by the bank. No customer can gain admittance to a box without proper identification.

Purpose of Audit
To determine if all boxes that are indicated as being rented are actually rented and that proper rental fees are being received. To determine if there is strict adherence to operating procedures. To determine if rental collections are credited to the proper income account.

Lease Agreements
Review exceptions noted in the last audit. Prepare a list of all safe numbers in the vault. If a prepared list is included with the working papers, make a visual check to verify the numbers. Review lease agreements for rented boxes. Place audit mark opposite the number on the list for each agreement held. If the agreement is new since the previous audit, check for proper completion and correctness of form used. Show initial and date on the agreement to the left of the safe number. (An alteration of safe number on the rental agreement should be initialed by the renter.) Check all court orders of guardianship and trusteeship covering new lease agreements. If a box is subject to restricted access because of a deceased depositor, two or more should be present or, if there is an attachment, list the number on a worksheet.

- Check to see that the agreement card is jacketed.
- Check to see that there is a plug in the lock of the customer's box.

Exhibit 5-4 (Cont.)

- Test-check access slips for boxes requiring two or more to be present by comparing signatures with the agreement card. Review customer access procedure with the safe deposit attendant.
- Ask attendant to outline procedure followed in admitting customer to box.
- Review current access slips for proper processing and filing.

At offices where a separate audit is made of the safe deposit department, indicate on the office rating sheet the number of boxes available and number of boxes rented. For example: "Of the 5,268 total number of boxes, 4,183 were rented on the date of our audit."

Additional segments of audit program include: Keys • Annual Rental Cards • Contents of Drilled Boxes • Storage • Night Depository • Articles Found on Bank Premises • Vacant Boxes.

Ambiguities

Precise instructions are most likely to produce precise audit information. Words like adequate, sufficient, and thorough mean different things to different people. Telling an auditor to "determine whether adequate competition was obtained" is to say nothing and to invite different responses from different auditors.

For example, assume that an audit program is to be carried out by audit teams in different locations. Assume further that their audit program tells them to "determine whether the installation has an adequate payroll system."

Some staffs might appraise every single part of the system, doing more work than was intended. Other staffs might decide to determine only that employees were properly paid — and no more. Still others, in their tests of payments to employees, may see errors in paid vacations or reimbursement of travel expenses. They might decide to concentrate on these known hazards and do very little auditing of the payroll system. In addition, staff auditors might be confused and spend unnecessary time discussing ambiguous program steps when they could be devoting their time to productive audits.

Instead of broad ambiguous instructions about "an adequate payroll system," the program could call for these specific steps:

- Determine if payments to employees are in accordance with approved time cards.
- Determine if employees are paid the correct amounts due.
- Determine if total salaries and wages paid are in agreement with the direct and indirect labor charged to appropriate contracts and accounts.

Most auditors would be likely to get answers to such program steps without further instructions, and they still would have plenty of latitude to decide how they would meet these program objectives.

Ambiguities are reduced if internal audit activities adopt uniform meanings for the various terms used in audit programs. Here are some definitions that can help eliminate confusion and build a sound bridge between the audit program writer and the staff auditor:

- **Analyze** — To break into significant component parts and determine the nature of something.
- **Check** — To compare or recalculate, as necessary, to establish accuracy or reasonableness.
- **Confirm** — To prove to be true or accurate, usually by written inquiry or by inspection.
- **Evaluate** — To reach a conclusion as to worth, effectiveness, or usefulness.
- **Examine** — To look at or into closely and carefully for the purpose of arriving at accurate, proper, and appropriate opinions.
- **Inspect** — To examine physically.
- **Investigate** — To ascertain facts about suspected or alleged conditions.
- **Review** — To study critically.
- **Scan** — To look over rapidly for the purpose of testing general conformity to pattern, noting apparent irregularities, unusual items, or other circumstances appearing to require further study.
- **Substantiate** — To prove conclusively.
- **Test** — To examine representative items or samples for the purpose of arriving at a conclusion regarding the population from which the sample is selected.
- **Verify** — To establish accuracy.

The term *audit* is too general to use in referring to a work step.

Relationship to the Final Audit Report

Audit steps are usually wasteful if they produce information that will not be reported. The audit program stage is not too soon to think about the final audit report. Some organizations even develop a standard report outline — a sort of digest — to indicate the subjects to be covered in the final report. This provides a useful discipline and sense of direction while carrying out the review and eliminates unnecessary audit work. Even if no such digest is prepared, auditors should keep in mind the general structure of the report and the programmed scope of audit. Economy and efficiency are also qualities desirable in internal auditing.

Some internal auditors find it efficient and helpful to write segments of their audit reports as the audit progresses. In large audit projects, progress reports provide early information to clients and make the final audit report easier to write. And if the audit report is kept in mind as the program is written, the format of the program itself will make the outline of the formal report easier to prepare.

Program Mechanics

The audit program should include estimates of the time required to carry out each of the segments of the audit. These are preliminary estimates, of course, but they help the auditor in charge and the audit supervisor to control and review the progress of the work. The estimates also help determine how many staff people should be assigned to the audit to complete the work in a reasonable time.

Adjustments to the estimates may be necessary, as the audit progresses, if circumstances differ markedly from those anticipated.

Audit supervisors or managers should approve all audit programs. They should also approve all significant changes. Audit programs tend to be evolutionary. It is rare indeed for the programmer to anticipate every circumstance or condition that will be encountered in the audit. A small rock seen in the preliminary survey may turn out to be the tip of a huge boulder when the auditors start digging.

In actual practice, the audit evolves from the initial programmed step. Audit programs should be updated periodically as the work progresses. If actual conditions are not those foreseen, it may be necessary to revise plans or even to discontinue the audit. Any significant changes should be reduced to writing with the reasons for the changes shown. Such changes should be approved at the same level of authority that approved the original program. Experience has shown that important information is overlooked when changes in audit scope or direction are not recorded.

The audit program should document the progress of the audit work. When tests are carried out, a simple method is to make reference in the audit program to the working papers. Each programmed audit step should bear a working paper reference. This will show what work was done and what still remains to be done. Also, it helps the auditor to avoid omitting steps inadvertently. If a step is deliberately omitted, the reason should be shown.

Small Audit Staffs

Audit staffs composed of one or two auditors may object to the time required to prepare audit programs. These objections have no merit.

An audit report is usually written by one person. A good report writer will prepare a careful outline before writing the report. The outline is the program for the written report. Similarly, even a one-person audit department should prepare programs for the audit projects. It is just as easy for that individual to forget or omit significant audit steps as it is for junior members in large audit departments. Also, the concept of association assists in more complete coverage.

Besides, even small organizations will want external auditors to make use of the work of their internal auditors to reduce external audit costs. But external auditors will have little respect for internal auditors whose audit work is not programmed and whose audit scope and objectives are not defined (see Chapter 24).

Obviously, an audit program prepared by the same internal auditor who will carry it out in its entirety need not be as detailed as one written for a junior auditor. It should, however, set forth the objectives of the operation being audited and show the audit procedures to be followed. These can be combined with the audit objectives. (For example: "Determine the adequacy and effectiveness of the controls to see that the names of people leaving the organization are promptly removed from the payroll.") Whichever way auditors decide to show the audit procedures, they should list them and carry them out.

Guidelines for Preparing Audit Programs

The preparation of an audit program is closely linked to the information gained during the preliminary survey. One phases into the other. Guidelines for preparing the program will take into account the results of the steps taken during the survey. As a summary of both survey and programming steps, here are some guidelines for carrying out the steps and the reasons for them:

Guideline	Reason
Review prior reports, audit programs and working papers, and other documents from preceding audits, and list any open items requiring action.	To gain the background and determine the results of past reviews to better decide on the scope of the current audit.
Perform a preliminary survey.	To determine the objectives of the activity to be reviewed, the actual or potential risks, and the existing systems of controls.
Review policies and procedures for the audited function, its operating manuals, organization charts, chart of authority, long-range and short-range objectives and goals.	To determine the areas that can be measured and appraised, and whether the function is operating in accordance with the intentions of management.
Review current internal auditing literature about the area under audit.	To obtain the latest information on techniques for auditing the activity under review.
Prepare a flowchart of the key operations of the audited function.	To identify any control weaknesses and to obtain a visual analysis of the transaction flow.
Review performance standards that have been established by management and, if possible, compare these with industry-wide standards.	To obtain a yardstick by which to measure and evaluate the efficiency and effectiveness of the operation and to determine whether they are meeting reasonable standards.
Interview the client and discuss the scope of the audit and the objectives the auditor seeks to achieve.	To obtain agreement from the auditee and to avoid any misunderstanding about the purpose and scope of the audit.
Prepare a budget detailing the resources it will take to complete the audit engagement.	To establish estimates for the number of auditors and time needed so as to ensure the efficiency of the audit process.
Interview key people who have an interface with the audited function.	To obtain an insight into the operation and the efficiency and effectiveness of the operation and to identify any problems in cooperation and coordination.

Guideline (Cont.)	Reason (Cont.)
List the material risks that must be considered.	To make sure that matters of the greatest vulnerability are addressed and receive appropriate attention.
For each of the identified risks, determine what controls are in effect and whether they are adequate.	To see if existing controls can eliminate or sufficiently reduce the identified risks.
Determine the substance of major problems and opportunities.	To identify the major areas of difficulty and determine the causes and possible remedies.

Criteria for Audit Programs

Audit programs should conform to certain criteria if they are to meet the objectives of the internal audit department. For example:

- The objectives of the operation under review should be stated carefully and agreed to by the client.
- Programs should be tailor-made to the audit assignment unless compelling reasons dictate otherwise.
- Each programmed work step should show the reason behind it, i.e., the objective of the operation and the controls to be tested.
- Work steps should include positive instructions. They should not be stated in the form of questions. General questions, particularly those calling for yes or no answers, do not lead to effective auditing. They usually result in superficial answers rather than in-depth analyses and evaluations. Moreover, the way that the questions are framed may call for answers with an undesirable slant or bias. This rule does not reject the use of yes or no questions as mind-joggers to help the auditor make certain that no significant audit objective is overlooked. As a practical matter, experienced auditors will jot down such questions to make sure they look at all important aspects of an operation. But the work steps leading to an objective, unbiased audit opinion should be positive.

- Whenever practicable, the audit program should indicate the relative priority of the work steps. Thus, the more important parts of the program will be completed within the allotted time or other restrictions.

- Audit programs should be flexible and permit the use of initiative and sound judgment in deviating from prescribed procedures or extending the work done. But audit supervisors should be informed promptly of major deviations.

- Programs should not be cluttered with material from sources readily available to the staff. Incorporate by reference if feasible.

- Unnecessary information should be avoided. Include only what is needed to perform the audit work. Excessive detail wastes the time of those who prepare the program and those who read it.

- Audit programs should bear evidence of supervisory approval before they are carried out. Significant changes should also be approved in advance.

- When client management asks the auditor to perform certain tests, these should be included in the audit program if the audit budget permits (or the budget should be modified if appropriate).

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Multiple-choice Questions

1. During an audit of your organization's purchasing function, you learned that buyers were allowed to develop long-term relationships with particular suppliers. Such a policy will have the impact of increasing:
   a. Confidence dispersion.
   b. Cost of purchases.
   c. Materiality.
   d. Risk.

2. You are the internal auditor for an organization with more than 10,000 employees. You want to test for payroll payments to unauthorized recipients. The best procedure would be to examine:
   a. Authorizations of newly hired employees by the human resources department.
   b. Procedures for internal verification of the accuracy of payroll calculations.
   c. Departmental supervisor approvals of hours worked.
   d. Procedures for distribution of paychecks.

3. Which of the following would not be generally considered an essential criterion for developing audit programs?
   a. Description of the objective of the client operation as agreed to by the client.
   b. Specificity as to the controls to be tested.
   c. Specificity as to audit work steps to be followed.
   d. Specificity as to the methodology to be used for the audit steps.

4. An internal audit supervisor reviewed the system of controls and the organizational objectives of the purchasing department. What facet of audit planning was the supervisor developing?
   a. Internal audit policy manual.
   b. Audit work schedule.
   c. Audit program.
   d. Internal audit budget.

5. The *Standards* require that internal auditors establish plans to carry out audit assignments. Such plans include:
   a. Reviewing the reliability and integrity of financial and operating information.
   b. Establishing audit objectives and scope of work to be performed.
   c. Determining whether assets are properly safeguarded.
   d. Appraising the economy and efficiency with which resources are employed.

6. An organization manufacturing special-order products is experiencing excessive rates of rejection of finished products. An audit procedure to identify the source of the problem would be:
   a. Evaluating communication from the sales department to the production department.
   b. Evaluating communication from the production department to the sales department.
   c. Analyzing customer demand for the product.
   d. Testing whether supply of the product is sufficient to meet customer demand.

7. The markup applied to an organization's products has varied between customers. An audit procedure most likely to uncover this is:
   a. Checking to see if sales have been made to customers with inadequate credit ratings.
   b. Checking to see if salespeople were able to set prices without clearance from the central office.
   c. Determining if production costs have been excessive.
   d. Analyzing selling costs for excessiveness.

8. In a payables application, checks are authorized and paid based on matching purchase orders, receiving reports, and vendor invoices. Partial payments are common. An appropriate audit procedure for verifying that a purchase order has not been paid twice is to:
   a. Sort the receiving report file by purchase order, compute total amounts received by purchase order, compare total amounts received with purchase order amounts, and investigate any discrepancies between the total amounts received and purchase order amounts.
   b. Sort the vendor invoice file by purchase order, compute total amounts invoiced by purchase order, compare total amounts invoiced with purchase order amounts, and investigate any discrepancies between the total amounts invoiced and purchase order amounts.
   c. Sort the receiving report file by vendor invoice amounts, and investigate any discrepancies between the total amounts received and vendor invoice amounts.
   d. Sort the check register file by purchase order, compute total amounts paid by purchase order, compare total amounts paid with purchase order amounts, and investigate any discrepancies between the total amounts paid with the purchase order amounts.

9. To ascertain that all credit sales are recorded in accounts receivable, an auditor should:
   a. Confirm selected accounts receivable balances by direct correspondence with customers.
   b. Trace from a sample of subsidiary ledger entries to related sales invoices and to related shipping documents.
   c. Trace from a sample of customer purchase orders to related shipping documents.
   d. Trace from a sample of shipping documents to related sales invoices and subsidiary ledger.

10. To determine if an organization is purchasing excess raw materials, an internal auditor should:
    a. Be sure that standards are established for quality, quantity, and sourcing of raw materials.
    b. Ascertain that production budgets and economic order quantities are integrated and have been used in determining quantities purchased.
    c. Obtain assurance that purchasing agent assignments are rotated periodically.
    d. Determine that the purchasing department has a written charter with a set of procedures and guidelines covering purchasing operations.

11. An internal auditor wishes to determine if salaried employees in the division being audited are taking more paid vacation time than they have earned. Which of the following audit procedures would be most effective?
    a. Observing which employees were absent because of vacation and tracing those absences through the payroll records to subtractions from accumulated vacation time.
    b. Comparing total vacation time taken by selected employees in the most recent 12 months per payroll records to the time taken by the same employees in the preceding 12 months.
    c. Sending confirmations to selected employees, asking them to verify the accuracy of the number of days of vacation used during the year and the number of remaining unused days as obtained from the payroll records.
    d. Comparing the accrued vacation pay liability as computed for the firm's most recent balance sheet with the corresponding amount for one year earlier, and investigating any significant change.

12. An auditor wants to perform a test to determine if people on the payroll of a particular department actually work there. Which of the following would be the best source of evidence for the audit test?
    a. The physical presence of properly identified employees observed during the distribution of paychecks in the department.
    b. Testimonials obtained by discussing the performance of each employee with the department manager.
    c. The physical presence of properly identified employees observed during a surprise departmental floor check.
    d. Time cards documenting reported work time that can be reviewed for employee and supervisor signatures.

13. The cross-reference of individual payroll time cards to personnel department records and reports allows an auditor to conclude that:
    a. Individuals were paid only for time worked.
    b. Individuals are bona fide employees.
    c. Individuals were paid at the proper rate.
    d. Personnel department records agree with payroll accounting records.

14. In a comprehensive audit of a not-for-profit activity, an internal auditor would be primarily concerned with the:
    a. Extent of compliance with policies and procedures.
    b. Procedures related to the budgeting process.
    c. Extent of achievement of the organization's mission.
    d. Accuracy of reports on the source and use of funds.

15. What action should an internal auditor take upon discovering that an audit area was omitted from the audit program?
    a. Document the problem in the workpapers and take no further action until instructed to do so.
    b. Perform the additional work needed without regard to the added time required to complete the audit.
    c. Continue the audit as planned and include the unforeseen problem in a subsequent audit.
    d. Evaluate whether completion of the audit as planned will be adequate.

16. Which of the following audit techniques would be most persuasive in determining that significant inventory values on the books of an organization being acquired are correctly stated?
    a. Obtain a management representation letter stating that inventory values are correctly stated.
    b. Flowchart the inventory and warehousing cycle and form an opinion based on the quality of internal controls.
    c. Conduct a physical inventory and bring in an independent expert if necessary to value the inventory items.
    d. Interview purchasing and materials control personnel to ascertain the quality of internal controls over inventory.

17. You are an internal auditor who has been assigned to an audit of the material acquisition cycle of an organization. To satisfy an audit objective of verifying that purchase transactions are categorized and are for needed materials, you should:
    a. Review signatures on a sample of receiving reports.
    b. Discuss a sample of transactions with the purchasing agent.
    c. Review a sample of purchase orders and their related purchase requisitions for proper approval signatures.
    d. Examine a sample of vendor invoices.

18. During an operational audit, the auditor compared the current staffing of a department with established industry standards to:
    a. Identify bogus employees on the department's payroll.
    b. Assess the current performance of the department and make appropriate recommendations for improvement.
    c. Evaluate the adequacy of the established internal controls for the department.
    d. Determine whether the department has complied with all laws and regulations governing its personnel.

19. Manufacturing operations that use just-in-time (JIT) inventory delivery must develop a system of total quality control (TQC) over parts and material. The objective of TQC is to:
    a. Provide an early warning system that detects and eliminates defective items.
    b. Statistically estimate the potential number of defective items.
    c. Detect and eliminate maintenance and processing problems that cause bottlenecks.
    d. Insure that the "pull" exerted by each assembly stage includes correct quantities and specifications.

20. An operational audit of the production function includes an audit procedure to compare actual costs to standard costs. The purpose of this operational audit procedure is to:
    a. Determine the accuracy of the system used to record actual costs.
    b. Measure the effectiveness of the standard cost system.
    c. Assess the reasonableness of standard costs.
    d. Assist management in its evaluation of effectiveness and efficiency.

21. Management believes that some specific sales commissions for the year were too large. The accuracy of the recorded commission expense for specific salespersons is best determined by:
    a. Computing selected sales commissions.
    b. Calculating commission ratios.
    c. Using analytical procedures.
    d. Testing overall reasonableness.

22. Which of the following factors would be considered the least important in deciding whether existing internal audit resources should be moved from an ongoing compliance audit to a division audit requested by management?
    a. A financial audit of the division performed by the external auditor a year ago.
    b. The potential for fraud associated with the ongoing audit.
    c. An increase in the level of expenditures experienced by the division for the past year.
    d. The potential for significant regulatory fines associated with the ongoing audit.

23. When faced with an imposed scope limitation, the chief audit executive should:
    a. Delay the audit until the scope limitation is removed.
    b. Communicate the potential effects of the scope limitation to the audit committee of the board of directors.
    c. Increase the frequency of auditing the activity in question.
    d. Assign more experienced personnel to the engagement.

24. A standardized internal audit program would not be appropriate for which of the following situations?
    a. A stable operating environment undergoing only minimal changes.
    b. A complex or changing operating environment.
    c. Multiple locations with similar operations.
    d. Subsequent inventory audits performed at the same location.

25. A determination of cost savings is most likely to be an objective of:
    a. Program audits.
    b. Financial audits.
    c. Compliance audits.
    d. Operational audits.

26. In deciding whether to schedule the purchasing or the personnel department for an audit, which of the following would be the least important factor?
    a. There have been major changes in operations in one of the departments.
    b. The audit staff has recently added an individual with expertise in one of the areas.
    c. There are more opportunities to achieve operating benefits in one of the departments than in the other.
    d. The potential for loss is significantly greater in one department than in the other.

27. Which of the following is an appropriate statement of an audit objective?
    a. To observe the physical inventory count.
    b. To determine whether inventory stocks are sufficient to meet projected sales.
    c. To search for the existence of obsolete inventory by computing inventory turnover by product line.
    d. To include information about stockouts in the audit report.

28. An auditor, nearly finished with an audit, discovers that the director of marketing has a gambling habit. The gambling issue is not directly related to the existing audit and there is pressure to complete the current audit. The auditor notes the problem and forwards the information to the chief audit executive but does no further follow-up. The auditor's actions would:
    a. Be in violation of The IIA's *Code of Ethics* for withholding meaningful information.
    b. Be in violation of the *Standards* because the auditor did not properly follow up on a red flag that might indicate the existence of fraud.
    c. Not be in violation of either The IIA's *Code of Ethics* or *Standards*.
    d. Both a and b.

29. The internal auditing department of a large corporation has established its operating plan and budget for the coming year. The operating plan is restricted to the following categories: a prioritized listing of all audits, staffing, a detailed expense budget, and the commencement date of each audit. Which of the following best describes the major deficiency of this operating plan?
    a. Requests by management for special projects are not considered.
    b. Opportunities to achieve operating benefits are ignored.
    c. Measurability criteria and targeted dates of completion are not provided.
    d. Knowledge, skills, and disciplines required to perform work are ignored.

30. Which of the following is the best means of determining if an internal audit department's goals are being met?
    a. Having the audit committee periodically review the quality of the department's goals being met.
    b. Developing measurement criteria to accompany departmental goals.
    c. Scheduling an outside peer review of the department every three years.
    d. Having the external auditors review and evaluate the work of the department.