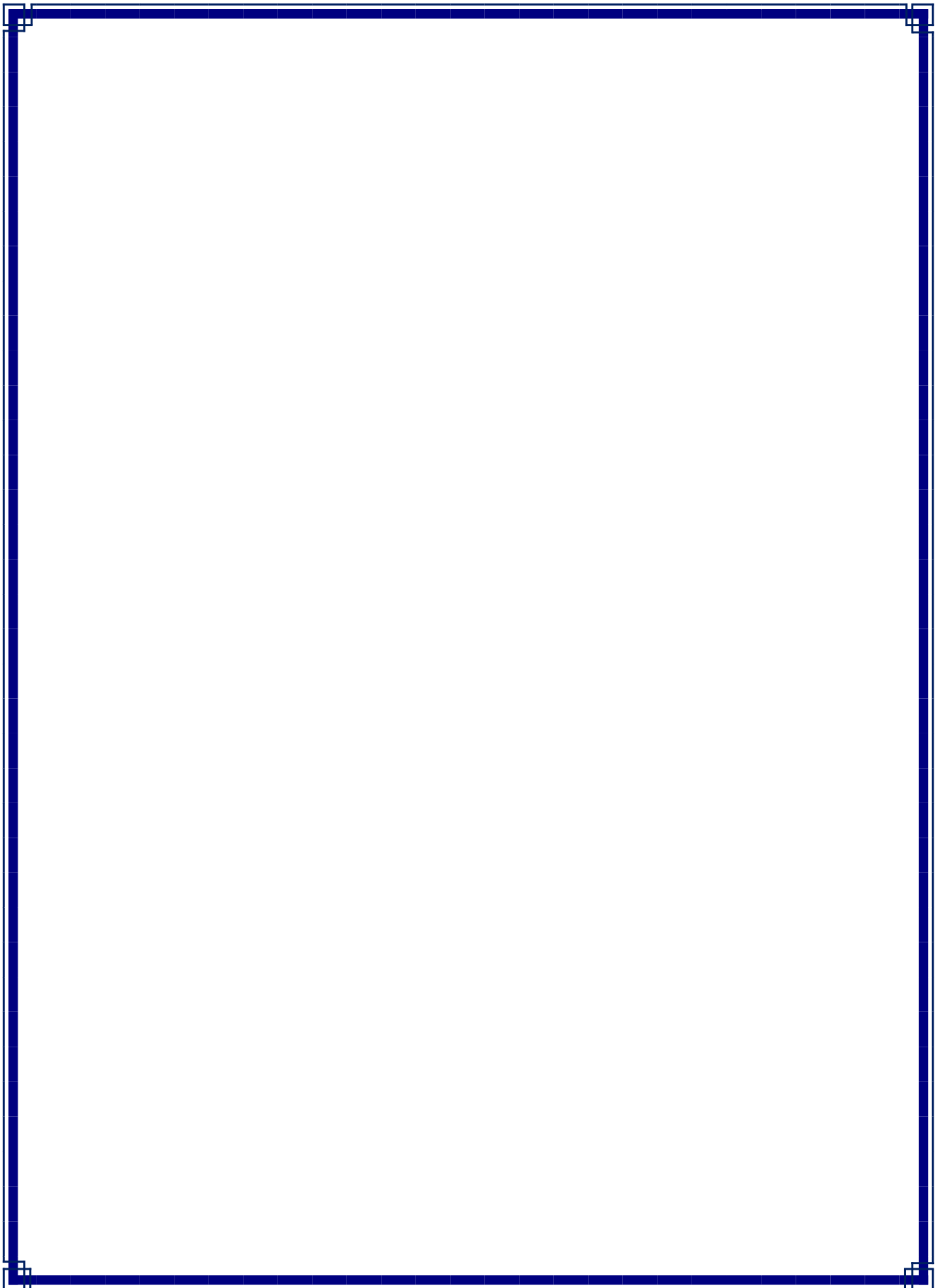


# WATER AND POWER DEVELOPMENT AUTHORITY



## INTERNAL AUDIT MANUAL

2014





## Table of Contents

1. INTRODUCTION .....	1
1.1. The Authority .....	1
1.2. Mission Statement .....	4
1.3. Custody .....	5
1.4. Revision.....	5
2. INTERNAL AUDIT FUNCTION .....	6
2.1. Internal Control Framework .....	6
2.1.1. Introduction .....	6
2.1.2. Framework Components.....	6
2.1.3. Control Environment .....	7
2.1.4. Risk Assessment and Risk Management.....	8
2.1.5. Control Activities.....	11
2.1.6. Information and Communication.....	17
2.1.7. Performance Monitoring.....	18
2.2. Internal Audit .....	20
2.3. Types of Audits.....	21
2.4. Internal Audit Evidence .....	22
2.5. Risk Based Audit and Statistical Sampling.....	27
2.5.1. Extent of Testing: Sampling Decision .....	27
2.5.2. Use of Information Technology in Audits .....	28
3. ORGANIZATION OF INTERNAL AUDIT DIVISION .....	29
3.1. Scope of internal audit .....	29
3.2. Fraud Detection .....	30
3.3. Internal Audit Charter .....	30
3.4. Roles and Responsibilities .....	33



3.5. Responsibilities of Internal Audit Officers .....	34
3.5.1. Introduction .....	34
3.5.2. Responsibilities of the Chief Auditor .....	35
3.5.3. Responsibilities of Deputy Chief Auditors .....	36
3.5.4. Responsibilities of Field Audit Officers (Audit Parties) .....	37
3.5.5. Responsibilities of Information Systems Audit Manager .....	39
3.5.6. Responsibilities of Information Systems Auditor .....	40
3.6. Internal Audit Staff Training and Development .....	41
3.6.1. Introduction .....	41
3.6.2. Annual Training Plan .....	42
3.6.3. Assessing Training/Development Progress: .....	48
3.6.4. External Training/ Development Evaluations: .....	48
3.6.5. Incentives for Qualification and Performance: .....	48
3.7. Internal Audit Strategy - Some Essential Internal Controls .....	49
3.7.1. Introduction .....	49
3.7.2. Some Essential Internal Controls .....	49
3.7.3. Performance and Accountability .....	49
3.7.4. Approval Authority .....	50
3.7.5. Verification of Expenditure Statements.....	50
3.7.6. Invoice Verification.....	50
3.7.7. Materials Ordering and Handling.....	51
3.7.8. Construction Materials and Services provided to Contractors.....	52
3.7.9. Contract Administration .....	52
3.7.10. Fixed Assets.....	53
3.7.11. Payroll Procedures .....	53
3.7.12. Computer Environment .....	53
3.7.13. Fraud Awareness .....	54



3.8. Quality Control and Assurance .....	55
4. INTERNAL AUDIT PROCESS .....	57
4.1. An Overview .....	57
4.2. Individual Audit Assignment Coverage .....	57
4.2.1. The Internal Audit Scope .....	57
4.2.2. Developing recommendations .....	57
4.3. Internal Audit Process .....	58
4.3.1. Internal Audit Office Planning Phase .....	60
4.3.2. Internal Audit Assignment Planning Phase.....	60
4.3.3. Internal Audit Review Phase.....	67
4.3.4. Internal Audit Evaluation Phase .....	67
4.3.5. Internal Audit Verification Phase .....	69
4.3.6. Internal Audit Reporting Phase .....	69
4.4. Interrelationship of Phases of Work .....	69
5. GETTING READY FOR FIELDWORK .....	70
5.1. Introduction .....	70
5.2. Audit Program .....	70
5.2.1. Objectives of the Audit Program .....	70
5.2.2. Contents of an Audit Program .....	71
5.3. The Substance of the Transaction .....	71
5.4. Inadequately Supported Transactions .....	72
5.5. Conflicting Audit Evidence .....	72
5.6. Control risk: Assessing the Control Environment.....	73
5.7. Ascertain and Record .....	74
5.8. Compliance Testing .....	76
5.9. Sample Size for Compliance Testing .....	77
5.10. Compliance Test Program .....	78



5.11. Compliance Audit .....	78
5.11.1. Objective: .....	78
5.11.2. Methodology: .....	79
5.11.3. Important Audit Components .....	79
6. VERIFICATION.....	83
6.1. Overview .....	83
6.2. Substantive Testing .....	84
6.3. Analytical Procedures .....	84
6.4. Types of Analytical Procedures.....	85
6.5. Substantive Tests of Details: .....	86
6.6. State Objective of the Test: .....	86
6.7. Define the Deviation and Error Conditions: .....	87
6.8. Define Population: .....	87
6.9. Selection of Methods of Testing: .....	87
6.10. Sample Size for Substantive Test of Details: .....	88
6.11. Monetary Unit Sampling (MUS): .....	88
6.12. Selecting A Sample:.....	89
6.13. Value-oriented Selection .....	89
6.14. Audit Completion:.....	90
6.15. Completion and Review of Audit Working Papers: .....	90
6.16. Exit Conference: .....	90
7. REPORTING AND FOLLOW-UP .....	92
7.1. Introduction: .....	92
7.2. Internal Audit Report .....	92
7.3. Considerations in arriving at Audit Conclusions: .....	92
7.4. Characteristics of an Effective Audit Report: .....	93
7.4.1. Current and Significant Information: .....	93



7.4.2. Fair and Objective: .....	93
7.4.3. Non-technical Expression: .....	94
7.4.4. Facile Presentation: .....	94
7.5. Style of an Audit Report .....	94
7.5.1. State the Structure of the Report in the Beginning: .....	94
7.5.2. Main Conclusions First: .....	94
7.5.3. Deductive Arrangement of Paragraphs: .....	95
7.5.4. Topical Sentence for Each Paragraph:.....	95
7.5.5. Positive and Constructive: .....	95
7.5.6. Comprehensive Table of Contents .....	95
7.5.7. Structure of Audit Findings .....	95
7.5.8. Audit Criteria: .....	95
7.5.9. Conditions found by the Auditors: .....	96
7.5.10. Effect of the Conditions: .....	96
7.5.11. Causes of the Situation: .....	96
7.5.12. Recommendations: .....	96
7.5.13. Sequence of Findings: .....	96
7.5.13.1. Significant Findings: .....	96
7.5.13.2. Less Significant Findings: .....	96
7.6. Distribution of the Audit Report: .....	96
7.7. Audit Report Follow-Up .....	97
7.8. Reporting the Results of the Follow Up:.....	97
8. INTERNAL AUDIT WORKING PAPERS.....	98
8.1. Introduction .....	98
8.2. Qualities of Good Working Papers .....	98
8.3. Working Paper Techniques .....	99
8.4. Descriptive Headings .....	99



8.5. Tick Marks.....	99
8.6. Cross-referencing.....	100
8.7. Indexing .....	100
8.8. Carry Forward.....	100
8.9. Types of Working Papers.....	100
8.10. Schedules and Analyses.....	100
8.11. Documents.....	101
8.12. Process Write-ups and Flowcharts .....	101
8.13. Interviews .....	101
8.14. Observations .....	102
8.15. Findings .....	102
8.16. Organizing Working Paper Files .....	102
8.17. Custody.....	103
9. INFORMATION SYSTEM AUDITING .....	104
9.1. Verification of Computerized Data .....	104
9.1.1. Introduction .....	104
9.1.2. Assessment of risk through review and evaluation .....	104
9.2. Computer Assisted Audit Techniques (CAATs) .....	105
9.3. Steps in the Use of CAATs .....	105
9.3.1. Planning a CAAT .....	105
9.3.2. What Data are Available .....	106
9.3.3. Identifying the Files for Interrogation.....	106
9.3.4. Specifying the information required for the CAA T.....	106
9.3.5. Specifying the format of the Data File .....	107
9.3.6. File Downloading and Conversion .....	107
9.4. Ensuring Data Integrity .....	107
9.5. Types of CAATs.....	108





9.6. Program CAATs Software .....	109
9.7. Embedded Audit Data.....	113
9.8. Parallel Simulation .....	114
9.9. Test Data .....	114
10. STANDARD AUDIT TOOL KIT .....	115
1. Forms .....	119
2. Checklists .....	124
3. Control Questionnaires.....	138
4. Audit Programs.....	143



WATER AND POWER DEVELOPMENT AUTHORITY  
INTERNAL AUDIT MANUAL



## 1. INTRODUCTION

### 1.1. The Authority

#### WAPDA Charter

The Pakistan Water and Power Development Authority (WAPDA) was established through an act of parliament in February 1958 for integrated and rapid development and maintenance of water and power resources of the Country. This includes controlling soil salinity and water logging to rehabilitate the affected land in order to strengthen the predominantly agricultural economy of the country.

As per the charter, amended in March 1959, WAPDA has been assigned the duties of investigation, planning and execution of projects and schemes for:

- a. Generation, Transmission and Distribution of Power.
- b. Irrigation, Water Supply and Drainage.
- c. Prevention of Water logging and Reclamation of Waterlogged and Saline Lands.
- d. Flood Management.
- e. Inland Navigation.

WAPDA was created for the purpose of coordinating and giving a unified direction to the development of schemes in Water and Power Sectors, which were previously being dealt with, by the respective Electricity and Irrigation Department of the Provinces. Since October 2007, WAPDA has been bifurcated into two distinct entities i.e. WAPDA and Pakistan Electric Power Company (PEPCO). WAPDA is now fully responsible for the development of Hydel Power and Water Sector Projects. PEPCO has been fully empowered and is responsible for the management of all the affairs of corporatized thirteen Distribution Companies (DISCOs), four Generation Companies (GENCOs) and a National Transmission Dispatch Company (NTDC).

#### The Authority

The Authority comprises of:

1. Chairman
2. Member (Water)
3. Member (Power)
4. Member (Finance)

The Members oversee the affairs of their respective wings through General Managers for the streamlined operations in their respective areas. Within wings, the activities are further divided into executing entities known as formations of WAPDA. These formations



include water and power projects completed by WAPDA and administrative units serving financial and administrative matters.

### **Water Wing**

Member (Water) controls the water wing, which is divided into North, Central, South and Northern Areas zones. These zones cover, in general, Khyber Pakhtunkhwa (KPK), Punjab, Sindh, Balochistan and Northern Areas respectively. The activity of water wing involves execution of surface and sub-surface water development and drainage-Salinity Control and Reclamation Projects (SCARPs). Chief Engineers and Project Directors at various levels are responsible for effective and timely implementation of Water Wing Projects.

### **Power Wing**

Member (Power) controls the Power Wing, through General Managers and Chief Engineers in the field of hydro-electric power, coordination and WAPDA Power Privatization Organization. WAPDA has an elaborate setup headed by a General Manager for training of its officers and officials at different levels covering all the wings of the organization.

### **Coordination Wing**

The Coordination Wing controls services common among WAPDA and includes functioning of departments of Finance, Internal Audit and Budget and Accounts. Member (Finance) is responsible for the functioning of the departments of Finance, Internal Audit and Budget and Accounts headed by Chief Auditor (Internal Audit) and Director General Finance (B&C). He also exercises administrative control over General Manager (Central Contracts Cell), Director General (Taxes) and Director Public Relations. Managing Director (Admn) is vested with the responsibility for overall administration and services.

### **Secretary**

Secretary WAPDA in addition to looking after day-to-day affairs of the Secretariat, prepares minutes of the Authority's meetings, maintains records of its decisions and issues its directives and coordinates among the three Wings besides monitoring and implementation of Authority's decisions.

### **Authority Fund**

The Authority Fund consists of the following:

- i. Loans and grants obtained from the federal and provincial governments
- ii. Sale proceeds of WAPDA Bonds
- iii. Loans obtained by the Authority with general sanctions of the government



- iv. Foreign aids and loans obtained from the IBRD, ADB and other international loan giving agencies on such terms and conditions as may be approved by the government
- v. Sale of power
- vi. All other sums received by the Authority

### **Human Resources**

WAPDA is one of the largest employers of human resources in Pakistan. Over the years WAPDA has built-up a reservoir of Technical know-how and expertise which has made it a modern and progressive organization.

During past 55 years of its operations, WAPDA has developed its human resource as a reservoir of knowledge, competence and expertise through training and experience gained at the accomplished projects and remaining associated with diversified development activities. These include professionals, specialists, scientists, economists, administrators, accountants and skilled workers for planning, building, managing and operating various projects.

The primary development role of WAPDA has been revived. It is now focusing only on Hydel Development and Water Sector Projects to support the national economy and poverty alleviation through improved Hydel-Thermal mix of Power Generation, provision of electricity at affordable price and most pertinently perspective planning and timely execution of Projects to meet the Water and Power demand of the growing population, agriculture and industry of the country.



## 1.2. Mission Statement

*"The mission of the Internal Audit division is to provide the WAPDA Authority and Management with systematic assurance, analysis, appraisals, recommendations, advice and information, with a view to assisting the Authority and the Management on the effective discharge of their responsibilities and the achievement of WAPDA mission and goals."*



### 1.3. Custody

This manual shall be reviewed and approved by the WAPDA Authority.

This manual shall remain in the permanent custody of the General Manager Finance (Coordination) with copies to the following:

- Members Water, Power and Finance
- Chief Auditor WAPDA
- General Manager Finance (Power & Water)

This manual shall remain the property of WAPDA; therefore, copies of this manual must not be provided to any external party except with the prior approval of Members WAPDA. However, access to this Manual shall not be restricted from such external parties who are entitled to it in accordance with the provisions of any law for the time being in force or in accordance with their terms of engagement.

### 1.4. Revision

This manual contains policy statement of WAPDA; therefore, it is subject to a high level and strict change control process. Changes in statutes, WAPDA's legal form & other conditions and practices may require periodic modifications of the internal audit procedures and processes. The overall responsibility for maintaining and updating this manual resides with the General Manager Finance (Coordination) with the approval of the WAPDA Authority, who will be duly notified about the proposed changes in the manual through circulation.

Feedbacks, comments, corrections and improvement suggestions on this manual (including any areas that are not sufficiently or well covered) can be received from those who were informed about the required changes through the circular.

The General Managers Finance (Power, Water & Coordination) shall collect feedback from other reviewers of respective disciplines on the following template:

Name: _____	
Designation: _____	
Date: _____	
Section number	Comments & suggested changes
<i>General</i>	
Signature: _____	
(N/A if submitted through official email)	



## 2. INTERNAL AUDIT FUNCTION

### 2.1. Internal Control Framework

#### 2.1.1. Introduction

An Integrated framework for evaluation of system of internal controls issued by the Committee of Sponsoring Organization (COSO)-the COSO Internal Controls- defines internal control as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- ☐ Efficiency and effectiveness of operations;
- ☐ Integrity and reliability of financial reporting;
- ☐ Safeguarding of assets; and
- ☐ Compliance with internal policies, procedures and applicable laws.

In short, system of internal controls helps an entity get to where it wants to go and avoid the pitfalls and surprises that may occur along the way.

It is the responsibility of the executive departments and agencies to put in place systems of internal control for managing and controlling the economical, efficient and effective delivery of services and the achievement of organizational objectives. The purpose of the present chapter is to provide guidance for establishing and maintaining effective internal control. The framework applies to all managers and not just financial managers. It covers all operations. Therefore the term "internal control" as used in this chapter is not limited to the traditional view of financial and related administrative controls, but covers the broader concept of management control.

#### 2.1.2. Framework Components

Internal Control system exists to help organizations to meet their goals and objectives. These controls enable the management to deal with the changes in the internal and external environments. These controls also promote efficiency; reduce risk of loss, and help ensure financial statement reliability and compliance with laws and regulations. Internal control under COSO consists of five (5) interrelated components that are derived from the way management runs a business and are integrated with the management process. The framework covers the following five areas:

- Control environment;
- Risk assessment and risk management;
- Control activities;
- Information and communication; and
- Monitoring.





Each of these areas of internal control framework has been described in detail in the following paragraphs.

### 2.1.3. Control Environment

#### **Tone at the Top: Integrity and Ethics**

Best practice and legal precedent emphasize the responsibility of the WAPDA Authority to establish an appropriate corporate culture, including codes of ethics and standards of conduct to both enhance the organization's reputation for fair and responsible dealing and to help maintain high standards of behavior throughout the organization. The responsibilities of the WAPDA Authority and the General Managers Finance include:

- Acting with honesty and good faith;
- Exercising due care and diligence;
- Using information and position properly;
- Employing discretion;
- Avoiding conflict of interest;
- Meeting public obligations;
- Managing financial obligations prudently; and
- Maintaining confidentiality.

These are the foundation attributes upon which the corporate culture is based, and which drive internal controls. An effective system of internal control, supported by an appropriate tone at the top, has an important role to play in creating and maintaining an ethical culture in an organization.

These values must be communicated to all levels of management. One method of communicating these values is by documenting and implementing a Code of Conduct, which should address all these above issues.

#### **Competence**

The officers and staff should have the appropriate skills and experience to perform their roles. This knowledge and experience constitutes a vital element within the internal control system. It implies a system of recruitment and staffing that is based on merit and not nepotism and favoritism. Hiring and staffing decisions should include assurance that individuals have the proper education and experience to carry out their assigned jobs. Once on the job, the individual should be given the necessary formal and on-the-job training. Managers and employees who possess a good understanding of systems of internal control and are willing to take responsibility for them are vital to an effective control structure

#### **Timely and Relevant Information**

Before the Principal Accounting Officer or Authority can apply his or its experience and



knowledge, he or it must perceive appropriate, relevant and timely information spanning a range of matters, including:

- changes in relevant policies and guidelines;
- financial performance and financial position;
- major public awareness and promotional initiatives;
- significant contracts;
- sensitive issues;
- major investigations;
- improper acts (e.g. litigation, defalcations, fraud or misuse of organization assets); and
- significant weaknesses in the system of internal controls.

In view of the significance of such information flows, the process by which the senior management is supplied with such information must be formalized.

### **Attitude**

The attitude of the Authority towards internal control has a dramatic impact on the attitude of all employees. The senior management should demonstrate and promote a positive attitude towards the achievement of the organizational objectives, a commitment to excellence, and a commitment to maintaining a strong system of internal controls.

### **Reporting of Significant Deficiencies**

There will be occasions when significant weaknesses in the system of internal control, or breakdowns in the operation of controls, come to the attention of the senior management, or the internal or external auditors. The Authority should encourage the reporting of significant weaknesses to them from such sources.

Once significant weaknesses have been brought to their attention, they must be prepared to conduct appropriate levels of investigation, and to institute corrective measures. The lower level staff members of the organization will often notice breakdowns in the system of internal control. The reporting and monitoring system, as embedded in the system of internal control, must provide for such individuals to be able to report breakdowns and apparent weaknesses in the system with impunity. It is the responsibility of all staff members to report such breakdowns and weaknesses.

## **2.1.4. Risk Assessment and Risk Management**

Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment and risk management is to establish objectives that are linked at different levels and are internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the



objectives, forming a basis for determining how the risks should be managed. Because economic, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

Risk assessment and management involves two steps:

- Identifying functions and tasks.
- Assessing and managing related risks.

### **Identifying Functions and Tasks**

Functions are distinct areas of activity performed in support of the organization's strategic objectives, e.g. procurement. Strategic objectives established by the WAPDA authority are, by definition, statements at a macro level, usually addressing major initiatives, resource allocation issues or priorities. The linkage between such strategic objectives and functions is often obscure. However, a transparent linkage is important, and is provided through the identification of specific tasks.

Tasks must be aligned with the organization's strategic objectives: the successful completion of tasks will lead to the realization of the organization's strategic objectives, and thus its mission, and ultimately its vision.

**Ensure employees receive adequate training to discharge their responsibilities effectively.**

Senior management should ensure that the tasks defined for each function are consistent with the organizational strategic objectives. Management must also prioritize tasks so as to ensure that scarce resources are allocated in the most effective manner.

### **Assessing Risks**

The management of functions and specific tasks includes responsibility for analyzing the risks associated with a task, and responsibility for establishing mitigating controls. This is a core element of the system of internal control.

Risk is the possibility that adverse or potentially adverse consequence will flow from a task. Risk management is the development of procedures that mitigate risk to an acceptable level. All the stakeholders, the Principal Accounting Officer and the Authority, and all tiers within the organization have a role to play in risk management. Whilst there are aspects of the risk management process that fall outside the ambit of the system of internal control, such as establishing risk management objectives and policies, there is considerable overlap between internal control and risk management.

Before beginning to assess its risks, it will need to identify its risks. Like strategic objectives, risk can be broadly defined at the organizational level. However, risk can be defined in more specific terms by linking risks to individual Tasks. When risk is more specifically defined and linked to individual tasks, the mitigation of risk becomes more manageable. This is because authority and responsibility for management of individual tasks is delegated to specific management tiers.

Each organization needs to assess those risks that can be managed by establishing



mitigating controls. For example, the risk of a major computer failure could be managed by disaster recovery planning. However, there may be some risks where the probability of the event occurring may be considered so low that the cost of establishing the control is not justified.

In assessing which risks should be mitigated, management should perform a risk analysis. The steps involved in risk analysis are:

- identifying risks;
- estimating the significance of a risk; and
- assessing the probability of the risk occurring.

The design of specific control procedures to mitigate risk should be focused on those risks which lead to the most significant consequences and those which have the highest probability of occurring.

### Managing Risk

Risk management has become a widely used term for a commonsense approach to managing. It is deciding where and in what measure to apply effort (or resources) to avoid the "intolerable" outcome. It depends on an assessment of the risks and the associated probabilities involved, which in turn depends on experience, knowledge, future fears, value judgments, intuition and attitude to risk.

In terms of public sector management responsibilities, this translates into: are the costs incurred by additional internal controls and the administrative inefficiency that may be necessary to provide additional visibility and accountability worth the avoidance of potential losses and costs? Potential losses and costs include not only the loss of money, assets or stores, but also the probability of administrative costs of follow up action if the risks materialize. Similarly, administrative costs can be incurred in answering public criticism or suspicion generally by a lack of visibility and accountability and too much of an "entrepreneurial" approach.

It is a good management practice that all organizations within the government and public sector institute a formal system of risk assessment and risk management. The internal auditors can then evaluate the effectiveness of this system in their routine audits.

The central plank to risk management is a Risk Management Plan. This provides the framework for monitoring risk management activities. The scope of the Plan will depend upon materiality considerations, non-financial impact considerations (e.g. adverse publicity), and the way in which the organization is structured. Best practice requires that the Risk Management Plan contain the following key elements:

- Risk descriptions.
- Risk analysis (impact analysis and probability of occurrence).
- Response evaluation.
- Description of reporting and monitoring procedures.



Risk Management Plans should be reviewed and updated on a regular basis to reflect changes in the organization's risk profile and risk responses.

### 2.1.5. Control Activities

#### Definitions

Internal controls structures are defined as the plans of an organization, including management's attitude, methods, procedures, and measures that provide reasonable assurance that the objectives are being achieved. Those objectives are:

- promoting orderly, economical, efficient, and effective operations and quality products and services consistent with the organization's mission;
- safeguarding resources against loss due to waste, abuse, mismanagement, deviations, errors, and fraud and irregularities;
- adhering to laws, regulations, and management directives; and
- developing and maintaining reliable financial and management data and fairly disclosing that data in timely reports.

This definition of internal control structures and the objectives for them are intentionally broad in scope to cover all operations. However, internal controls have been organized and defined in various other ways. The following descriptions have been provided as a point of reference.

#### Categories

When describing individual internal controls by their role in the organizational structure, they have often been organized into the broad categories of management, administrative, and accounting controls. Management controls are often viewed as encompassing all individual controls. They are the framework of the organization all the plans, policies, procedures, and practices needed for employees to achieve the entity's objectives. Administrative controls are those procedures and records concerning the decision-making processes that lead employees to carry out authorized activities in achieving the organization's objectives. Accounting controls cover the procedures and documentation concerned with the safeguarding of assets and the reliability of financial records.

Internal controls have also been categorized by their intended purpose: to prevent deviations or errors (for example, by segregating duties and authorization requirements); to detect deviations or errors (for example, by establishing production standards to detect variances in actual results); to correct errors or the cause of deviations that have been detected (for example, by collecting an overpayment to a vendor); or to compensate for weak controls where the risk of loss is high and additional controls are needed.

In practice, the distinction among these categories and types is often difficult to recognize because an effective internal control structure requires elements of each. Even the descriptions of each category of control can vary among individuals. However,



regardless of how individual internal controls are organized or defined, they should not be thought of as alternatives to each other. They should be complementary. Any one control has advantages and disadvantages, so an effective internal control structure uses a mix of controls to compensate for the particular disadvantages of individual controls.

### Criteria

To be effective, individual internal controls must satisfy three basic criteria:

- They must be appropriate (that is, the right control in the right place and commensurate to the risk involved).
- They must function consistently as planned throughout the period (that is, complied with carefully by all employees involved and not bypassed when key personnel are away or the workload is heavy).
- They must be cost effective (that is, the cost of implementing the control should not exceed the benefits derived).

### Control objectives

Specific control objectives should be identified or developed for each department activity and should be appropriate, comprehensive, reasonable, and integrated into the overall WAPDA objectives.

The objectives are the positive effects that management tries to attain or the adverse conditions or negative effects that management seeks to avoid. The objectives should be tailored to fit the specific operations in each activity while being consistent with the overall internal control objectives, which would be set forth by the authority or ministry or in legislation.

**Develop specific control objectives:** all operations should be grouped first into broad categories. Then, within each broad category, operations should be grouped into one or more sets of regularly recurring activities (such as identifying, classifying, recording, and reporting information) that are required to process a particular transaction or event. These groupings should be compatible with the organizational structure of the entity and its division of responsibilities.

An organization's operations can often be broadly categorized as follows.

- Management activities cover the overall policy and planning, organization, and audit functions.
- Program (operational) activities are those that relate to the organization's mission(s).
- Financial activities cover the traditional control areas concerned with budgets, the flow of funds (revenues and expenditures), related assets and liabilities, and financial information.
- Administrative activities are those that provide support to the organization's



primary mission, such as library services, mail processing and delivery, printing, and procurement.

To develop the control objectives, the set of recurring activities must be identified and analyzed. For example, the recurring activities associated with the procurement of materials (an administrative activity), would include:

- need assessment;
- identifying needed items;
- selecting a vendor;
- contracting for the items;
- receiving the items; and
- checking for quality.

One of the control objectives to be achieved here could be that only those requests for materials that meet management's criteria should be approved. Another may be that only requested materials should be accepted.

Obviously, the broad categories mentioned above interact, and control objectives over this interaction must also be established. For example, while the above example was considered an administrative activity, payment for the materials is a financial activity and the use of the materials may be a program activity. The categories would need to interface to properly control and record the payment.

### Principles

**Documentation:** The internal control structure and all transactions and significant events should be clearly documented, and the documentation is to be readily available for examination. An organization must have written evidence of its internal control structure, including its objectives and control procedures; and all pertinent aspects of significant events and transactions.

Also, the documentation must be available and easily accessible for examination by appropriate personnel and the auditors.

Documentation of the internal control structure should include identification of an organization's structure and policies and its operating categories and related objectives and control procedures. These should appear in documents such as management directives, administrative policies, procedures manuals, and accounting manuals.

Documentation of transactions or significant events should be complete and accurate and should enable each transaction or event (and related information) to be traced from its inception, while it is in process, to after it is completed. Documentation of the internal control structure, transactions, and significant events must have a clear purpose, contribute to achieving the organization's objectives, and be useful to managers in controlling their operations and to auditors or others involved in analyzing operations. Documentation without a clear purpose will hinder the efficiency and





effectiveness of an organization.

**Prompt and Proper Recording of Transactions and Events:** Transactions and significant events should be promptly recorded and properly classified if information is to maintain its relevance and value to management in controlling operations and making decisions. This applies to the entire process or life cycle of a transaction or event, including:

- the initiation and authorization;
- all stages while in process; and
- its final classification in summary records.

It also applies to promptly updating all documentation to keep it relevant.

Proper classification of transactions and events is also required to ensure that reliable information is available to management. Proper classification is the organizing and formatting of information from which reports, schedules, and financial statements are prepared.

Prompt and proper recording of information is essential for assuring the timeliness and reliability of all information used by the organization to support its operations and decision-making.

**Authorization and Execution of Transactions and Events:** Transactions and significant events are to be authorized and executed only by persons acting within the scope of their authority. Management decides to exchange, transfer, use, or commit resources for specified purposes under specific conditions. Authorization is the principal means of ensuring that only valid transactions and events are initiated as intended by management. Authorization, which should be documented and clearly communicated to managers and employees, should include the specific conditions and terms under which authorizations are to be made. Conforming to the terms of an authorization means that employees execute their assigned duties in accordance with directives and within the limitations established by management or legislation.

**Segregation of Duties:** Key duties and responsibilities in authorizing, processing, recording, and reviewing transactions and events should be separated among individuals. To reduce the risk of deviation, error, waste, or wrongful acts and the risk of not detecting such problems, no one individual or section should control all key stages of a transaction or event. Rather, duties and responsibilities should be assigned systematically to a number of individuals to ensure that effective checks and balances exist. Key duties include authorizing and recording transactions, issuing and receiving assets, making payments, and reviewing or auditing transactions. Collusion, however, can reduce or destroy the effectiveness of this internal control technique.

**Supervision:** Competent supervision is to be provided to ensure that internal control objectives are achieved. Supervisors should review and approve, as appropriate, the assigned work of their employees. They must also provide their employees with the





necessary guidance and training to help ensure that deviations, errors, waste, and wrongful acts are minimized and those specific management directives are understood and achieved.

Assignment, review, and approval of an employee's work require:

- clearly communicating the duties, responsibilities, and accountabilities
- assigned each staff member;
- systematically reviewing each member's work to the extent necessary; and
- approving work at critical points to ensure that it flows as intended.

Assignment, review, and approval of staffs work should result in the proper control of their activities, including: following approved procedures and requirements;

- detecting and eliminating deviations, errors, misunderstandings, and improper practices;
- discouraging wrongful acts from occurring or from recurring; and
- reviewing for efficient and effective operations.

A supervisor's delegation of work should not diminish the supervisor's accountability for these responsibilities and duties.

***Access to and Accountability for Resources and Records:*** Access to resources and records is to be limited to authorized individuals who are accountable for their custody or use. To ensure accountability, the resources are to be periodically compared with the recorded amounts to determine whether the two agree. The asset's vulnerability should determine the frequency of the comparison.

Restricting access to resources reduces the risk of unauthorized use or loss to WAPDA and helps achieve management directives. The degree of restriction depends on the vulnerability of the resource and the perceived risk of loss, both of which should be periodically assessed. For example, restricted access to and accountability for highly vulnerable documents, such as cheque book, can be achieved by:

- keeping them locked in a safe;
- assigning a sequential number to each document; and
- assigning custodial accountability to responsible individuals.

When determining an asset's vulnerability, its cost, portability, exchangeability, and perceived risk of loss or improper use should be considered.

***Verifications:*** Transactions or events are verified to ensure correctness and validity. Personnel records/service books are periodically verified to ensure their correctness.

***Reconciliations:*** Reconciliation of one set of records with another (the Project Director/DDO's accounts with GM (F)/AG's records, cash book with bank statements).



*Reviews and Post Audits:* ensures that activities have taken place in accordance with the intent and objectives of the management.

### Limitations

No internal control structure, however detailed and comprehensive, can by itself guarantee efficient administration and complete and accurate records or be foolproof against fraud, especially when those involved hold positions of authority or trust. Internal controls dependent on the segregation of duties can also be rendered ineffective where collusion by several individuals is involved. Also, the person in whom the authority is vested, as well as the management, is frequently in a position to override the controls it has established. To maintain an internal control structure that would eliminate the risk of loss is not realistic and would probably cost more than is warranted by the benefit derived.

Because any internal control structure depends on the human factor, it is subject to flaws in design, errors of judgment or interpretation, misunderstanding, carelessness, fatigue, or distraction. While the competence and integrity of the personnel designing and operating the system may be controlled by selection and training, these qualities may alter due to pressures from within and outside the organization. Furthermore, no matter how competent the staff, the control they operate may become ineffective if they do not correctly understand their function in the control process or choose to ignore it.

Organizational changes and management attitude can have a profound impact on the effectiveness of an internal control structure and the personnel operating the structure. Thus, management needs to continually review and update controls, communicate changes to personnel, and set an example by adhering to those controls.

Internal control structures are to provide reasonable assurance that the general objectives will be accomplished.

Reasonable assurance equates to a satisfactory level of confidence under given considerations of costs, benefits, and risks. Determining how much assurance is reasonable requires judgment. In exercising that judgment, managers should:

- identify the risks inherent in their operations and the acceptable levels of risk under varying circumstances; and
- assess risk both quantitatively and qualitatively.

Reasonable assurance recognizes that the cost of internal control should not exceed the benefit derived. Cost refers to the financial measure of resources consumed in accomplishing a specified purpose and the economic measure of a lost opportunity, such as a delay in operations, a decline in service levels or productivity, or low employee morale. A benefit is measured by the degree to which the risk of failing to achieve a stated objective is reduced. Examples include increasing the probability of detecting fraud, waste, abuse, deviation or error, preventing an improper activity, or enhancing regulatory compliance.

Designing internal controls that are cost beneficial while reducing risk to an acceptable



level requires that managers clearly understand the overall objectives to be achieved. Government managers may design systems with excessive controls in one area of their operations that adversely affect other operations. For example, employees may try to circumvent burdensome procedures, inefficient operations may cause delays, and diluted responsibilities may make it difficult to identify the individuals who are accountable. Thus, benefits derived from excessive controls in one area may be outweighed by increased costs in other activities.

## **2.1.6. Information and Communication**

### **Information**

All staff of an organization needs timely and relevant information to perform their tasks effectively. The system of internal control should facilitate both the identification of information needs, and the flow of information to appropriate users. The information flow will be from top tiers of an organization downwards, and from the lower tiers upwards. It could also be a horizontal flow.

Identifying relevant information will involve filtering, collation, summarizing and analyzing information. Information passing between tiers of the organization needs to be filtered so that information communicated to other tiers is relevant. The strategic objectives identified by the WAPDA may not be relevant to all individuals in performing their assigned tasks. For instance, objectives relating to human resources may not be relevant to individuals responsible for procurement. The system of internal control must, therefore, "filter-out" information relating to human resource planning before it reaches individuals performing procurement tasks. However, human resource objectives must be communicated to individuals responsible for human resource tasks.

Information flowing up through the organization's management tiers will also need to be filtered. In addition, the detailed information generated by lower management tiers will need to be collated, summarized, and often analyzed, before it is communicated to higher management tiers.

Clearly this is a complex process and the information needs of higher and lower tiers in an organization needs to be carefully gauged. Information systems and related technology is a major consideration for public sector management.

### **Communication**

Effective generation or collection of relevant information will not assist the organization to achieve its objectives unless the information is effectively communicated to appropriate tiers of the organization. Effective communication is the timely transmission of relevant information to appropriate parts of an organization.

Effective communication must occur up and down the management tiers, and between those responsible for the multiplicity of tasks performed within the organization.

There are many methods of communication, including directives, minutes, policy manuals, guidelines, electronic mail, internal mail, staff meetings, conferences and seminars. The most appropriate and effective means of communication will need to be



assessed for each type of information flow, bearing in mind urgency, relative importance, relative confidentiality and the relative cost of different communication methods.

The system of internal control needs to recognize the importance of effective communication. It may therefore be appropriate to specify the method and frequency of communication for certain types of information.

#### **2.1.7. Performance Monitoring**

As described above, the system of internal control must facilitate information flows, and communication both within and outside the organization. This enables performance to be monitored. In addition, the performance of the system of internal control itself must be monitored.

A system of internal control requires regular monitoring to ensure it remains effective. Over a period of time, changes in an organization's strategic objectives may lead to gaps in controls, redundant controls or duplicated controls.

Monitoring of the system needs to be performed by all tiers of management, and by staff.

Monitoring includes traditional management and supervisory activities, together with encouraging employees to identify breakdowns, redundancies, duplications or gaps in internal control procedures.

In addition, the Principal Accounting Officer and the Authority should undertake periodic reviews of the system of internal control. The frequency of these periodic reviews will depend upon the rate of change in the organization's underlying objectives, the level of risk and the number and nature of modifications to the system of internal control.

The quality of internal controls can be more formally assessed by requiring a periodic evaluation and report from managers to ensure that the controls for which they are responsible continue to be appropriate and are working as planned. These periodic management assessments can be mandated in a number of ways. They can become part of management's policies, or the Authority can mandate them administratively. In brief, managers should be required to annually assess and report to the GM (F) on the effectiveness and efficiency of their systems of internal control in achieving their goals and objectives and their plans to correct weaknesses identified.

Where risks and objectives change frequently, reviews of the systems of internal control will need to be more frequent. Changes in risks and objectives will often evolve over a number of years. In such cases, reviews may be limited to those functions of the systems of internal control affected by the changes.

Where evidence gathered through monitoring indicates that there are breakdowns, redundancies, duplications or gaps in the systems of internal control, these should be effectively communicated to higher tiers of management and higher tiers of management should expedite the appropriate corrective measures.



Periodic evaluations of the systems of internal control should be made utilizing consistent procedures that meet minimum levels of acceptability. Management should have a clear plan for periodically evaluating its internal controls, reporting problems, and correcting weakness. The types of procedures that might be considered include:

- segmenting the organization into components;
- identifying programs and administrative functions within each component;
- assessing the general control environment and the vulnerability within each program and activity to waste, loss, impropriety, or failure to meet other established objectives;
- planning and scheduling internal control evaluations of selected programs and functions;
- evaluating and testing the effectiveness of the internal controls within the selected programs and functions;
- determining and scheduling corrective action where necessary; and
- reporting the results of the overall assessment and the corrective action to be taken.

Management can also use its internal audit unit to help monitor the effectiveness of internal controls. The closeness of internal auditors to the day-to-day operations usually places them in a position to continually assess the adequacy and effectiveness of internal controls and the extent of compliance. The internal auditors have a responsibility to management for reporting any inadequacies in the internal controls and any failure of employees to adhere to them and recommending areas needing improvement. In addition, they should establish procedures for following up on previously reported internal and external audit findings to ensure that general managers have adequately addressed and resolved the matters brought to their attention.

*The purpose of this part of the manual is to provide guidance for establishing and maintaining effective internal controls. The framework applies to all general managers and not just financial managers. It covers all operations.*

*The term "internal control" as used in this manual is not limited to the traditional view of financial and related administrative controls, but covers the broader concept of management control. WAPDA should adopt the control framework discussed in this manual for creating an effective internal control structure. The internal audit function of WAPDA, Government auditors of the Auditor General of Pakistan and the commercial auditors can then use the framework to help evaluate those structures.*



## 2.2. Internal Audit

In today's dynamic operating environment, new and changing regulations, significant technology related risks, opportunities for fraud and abuse and other issues such as Sarbanes-Oxley require internal audit function to have at its disposal a larger and deeper talent pool to meet the challenges of complex and fast changing risk universe.

The traditional role of internal auditing has largely been restricted to the routine audit procedures. Typically, such audits had involved a review of routine laid down procedures based on standardized checklists, routine checking and verification procedures without appropriate planning. Hitherto, the internal auditor has typically operated as the "corporate financial cop" and often alienated the very audience that the internal auditor was ostensibly meant to assist. Such an approach had only limited use and benefits for senior management and in many situations, would not be cost justified. These outcomes needed to change for internal audit to survive, particularly in an environment where business entities are constantly seeking to create value through continuous performance improvements.

The new approach of world-class internal audit professionals is that they work with management to help them achieve their business objectives rather than simply imposing costly risk-averse processes. Accordingly, the objectives of internal audit function places greater emphasis on elements such as review of efficiency and effectiveness of operations, internal control and risk management and governance processes, review of compliance with laws, regulations and management's policies and relevance and reliability of financial information.

An effective internal audit function can be a key element of organization's risk management infrastructure. The objective of internal audit function is to assist management of the organization in the effective discharge of their responsibilities. To this end, internal audit furnishes them with analysis, appraisals, recommendations, counsel, and information concerning the activities reviewed. The scope of the internal audit function is therefore to add value and to improve an organization's governance, risk management and control processes through its recommendations without assuming management responsibilities.

To achieve this, the internal auditor should ensure that audits are conducted according to the International Standards for the Professional Practice of Internal Auditing promulgated by the IIA. In order to meet the challenges of complex and fast changing risk environment, the focus of the internal audit function has been redefined in line with best practices of internal auditing, as highlighted in the definition of internal auditing given by the Institute of Internal Auditors (IIA) which is reproduced below:

*"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systemic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."*

Internal Audit's mission is to assist the Management in the achievement of its aims by objective, independent and professional review of operations and by positive constructive





recommendations for improvement as a contribution to the proper, economic, efficient and effective use of resources.

Independence is an essential element of the effectiveness of internal audit. Independence is obtained through organizational status and objectivity. The authority of internal auditor is sufficient to ensure both a broad range of audit coverage and the adequate consideration of and effective action on the audit findings and recommendations.

The other important objectives concerning the Internal Audit function would be:

1. to understand and focus on corporate objectives to ensure that the operations reviewed are appropriately aligned with the overall objectives;
2. to identify major risks in achieving management's objectives and to evaluate whether management has identified such risks and that adequate controls are in place or steps have been taken for mitigation of such risks; and
3. to assess the adequacy of Information Technology (IT) underlying IT systems including IT governance with a view to ascertain the reliability of management information.

The importance and role of the internal audit and their contribution to such processes has increased significantly due to continuing evolution of the definition of internal control, which has expanded far beyond accounting controls to a point where there is little difference between the terms "internal control" and "management" and the rapid evolution of the Corporate Governance and risk management principles.

The above concepts are based on the premise that an audit, like all other processes, must add value to the business.

An efficient accounting process produces timely financial and management information for decision making by the Management. Decisions relating to investments, sales and other similar decisions underlie the objectives of financial reporting and an effective and efficient accounting system. The internal audit tasks would include, among other things, examining, evaluating and monitoring the adequacy and effectiveness of systems of accounting and Internal Controls.

A system of strong internal controls can help to ensure that the goals and objectives of an organization will be met, that the organization will achieve long-term profitability targets, and maintain reliable financial and management information. In order to carry out an effective audit, the internal auditor must consider that it will be necessary to carry out an overall review and evaluation of system of internal controls with emphasis in the areas mentioned in the audit plan agreed with the management.

### **2.3. Types of Audits**

The audit assignments which shall be undertaken by the internal audit division include, but are not limited to:

1. *Compliance Audits*



2. *Operational audits*
3. *IT Audits*
4. *Value-for-money Audits*
5. *Management Audits*
6. *Performance Audits*
7. *Environmental Audit*

Additionally, the internal auditor will proactively perform reviews and give reasonable professional advice on controls and risks pertaining to the development of new systems and processes in WAPDA, to ensure that effective systems of internal controls exist and they operate as intended with full audit trails.

The main type of internal audit that the internal audit division will perform will be "Compliance Audit" or "Compliance with Authority Audit". The function of the internal audit division is to ensure that best practices of management controls and financial and other rules and orders framed/adopted by the Authority from time to time in connection with execution of works, pay and allowances, fixed assets, stores, etc. and for maintenance of various accounts, books, etc. had been adequately followed by all Wapda units/offices and the defects/irregularities noticed in such accounts/books rectified as far as possible.

## 2.4. Internal Audit Evidence

### a) Introduction

The efficiency and effectiveness of audit work depends on the manner in which evidence is collected. The internal auditors should have a sound understanding of:

- The nature of evidence;
- What constitutes an appropriate quality and quantity of evidence;
- The most appropriate methods of collecting evidence.

The internal auditors should also have a sound understanding of techniques and procedures such as inspection, observation, enquiry and confirmation to collect audit evidence. They should adequately document the audit evidence in the working papers, including the basis and extent of the planning, work performed and the findings of the audit.

Adequate documentation is important for several reasons. It will:

- Serve as evidence of the internal auditor's compliance with the Standards for the Professional Practice of Internal Audit.
- Help to ensure that delegated work has been satisfactorily performed.
- Increase the efficiency and effectiveness of the audit.
- Help the auditors' professional development.
- Serve as a source of information for preparing reports.





- Serve as a source of information for answering any enquiries from the Authority, Parliament and its committees, or from any other party.
- Serve as a source of information to assist in the planning of audit for the following year.
- Help the individuals who are doing the audit work in the following year to perform their work.

The internal auditors should bear in mind that the content and arrangement of the working papers reflect the degree of their proficiency, experience and knowledge. Working papers should be sufficiently complete and detailed to enable an experienced auditor having no previous connection with the audit to ascertain from them what work was performed to support the conclusions.

#### **b) Attributes of Audit Evidence**

The evidence that the auditor collects to support the findings, conclusions and recommendations should be:

- i. Sufficient
- ii. Relevant
- iii. Timely
- iv. Reliable
- v. Objective

##### **i. Sufficient**

Evidence should be sufficient to lead a reasonable person to the same conclusions as the internal auditors. The sufficiency of evidence will be influenced by a wide variety of matters including:

- The internal auditors' knowledge of the entity's control environment.
- The size of the matter relative to the internal auditors' materiality amount.
- The amount of assurance that the internal auditors want to place on the evidence.
- The quality and persuasiveness of the evidence.
- The corroborativeness of the evidence by management officials.

The internal auditor should take care that the evidence is strong enough to support the conclusions reached even if management officials, at the time of reviewing the report, do not challenge the evidence, or the extent of the evidence. There is always the possibility that management officials may wish to revisit the supporting evidence, such as when they are putting together a corrective action plan. When the officials are developing their plan, they may want to discuss with the internal auditors all the examples that were found in need of correction. If in reviewing these details; management concludes that the evidence is insufficient to support the conclusions; the internal auditors are in an embarrassing position.



## ii. Relevant

The relevance of audit evidence refers to the relationship of the evidence to its use and applicability. In the case of a financial audit, audit evidence is relevant if it relates directly to the specific financial audit objectives, related compliance with authority objectives and potentially big errors for which the auditors are seeking assurance. The auditors need to obtain sufficient relevant evidence to conclude against each specific financial audit objective, related compliance with authority objective and potentially big error.

Evidence must support audit statements directly. Evidence should not take the form of an implication. For example, statements that the manager is often absent does not necessarily imply that there is insufficient supervision. The auditors must establish the linkage by obtaining sufficient relevant evidence to support the conclusion.

## iii. Timely

Evidence to support audit conclusions should, as far as possible, be timely. The relevance of audit findings generally diminishes over time. The auditors, in providing a useful function to management, need to focus as far as possible on current situations so that management can receive useful "lessons learned" and take corrective actions. For example, major capital projects may proceed through the planning, contracting and construction stages over many years. If the auditors identify a weakness in the planning stage of a project now complete, the finding may not be applicable to other projects. The managers may have changed, or the systems, procedures and practices may have changed. Wherever possible, the auditors should review the current systems, procedures and practices and determine whether the weaknesses of the past still exist or have been corrected. The current situation may not affect the conclusion on the historical evidence but it certainly influences the recommendations.

## iv. Reliable

The auditors have a professional responsibility to ensure that, as far as possible, the evidence obtained is reliable. That is to say, the evidence is:

- Based on fact, not opinion;
- An accurate reflection of reality;
- From a reliable source;
- Consistent with other evidence;
- Remaining true for all situations within the audit domain.

Interviews are a source of useful evidence but the auditors should appreciate that often statements are based on opinions, are not necessarily accurate and may on occasion be intentionally false. Wherever a statement from an interview can be checked against documented evidence, the auditors should follow up with an examination of the relevant documents. For example, if the auditors are informed that a particular transaction was



delayed for some time, the documentation of the transaction should be sought to confirm what was said in the interview.

Occasionally, even documented evidence can be unreliable. The auditors should be continually reviewing, questioning and deciding on the reliability of the evidence. Where the auditors are not satisfied with the reliability of the evidence, they need to search for alternative sources of evidence to obtain the required amount of assurance. The auditors could seek management's assistance in getting the most reliable evidence.

Where there is a good internal control structure, the auditors can be more confident of the reliability of information produced by the audited unit than where the internal controls are weak.

#### **v. Objective**

Evidence should be objective and free from bias. To the extent that it relates directly to other evidence that the auditor has obtained, or is directly influenced by that other evidence, it is not really providing the auditors with additional assurance.

#### **c) Types of Evidence**

Evidence can take the form of inspection, observation, enquiry, documentation, analysis, and confirmation. Evidence can be classified according to the following:

- i. Documentary
- ii. Observation
- iii. Oral
- iv. Analytical

##### **i. Documentary**

Although the auditors may rely on interviews for determining where to look and what to look for, the main source of audit evidence is, usually, documentary. Documentary evidence can be further broken down into internal or external.

Internal documentary evidence originates within the entity and may include accounting records, copies of outgoing correspondence, job descriptions, work plans, budgets, internal reports and memoranda, personnel documents, appraisals, organization charts, and internal policies and procedures.

External documentary evidence may include letters or memoranda received by the entity, suppliers' invoices, leases, contracts and other reports, and third party confirmations.

Auditors should be wary of possible errors or misstatements in documentary evidence. Their reliability depends on their source, and how they are collected and processed. Although electronic processing is far less prone to error than manual processing, yet:

- The errors that are generated by electronic processing are likely to be Systematic;



- Even with electronic processing, the input of the data is frequently done manually and therefore prone to human error.

Various reconciliations and analytical procedures can be performed to confirm the data's completeness and consistency, and to increase the auditors' assurance of its reliability.

As discussed in this manual, auditors also need to consider the substance of the transaction that is being supported by the documentary evidence. There may be a significant difference between the form of the transaction and the substance of the transaction. For example, a bribe may be disguised as a commission, or a purchase may be disguised as a long-term lease. The auditors need to ensure that the documentary evidence is clear enough that they can determine the substance of the transaction, as opposed to just its form.

## **ii. Observation**

Observation can include observing people and events or inspecting property. All observations obtained by the auditors should be recorded, either in the form of notes to file, photographs, or other pictorial representations. The evidence is strengthened if:

- Two auditors obtain it;
- The observation takes place several times during the year, as opposed to only once.

The observation is discussed at the time of the observation with a representative of the entity, preferably someone responsible for the activities being audited.

## **iii. Oral**

Oral evidence takes the form of statements that are usually in response to enquiries or interviews. Interviews can provide important leads not always obtainable through other forms of audit work. There are many sources of oral evidence:

- Various levels of management;
- Personnel directly involved in operations;
- Suppliers and contractors;
- Recipients of services;
- Other divisions/departments/agencies of WAPDA;
- Experts and consultants.

In approaching both personnel within the audited unit and personnel external to the unit, the internal auditors must take care to follow appropriate protocol and procedures. Generally, management personnel in charge of a particular area of the audited unit should be notified before the internal auditors approach lower levels of staff within that area. Similarly, before approaching personnel outside the unit to discuss matters pertaining to the unit, it is usually appropriate to first clear the interview with the appropriate management personnel inside the audited unit.



When approaching experts or consultants to discuss aspects of the unit, care should be taken to avoid placing them in a position of conflict.

The internal auditors should always prepare a written summary of the interview. The internal auditors should not normally "quote" a specific individual nor indicate the source of oral information in a report or briefing. If a person is to be quoted, then the internal auditors should obtain that person's agreement.

Wherever possible, the internal auditors should obtain oral information from more than one source. The reasons for this include:

- It increases the reliability of the information, particularly where the sources are independent;
- The source of the information is less likely to be traceable to one particular individual;
- A stronger statement can be made, such as "the majority of those interviewed commented that ", or "x% of managers responded ..."

Internal auditors need to be concerned of placing too much emphasis on a source that could be biased. A way of strengthening oral evidence, and confirming other forms of evidence, is to produce a list of observations to discuss at an exit interview for a particular location or visit, preferably with the person responsible for the area. The internal auditors do not need to divulge the source of the information; only confirmation of its correctness is discussed during the exit interview. If the internal auditors want further documentation of these findings, then minutes of this meeting can be sent for confirmation.

#### iv. Analytical

Analysis of data can provide conclusions that are not necessarily directly available from lists of data, reports, studies or other sources. Internal auditors with strong analytical skills can provide information that may not be known already to managers of the audited unit.

## 2.5. Risk Based Audit and Statistical Sampling

### 2.5.1. Extent of Testing: Sampling Decision

While writing the audit program, the internal auditors often have to design the audit steps with reference to the extent of testing. The audit program would guide the internal auditor about the amount of testing that would be necessary to achieve the audit objective. Therefore, at this stage, the internal auditor must be quite clear about the extent of testing. It involves decision relating to sampling.

There can be no hard and fast rules about the amount of testing necessary. The cost of testing 100% of large populations is usually prohibitive, unless computer interrogation is possible. Statistical sampling techniques, which provide a measure of the reliability of the results as well as reducing costs, may be used in testing such populations. In some



cases, non-statistical sampling may be adequate to meet the testing objective. The auditor should take into account all relevant factors, including:

- **The testing objective:** The objective could be to confirm the auditor's understanding of the system (a walk through procedure, for example), to test the application and effectiveness of controls (compliance), or to attempt to quantify the amount of an error (substantive).
- **Materiality and significance:** The extent of testing should take into account the materiality/significance being used. Generally, the larger the materiality/significance amount relative to the population being tested, the smaller the required sample size.
- **The amount of assurance desired from the procedure:** If, for example, the auditor wishes to place a lot of reliance on the internal control structure in auditable segments where the control risk is low, the auditor would need a larger compliance test sample size than if the auditor only wanted to place a limited amount of reliance on the internal control structure.
- **The time available:** This tends, in practice, to be a limiting factor. It is important to make best use of the testing effort, so it is normally not appropriate to perform more work than is required to achieve the audit objectives. At the same time, though, there is a need to devote the time that is required to achieve the audit objectives. The senior auditor should refer to the respective Deputy Chief Auditor if there is good reason to devote more time than planned.

It should be noted that, with the generally accepted sampling techniques, the variability and volatility of the population to be tested is normally NOT a factor to consider when determining the sample size.

### 2.5.2. Use of Information Technology in Audits

The Chief Auditor WAPDA should consider the use of information technology tools in the conduct of audits where appropriate, to increase the effectiveness and efficiency of audit process and enable internal audit staff to acquire technical skills and knowledge in the use of specialized software for audit purposes. There are several specialized audit softwares which enable analysis of huge amount of data from source, and also help detect suspicious transactions and activities. Audit Command Language (ACL) is one such software which is commonly used by internal auditors for this purpose. Use of such IT tools will also help the internal audit division with its continuous auditing efforts to check selected set of transactions on regular intervals.

Similarly, use of special software for audit working paper management and audit documentation system to automate the recording of the audit process will help provide, among other things, time tracking capability with a view to increasing the time efficiency in audit assignments.



### 3. ORGANIZATION OF INTERNAL AUDIT DIVISION

#### 3.1. Scope of internal audit

It is the responsibility of the WAPDA Authority to put in place systems of internal control, including internal audit, for managing and controlling the economical, efficient and effective delivery of services by each of the functional wings, divisions and formations and the achievement of organizational objectives.

The scope of internal audit encompasses the following activities:

- a. Review the adequacy and effectiveness of systems of internal control;
- b. Review established systems, policies and procedures to ensure the audit unit is in compliance with rules, regulations and directives;
- c. Review means of safeguarding assets;
- d. Appraise efficiency and effectiveness with which resources are deployed;
- e. Coordinate internal audit efforts with the external auditors;
- f. Participate in the design and development of new computer systems to ensuring adequate control framework;
- g. Participate in the planning and performance of audits of potential acquisitions;
- h. Review the Authority's compliance guidelines for adherence to ethical standards;
- i. Evaluate plans and actions taken to correct reported conditions;
- j. Provide adequate follow-up to ensure corrective action is taken and evaluate its effectiveness; and
- k. Periodically report audit findings and status of corrective action to the respective management and General Manager Finance.

The internal audit function shall be responsible for the review and examination of financial, operational accounts and related records of all formations and projects of WAPDA's water, power and coordination wings irrespective of the financial limits. The internal audit shall also include physical verification of stocks held at various stores, checking of payments made to consultancy services engaged on development projects and special audit as per directives of the Authority.

WAPDA's ongoing projects' profile contains several under construction dams, canals, drainage systems, hydropower projects and barrages with their own elaborate financial and operational accounting systems and methods prescribed by the sponsoring agencies and international financial institutions which although fall under the domain of the Auditor General of Pakistan but shall also be covered in the scope of internal audit function.

The internal audit procedures shall be performed specifically with the objectives of, but not limited to, verifying that:

- i. The books of accounts are properly maintained in accordance with the generally accepted accounting principles.





- ii. There is adequate and relevant Chart of Accounts.
- iii. Transactions are posted in the relevant account heads and accounting periods.
- iv. All receipts for the period have been deposited in the bank accounts.
- v. There are adequate and effective accounting and financial reporting procedures to meet the desired objectives, from the initiation of significant transactions and other events to their inclusion in the books of accounts.
- vi. The System of Internal Controls is relevant, adequate and effective to avoid the risk factors.
- vii. There are proper written accounting and financial policies and procedures for authorization of transactions, financial reporting and maintaining proper books of account.
- viii. The written policies and procedures, if available, are communicated to the relevant staff for guidance on accounting treatment of routine and specific transactions.
- ix. Accounting Policies are being applied with consistency or a change in accounting policy is applied properly and disclosed.
- x. Financial and Management information is appropriately and accurately presented and all information that is necessary for fair presentation and compliance with professional standards is disclosed.
- xi. The segregation of duties exists for preparation, approval and recording of transactions in the system particularly the transactions involving payments.
- xii. Discretionary power limits are defined in line with Book of Financial Powers and complied with for approving transactions related to payments.
- xiii. Accounting and Finance staff are appropriately qualified, suitably experienced and properly trained for their respective jobs.
- xiv. Staff is properly trained to use standardized or in-house developed accounting software, if any.

### **3.2. Fraud Detection**

It may be understood that internal auditors are not responsible for fraud detection on the basis of their routine audit activity. Fraud prevention and detection is the primary responsibility of the management of the audited unit which must design and implement an effective system of internal controls in this regard. In case of special audits assigned to internal auditors their role is confined to gathering reliable audit evidence which may prove or deny the existence of a suspected fraud in the audited WAPDA formation/project.

### **3.3. Internal Audit Charter**

The Chief Auditor will prepare a new Internal Audit Charter for the Internal Audit Division and will get it approved from Member (Finance)/Authority WAPDA. This Charter may then be revised at periodic intervals by the Chief Auditor on need basis to incorporate expanding role





of the internal audit function in the light of changes taking place in the realm of scope of internal audit, activities and processes of authority, and audit methodology.

Before the corporatization of WAPDA the internal audit function was being performed by the Internal Audit Division headed by the Chief Auditor who was responsible to the Authority for the examination of accounts and related records of WAPDA formations. However, the accounts of power and water projects over the financial limit of Rs.20.00 million were being audited by Director WAPDA Audit as representative of the Auditor General of Pakistan. The accounts of such projects/units were not subject to regular audit by internal audit division but the Authority had the power to get the accounts of any of these projects/offices audited by internal audit division as a special case when considered necessary.

The Internal Audit Division comprised of the following:

1. Chief Auditor WAPDA
2. Chief Auditor (Administration)
3. Deputy Chief Auditor (Headquarters)
4. Deputy Chief Auditor (Statutory Audit Liaison)
5. Deputy Chief Auditor (one for each region)
6. Incharge (Policy Procedures Reporting Section)

The internal audit of all WAPDA formations, including revenue, XENs, divisional, sub-divisional offices, etc. of Power Wing, Water Wing and Common Services, was being conducted through following three types of audit parties comprising of Senior Audit Officers, Audit Officers, Assistant Audit Officers, Audit Assistants, Stock Verifiers and Audit Clerks:

1. Local Audit Parties
2. Test Check Parties
3. Audit Parties

The function of the internal audit division was to ensure that financial and other rules and orders framed/adopted by the Authority from time to time in connection with execution of works, pay and allowances, stores, etc. and for maintenance of various accounts, books, etc. had been adequately followed by all WAPDA formations/offices and the defects/irregularities noticed in such accounts/books rectified as far as possible. It was not otherwise the function of internal audit division to prescribe such rules and orders.

After the corporatization of WAPDA formations, the internal audit division has been reconstituted and now comprises of:

1. Chief Auditor WAPDA
2. Deputy Chief Auditor (Admin/SAL)
3. Deputy Chief Auditor (Certification Audit)
4. Deputy Chief Auditor (HQ/PAS)



The Office of Chief Auditor WAPDA (as part of primary management control process) shall be responsible for the audit of all WAPDA projects, formations, offices, transactions, consultants, autonomous divisions, etc., without any monetary and administrative limitations. This is to ensure that an effective risk-based audit approach may be adopted by the Chief Auditor WAPDA in a holistic manner to add value to organizational processes and systems. The rights of the Director WAPDA Audit as representative of the Auditor General of Pakistan will remain the same.

The business of internal audit function shall be divided in two sections namely Administration/Statutory Audit Liaison section and Headquarters/Performance Audit section, each headed by deputy chief auditor. The Administration/Statutory Liaison section shall be responsible for coordinating with all WAPDA formations for finalizing and compiling the management responses on the Auditor General of Pakistan audit reports and performance audit reports for the necessary discussion in the meetings of the Public Accounts Committee/Departmental Accounts Committee. The Headquarters/Performance Audit section shall be responsible for performing financial audits and special audits of all WAPDA formations and projects, including audit of payments made to consultants engaged by WAPDA for various projects as well as stock verifications.

The internal audit division shall perform the internal audit of the auditable segments and key financial areas of WAPDA wings, divisions and offices in accordance with the scope of internal audit described in the preceding section. The internal audits shall be conducted by Audit Parties, comprising of Senior Audit Officers, Audit Officers, Assistant Audit Officers, Audit Assistants and Stock Verifiers allocated according to the need of the engagement, each headed by a Deputy Chief Auditor.

The internal auditors shall have a vested interest in ensuring that satisfactory internal control exists in the formations they audit. However, it is important and necessary that independence be maintained. The auditors shall therefore not take responsibility for implementing the specifics of the internal control procedures in any auditable formation, division/wing of WAPDA. This is the responsibility of the respective General Manager Finance.

The internal auditors shall gear their work toward assessing the adequacy in principle, and the effectiveness in practice, of existing internal controls in auditable segments of divisions/wings. Where these are found to be inadequate, the weaknesses, their causes, and possible effects should be fully documented and promptly communicated to the heads of auditable units/divisions.

Recommendations shall also be made, both formally and informally, on how to correct the situation. Before making these recommendations, internal auditors shall seek the views of the concerned general managers and strive to ensure that the recommendations are relevant and practical. In particular, the internal auditor shall relate the cost of implementing the proposed control measures to the risk inherent in the prevailing situation.

When assessing internal controls, the internal auditors shall consider the following steps:



- i. Determine the significance and the sensitivity of the subject matter for which controls are being assessed.
- ii. Assess susceptibility to misuse of resources, failure to attain objectives, and noncompliance with laws and regulations.
- iii. Identify and understand the relevant internal controls.
- iv. Determine what is already known about control effectiveness.
- v. Assess adequacy of the control design.
- vi. Determine, through testing, if controls are effective.
- vii. Report on the internal control assessments and discuss needed corrective actions.

It would be appropriate for internal auditors to comment on the effectiveness of existing control arrangements and to make recommendations for improvement. This can be done without loss of independence since the responsibility for deciding on and implementing the control provisions would still rest with the WAPDA Authority and/or the General Managers Finance of the respective wings.

### **3.4. Roles and Responsibilities**

#### **The WAPDA Authority**

The WAPDA Authority shall be responsible for developing and promulgating an organization wide definition of internal control structure, the objectives to be achieved by that structure, and the standards to be followed when designing an internal control structure. This responsibility is implicit in the WAPDA Act.

#### **Management**

Internal control is a management tool. It is management's responsibility to implement and monitor the specific internal controls for its operations. All General Managers Finance should realize that a strong internal control structure is fundamental to the control of their respective wings/divisions, its purpose, operations, and resources. They should accept responsibility for it.

To design, establish, and maintain an effective internal control structure, the General Managers Finance should understand the objectives to be achieved. WAPDA Authority shall prescribe the policies General Managers are to follow to implement and monitor their internal control structures and to report on the adequacy of those structures.

Management often establishes an internal audit function as part of its internal control structure. While internal auditors can be a valuable resource to educate and advise on internal control, the internal auditor shall not be a substitute for a strong internal control structure.



The internal control standards require general managers to continually monitor their operations. The WAPDA Authority is ultimately responsible and should assume "ownership" of the system. The WAPDA Authority sets the "tone at the top" that affects integrity and ethics and other factors of a positive control environment. The WAPDA Authority fulfills this duty by providing leadership and direction to General Managers Finance and reviewing the way they are controlling the operations of their respective wings/divisions. General Managers Finance, in turn, assign responsibility for the establishment of more specific internal control policies and procedures to personnel responsible for the wing/division's functions.

### **Accountability**

In WAPDA, the management is accountable to the WAPDA Authority which provides governance, guidance and oversight through its members. A strong, active management, particularly when coupled with effective upward communications channels and capable financial, legal and internal audit functions, is often best able to identify and correct any problem dealing with accountability.

### **Other Personnel**

Internal control is, to some degree, the responsibility of everyone in WAPDA and therefore should be an explicit or implicit part of everyone's job description. Virtually all employees produce information used in the internal control system or take other actions needed to effect control. Also, all personnel should be responsible for communicating upward problems in operations, noncompliance with the code of conduct, or other policy violations or illegal actions.

### **External Parties**

A number of external parties often contribute to achievement of an entity's objectives. External auditors, bringing an independent and objective view, contribute directly through the financial statement audit and indirectly by providing information useful to management and the Authority in carrying out their responsibilities. Others providing information to the entity useful in effective internal control are legislators and regulators, customers and others dealing with the organization. External parties, however, are not responsible for, nor are they a part of, the entity's internal control system.

## **3.5. Responsibilities of Internal Audit Officers**

### **3.5.1. Introduction**

The internal audit division of WAPDA shall be headed by the Chief Auditor WAPDA who shall be assisted by three Deputy Chief Auditors. Each Deputy Chief Auditor shall have a Senior Audit Officer who supervises the work of field auditors comprising of Audit Officers, Assistant Audit Officers and Audit Assistants. The field auditors shall be called



Audit Parties and include Stock verifiers where needed.

Depending upon the extent of computerization, some internal audit functions also use the help of Information Systems Auditors who specialize in computer audit. The Information Systems Audit section shall comprise of Information Systems Audit Manager and Information Systems Auditors, who could also be CAATs specialists.

The present section defines the roles and responsibilities of various levels of internal audit officers.

### **3.5.2. Responsibilities of the Chief Auditor**

The Chief Auditor, who is the head of internal audit function, shall report to the Chairman WAPDA. The Chief Auditor would have an appropriate authority level according to the WAPDA Act. However, in any case, the Chief Auditor would be a member of the senior management, and not the functional management, of WAPDA.

The Chief Auditor shall be responsible for the administration of the internal audit activity. He / She shall be responsible for properly managing the internal audit activity so that:

- a. Audit work fulfills the specific and general purposes and responsibilities approved by WAPDA Authority/Ordinance.
- b. Directs and coordinates analysis of operating departments and functions and makes recommendations to promote maximum managerial effectiveness and operational efficiency when appropriate.
- c. Internal audit resources are efficiently and effectively employed.
- d. Audit work conforms to the Standards for the Professional Practice of Internal Auditing applicable in Pakistan.

For achieving these objectives the Chief Auditor shall be responsible for:

- i. Preparing plans to carry out the responsibilities of the internal audit activity. This process involves establishing goals, identifying activities subject to audit, evaluating their significance and assessing the degree of risk inherent in the activity, preparing audit work schedules, staffing plans, financial budgets and activity reports.
- ii. Establishing and maintaining a program for selecting and developing the human resources of the internal audit function.
- iii. Developing policies and procedures for the guidance of internal audit staff.
- iv. Training and instructing support staff.
- v. Supervising procedures and records for their adequacy to accomplish intended objectives, appraising policies and plans relating to the activity of the internal audit function.
- vi. Reviewing and ascertaining the reliability of management data developed within



- the auditable segment. He/She also recommends and develops internal auditing policies, standards of performance, procedures, and programs.
- vii. Providing the WAPDA Authority and/or the General Managers Finance with annual reports on the results of audited activities including recommendations for improvements.
  - viii. Serving in an advisory capacity and making recommendations for improved financial management systems.
  - ix. Appraising the adequacy of corrective action taken by functional management and preparing a variety of related reports and analysis.
  - x. Serving as liaison with many departments and offices to assist with problems and determine need for audits.
  - xi. Coordinating internal and external audit efforts to ensure adequate audit coverage, minimize duplicate audit efforts, and to assure high quality audit output.
  - xii. Determining fiscal requirements of internal audit operations and preparing budgetary operations. He monitors, verifies, and reconciles expenditure of budgeted funds.
  - xiii. Performing special reviews as requested by the WAPDA Authority.
  - xiv. Reviewing auditable segment's policy and structural changes that might alter audits and coverage.
  - xv. Establishing and maintaining a quality assurance program to evaluate internal audit operations and performance.
  - xvi. Performing other duties incidental to the work described above.

### **3.5.3. Responsibilities of Deputy Chief Auditors**

The Deputy Chief Auditor shall be incharge of the respective internal audit function in accordance with the assigned responsibilities. The Deputy Chief Auditor shall be responsible for the internal audit plans, the conduct of internal audits and the internal audit reports issued within the auditable segment(s) where audit responsibility has been assigned. These responsibilities shall include but not limited to:

- a. Developing audit objectives, plans, and scope consistent with the divisions/wings objectives, the assessment of audit risk inherent in the auditable segments, and the audit needs and priorities set by the WAPDA Authority or the General Managers Finance.
- b. Scheduling audits, determining the resources that are necessary, and seeing that the approved audit plan is accomplished to the extent staffing allows.
- c. Communicating with those who need to know about audits and interfacing with personnel throughout WAPDA, particularly those being audited, to resolve audit issues



and achieve the desired corrective actions.

- d. Supervising audits and reviewing the work performed to ensure the adequacy of audit scope, the adequacy of tests performed, and the accuracy of conclusions reached. Audit work will also be reviewed for compliance with policies and procedures and the Standards for the Professional Practice of Internal Audit in the Government independent entities. Supervision is a continuing process, beginning with planning and ending with the conclusion of the audit assignment. Supervision includes:
- Documenting audit objectives and time budgets, providing suitable instructions, and approving the audit plan before fieldwork begins.
  - Ensuring that the approved audit plan is carried out.
  - Determining that audit working papers support the auditor's findings.
  - Ensuring that reports are accurate, objective, clear, concise, constructive, and timely.
  - Determining that objectives are met.
  - Reviewing and approving detailed audit programs tailored to each audit to ensure that no specific tests or activities necessary for the audit are overlooked, and to assist in preventing ineffective audit techniques from being performed. This review process is directed at specific accomplishment of defined audit objectives.
  - Evaluating auditors' performance and counseling auditors to strengthen the person's knowledge, skills, and development.
  - Editing audit reports to facilitate recommendations and ultimately corrective actions.
  - Facilitating the audit process by resolving issues and staff questions during the day-to-day progress of audits.
  - Performing administrative duties delegated by the Chief Auditor.

#### **3.5.4. Responsibilities of Field Audit Officers (Audit Parties)**

The field audit officers comprising of senior audit officers, audit officers, audit assistants, stock verifiers, etc. shall be responsible for the execution of the audit activities identified in the audit plan. These officers are the grass-roots operational persons responsible for fieldwork. Although the senior audit officers shall be involved at the time of planning, the main responsibilities of the field audit officers shall revolve around supervising and executing the audit work in the auditable segment. Particularly, the responsibilities shall include but not limited to:

- Following the audit program and executing the instructions given in it.
- Preparing working papers for the entire work done.





- Pointing out any need for revision to the audit program in the light of facts.
- Interacting with the auditee focal person and seeking any clarifications needed.
- Communicating initial audit observations during the course of the audit.
- Preparing a brief for the Deputy Chief Auditor for discussion with the General Managers Finance on the last day of audit.
- Piecing together the material in the working papers as basis for the audit report.
- Following up audit observations and send further comments to the replies received from the auditee.
- Finalizing the audit observations either for settlement or for report of the Deputy Chief Auditor.

#### **Attributes of Internal Audit Staff**

##### **a. Professional Proficiency**

Internal audit staff is expected to possess adequate knowledge, technical skills and competencies to be able to apply and comply with the provisions of the WAPDA Charter, international standards for professional practice of internal auditing and procedures covered in this Manual. The Chief Auditor WAPDA has the overall responsibility to ensure that the internal audit staff fully understands the requirements of this Manual.

Knowledge, skills, and other competencies is a collective term that refers to the professional proficiency required of internal auditors, to effectively carry out their professional responsibilities. Internal auditors are encouraged to demonstrate their proficiency by obtaining appropriate professional certifications and qualifications.

##### **b. Due Professional Care**

Internal auditors must apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility. However, internal auditors must exercise due professional care by considering:

- The extent of work needed to achieve the assignment's objectives;
- The relative complexity, materiality, or significance of matters to which assurance procedures are applied;
- The adequacy and effectiveness of governance, risk management, and control processes;
- The probability of significant errors, fraud, or noncompliance; and,
- The cost of assurance in relation to potential benefits.

In exercising due professional care, internal auditors must consider the use of technology-





based audit and other data analysis techniques. Internal auditors must be alert to the significant risks that might affect objectives, operations, or resources. However, assurance procedures alone, even when performed with due professional care, do not guarantee that all significant risks will be identified.

#### **c. Continuous Professional Development**

Internal Audit staff is responsible for continuing their education in order to maintain their proficiency. They should keep abreast of latest developments and improvements in internal auditing standards, procedures, and techniques. Continuing education may be obtained through membership and participation in professional societies, attendance at meetings, seminars, college courses, in-house training programmes, on-line or correspondence courses and participation in research projects. However, these activities should be kept at a reasonable level and not impinge on the internal audit staff's availability.

The Internal audit division should adopt a training policy that sets out the framework of training activities for each section, i.e. Internal Audit, Investigation and Evaluation, and individual staff members within the division, to ensure that internal audit staff possess the necessary technical knowledge, skills and competencies to be able to carry out duties and responsibilities they are assigned to.

#### **3.5.5. Responsibilities of Information Systems Audit Manager**

The Information Systems Audit Manager reports to the head of internal audit. He provides support to the internal audit staff in the audit of computerized systems. His responsibilities shall be as follows:

1. Participating in the development of new system applications to:
  - Ensure that adequate controls are established and installed to meet management objectives.
  - Verify that users and computer operation's staff have been trained in the system functions and controls.
  - Determine whether level of security is appropriate.
  - Verify that backup and recovery procedures are complete.
2. Performing audits of existing computerized applications, the related network links and the supporting computer data centers.
3. Preparing detailed audit programs and describing tests to be performed.
4. Obtaining sufficient competent and relevant evidential matter, analyze and summarize data to support an objective informed opinion on the adequacy and effectiveness of internal controls, the accuracy of institutional data, and the level



- of compliance with audit entity's policies.
5. Drafting written reports expressing opinions on the adequacy and effectiveness of system controls, the accuracy of institutional data, and the level of compliance with relevant policies, procedures, and government statutes.
  6. Recommending changes in policies and procedures to enhance controls or correct deficiencies.
  7. Appraising the adequacy of departmental replies to final audit reports and performing post-audit reviews to determine the extent to which audit recommendations have been implemented.
  8. Assigning work and supervising Information Systems Auditor so that the audit is conducted in a professional manner and the audit objectives are accomplished.
  9. Reviewing information systems audit working papers and conducting performance appraisals so that standards are complied with and evaluations can be accurately completed.
  10. Providing guidance, training, and assistance to field auditors in using computerized audit techniques, maintaining library of standard audit programs, administering department's computer network, etc.
  11. Acting as CAATs specialists and helps the field auditors in the following:
    - Planning a CAATs application for an audit.
    - Advising on appropriate software for CAATs.
    - Writing in-house software for systems evaluation.
    - Developing appropriate interrogations for systems evaluations.
    - Selecting the sample.
    - Identifying the files and fields of data.
    - Downloading the data.
    - Analyzing and manipulating data.
    - Preparing test data for testing.
    - Preparing embedded audit data tests.

### **3.5.6. Responsibilities of Information Systems Auditor**

The Information Systems Auditor shall report to the Information Systems Audit Manager.

Using specialized knowledge of auditing and information technology, participates in audits of information systems, systems development processes, LANs, and related resources/processes to determine the adequacy of general and application controls and



to assess compliance with applicable policies, procedures, statutes, and contract requirements. This entails analyzing evidential data as a basis for an informed, objective opinion and preparing comprehensive reports.

The responsibilities of the Information Systems Auditor include the following:

1. Planning and conducting audits in accordance with applicable professional audit standards.
2. Exercising professional judgment to determine adequacy of controls, materiality of findings, and sufficiency of evidence to support opinions and findings presented in audit reports. Prepares working papers containing sufficient, competent, and relevant evidence to support findings and opinions in internal audit reports.
3. Drafting internal audit reports containing the results of the audit, including findings, recommendations, and opinions.
4. Assisting the internal audit staff performing financial and operational procedures in applying information systems audit principles and concepts, identifying the relevant automated controls to include in the audit scope, designing audit programs/procedures to assess their adequacy, and documenting the impact of strengths or weaknesses to current audit procedures/objectives.
5. Performing post-audit reviews to determine the extent to which audit recommendations have been implemented. Appraises the adequacy of departmental replies to final audit reports, and performs post-audit reviews to determine the extent to which audit recommendations have been implemented.
6. Discussing deficiencies with management and recommends actions to improve controls, enhance information integrity, streamline processes, and reduce costs. Where appropriate, recommends changes in policies and procedures to enhance controls or correct deficiencies.
7. Writing and developing computer assisted audit techniques (CAATs) to extract and manipulate data from complex computer systems and to facilitate audit compliance and substantive testing procedures.
8. Assisting in administering and supporting the internal audit of Local Area Network (LAN).
9. Performing other duties as assigned by the Information Systems Audit Manager.

### **3.6. Internal Audit Staff Training and Development**

#### **3.6.1. Introduction**

The increasing complexity of WAPDA operations requires that internal auditors continually develop their professional skills to remain effective. It is, therefore,



necessary that the internal audit department have a formal plan for training and development, which will encourage individual initiative and develop the competence for working with confidence and professionalism.

### **3.6.2. Annual Training Plan**

The internal audit division shall prepare an annual training and development plan. The plan shall have two main components:

- a. Orientation and training program for new staff members.
- b. Continuing Professional Development of the existing staff.

#### **a. Orientation Program for New Staff Members**

All new staff members should be afforded an opportunity to become quickly acquainted with the internal audit division and the divisions/functions they would be auditing.

The internal audit orientation program should include:

- i. General Orientation.
- ii. Internal Audit Division Orientation.
- iii. Audit Entity Orientation.
- iv. Information Systems Orientation.

Complete knowledge and mastery of the orientation topics are not expected of new staff members at the completion of orientation. However, in the post-orientation period, new employees should understand the basic work rules. New employees should also grasp internal audit's role and responsibilities, the sources of information and reference materials, who can provide the information they seek and how to become an informed participant. New staff members should be encouraged to make notes and ask questions throughout the orientation process.

Prior to the job starting date of new audit staff the head of internal audit should designate an officer responsible for their orientation. The designated officer will assume responsibility for overall orientation and will coordinate the various orientation activities. The officer should act as a mentor until the new staff member has adjusted to his roles and has begun to develop solid working relationships.

#### **i. General Orientation**

The general orientation will cover the facility where employees will be headquartered and introduction to internal audit department personnel. This part of the orientation



process will begin immediately on the employees joining the department. Specific items to be covered under the General Orientation include:

- Discussion of overall orientation objectives.
- Meeting with the head of internal audit.
- Introduction with all other internal audit staff members on site.
- Assigning an office desk.
- Conducting a complete building tour (include rest rooms, cashier window, facsimile/copying machines, cafeteria, conference rooms, and the locations of the various other departments).
- Explaining telephone services and usage.
- Filling-in of the charge assumption report.
- Filling-in of the computer input data form for salary.
- Filling-in form for departmental ID cards.
- Providing following materials to be used later in the orientation process:
  - Organization chart of the audit function.
  - General audit manual of internal audit.
  - Basic stationery supplies.
  - Copy of travel rules and procedures.
  - Internal audit telephone directory.
  - Telephone directory of audit entities.
  - Organization chart of the Ministry or Department or audit entities.
- Confirming that arrangements are under way for a telephone and a name plate.

## **ii. Internal Audit Division Orientation**

The Internal Audit Orientation will focus on the organization, responsibilities and administration of the Internal Audit Division. The Internal Audit Manual should serve as the foundation of these discussions. Generally, a format, where new employees read a section of the manual followed by a question and answer session about that section, works best.

Orientation topics to be specifically covered include the following:

- The Internal Audit Charter.
- The Standards for the Professional Practice of Internal Auditing applicable in



Government of Pakistan, and Code of Ethics for Internal Auditors.

- Reporting relationships with the auditee division/wing.
- An introduction to various administrative arrangements regarding office timing, leave, travel arrangements approval, individual development and training arrangements and options, audit planning and its approval process, and audit supervision arrangement.
- Using new staff members' next assignment will facilitate both orientation and briefing for the next assignment. In this manner, prior working papers are reviewed and used to illustrate the audit techniques applied.
- The risk assessment process, the planning and objectives process, the detailed audit program, audit documentation and audit reporting and follow-up should all be covered.

Information Systems auditors' orientations will equally emphasize factors such as:

- the scope of IT auditing, roles and responsibilities, the risk assessment process, and the planning process;
- expense reimbursement procedures, a petty cash voucher, and a travel advance request;
- telephone messages, correspondence, and arrangements for mail;
- the audit schedule and project assignments;
- Divisions/Wings files, procedures used when files are removed, and departmental record retention practices;
- reference materials/library listing;
- arrangements for making reservations for air travel and lodging;
- assignment of a laptop computer, completion of the related ownership agreement, and an assessment of new staff members' training needs, if any, related to the various software programs currently in use in the internal audit division. If further training is needed, appropriate training arrangements should be scheduled. Teaming the new staff member with an experienced software user may accomplish the same objective;
- performance management system that includes performance appraisal and professional development.

### **iii. Audit Segment Orientation**

The newcomer should be attached to an audit team. Normally, the audit team will be responsible for the audit of designated divisions or functions of Water, Power or Coordination Wings of WAPDA. The new comer should get a fairly detailed introduction



about the audit entities for which the audit team is responsible.

The orientation should cover organizational topics useful to people not familiar with the audit entities. Orientation in this regard provides a future reference and framework of how the overall organization fits together. Specific items that should be on this orientation agenda are:

- The Organization Chart of the audit entities, and discussion of who's who in each entity.
- Introduction to the senior management teams of the audit entities
- Meetings with the officer responsible for coordinating with the audit, directed at obtaining a basic understanding of the roles and responsibilities of those entities.
- Compilation of policies, directives and procedures and manuals, if any, specific to the respective entities.
- The entities' latest annual report, if separately prepared, and an understanding of the functions and operations of the division/wing.
- The Chart of Accounts and an overview of how the accounting system is structured and how the various general ledgers and locations are numbered and consolidated.
- Discussion about each of the auditable segment within the entity and what their functional roles are.

#### **iv. Information Systems Orientation**

The orientation of Information Systems auditors will additionally include steps to acquaint the new staff member with the Information Systems function. This orientation should focus on:

- The roles and responsibilities of the Information Systems function.
- The operating systems (hardware/software) maintained.
- The significant new system development efforts under way
- The systems support services provided.
- Introductions to the key Information Systems Managers and personnel. These introductions would include personnel at both Headquarter and Regional levels where accounting function is performed.
- The internal audit risk analysis of the Information Systems activities and the audit priorities that have been established.
- The interface with other internal audit staff.



### **On the Job Training of New Staff**

The orientation program should be followed by a plan for on-the-job-training (OJT). OJT supplements the classroom training and makes a real difference in the learning of skills. Following guidance is relevant for OJT.

The OJT should not be on a piecemeal basis. It should be based on a plan that results in continuing development of the internal auditors.

Each successive assignment to the new auditors should be based on the performance of the auditors in the previous assignment. The OJT plan should remain under constant review and each assignment should be tailored according to the need of the trainees.

Generally, the training plan should follow from simpler to more complex assignments. Diversification should be the general guiding principle. It is through rotation on different types of assignments that the newcomer becomes familiar with the whole gamut of complex problems.

The Deputy Chief Auditor should remain vigilant about the performance of the new staff members in the field and continually advise them about their performance. The senior auditor should hold a briefing session with the newcomers before the audit team goes to field. He should explain in detail the audit program and the objectives to be achieved.

The senior auditor should adopt an effective program of counseling to advise the new comers on their weaknesses. It helps the new comers adjust to the culture of the internal audit division. The counseling should also emphasize the ability to get along with others, intelligent communication skills, leadership qualities, decision-making skills, ability to plan, organize and control work.

### **b. Continuing Professional Development (CPD)**

The existing staff requires continuing professional development in view of the rapid changes that are taking place in WAPDA functions, information technology and the governance styles. The auditors at all levels need to remain abreast of these changes and adjust their methodologies accordingly.

**The CPD has two dimensions:**

- i. How much training for each person?
- ii. What should be the contents of training?

#### **i. How Much Training?**

There is no universally accepted scale for the length of training of each person in an





organization. Generally, training is closely related to what a person already knows and what he needs to know. Yet some organizations use rules of thumb for a minimum training level for each person during a year.

As general guidance, the following should be the minimum training in a year for each level of officers in the internal audit division:

Chief Auditor/Deputy Chief Auditor	3 days
Senior Auditor	8 days
Field Auditor (incl. stock verifier)	12 days

## ii. What Should Be the Contents of Training?

The contents of training should depend on the judgment of the Deputy Chief Auditor based on the following factors:

1. Individual Self-appraisal.
2. Assessment of Individual Performance.
3. Assessment of Individual Knowledge.

### 1. Individual Self-appraisal

At the time of annual planning, each internal audit team member should complete the Audit Staff Self-Appraisal. It will be part of the basis for finalizing an individual training plan.

### 2. Assessment of Individual Performance

The second basis for developing a training plan for each individual auditor is the assessment by the senior auditor of the work done by individual auditor on each assignment. Obviously, the instrument for assessment would depend upon the work assigned to an individual auditor. As a rule of thumb, auditors scoring low would require more training. The areas in which they would require training would also depend upon the score attained; the lower the score the higher the need for training.

### 3. Assessment of Individual Knowledge

The assessment of an individual auditor's existing knowledge is the third part of the training need assessment process. As a rule of thumb, the lower the score in any area, the higher the need for training and development.

Combining the results from above would lead to preparation of an individual training plan for the year. The individual plans should be reviewed by the respective Deputy Chief



Auditor and then by the Chief Auditor WAPDA. The general guidance is that the individual should be trained in those areas where his present knowledge and skill is deficient. It should then be matched with the training time and money budgets of the internal audit division. Obviously, it would require summing up the training needs of all individual auditors and then adjusting it in an iterative manner.

### **3.6.3. Assessing Training/Development Progress:**

Each individual auditor's training and development plan should be reassessed and updated annually. This annual update will essentially repeat the process used to prepare the existing training and development plan. The existing training and development plan will serve as a foundation for the annual internal audit office plan.

A semi-annual review will also be required to make sure that the annual plans keep on track the self-study, scheduling assignments, internal and external training. The senior auditors should be responsible for a semi-annual review of training and development status of each of the individual auditors working under them. The Deputy Chief Auditor should be made aware of significant deviations or training milestones not met, and the reasons for under-achievement.

### **3.6.4. External Training/ Development Evaluations:**

Part of the individual training plan would relate to training received from outside. It is important that the internal audit division has a fair assessment of the benefits received by the internal auditors from the external training.

At the conclusion of external training, seminars, conferences, etc each individual auditor attending should prepare a brief written evaluation. Such evaluations will indicate the subject matter, the host or sponsoring organization, the person(s) who made the presentation, the total cost of attending, and a brief summary of the program. The evaluation should also include a conclusion regarding the specific benefit(s) derived and whether it would be appropriate for other internal auditors to attend a similar session. If a negative evaluation results, the specific reasons for the negative or marginal rating should be explained.

### **3.6.5. Incentives for Qualification and Performance:**

The internal audit division should have an incentive system for encouraging the internal audit staff to acquire professional qualification. It should also have a scheme to encourage excellence in performance of professional work. Briefly, the proposed scheme encourages the individual internal audit staff members to acquire professional qualification by reimbursing the cost of studies and by an increase in the individual's salary. Similarly, the scheme provides an incentive to internal audit staff members for excelling in performance. It adopts several indicators of good performance as the basis



for evaluation. The scheme should be widely circulated before implementation.

### **3.7. Internal Audit Strategy - Some Essential Internal Controls**

#### **3.7.1. Introduction**

WAPDA has to establish a set of internal controls according to the nature of its objectives and operations. The ultimate objective for establishing these controls remains:

- integrity of information;
- compliance with rules, regulations and directives;
- safeguarding of assets; and
- economical and efficient operations.

However, there are certain essential controls, which are common to almost all types of public sector entities which the internal audit staff must also be familiar with in order to perform the internal audit activity more effectively and efficiently. The present section, therefore, summarizes these essential internal controls as a source of information for the benefit of WAPDA officers and staff, and refresher material for the field audit officers. The summary is only indicative of the types of controls that WAPDA should consider before finalizing the respective sets of internal controls. In the final analysis, each wing/division would need to modify this summary according to its requirements.

#### **3.7.2. Some Essential Internal Controls**

Some of the essential internal controls discussed herein would provide the WAPDA officers and staff information for monitoring their respective activities from a control viewpoint. Control activities discussed in the ensuing paragraphs briefly present the essential internal controls which are relevant to the safeguarding of assets and to produce reliable financial records and reports. The last item of control activities discussed hereunder points out indicators to which one should be alert in order to deter fraud related activities in WAPDA. Although this summary is not all-inclusive, it does incorporate the basic elements of internal controls upon which WAPDA officers should focus their attention.

#### **3.7.3. Performance and Accountability**

##### **Complete and Accurate Books and Records**

The books and records of the WAPDA Wings/Divisions shall be kept in a complete and accurate manner, which fairly reflect their activities. Any willful omission or falsification of records is prohibited.

To a large extent senior management relies on financial, statistical and narrative reports as the basis for decision and action. The officer in charge of each function and segment should take steps to ensure that procedures are in place to ensure the accuracy,



reliability, and completeness of reports issued by his function/segment. Compliance with such procedures should be monitored on a continuing basis.

#### **3.7.4. Approval Authority**

##### **Delegation of Powers**

WAPDA exercises control over its activities through delegation of authority described in the Book of Financial Powers. However, in actual operations, operational staff at times feels constrained about the extent of delegation. The Functional Head should regularly review the current monetary level of authority delegated, and take up the matter of any possible revisions with the delegating authority. Functional Heads should also ensure that their function's approval authorities are understood and not exceeded. For downward re-delegations to subordinates, the responsibility for controlling the exercise of the authority re-delegated remains with the Functional Heads.

#### **3.7.5. Verification of Expenditure Statements**

##### **i. Review of Budget/Expenditure Statements**

Expenditure statements should be reviewed by controlling officers on a regular and timely basis to detect and report any inappropriate or erroneous charges. While it is not necessary to trace all charges on budget/expenditure statements back to approval files, the controlling officers should occasionally on a test basis make such a comparison.

##### **ii. Unnecessary Items on the Work Orders**

For work orders, the controlling officers should review costs for reasonableness and for non-consumables and equipment not required in the work order definition.

##### **iii. Cash Disbursements**

For cash disbursements, the budget and accounts officers should ensure that disbursements are in compliance with the WAPDA regulations, particularly the Book of Financial Powers, established policies and procedures, and that petty cash disbursements are within the scope and intent of funds. These funds should be kept in a secure location and a surprise count should be performed periodically.

#### **3.7.6. Invoice Verification**

##### **i. Verification by the Purchaser**

The primary responsibility for the validity of an invoice rests with the person who placed the purchase order. His/her verification of an invoice signifies that:

- The goods and services covered by the invoice were satisfactorily procured/performed and in conformance with the terms of the contract agreement between the parties.
- The quantities, prices and payment terms are correct as stated in the invoice and



the proper accounts are charged to reflect fairly the results of transactions.

- The payment in process has been checked to determine that payment has not already been made.

**ii. Verification by the Accounts Section**

The accounts section staff should also check accuracy of the invoices with reference to purchase orders. For this purpose, they should have copies of the payment terms as contained in the contract as well as copies of the contract, amendments and change orders, as applicable.

Payments should be made only against original invoices, and any alterations thereto should be questioned.

When applicable, final payment should not be approved until satisfied that all materials and services provided have been duly charged to the contractor.

The purchase officer should retain records in sufficient detail to easily verify contractor/vendor invoices by matching independently prepared documents.

**3.7.7. Materials Ordering and Handling**

**i. Segregation of Duties**

An underlying control principle is segregation of duties so that no one individual has approval authority over all the activities of ordering, receiving, storing and issuing materials. Points should be designated in the department to control these activities, and procedures should be implemented to ensure the materials are charged to the operating account where the material is used.

**ii. Authorized Personnel to Order Purchases**

Delegation of authority to order materials should be made only to personnel whose positions require it and should be limited to the maximum extent possible. A list of personnel authorized to order materials should be reviewed periodically. The names of terminated or transferred personnel should be promptly removed.

**iii. Access to Store Rooms**

Access to store rooms should be limited to the authorized personnel. The personnel authorized to sign gate passes should be kept to a minimum.

**iv. Inventory Control**

Dead stock registers for durable goods and stock registers for consumable stores should be maintained. If the size of the operation warrants, perpetual inventory records should be maintained for stored materials.

Confirming copies of documents (e.g., material issues, gate passes, etc.) should be reviewed promptly upon receipt/issues for validity of transactions. The documents should be filed for later use in verifying expenditure statements.



### **3.7.8. Construction Materials and Services provided to Contractors**

#### **i. Verification of Contractor's Records**

The contract agreements for construction works should require the contractors to maintain records enabling them to account, on request, for the material issued to them by the department. Periodically, a sampling of materials found on hand in a contractor's yard should be traced to contractor's stock cards and to relevant departmental records. A sampling of materials recorded on the contractor's stock cards should be verified to their existence in the contractor's materials yard.

The WAPDA officers should ensure that any materials, equipment or services provided by the department to a contractor are handled in accordance with contract terms and, if so required, recorded and back charged to the contractor on a timely basis to ensure accounting for it before releasing the final payment.

#### **ii. Surplus Material**

Identify and transfer surplus materials promptly to other projects or storerooms.

### **3.7.9. Contract Administration**

#### **i. Formal Contract**

No contractual or other commitments can be made and no work can be started until a formal contract document is signed and approved by the Central Contract Cell of WAPDA. (An exception to this general rule is an emergency situation approved by WAPDA Authority, which is subsequently formalized by a signed contractual agreement.).

In situations where practical, a specific employee(s) should be assigned the administration of the contract from start to conclusion.

#### **ii. General Services, Technical Services and Miscellaneous**

Maintenance and repair type contracts that are executed with several contractors for the same scope of work require controls over expenditure commitments and work to be done. The employees involved in initiating work requests or monitoring the contractor's performance should not control the selection of the contractor.

There should be written procedures for certifying work done and maintaining performance. Actual work quantities completed should be agreed to the approved service orders, the invoice in turn should be checked to these verified work quantities and to the contract payment terms. The employee who certifies the completion of the work or receipt of the service should be someone other than the originator of the service or work order.

The person approving payment should make periodic job site visits to verify performance of the work. Short form contracts for repetitive type work should be converted into competitively bid Long Form Contracts.



### **3.7.10. Fixed Assets**

A register of fixed assets should be maintained by each unit/department using the approved format. Every unit/department should allocate distinct series of numbers for each type of assets. The asset records should show the assets numbers and physical location to facilitate physical inventories and to fix responsibility for custodianship.

#### **High-Risk Items**

High-risk items represent those assets which can be easily pilfered. Examples are mobile and portable assets such as mobile phones, cameras, test equipment, notebook computers, stationery items, consumable stores, etc. Physical inventories and check of custodianship should be carried out periodically by WAPDA Officers. The principle of segregation of duties entails the separation of asset custody from the asset record-keeping function. These items should also have distinct numbers as for fixed assets.

### **3.7.11. Payroll Procedures**

- i. The respective departments/divisions should maintain an up to date payroll sheets of all employees with duty stations duly verified by the payroll officers.
- ii. The departments should keep up to date account of leave of employees, showing any leave without pay.
- iii. The competent authority should properly authorize overtime pay claims of eligible staff including drivers, naib qasids, etc.
- iv. Employee pay cheques, to be distributed within a department by authorized employees, should be securely locked up, by a clearly identified custodian, prior to distribution. When an employee is not present to receive his cheque, the cheque should be securely locked up until his return.
- v. Cash payroll should be distributed by authorized employees under supervision of payroll officers; undistributed cash should be securely locked up by a duly authorized custodian.

### **3.7.12. Computer Environment**

#### **Data Security**

The department should issue a policy stating, inter alia, that Computer data is an asset. The WAPDA officers and staff should see to it that control procedures are in place to retain and protect this data. The following are control practices that should be strictly adhered to in an accounting unit:

- Back-up of departmental data should be made on a regular basis.
- Access to data should be granted only on a need to know basis.
- Access privileges should be suspended on a timely basis when an employee is





transferred or released.

- Passwords should be protected.

The increased use of information systems for such areas as materials ordering and employee time reporting requires functional heads to review their delegation of authority and supervisory review procedures to ensure that departmental controls over these activities are still adequate and effective.

### **3.7.13. Fraud Awareness**

An important step for functional management to take in the prevention and detection of fraud is to recognize that fraud exists and that any segment can become a victim of fraud.

There are many indicators of conditions that provide the initial recognition that something is wrong and that further attention is needed to correct the wrong. Knowledge of the fraud indicators by all employees, especially management personnel, coupled with a need to be sensitive to the conditions that invite fraud, abuse, and waste are needed to detect the problem.

#### **Fraud Indicators**

The following are some conditions and situations that, if allowed to exist, lend themselves to fraud, waste, and abuse:

- Concentration of authority over, and responsibility for, resources of an entire process in one person.
- Inadequate feedback on results of projects or operations.
- Lack of standards for judging the results of projects or operations.
- Lack of independent verification of the accuracy of records, transactions and reports.
- Vague and confusing procedures.
- Inadequate physical safeguards over resources.
- Inability to identify responsibility.
- Lack of adequate supervision.
- Changes in an employee's behavior.
- Unreasonable budgetary and procurement requirements.
- Failure to strictly enforce contract provisions.
- Failure to correct deficiencies identified by existing control systems.

Mere compliance with accepted departmental procedures does not necessarily prevent





fraud. One of the best ways to detect fraud is to get feedback from employees regarding situations that are questionable. Employees need to know that functional heads are interested about combating fraud, waste, and abuse.

Let employees know that if something is going wrong, management wants to know about it and will see to it that it is corrected. Once a WAPDA official becomes aware of, or suspects, an irregularity, he should inform the senior management and initiate necessary follow-up action.

### **3.8. Quality Control and Assurance**

The Chief Auditor WAPDA shall ensure that all audit staff are equipped with necessary knowledge, technical skills and competencies in discharging their duties and responsibilities and that audit work is carried out in line with the International Standards for the Professional Practice of Internal Auditing as adopted by Government independent entities. Each internal auditor shall strive to acquire the necessary skills and competencies to be able to effectively carry out tasks entrusted to him/her.

The respective Deputy Chief Auditor should ensure that internal audit staff at all levels is appropriately supervised throughout all audit assignments to monitor progress, assess quality and coach staff. Supervision should include:

- Ensuring compliance with the internal auditing standards and manual.
- Providing suitable instructions at the outset of an audit activity
- Approving audit objectives and work plans.
- Ensuring audits are conducted as planned or that variations are approved.
- Ensuring that appropriate audit techniques are used.
- Ensuring that audit findings, conclusions and recommendations are adequately supported by relevant and sufficient evidence.
- Ensuring that reports are accurate, objective, clear, concise and timely.
- Ensuring that work is achieved within resource budgets, or variations are approved.

The extent of supervision will depend on the experience and training of the individual field auditor. Particular care should be taken to ensure that all work by trainee auditors is subject to comprehensive supervision, and that trainee auditors never work without the supervision of a suitably qualified and experienced field auditor.

#### **Quality Assurance Reviews**

In addition to the routine quality control and assurance exercise of internal audit assignments carried out by the respective Deputy Chief Auditor, the WAPDA Authority or General Managers Finance of the respective wing/division should also monitor the quality of the internal audit division's work through Quality Assurance Reviews (QAR). QAR is an appropriate tool for review of the performance of large internal audit functions like that of



WAPDA. It could be performed internally or by an external reviewer. Generally an independent QAR is performed every five years with frequent internal QAR performed by the internal audit division itself.

If considered appropriate the WAPDA Authority or the respective General Manager Finance should plan and undertake a formal QAR performed by the internal audit staff itself. Such a review could be conducted by assigning the review to members of internal audit staff in such a manner that for each set of audit assignments the reviewer should be someone other than those who conducted the audit. The total exercise of QAR should cover the work of all teams.

#### **Objectives of Quality Assurance Review (QAR)**

The QAR serve the following purposes:

- Identify degree of internal audit division's compliance with the Standards for the Professional Practice of Internal Auditing adopted by non-departmental public entities.
- Ensure that audit operations are in compliance with WAPDA and its wings / divisions' policies and procedures.
- Provide insights into the level of internal audit effectiveness and efficiency.
- Provide recommendations for improving the internal audit activity.
- Prepare the internal audit function for an external quality assurance review, if considered appropriate.

The reviewer should, as far as possible, follow the same standards of independence and objectivity, as the internal auditors are required to follow during an audit. The only significant difference should be that now the audit unit is the internal audit division itself. Like a normal internal audit, the reviewer should prepare a schedule of his activities and agree with those whose work would be reviewed.



## 4. INTERNAL AUDIT PROCESS

### 4.1. An Overview

Internal audits should cover all the important aspects of an audit unit's operations. They should not be restricted to accounting matters or to books, records, and documents only. The purpose of this chapter is to give an overview of the internal audit process. The overview will describe briefly the stages through which an internal audit assignment shall pass.

Auditors generally classify internal audit assignments according to the following four major categories:

1. Audits to assess the integrity of financial and other information.
2. Audits to assess the adequacy of risk management, and the controls over public property, revenues and expenditures.
3. Audits to assess the degree of compliance with objectives, policies, plans, procedures, laws, and regulations.
4. Audits to assess the extent to which there is management with due regard to economy, efficiency and effectiveness.

### 4.2. Individual Audit Assignment Coverage

For each audit assignment, the auditors should establish specific objectives within the framework of the general objectives listed in this manual. On any specific audit assignment, it will seldom be possible, or practical, to do enough work to permit internal audit to fully evaluate at one time the performance of a function's audit categories described above. However, over time, the audit coverage of each audit segment should embrace all four categories of audit.

#### 4.2.1. The Internal Audit Scope

The basic operations performed in achieving specific audit objectives established on specific assignments consist of an integrated combination of gathering information, verifying and assessing the accuracy and adequacy of information within the auditable unit.

#### 4.2.2. Developing recommendations

One of the most important methods of obtaining needed information in an audit is by reviewing and testing the manner in which various kinds of responsibility are carried out. The auditors can obtain much of the needed information by examining individual transactions or items. The main purpose of obtaining information in this manner, and making related evaluations, is to test the effectiveness of management control over the activity, program, function, or operation being examined and to establish a proper basis for reporting on the results of the audit.



Other important information-gathering procedures are the use of questionnaires distributed on a sample basis, and interviews with the auditable unit's employees and officials.

#### 4.3. Internal Audit Process

The internal audit process includes the following broad phases of work:

1. Audit office planning phase.
2. Assignment planning.
3. Review phase.
4. Evaluation phase.
5. Verification phase.
6. Reporting phase.
7. Follow-up

This section of the Manual will give an overview of these phases. The table below illustrates the internal audit process in a summary form.



## INTERNAL AUDIT OFFICE

**AUDITEE/AUDIT UNIT**



#### **4.3.1. Internal Audit Office Planning Phase**

The planning phase consists of two major tasks, each involving several steps. The first task is to plan for the Internal Audit Division as a whole. Internal Auditing standards require that internal audit Division shall prepare an internal audit plan in consultation with the management, which should be reviewed periodically in line with the critical auditable segments and key financial areas.

The strategic plan shall be broad in scope and coverage and deal with strategic questions of audit issues, audit cycle, audit approach, physical resources for audit teams; use of specialists over the plan period; reporting strategy; and relationship with external auditors.

The internal audit plan covers such questions as the auditable segments and key financial areas of respective wings/divisions to be audited, time for each assignment, scheduling of audit assignments, time budget of individual auditors, arrangements for fieldwork, supervision and reporting guidelines. The plan shall also cover follow-up of previous audits observations.

#### **4.3.2. Internal Audit Assignment Planning Phase**

##### **i. *Scope and Objectives***

The second major task in the planning phase is to plan for each audit assignment. Efficient performance of an audit requires careful advance planning of the work to be done, identification of specific, attainable objectives, and adequate written work programs for each phase of work to facilitate control and supervision over performance.

##### **ii. *Developing Specific Plan***

Once the internal audit team has identified the scope and objectives of each auditable segment within the audit universe at the planning stage, it should develop a specific plan of action before work begins. The field auditors must carry out sufficient research to decide what matters to emphasize and select the appropriate audit approach and techniques. They can modify these preliminary decisions as a result of information obtained during the audit.

##### **iii. *Documenting Background Information***

The planning phase consists of obtaining and documenting background information on the auditable segment, to gain an understanding of its activities, procedures and personnel. The information gathered should include internal information on operations and sufficient external information to be able to place the operations in proper perspective.

##### **iv. *Identify Significant Financial Areas***

The field auditors should examine recent financial data, estimates, organization charts, audit planning notes, and permanent files to identify the areas that are likely to be most



significant and relevant in the current audit. These can be identified as those activities:

- which are susceptible to fraud, abuse, or mismanagement;
- in which there is a large rupee volume of transactions or large investments in assets that are subject to loss if not carefully controlled;
- about which management has expressed concerns; and
- in which prior audits have disclosed major weaknesses or deficiencies.

They should also discuss with appropriate officers of the audit unit about any recent changes in systems, operations or personnel. They should prepare extracts for the working papers from all regulations and policies applicable to the audit unit, to the extent that they give rise to audit considerations.

*v. Extent of Computerization*

At this stage, the field auditor should also gather information regarding the extent of computerization and determine where the computer processing fits into the system. An adequate internal audit cannot stop at the point where computer processing begins. The proper audit approach in a computer environment includes a complete consideration of computer control objectives and standards and computer assisted audit techniques. In particular, the field auditor should ascertain the extent and nature of EDP facilities: in-house, off-site distributed processing systems, or on-line systems.

*vi. External Reviews*

If other groups such as the external auditors have previously reviewed the area subject to audit, reports may be available which will be useful to the internal auditors in determining the direction and depth of the examination. In addition, reports and working papers resulting from previous internal audits in case of recurring audits will also be a major source of information during the planning phase.

*vii. Risk Assessment*

The risk assessment process will take into account the following criteria:

- *Materiality - High monetary value and/or volume of transactions;*
- *Past audit coverage;*
- *Degree of Organizational and Management Change;*
- *Essential functions;*
- *Financial exposure of the area being audited;*
- *Inherent risk of the area being audited;*
- *Existence of Fall Back Arrangements;*
- *Complexity and maturity of IT systems.*



The risk assessment criteria are applied to each operational area/process to develop a risk factor for each auditable unit. The criteria being used for risk ranking are assigned a value and then sorted by significance to identify high audit areas in order of risk.

The internal audit activity shall be a continuous process. However, the internal audit division should plan full audit coverage of the "Audit Universe" within a reasonable time frame which may range from one to two year cycle. Typical auditable segments within WAPDA's audit universe may include:

1. *Procurement and Contract Management*
2. *Stores Accounting and Inventory Management*
3. *Payroll and HR Management*
4. *Fixed Assets Management*
5. *Funds Management*
6. *Internal Control Framework and Risk Management*
7. *Accounting and Finance*
8. *Project Management*
9. *Information Technology*

Each auditable unit and formation of WAPDA will have to modify the list of auditable areas according to their functional structure. It is worth underlining that in planning the time schedule for audits, the priority will be set in accordance with the ranking of each auditable area, the area of high audit concern being the top priority.

Based on the risk ranking, the internal audit division shall plan to cover all operational areas with the following frequency:

- High Risk Areas: Twice in a year
- Medium Risk Areas: Once in a year
- Low Risk Areas: Once in two years

All of the highest risks that have been identified may be audited at least twice in a year to minimum defensible levels of assurance. For the purpose of identifying all high risk audit tasks, and the planning of assurance for lower levels of risk over time frame of audit cycle, a reliable risk assessment process is undertaken to identify the level of audit coverage and the resources necessary to meet this objective in the audit work plans and programs.

The planned audit cycle will be reassessed and modified in the audit planning process to ensure that the internal auditor is in due course able to achieve the goal of auditing all operations at least once within the specific audit cycle.





viii. Guidelines for Risk Ranking Criteria

**Total Monetary Value:** It refers to the budget for expenditure, or total grant, or total value of assets being managed by the auditable unit or any other financial area which the internal auditor would consider to be of significance in relation to the functions of the auditable unit. In case of projects, it could be total project layout or up-to-date expenditure on the project. The internal audit division can use any reasonable scale to rank the monetary values. For example, it can decide that monetary values up to Rs 10 million will have a rating of 1, up to 100 million will have 2 and beyond that 3. It would depend upon the total universe of auditable units under the audit mandate of respective Deputy Chief Auditor.

**Prior Audit Findings:** Findings in previous audits are one indication of the internal control discipline within an auditable unit. Problems are often characterized by significant control deficiencies, large adjustments, a greater than normal number of findings, and repetitive findings not fixed. Conversely, the lack of findings or timely correction of previous findings indicates control discipline.

**Sensitivity:** This represents an assessment of the inherent risk associated with the auditable unit being rated. It is an assessment of what potentially could go wrong and what the related reaction would be. It could be risk connected with loss or impairment of assets, risk connected with undetected deviation or error, risk connected with liability not recognized or not accurately quantified, or risk of adverse publicity, legal liability, etc. The rating of sensitivity also should consider relative size of the auditable segment in the audit universe, potential exposure and probability.

**Control Environment:** The control environment represents the collective policies, procedures, routines, physical safeguards and employees in place. Essential to a favorable control environment is tone at the top, adherence to documented policies and procedures, reliable systems, prompt detection and correction of deviations or errors, adequate staffing and controlled turnover of personnel. Conversely, lack of supervision, high deviation or error rates, and lack of documentation, unmanageable backlogs of work, high turnover, and non-routine transactions are symptoms of a poor control environment.

**Comfort with Operating Management:** This criterion reflects the confidence that audit management places in management directly responsible for the auditable unit and its commitment to internal control. Comfort is characterized by factors such as past audit interaction, experience of management in the work environment, and feelings about the quality and level of staffing.

**Changes in People and Systems:** Corporate history indicates that changes impact internal controls and financial reporting. Change usually occurs to effect improvement in the long term, but often has short-term offsets that require increased audit coverage. Changes include reorganizations, business cycle changes, expansion, new areas of



operation, new systems, new regulations, and personnel turnover. Auditable units not subject to change require less audit coverage.

**Complexity:** This risk factor reflects the potential for deviations, errors or misappropriation to go undetected because of a complicated environment. The rating for complexity will depend on many factors. Extent of automation, complex calculations, interrelated and interdependent activities, number of auditable segments, the time spans of estimates, dependency on third parties, contractual demands, processing times, applicable laws and regulations and many other factors, some not recognized, affect judgments about the complexity of a particular audit.

**Deviations from Budget:** Generally, it would refer to any significant deviations from the approved budget. However, it can also include any cost overruns or time overruns. The rating will depend on the size of budget deviations observed in the total audit universe.

**ix. Audit Approach**

Having identified potential areas for examination and made an initial assessment of significance, the internal auditor must develop an overall strategy and approach for the audit assignment, which will ensure that all significant audit areas are covered in the most effective and efficient manner. The audit strategy should be such that it encompasses:

- Adequate coverage of all major audit areas;
- An approach consistent with the scope and objectives of the audit; and,
- Appropriate extent and depth of testing.

The information gathered during the planning phase will allow the field auditors to assess the risk, determine the policies, systems and activities that warrant examination. Previously identified control weaknesses, nature of the activities, management concerns, systems, and materiality are major factors in these determinations.

The critical factors in developing the overall audit approach will be the scope of the audit and the audit objectives established. At this stage of the audit it is not expected that detailed procedural guides will be prepared but rather that the general thrust of the audit approach will be determined and whether systems, data or interview based techniques will be employed.

The depth of the audit and the extent of testing will be determined largely by the audit scope and objectives, the availability of time and human resources and the needs of the potential users. The internal auditor should be in a position to outline the depth of coverage and indicate the proposed extent of testing. Further development of these factors will take place during the review and evaluation phases of the assignment and will crystallize in the verification audit plan. The audit strategy should cover the following areas:



- Materiality/significance.
- Audit risk.
- Audit resources.
- Relation with external audit.
- Need for specialists.

Audit strategy requires important decisions by the Deputy Chief Auditor regarding the audit risk. These decisions would affect the audit approach and further audit work in a significant manner. When determining the audit risk, the internal auditor would normally consider the following components of risk:

***Inherent Risk:*** Inherent Risk refers to the risk involved in the nature of business or transaction. Transactions involving exchange of cash may have higher Inherent Risk than transactions involving settlement by cheques.

***Control Risk:*** Control Risk refers to the risk that a misstatement could occur but may not be detected and corrected or prevented by the auditable unit's internal control mechanism. (for assessment of control risk the internal auditor needs to evaluate the internal control framework discussed in Part 2 of this manual)

***Detection Risk:*** Detection Risk is the probability that the audit procedures may fail to detect existence of a material error or fraud.

Inherent Risk assumes no internal controls and depends on the professional judgment of the internal auditor. Control Risk depends on the strength or weakness of the internal control procedures, Detection Risk is either due to sampling error or incorrect application of audit procedures i.e. human factors.

Factors affecting **inherent risk** include:

- i. The nature of the account being audited. Accounts such as cash are usually more susceptible to manipulation or loss than, say, fixed assets.
- ii. The extent to which the items making up the account are similar in size and composition. If the population is composed of relatively homogeneous items, it would be easier for management (and the auditor) to detect incorrect transactions and amounts.
- iii. The volume of activity. If there are a lot of transactions being processed, the chances of an error occurring may be higher than if only a few transactions are being processed.
- iv. Capability of the staff processing the transactions, if the staff are experienced and take their jobs seriously, there is probably a lower inherent risk than if the staff are inexperienced or careless.
- v. The number of locations.



- vi. The accounting policies being used. Many components have a lower risk of error when the cash basis of accounting is being used than when the accrual basis of accounting is being used.

For assessing the **Control Risk** the auditors carry out three-tier procedures:

**Identify Controls:** As a first step they identify the internal controls and assess whether they are adequate or not. This is, more or less, a conceptual exercise.

**Evaluate Controls:** At the second stage, they evaluate the internal controls by inquiry, observation or walk-through procedures (selecting a small sample - one or two transactions - from the relevant transaction cycle and "walking" them through the cycle to confirm their understanding of the internal controls.

**Testing Controls:** At the third stage they carry out compliance testing to assess whether the internal controls were in place throughout the period of audit. For this purpose they select a larger sample.

**Detection Risk** refers to the risk that the auditors assume by failing to detect the errors through substantive audit procedures. These procedures are often grouped into two categories analytical procedures and substantive tests of details.

Once the respective internal audit unit is able to establish the size, nature, risk and complexity of the audit assignment, it can determine the skills required in the various parts of the audit assignment. The Deputy Chief Auditor can then assign staff with the appropriate skills, to ensure the effective and efficient execution of the assignment. An important result of effective staffing arrangements is a continued increase in the level of competence of all members of the internal audit team.

To ensure that planning decisions reached during this phase are properly implemented, and to provide useful information to the internal audit unit in formulating planning decisions, the respective Deputy Chief Auditor should develop a time budget for each part of the audit assignment.

Finally, the Deputy Chief Auditor should document decisions regarding objectives, scope, risk assessment, audit approach, time budgets, and assignment of staff in an Assignment Planning Memorandum. This should also set out the decisions reached concerning resource requirements, including the use of experts and specialists, and supervision and review arrangements. The planning memorandum should also include responsibility for the drafting of the report, and any constraints such as availability of auditable unit's staff. It should also record the potential impact of the assignment on future assignments. The memorandum is essential to ensure that each internal auditor understands the objectives of the assignment and the basic approaches to achieving them, should prepare extracts for the working papers from all regulations and internal policies applicable to the auditable segment, to the extent that they give rise to audit considerations.

Before the review phase starts, the internal audit team gets ready for it by (a) writing



audit programs for key financial issues and (b) establishing contact, formal or informal, with the auditable unit's management to discuss the preliminary arrangements for carrying out the assignment.

#### **4.3.3. Internal Audit Review Phase**

The review phase of an audit is devoted to the preliminary gathering of information and testing processes to identify problems or other matters warranting detailed examination. This phase encompasses the following steps:

##### **i. Gathering General Working Information**

The field auditors should gather and review general working information on the project or activity being audited in as short a time as possible. They should use this information in planning succeeding phases of the audit and as a source of reference in carrying out the detailed examination work.

##### **ii. Studying Regulations**

The pertinent rules and regulations governing the auditee division should be carefully studied to ascertain:

- the purpose, scope, and objectives of the activity or program being examined;
- the manner in which they are to be conducted and financed; and
- the nature and extent of the division's/department's authority and responsibility.

##### **iii. Limited Testing of Management Controls**

The field auditors should analyze policies established to govern the activities under examination for conformity with applicable rules and regulations and their appropriateness for carrying out authorized activities or projects in an effective, efficient and economical manner. They should also obtain practical working information on how the auditable unit's system of controls actually works by testing the effectiveness and usefulness of controls over specific work activities. This information is useful in identifying possible management weaknesses and other matters that will warrant additional time and effort during the evaluation phase.

When the review phase is complete, the senior auditor should be able to clearly identify important issues and problems to be examined in more depth. The senior auditor should use the review information to establish specific audit objectives, estimate staffing requirements, schedule work at specific locations, prepare work programs, and establish target dates for completion of the evaluation, verification and reporting phases.

#### **4.3.4. Internal Audit Evaluation Phase**

In this phase the field auditors must evaluate the design of the internal control framework to determine whether it will:



- Ensure the utilization of resources in compliance with regulations or other authorities.
- Protect funds and other public property from losses due to fraud, mismanagement or inefficiency.
- Provide data that will assist managers in ensuring that what is planned is accomplished.
- Provide for full and accurate disclosure of results to a higher level of authority.

The analysis consists of comparing the design of the framework, as documented in the review phase, with a predetermined control model, and requires the application of an appreciable amount of expert judgment on the part of the internal auditor. The use of standard control questionnaires or checklists may assist the internal auditor in the complete and systematic application of this predetermined model. However, the field auditors should take care about standard internal control questionnaires. Such instruments, by their nature, are quite general and may require adaptation to specific circumstances.

The result of this evaluation will be the identification of the control deficiencies and inefficiencies in the framework. The deficiencies include control weaknesses, and all failures to comply with the external requirements of Government directives, ministries or WAPDA. The field auditors should also be alert for other controls, which compensate for apparent weaknesses in the area under audit. They should also evaluate thoroughly the effect of these compensating controls, as well as environmental controls.

It is normally not cost-effective to carry out in-depth verification of all controls. The field auditor should therefore identify those areas where there is the greatest potential for considerable loss, deviation or error. This requires identification of essential controls, significant weaknesses and major inefficiencies. Essential controls are those considered by the field auditor to be critical to the effective operation of the system.

A significant weakness is the absence or ineffective operation of an essential control. All failures to comply with mandatory external requirements are deemed to be significant deficiencies by their nature. The conclusions provided up to this point are not final. Further verification is required to determine that essential controls are operating as designed and have been effective throughout the period under audit. It requires a larger sample taken from the data relating to the entire period under audit. This is also called compliance testing.

The objectives of auditing are not affected by the introduction of computer processing, but the field auditor must take the different control techniques employed into account during his evaluation. The management of auditable segment is responsible for evaluating the adequacy of the entire control framework, whether it is in-house or located in an off-site EDP facility.





#### **4.3.5. Internal Audit Verification Phase**

In this phase the audit is concentrated on the in-depth verification of the data to substantiate field auditors' assessment of controls and other information, to assess their effect, and to identify their causes. For this purpose the field auditors shall employ analytical procedures and other tests known as substantive tests.

Any additional significant deficiencies or major inefficiencies disclosed during the verification of essential controls will be subjected to the same verification process as those originally identified during the evaluation phase. In addition to substantiating significant deficiencies and major inefficiencies, the audit program should determine their effect and cause.

The field auditors must clearly define the objectives of each verification step prior to developing a comprehensive audit program. These objectives and the nature of the policy, system or activity under review will determine the verification technique required. The field auditors can select from a wide range of techniques in developing the audit program, including transaction testing, personal observation and enquiry, report and data analysis, independent or third party confirmation or interviews, and comparison and analysis of costs or other data for similar activities. In developing the audit program the field auditors should be alert to conditions where statistical sampling or computer-assisted audit techniques can be employed. These techniques can result in more efficient and effective auditing.

Prior to preparing the draft report and recommendations the auditor should verify the audit facts with the officers and staff of the audited segment.

#### **4.3.6. Internal Audit Reporting Phase**

The result of audit work should be promptly communicated in writing to appropriate officials of the auditable segment's management as a basis for action, where necessary, and for information purposes. Except in very unusual circumstances some type of communication should follow every audit performed.

### **4.4. Interrelationship of Phases of Work**

A close relationship exists between all phases of work performed on an audit assignment. The manner and extent to which these phases are carried out and the interrelationship between them vary between assignments, depending on the objectives established in each case, whether the audit is being done for the first time or is a recurring activity or follow-up assignment, and the significance of the activities or projects to be examined. For example, more review work would normally be performed on an initial assignment than on one involving activities which have been previously reviewed. In the latter cases, some updating of general information will be required, but complete new reviews should not be necessary.

In all assignments, the nature and objectives of the reporting should be established as soon as possible and all audit work performed so as to meet these requirements adequately and promptly.



## 5. GETTING READY FOR FIELDWORK

### 5.1. Introduction

The fieldwork normally consists of three main stages: review of internal controls; evaluation of internal controls; and verification and analytical review of the information collected. Since it is going to be an extensive exercise, the auditors should plan it well. The instrument for planning the fieldwork is the audit program. The Manual shall deal with the fieldwork itself in the next three chapters. The paragraphs hereinafter provide guidance on the audit program and some of the evidential matters that would arise during the fieldwork phase. While getting ready for the fieldwork, the auditors need to establish some initial contacts with the audit unit.

### 5.2. Audit Program

The audit program outlines the necessary steps to achieve the objectives of the audit within the defined scope as discussed in the manual. The audit program is a detailed plan for the work to be performed during the fieldwork. A well-constructed audit program is essential to complete the audit assignment in an efficient manner.

#### 5.2.1. Objectives of the Audit Program

A well constructed program provides:

- i. A systematic plan for each phase of the work that can be communicated to all audit personnel concerned.
- ii. A means of self control for the audit staff assigned.
- iii. A means by which the senior auditor can review and compare performance with approved plans.
- iv. Assistance in training inexperienced staff members and acquainting them with the scope, objectives, and work steps of an audit.
- v. An aid to the senior auditor making possible a reduction in the amount of direct supervisory effort needed.
- vi. A basis for the format of working papers of the auditors and provides evidence of the work done by each auditor.





### 5.2.2. Contents of an Audit Program

The audit program consists of specific directions for carrying out the assignment. It should contain a statement of the objectives of the operation being reviewed. For each segment of the audit, the program should:

- a. state the audit objectives;
- b. list the risks that must be covered in that segment;
- c. show for each risk the controls that are needed to protect against the indicated risk;
- d. show for each of the listed controls the audit steps required to test the effectiveness of those controls, or set forth the recommendations that will be required to install needed controls;
- e. include special instructions to be followed in handling any significant or unusual developments;
- f. provide space for referencing the related audit working papers;
- g. distribute the total audit assignment time budget over the different segments of the assignment; and
- h. nominate the field auditors for each segment of work.

It is the duty of the senior auditor to develop standard audit programs for the most commonly experienced audit issues. These audit programs should be available to the audit teams. However, these programs cannot be used blindly. Each time an audit assignment has to be executed, the senior auditor should have a comprehensive look at any standard audit program and adjust it according to the situation.

### 5.3. The Substance of the Transaction

Auditors should be satisfied with the nature, adequacy and relevance of audit evidence before placing reliance upon it. One aspect of this is to consider the substance of a particular transaction that is being supported by the documentary evidence. There may be a significant difference between the form of the transaction and the substance of the transaction. For example, a bribe may be disguised as a commission, or a purchase may be disguised as a long-term lease. The auditor needs to ensure that the documentary evidence is clear enough that he can determine the substance of the transaction, as opposed to its form.

If the auditor suspects that the substance of a transaction is different from its form, the auditor should consider what should be the correct treatment under the circumstances. The auditor should discuss his findings and conclusions with audited unit's officials. Should the auditor still believe that the substance of the transaction is different from the form of the transaction; the auditor should keep a note on a working paper for subsequent discussion and resolution with management of the audited unit.



#### 5.4. Inadequately Supported Transactions

Inadequately supported transactions are often the result of missing documents. They may also be due to the fact that the audit unit's system does not call for the documentation that the auditor would consider appropriate. When a document is missing, the auditor should make a reasonable effort to identify the missing document. If the auditor does not make the appropriate effort to find what is considered missing, this could create a situation if unit's officials were able to find the document at a later date.

If the document cannot be found, the auditor should consider if other evidence exists to support the transaction. For example, assuming that the audited unit has paid for a particular piece of equipment and that the auditor is able to find the supplier invoice and the purchase order, but not the receiving report or other documentation, indicating that the item was received, in such a case, the auditor may be able to physically examine the particular piece of equipment, and query the individuals using the equipment as to when it was received. These procedures may provide the auditor with sufficient assurance as to the validity of the purchase transaction.

In many situations, the auditor will not be able to find relevant, reliable, sufficient and convincing audit evidence to compensate for the missing documentation. Using the above example, the auditor may not be able to identify the particular piece of equipment that has been delivered, or to obtain independent evidence as to its delivery date. In such cases, the transaction should be considered to be in deviation of the procurement procedures, and noted in a working paper for subsequent discussion and resolution with management.

In addition, the auditor should document whatever efforts were made to locate the missing receiving report, and to otherwise support the validity of the purchase transaction. This documentation should include his discussions with audit unit's officials, and the steps that the officials were to have taken. This will reduce the risk of the auditor being criticized should the missing document be found at a later date.

#### 5.5. Conflicting Audit Evidence

Conflicting audit evidence occurs when the auditor receives evidence with respect to a particular balance, transaction or event that is not consistent with other evidence that the auditor has received. Examples of conflicting audit evidence are:

- The auditor's analytical procedures indicate that material error exists in a particular segment, while the auditor's substantive tests of details indicate that there are no errors in the segment being audited.
- One official provides the auditor with information or an explanation that is inconsistent with the information or explanation provided by another official of the same unit.



- The auditor identifies what appears to him to be a material error and asks officials to investigate. The officials respond with an analysis or explanation indicating that no error exists.

The first step the auditor should take is to re-evaluate the evidence received. The auditor should always maintain an open mind, and should guard against assuming that the initial findings or assumptions are the only interpretation of the situation. Evidence should be evaluated objectively, and alternative interpretations of the evidence should be considered.

It is not appropriate for the auditor to disregard some of the evidence received. For example, in the first illustration it would not be appropriate for the auditor to ignore the results of analytical procedures performed. What the auditor should do instead is to seek further evidence to determine whether the results of the analytical procedures or the substantive tests of details are correct, or to obtain a satisfactory explanation as to why the evidence is not consistent.

One way to do this would be to seek input from audited unit's officials. They may be able to provide the auditor with additional information that helps to explain the fluctuation identified by the analytical procedures.

In the second illustration, it would not be appropriate for the auditor to disregard the information or explanation received from one of the officials. The auditor should consider/determine:

- i. whether there are legitimate reasons why the two officials would have provided different information or explanations; and
- ii. the reliability of the information or explanations received from each individual.

It may be appropriate for the auditor to seek the same information or explanation from a third or even a fourth individual to determine which of the two original providers of the information or explanation appears to be incorrect.

With respect to the third illustration, the auditor should audit the unit's analysis and the supporting documentation to determine if the further analysis:

- i. deals directly with the matter at hand;
- ii. was sufficient and appropriate, and done correctly; and
- iii. explains why the auditor's original estimation of the error was not correct.

Until such time as the conflicting audit evidence is satisfactorily resolved, the auditor should not take any assurance from any of the affected audit procedures.

## **5.6. Control risk: Assessing the Control Environment**

The internal control framework provides a basis for assessing control risk related to the audit unit's overall control environment. A prerequisite to this phase of work is a deeper



understanding of the internal control framework. Therefore, the auditors should commence this stage by ascertaining and recording the internal control framework.

As discussed in this manual, the internal control framework consists of the following components:

- Control environment.
- Risk assessment and risk management
- Control activities.
- Information and communication.
- Monitoring.

The present section of the manual gives guidance about recording the control systems so that the auditors have a deeper understanding of the whole framework. It suggests evaluation criteria for assessing the control risk emanating from any inadequacies in the control framework. The evaluation criteria would help the auditors in concluding about the extent of control risk. The conclusion about inherent risk along with the conclusion about control risk related to the broad internal control framework and the controls related to specific critical systems would enable the auditors to decide on the audit approach. The approach in an internal audit will normally be System Based Auditing (SBA). The amount of compliance testing that the auditor will conduct will depend upon the auditor's assessment of the inherent risk and the control risk.

#### **Internal Control Questionnaires**

Internal Control Questionnaires (ICQs) help the auditor to identify control strengths and weaknesses. They are lists of questions related to specific control objectives that might be expected to be achieved in a particular system. On their own they do not provide a clear or complete picture of systems in operation or a sufficient basis for evaluating internal control.

### **5.7. Ascertain and Record**

#### **i. Identify Controls in Critical Systems**

The first step is to identify the critical systems and the related audit issues. In case of internal audit procedures relating to financial matters, these could relate to accounting areas such as:

- a. Receipts and payments.
- b. Payroll.
- c. Stocks and stores.
- d. Contracts for construction works, etc.



There is no hard and fast rule to define an audit issue. As a general principle, however, all transactions, balances, or events in an audit issue should have the following characteristics:

- They should be generated by the same system and be subject to the same internal controls.
- They should be capable of verification by the same type of tests.

Whatever the audit issues, they have to be closely linked to the original audit planning. Once the audit issues have been identified and approved by the Deputy Chief Auditor, the auditors would proceed with ascertaining and recording of the system.

## ii. Methods of Collecting Information

There are a number of ways of collecting information:

1. Examination of documents such as rules, regulations, organization charts, manuals and instructions. These may indicate how the system is intended to operate but may not necessarily reflect actual practice. The adequacy of documentation may be a good indication of the attitude of management to internal control.
2. Interviewing of staff involved in the system helps the auditors to ascertain how the system operates in practice. The auditors should interview as many staff at different levels as is necessary to obtain the fullest picture, and should resolve any queries. The evidence obtained from interviewing is more likely to be challenged than that from written sources and the auditors should, where appropriate, obtain confirmation of the facts elicited, for example by asking the interviewees to initial the record of the interview.
3. Observation of the physical environment and working methods will provide evidence of actual practice. It is a particularly useful method of fact-finding where no physical evidence remains of an action having taken place. It should be borne in mind, however, that the presence of the auditor may influence the behavior of staff and the practices observed may not, therefore, be typical of what usually occurs. The evidence may also be difficult to substantiate. Activities should be clearly recorded in narratives, flowcharts or other diagrammatical means. Records should indicate the flow from inputs to outputs through all stages of processing.

## iii. Design of ICQ

In whatever way the auditor decides to collect the information, it is highly desirable that the auditor prepare an ICQ for each audit issue. The ICQ is addressed to the auditor himself and not to audited unit's management and staff. The focus of the ICQ should be as follows:

- ☐ Types of deviations, errors and irregularities that could occur.
- ☐ Control procedures to prevent or detect such deviations, errors and irregularities.
- ☐ Whether the control procedures have been adopted and are being followed satisfactorily.



- ❑ Weaknesses that would enable deviations, errors and irregularities to pass through existing control procedures.
- ❑ The effect these weaknesses have on the nature, timing, and extent of auditing procedures to be applied.

#### iv. Assessment Criteria

For each audit issue the auditors should frame a number of questions and collect information on each question. They should then evaluate the adequacy of each control, and use the conclusions reached to make an assessment of control risk for each account area, and then for each audit objective within each account area.

The Control Risk and the Inherent Risk thus determined would enable the auditors to decide:

- 1) The audit approach
- 2) The sample size for both compliance testing and substantive testing for evaluating the controls of the following areas:
  - a. Payments/ expenditure.
  - b. Receipts / Budgetary Funds.
  - c. Fixed assets.
  - d. Stores and spares
  - e. Construction works and work in progress.
  - f. Receivables.
  - g. Cash at bank and in hand.
  - h. Contingencies and commitments.

In actual practice, the auditors would prepare the ICQs for each audit issue according to the prevailing situation. Again, there is nothing sacrosanct about these questions. The Deputy Chief Auditor or senior auditor should review them and adapt them according to each situation.

### 5.8. Compliance Testing

The objective of compliance testing is to get an assurance that the internal controls on which the auditors have decided to rely had been in place throughout the period of audit. Prior to proceeding to compliance testing, the auditors have already twice addressed the question of internal controls. First, they developed an understanding of the control framework and then they evaluated individual controls for each audit issue. Now they need to satisfy themselves that the controls did operate in practice and throughout the period of audit. This is necessary since the assessment of control risk is based on inquiry, observation and the walk-through of a few transactions only. They are yet not sure that the controls on which they are going to



rely had been in place throughout the period of audit. For this purpose they need to extend their sample size.

### **5.9. Sample Size for Compliance Testing**

The sample size for compliance testing generally depends on three things.

- a. Upper Error Limit (UEL).
- b. Expected number of compliance deviations in the sample.
- c. Confidence level to be obtained from the audit procedure.

There is a fourth factor that also can have an impact on the number of items in the population - the population size as opposed to the population value. This factor though, only applies when the population size drops below a reasonable limit, say about 2,000 items.

A common example of a small population size is a monthly reconciliation. Here there will only be 12 reconciliations in the total population of reconciliations for the year.

#### **a. Upper Error Limit (UEL)**

The upper error limit is the maximum possible number or percentage of compliance deviations in the population that the auditor is prepared to tolerate. For example, let's consider the approval of supplier invoices. In this internal control, as for any other internal control, perfection is not possible - there is always a possibility that some invoices may escape the approval process. The auditors need to decide what is the maximum percentage of the population that can contain deviations (unapproved supplier invoices) before the auditors consider the results to be unacceptable. If, for example, the auditors decide that, should there be 6% or more of the invoices in the population not properly approved there will be an unacceptably high risk of material errors occurring in the population, the UEL would be set at 6%.

#### **b. Expected Number of Deviations in the Sample**

The auditors need to estimate the number of compliance deviations that they will find in their sample. The auditors make this estimate considering their experience and their understanding of the audited unit's accounting environment. Also, should the required sample size turn out to be substantially different than expected, the auditors can simply re-estimate the expected number of deviations.

For example, the internal auditor makes an allowance for 2 deviations in their sample based on their understanding that 1% of the population will contain compliance deviations. If the actual sample size is, say, 100, the auditors will only need to allow for 1 deviation in their sample. (1% of 100 is 1 deviation.)

#### **c. Confidence Level to be obtained from the Audit Procedure**



The confidence level should relate to the amount set for control risk. The lower the control risk, the higher the amount of reliance being placed on the controls and the higher the required confidence level.

### 5.10. Compliance Test Program

For carrying out compliance testing the auditors need to write an audit program for each audit issue. The compliance test program should have the following minimum information.

It should:

- i. Specify its overall objective.
- ii. List the tests the auditors should perform along with the test technique (i.e., observation, re-performance, etc).
- iii. Be drawn up for controls of each audit issue to be evaluated.
- iv. Have its tests cross-referenced to the specific controls in the control framework evaluation
- v. Be revised after any major change in controls.
- vi. Test only key controls.
- vii. Specify what is meant by a control failure (i.e. what a control deviation would be).
- viii. Specify when tests are to be performed.
- ix. Specify the sample size and the length of observation period, etc.

### 5.11. Compliance Audit

#### 5.11.1. Objective:

1. Audit against provision of budgetary funds to ascertain whether the moneys recorded as expenditure were authorized for the purpose for which they were spent.
2. Audit against rules and regulation to see that the expenditure incurred was in conformity with the rules and regulations framed to regulate the procedure for expending budgetary funds.
3. Audit of budgetary sanctions of expenditure to see that every item of expenditure was incurred with the approval of the competent authority in WAPDA for expending the budgetary funds.
4. Propriety Audit which extends beyond scrutinizing the mere formality of expenditure to its wisdom and economy and to bring to light cases of improper expenditure or waste of funds.





5. While conducting the audit of receipts the internal auditor should satisfy himself that the rules and procedures have been properly adopted and ensures that the assessment, collection and allocation of revenue are done in accordance with the rules and there is no leakage of revenue which legally should come to WAPDA.
6. Review, analyze and comment on various Government policies relating to different sectors.

#### **5.11.2. Methodology:**

- i. Updating the understanding of the business processes with respect to control structure;
- i. Identification of key controls on the basis of prior years' audit experience/special directions from the Deputy Chief Auditor;
- ii. Prioritising risk areas by determining significance and risks associated with identified key controls;
- iii. Design audit programs including 'Analytical Procedures' for testing identified risk conditions;
- iv. Selection of auditable units/formations i.e. DDOs on the basis of:
  - a. Materiality/ significance
  - b. Risk assessment
- v. Review of left out units/formations for carrying out analytical procedures, if deemed necessary;
- vi. Selecting samples by using a statistical sampling technique for covering the entire population;
- vii. Execution of audit programs;
- viii. Identification of weaknesses in internal controls and development of audit observations and recommendations relating to non compliance of rules, regulations and prescribed procedures;
- ix. Integrating the work with statutory/commercial auditors, where possible;
- x. Evaluating results;
- xi. Reporting; and
- xii. Follow up.

#### **5.11.3. Important Audit Components**

Some of the specific risks relating to WAPDA include:

- i. Award of contract to unsuitable supplier/contractor;



- ii. Time overrun leading to exorbitant cost overrun;
- iii. Delay in completion of Projects;
- iv. Line losses;
- v. Repeated revisions of drawings/estimates and administrative approvals;
- vi. Maintenance of stock without its actual requirement;
- vii. Theft of electrical material;
- viii. Undue generation of revenue due to over billing;
- ix. Violation of WAPDA rules for the deposit of funds;
- x. Non-maintenance of record relating to assets;
- xi. Non-maintenance of agreed percentage at the time of the approval of the contract, at the time of making final payment;

The internal auditor should decide what aspects of these risks should be taken into account when planning the audit.

The major focus of the internal audit division shall be on:

- a. Revenue/receipts;
- b. Expenditure incurred;
- c. Assets maintained;
- a. **Audit of Revenue/Receipts**

The main components of revenue/receipts are:

- i. Sale of Electricity
- ii. Sale of Scrap
- iii. Receipt of Funds

The receipts of money should be reviewed to check that they have been properly dealt with from a revenue perspective in accordance with the objectives of internal audit. The auditor, therefore, needs to keep his/her knowledge up to date in auditing standards, applicable rules, regulations and orders. The auditor should also conduct an examination of the terms and conditions attached to the revenue/receipts to ensure compliance.

- b. **Audit of Expenditure**

The major types of activities in the division/departments being audited may include:

- i. Expenditure relating to Capital works (Civil works and Electrical works);



- ii. Operations, maintenance and repairs costs (including civil works and electrical works); and
- iii. Payroll, allowances and other employee related costs.

These activities are multifarious in nature and widely dispersed across the country. A significant challenge for the audit team shall be to decide on the appropriate and judicious use of audit effort and resources.

- i. In deciding what capital projects to audit, the audit team should begin with a list of projects (given in the monthly accounts maintained by respective wings/divisions and authority offices) which are either ongoing or have reached completion in the period being audited. The sample of projects to be audited will then be selected from this list. The focus of the audit team shall be those projects:

- on which substantial expenditure has been incurred;
- which are long-term, extending beyond one year in implementation; and
- in which weaknesses or problems have been identified in previous audits.

The auditor may also include a random sample of smaller projects, based on materiality and significance.

- ii. In the area of operations, maintenance and repairs, the auditor should apply the following analytical techniques, as applicable, to identify anomalies:
  - a. From one year to the next at particular locations; or
  - b. By comparing similar facilities across the country, allowing for such factors as the size of the facility or cost/employee working at the facility.

This will provide a basis for selecting locations which should be subject to scrutiny. The auditor may also perform random sampling of transactions.

- iii. The key areas for internal audit of payroll, allowances and other employee related costs shall include:
  - a. Procedures relating to hiring of personnel
  - b. Procedures relating to termination of personnel
  - c. Calculation of payroll
  - d. Procedures for disbursement of payroll
  - e. Maintenance of payroll master files

A sound knowledge of audit unit's field of operations will help the auditor identify potential problem areas. For example, if money has been spent in the previous year on particular area of work and then in the current year there is further expenditure on the same work, the auditor may decide to investigate reasons for further expenditure.

- c. Audit of Assets



The auditors should check that the auditee divisions/departments have maintained proper records of purchase and sale of assets, and that all rules and regulations are being followed in this respect. The auditors should also check that the auditee divisions/departments have maintained a Fixed Assets Register which must reflect the current status of assets. Moreover, the auditors should observe that necessary steps have been taken by the audited unit/departments for safeguarding the assets.



## 6. VERIFICATION

### 6.1. Overview

This is the last audit process: Substantive Testing. This would lead to audit conclusions and recommendations. The auditor has carried out an assessment of Inherent Risk and the internal control structure (Control Risk). On the basis of the work done, the auditor will decide to proceed further with either the System Based Auditing (SBA) or Direct Substantive Testing (DST). This conclusion will be based on an assessment of control risk and a consideration of most time/cost-effective option. Where control risk is low and a lot of assurance can be derived from compliance testing, the auditor may decide, for efficiency and effectiveness reasons, to place very little reliance on the internal control structure and to do a lot of substantive testing. Whatever the auditing approach, the auditor will normally need to verify a sample of transactions to arrive at conclusions and recommendations.

This stage has a close relationship with the audit objectives. In the case of internal audit of financial data, the objective of substantive testing is to provide assurance as to the completeness, accuracy, validity and appropriateness of the figures in the accounting records. In the case of other audit assignments such as a performance audit, compliance with authority audit, IT systems audit or fraud audit, the audit objective would differ from assignment to assignment. In each case, the objective of substantive testing would be to conclude about audit objectives supported by appropriate analysis and evidence.

Where the auditors find internal controls reliable they should not obtain all of their assurance from compliance testing only. Some substantive testing must always be performed. This is because the ability of the internal control structure to prevent or detect material error is subject to practical limitations, such as:

- Members of management may be in a position to override specific internal controls.
- Collusion can circumvent internal controls that depend on a good segregation of duties to be effective.
- Inexperienced officials of audited unit may not perform their control procedures properly. There is always a possibility of human deviation or error.
- Internal controls are often designed to address transactions arising from the normal course of the audited unit's activities. They may not cover transactions of an unusual nature, or arising from new activities.
- Management may not be prepared to devote the resources that would be required to prevent or detect all deviations and errors. Rather, management normally requires that the internal controls be cost-effective. This means that the benefits of having the controls must exceed their costs.



## 6.2. Substantive Testing

Like compliance testing, the purpose of substantive testing is to support a conclusion on the correctness and accuracy of information and records. However, unlike compliance testing where indirect assurance is provided by testing the strength and compliance with the internal controls, substantive testing is used to obtain direct assurance with respect to the completeness, accuracy, validity and appropriateness of the information and records.

Substantive procedures involve the use of analytical procedures and substantive tests of details based on sample. The nature and extent of audit evidence required, which determines the level of testing to be employed, will itself depend on the level of materiality or significance of the issue under review and the level of assurance required to support audit findings.

Audit evidence is required to support auditor's findings and observations. What constitutes audit evidence will be determined in general terms by the nature of the audit engagement. For example, in functional audit engagements the evidence gathered must support observations regarding the manner in which management responsibilities have been effectively, economically and efficiently fulfilled. In this situation, audit evidence will often be persuasive rather than conclusive, and may be derived from interviews and observation rather than by transaction testing and analysis.

Accordingly, testing methods will vary depending on:

- The nature of the activity being audited.
- The purpose of the test.
- The type of evidence available.

The auditors should always attempt to select testing methods that are appropriate to the environment, time/cost effective and designed to give the level of coverage and assurance necessary to support audit observations.

## 6.3. Analytical Procedures

Analytical procedures are techniques by which the auditors:

- i. Study and use meaningful relationships among elements of financial and non-financial information to form expectations about what the recorded amounts should be.
- ii. Compare such expectations with the recorded amounts.
- iii. Use the results of the comparisons to help determine what, if any, other audit procedures are needed to obtain reasonable assurance that the recorded amounts are not materially misstated.

The reason auditors embark upon analytical procedures is that they can reduce the substantive test of details still further if they are able to get some comfort from the analytical procedures. However, the auditors should be aware of the limitations of the



analytical procedures. The auditors should use their judgment to decide whether that difference is acceptable or not.

Factors that affect the degree of substantive assurance that can be derived from a particular analytical procedure include:

- i. The sophistication of the procedure used.
- ii. The plausibility and predictability of the underlying relationship between the amounts used for comparison.
- iii. The extent to which the data used are independent, verifiable, relevant and reliable.

#### **6.4. Types of Analytical Procedures**

##### **i. Reviews for Reasonableness:**

Reviews for reasonableness involve the identification of unusual account balances and unusual items within financial data. They include scanning or analysis of entries in transaction listings, subsidiary ledgers, and general ledger control accounts, adjusting entries, suspense accounts and reconciliations. The important questions are:

What is significant or unusual?

What volume of activity is normal / expected?

What is the nature of the transactions going wrong?

These procedures are generally designed to direct the auditor to potential high risk areas, rather than to provide a specific level of assurance.

##### **ii. Comparative Analysis:**

Comparative analysis involves comparison of the current year's reported amounts or ratios with those of the prior years. The auditors determine a cut-off amount or percentage subjectively usually with reference to materiality and expected errors for the audit beyond which they consider the fluctuations significant. They do not adjust the prior year's data for all known changes.

##### **iii. Predictive Analysis**

Predictive analysis is the same as comparative analysis except here the auditors adjust the amounts or ratios from prior years for all known changes. It therefore tends to provide more assurance than comparative analysis.

##### **iv. Statistical Analysis:**

Statistical analysis involves analyzing the known behavior of variables and developing an equation or model that explains the average relationship between these variables. It gives a greater precision than the "predictive analysis" mentioned above.



**v. Overall verification procedures:**

These involve the creation of an expectation using operating or external data (independent of the accounting process) as well as financial data to predict an amount under examination, for example, using employee head counts and average remuneration statistics to predict payroll expense.

**6.5. Substantive Tests of Details:**

The auditors should design substantive tests of details separately for each audit issue and for each audit objective.

Substantive tests of details involve looking at individual transactions in an account. These procedures include physically inspecting an asset, checking transactions recorded in the books and records to supporting documentation, and confirming amounts with third parties.

The auditor usually tests a sample of transactions as opposed to verifying 100% of the transactions. 100% verification is normally not required, and is normally not possible given cost and time constraints. Therefore, when the term "substantive test of details" is used, the work being performed normally involves a substantive test on a sample of transactions or other amounts.

Substantive tests of details, though, often involve more than sampling. There are often specific transactions that the auditor wants to examine. These could be very large transactions, or high risk transactions.

Very large transactions are often audited 100% because they are large enough that, should they be in error, the error could be significant. The auditor therefore does not want to risk failing to find an error in these transactions.

High risk transactions are transactions that, because of their nature, contain a high risk of being in error. These transactions are often audited 100% because, while the error in each one of these transactions may not be significant, the high likely error rate in these transactions could result in a significant error in total.

What auditors often do is audit 100% of the very large transactions and the high risk transactions, and samples remainder of the transactions.

**6.6. State Objective of the Test:**

Before starting the test, the auditors should define the audit objectives. The audit objectives would depend upon the audit issue. For example for auditing accounts balances the usual objectives are as follows:

- **Completeness:** All account balances have been recorded.
- **Existence:** All recorded balances represent actual transactions.
- **Valuation:** All account balances are accurate and according to generally accepted accounting principles.





- **Ownership:** For balances representing assets and liabilities, the audited unit owns the assets and the liabilities are appropriately those of the audited unit. Both arise from regular activities.

For auditing payments and expenditure, the objectives of audit are as follows:

- **Completeness:** All transactions have been recorded.
- **Occurrence:** All recorded transactions properly occurred and were relevant to the reporting period.
- **Measurement:** The recorded transactions have been properly measured and calculated.
- **Compliance with Authority:** The recorded transactions are covered by the rules and regulations.

#### 6.7. Define the Deviation and Error Conditions:

What is a deviation or an error? The auditors should define it for each audit objective. For example, in the case of audit objective relating to Measurement of payments and expenditure, the error will be a wrong amount recorded or paid. In the case of a Compliance with Authority Objective, the deviation will be a recorded payment not according to the rules.

#### 6.8. Define Population:

The population to be tested will depend on the objectives of the audit. In an audit of a transactional process the population will be all transactions taking place during the period under review. In an audit of effectiveness the population may be more restricted or significantly expanded. Whatever the size of the population, the auditor should attempt to determine its principal characteristics and the best source for selecting a sample.

#### 6.9. Selection of Methods of Testing:

The following methods of testing are commonly used by the internal auditors to obtain reasonable assurance about the completeness, accuracy and authenticity of any transaction.

- Physical examination.
- Re-performance.
- Independent third party confirmation.
- Scrutiny.
- Vouching.
- Inspection.

In order to use the appropriate method of testing any transaction, the internal auditor would require developing substantive test audit procedures that are appropriate for the type and nature of transaction and designed to give the level of coverage and assurance necessary to



support audit observations. However, the substantive test audit program would normally require that the auditors determine their sample size before they start actual testing.

#### **6.10. Sample Size for Substantive Test of Details:**

The selection of a sample can be either statistical or non-statistical. Both are acceptable if the auditors take proper care in applying them. The sample can be selected statistically or on the basis of judgment.

#### **6.11. Monetary Unit Sampling (MUS):**

The most commonly used statistical sampling method for substantive testing is Monetary Unit Sampling (MUS). MUS assume that the whole population consists of rupee units. All the units being of equal value have the same chance of selection. Since each rupee unit is part of some invoice, the selection of a rupee unit from the population would lead to the selection of some invoice for audit. Thus the rupee unit acts as a hook for selecting specific invoices. MUS results in the sample being biased towards the largest monetary items in the population. A Monetary Unit Sample size for substantive testing depends on three things:

- a. Materiality or significance (the equivalent of the Upper Error Limit (UEL) for compliance testing).
- b. An allowance for error in the population (the equivalent of the expected number of compliance deviations in the sample for compliance testing).
- c. Confidence level to be obtained from the audit procedure.

##### **a. Materiality or Significance:**

The materiality of error in a class of transactions is the maximum possible error in the population that the auditor is prepared to tolerate. For audit of financial data, the maximum possible error would be the materiality amount.

##### **b. Allowance for Error in the Population**

The auditors need to make an allowance for errors in the population both an allowance for what they expect to find and an allowance for further possible errors.

While auditors can use the results of prior audits and known changes in accounts balances in current year to estimate the required allowance for expected error and while formulae exist to calculate the required allowance for further possible error for various confidence levels, for simplicity auditors may set the allowance for error equal to one-half the materiality amount.

##### **c. Confidence Level**

For a substantive test of details, the confidence level is the converse of the auditors' assessment of the acceptable risk. If the acceptable level of risk is calculated to be 10%, the auditors would use a 90% confidence level for their sampling procedures.



### 6.12. Selecting a Sample:

Sample selection follows slightly different procedures in statistical and non-statistical sampling. The characteristics of each type of sampling techniques are discussed in the following paragraphs.

#### i. Statistical Sampling:

There are several methods of sample selection under a statistical sampling regime, such as monetary unit sampling which has been discussed in the preceding paragraphs. Fixed interval selection as a basis for monetary unit sampling is more popular among the internal auditors because of its common use and simplicity.

#### ii. Fixed Interval Selection

This method is the most common method used to select a monetary unit sample. The method to manually select a monetary unit sample using fixed interval selection is described below:

- The population, divided by the sample size, gives Average Sampling Interval (ASI).
- The process should start with a random number. The random number carries a negative sign.
- The auditors should add invoice totals sequentially to this random number. They should give a plus sign to these invoice values and watch the sub-total after each entry and select the invoice where the sub-total turns positive.
- They should start again, now with the ASI, giving it a negative sign. They should deduct the difference of the previous sub-total from the ASI to start with and add the invoice values to it sequentially. They should select the invoice where the sub-total again turns positive.
- If the value of the sub-total of the previous entry is larger than the ASI, then they should take the ASI twice or more times until the resulting figure turns negative. Now they should follow the procedure all over again as at step 4 above.

#### iii. Non-Statistical Sampling:

There are several methods of sample selection in non-statistical sampling. The idea of all of them, though, is to try to approximate a statistical sample.

### 6.13. Value-oriented Selection

With a monetary unit sample selected using the method illustrated above, any item in the population greater than the sampling interval will automatically be selected, any item with a value of 80% of the average sampling interval will have an 80% chance of being selected, any item with a value of 50% of the average sampling interval will have a 50% chance of being selected, any item with a value of 20% of the average sampling interval will have a 20% chance of being selected, and so on.



Therefore, to approximate the above sample selection technique, the auditors could divide the population to be sampled into ranges, and then select an appropriate percentage of items from each range. For example, let's assume that there are approximately 10 items in the population with a value greater than the sampling interval, 40 items in the population with a value of 80% to 100% of the sampling interval, 110 items in the population with a value of 60% to 80% of the average sampling interval, and so on. The auditors could then randomly select all of the items in the first group, 90% (36) of the items in the second group, 70% (77) of the items in the next group, and so on. The result would be a good approximation of a monetary unit sample.

#### **6.14. Audit Completion:**

After the substantive tests the auditors start the wind up of the audit work. At this stage they should re-assure themselves that they have done all the work that was necessary, and that the working papers are complete in all respects. Audit offices often devise a checklist to provide assurance to senior management about the audit conclusions.

#### **6.15. Completion and Review of Audit Working Papers:**

The Senior Auditor should review the audit working papers on a regular, on-going basis as the audit progresses. As a minimum, senior auditor should review the audit working papers at the end of the verification phase. The senior auditor's review should ensure that:

- Audit coverage has been adequate.
- Files and working papers are complete
- Appropriate evidence has been obtained and documented to support audit observations.

In order to adequately substantiate audit findings the working papers should include:

- Audit procedures, and the nature and extent of audit work performed.
- Appropriate documentation of the audited unit's systems, activities and controls.
- Evidence of supervisory review.
- Evidence of a quality control review, where applicable, of the conduct of the audit.
- Appropriate index and cross-references.

Standard review checklists should be developed to provide the basis for, and evidence of, supervisory review. The completed checklist will form part of the audit working papers.

#### **6.16. Exit Conference:**

There should be a continuous dialogue between auditors and auditee management throughout the course of the audit assignment. The Deputy Chief Auditor should provide the auditee management with a summary of audit findings and recommendations prior to drafting the final report. This should take place in a formal exit conference.



The Deputy Chief Auditor should discuss all audit findings and conclusions with the Senior Auditor before the exit conference is held.

Prior to the exit conference, a presentation strategy should be developed. Related issues should be combined, and a presentation sequence developed. The auditors should avoid initial points that establish a tone of auditee disagreement. Findings should be grouped into two categories and presented as such.

- Reportable Items--receive top management visibility.
- Memo Comments--less serious issues which will be communicated verbally or by informal memo to auditee supervisory personnel.

The Deputy Chief Auditor is responsible for scheduling the exit conference. The goal is to have auditee supervisory and management personnel at the meeting. Exit conferences should be held prior to the last day of fieldwork to provide time for any auditee requested follow-up.

The purpose of the exit conference is to inform management of the organization audited about the audit results and the report process, reach agreement on findings, and learn of corrective action measures planned or taken to correct any deficiencies disclosed by the audit. The Deputy Chief Auditor and Senior Auditor should review the audit objectives, scope, and reporting process before discussing the audit findings. Where practical, audit findings and recommendations should then be discussed by the individual who developed the audit findings or audited that area. Consideration should also be given to noting any commendable practices or procedures observed. One audit employee should be assigned to document all discussion during the meeting. After the conference is over, the proceedings should be documented in the form of a memo summarizing each finding discussed during the exit conference.



## 7. REPORTING AND FOLLOW-UP

### 7.1. Introduction:

This is the stage of internal audit where the auditors consider the results of work performed, and arrive at conclusions before reporting within the unit and to the management of the area audited. The auditors will have arrived at conclusions during evaluation and testing. These conclusions when combined will enable the internal auditor to report the adequacy or otherwise of the internal control system.

The auditors should issue an internal audit report for each Audit Assignment. The form and content of the audit report would depend upon the objectives of the audit. The objective and scope of an Audit Assignment could be the conclusion on the adequacy of the financial reporting framework as well as an examination of compliance with the rules, regulations and controls. It could also be an investigation of fraud or an evaluation of a specific function from the point of view of economy, efficiency and effectiveness (performance auditing). The form and style of the audit report would differ according to the nature of the Audit Assignment.

### 7.2. Internal Audit Report

In most cases internal auditors issue a long-form report, as the requirements include reporting on the effectiveness and operation of internal controls. Internal auditors may also be auditing the major computerized systems, investigating frauds, or auditing for economy, efficiency and effectiveness. In all such cases internal auditors examine aspects of the functions, operations or controls of the audited unit and provide long-form reports against pre-determined criteria. The following discussion gives guidance on such long-form internal audit reports.

### 7.3. Considerations in arriving at Audit Conclusions:

In arriving at their conclusions the internal auditors need to be satisfied that they are able to judge whether:

- i. The controls evaluated are adequate.
- ii. Testing has shown them to be operating in practice. There should be sufficient, relevant and reliable evidence to support the auditors' conclusion on internal controls. In assessing the adequacy of controls, the auditors should consider for each control objective:
  - a. Any control weaknesses identified during evaluation or testing.
  - b. Any duplicated, excessive or inappropriate controls.
  - c. Controls that are not being operated.
  - d. The effect of the weaknesses.
  - e. The materiality of the process.



- f. The effect of compensating controls.
- g. The consequences of over-control.
- h. The overall effect of the above.

The auditors' good judgment is of paramount importance in interpreting and presenting audit conclusions and in making appropriate recommendations. The auditors should not only arrive at conclusions but also be able to convince management of the need to act upon recommendations. The risks to which management is exposed by weaknesses in controls or their operation should be identified as should, also, the economic consequences of over-control.

After discussion on the conclusions with audited unit's management, the auditors should determine the recommendations to be made to the audit committee of the respective wing . These should indicate:

- New or alternative controls to correct or mitigate weaknesses.
- Where controls are not being effectively applied, the action required to ensure compliance.
- Unnecessary controls.
- Any action that should be taken by management to check that weaknesses in control have not been exploited.

Whenever possible, recommendations should first be discussed with audited unit's management before submission to the audit committee of the respective wing, but it is not the auditor's responsibility to propose corrective action in detail or to be involved in its implementation or operation. However, where a weakness is detected, the auditor should be prepared to offer advice for improving the situation.

#### **7.4. Characteristics of an Effective Audit Report:**

An effective audit report has four characteristics as discussed in the following paragraphs:

##### **7.4.1. Current and Significant Information:**

The internal audit report should provide current and topical information. A report that talks of the remote past or deals with a trivial issue is of little interest to the reader. In fact, the quality of an internal audit report has a lot to do with how well the audit planning was carried out. If at the time of audit planning, significant issues were missed, the writer of the report cannot produce an accurate or meaningful report.

##### **7.4.2. Fair and Objective:**

The internal audit report should not appear to be a biased document focusing on negative findings only. It should fairly report the positive achievements of the audited unit as well. The report should mention the constraints of the audited unit in achieving economy,





efficiency and effectiveness in managing its affairs. It should project, fairly, the point of view of the management. An indirect benefit of this type of reporting is to persuade the management to accept the auditors' recommendations. A biased report only builds resistance against improvement that is not in anybody's interest. Fair reporting does not mean that the auditors should unduly search for positive achievements of management. It only means that while auditing against the set criteria, if the auditors note achievement of the criteria, they should report that.

#### **7.4.3. Non-technical Expression:**

The report should use commonly understood language. Most of the readers of the audit report are busy people and may not have a background in accounting and auditing. Non-accountants will be put off if the report uses accountant's technical jargon or adopts a style that is hard to understand. The report should provide background information only where it is necessary and that too, in plain simple language.

#### **7.4.4. Facile Presentation:**

Where possible, the internal audit report should use a style that is quick to grasp. It should use graphics, headings, sub-headings, visual aids and charts. The graphics should be produced in such a manner that the reader does not have to read the whole text to understand them. In fact a successful report will communicate its message through such visual aids without requiring the busy reader to read the entire report word for word. In brief, the report should be "scan-able", which means even if someone does not have time to read it through, that person should be able to get the main messages by just browsing through it.

The internal audit report should suggest a course of action that the auditors believe the reader or the audited unit's management should take. A report that merely pinpoints the faults but does not suggest remedial action leaves the reader wondering about the possibility of improvement.

### **7.5. Style of an Audit Report**

The audit report may be written in the following style:

#### **7.5.1. State the Structure of the Report in the Beginning:**

The reader of the report should anticipate the material contained in the report. The report should tell quite early about its structure so that the reader is able to approach it without any surprise.

#### **7.5.2. Main Conclusions First:**

The main conclusions of the report should be stated in the beginning. It saves the reader from wondering: "What does this report say to me?" This often becomes difficult for the auditors who are tempted to state the facts as they gather them and state the conclusion





in the end. The auditors should remember that the audit report should not, necessarily, follow the same sequence as they follow for collecting and analyzing the data.

The auditors should state the positive conclusions first. It means that the auditors should first state quite objectively about what has been achieved by the audited unit before they proceed to point out deficiencies in the performance.

#### **7.5.3. Deductive Arrangement of Paragraphs:**

The chapters of the report should follow some logic. Similarly, the paragraphs of each chapter should be logically related so that each succeeding paragraph is deduced from the previous one.

#### **7.5.4. Topical Sentence for Each Paragraph:**

As far as possible, main conclusions of the report should be carried to individual parts and even to paragraphs of the report. The first sentence of each paragraph should state the point that the writer is going to make in it. This helps the busy reader in skipping over the details, if he so chooses.

#### **7.5.5. Positive and Constructive:**

The auditors should be careful with their language. They should use positive and constructive rather than negative and derogatory expressions. Expressions like "frauds", "embezzlements", "violations" often blow up tempers and build resistance against acceptance of the internal audit report. In general, the language should be polite and courteous. It should not injure the self-respect and dignity of the audited unit's personnel. However, it is not to suggest that the auditors should cover up any frauds or embezzlements. They should use such expressions only when they have all the assurances to use them.

#### **7.5.6. Comprehensive Table of Contents**

The table of contents should outline the report. It should be as comprehensive as possible. Many readers will like to look into the table of contents before looking at the main conclusions.

#### **7.5.7. Structure of Audit Findings**

The text of the audit report summarizes the audit findings. Each finding should state the following after the topical sentence:

#### **7.5.8. Audit Criteria:**

What were the criteria adopted by the auditors? Until this is made clear, the report will make little sense to the reader.



#### **7.5.9. Conditions found by the Auditors:**

What were the conditions noticed by the auditors? It should also state the operating and control environments of the audited unit, and any constraints affecting their performance, including those that were beyond the control of the audited unit.

#### **7.5.10. Effect of the Conditions:**

How do the conditions noted by the auditors affect the objectives of the organization? How did they affect the economy, efficiency and effectiveness of the auditee? It should try to answer the question: if these are the facts, so what? The reader should have a fairly good idea of the implications of the conditions found by the auditors.

#### **7.5.11. Causes of the Situation:**

What are the possible causes of the situation? What could the auditee have done to avoid the negative effects or to reinforce the positive effects?

#### **7.5.12. Recommendations:**

What is the possible remedial action? A report that is silent on this question loses all impact.

#### **7.5.13. Sequence of Findings:**

##### **7.5.13.1. Significant Findings:**

Most significant findings should be placed in the beginning. The significant findings requiring corrective action should be discussed in detail.

##### **7.5.13.2. Less Significant Findings:**

Findings and comments that can be categorized as less significant should be included on a separate list. If possible, minor findings should not find a place in the report. They may be sent to the audited unit separately as a memo for taking remedial action. Less significant audit findings will generally not require a management response for report purposes.

Combine the same finding at one place instead of mentioning it at different places in the same report. It would save some writing and reading effort.

#### **7.6. Distribution of the Audit Report:**

Before an audit report is laid before the audit committee, the auditors should reach agreement with affected personnel concerning the correctness of the facts surrounding the audit findings. Where appropriate, corrective action to be taken should be ascertained and included in the report. The individual responsible for the corrective action and the key milestone dates for completion of corrective action should also be included. On occasions the



internal audit staff may work with auditee management to seek the best solution to deficiencies noted during the audit.

#### **7.7. Audit Report Follow-Up**

Having discussed the report with the unit's management during the course of an audit assignment the internal auditors have communicated to management deficiencies that, in the auditors' judgment, will expose management to risks unless they are corrected. The prime responsibility for implementation of the corrective actions lies with the management of the audited unit and not with the auditors. However, the auditors do have a responsibility to report on the progress of implementation of audit recommendations.

The Deputy Chief Auditor will determine whether implementation of the action plan has been satisfactory, and where appropriate, report inadequate action.

#### **7.8. Reporting the Results of the Follow Up:**

The means by which the follow up work is reported are often the same as the means by which the original deviations, errors or recommendations were reported. They can be included in reservations to the internal audit reports. If the auditor concludes that the corrective action was not adequate, the Deputy Chief Auditor may seek approval of the Chief Auditor WAPDA for referring the matter to the respective Internal Audit Committee of WAPDA.

The WAPDA has already constituted three Internal Audit Committees headed by Members Finance, Water and Power for implementing the findings of the internal audit reports within their administrative jurisdiction. The timing and frequency of the Internal Audit Committee meetings shall be planned in consultation with the Secretary WAPDA to avoid clash with the Authority meetings. However, it is desirable that each of these Internal Audit Committees must meet at least twice a year for timely disposal and follow up of internal audit reports.

The administrative head of the audited unit must take the follow up reports issued by internal audit seriously. It is desirable that the management of the audited unit must take corrective action within three to six months of the completion of internal audit assignment in the light of findings of the internal audit report to ensure effectiveness of the whole process.



## 8. INTERNAL AUDIT WORKING PAPERS

### 8.1. Introduction

Working papers are files established by the auditors during planning and execution of an audit. The main purpose for establishing these files is to document and preserve information of continuing importance during and after report writing. Properly kept working paper files allow senior auditors to satisfy themselves about the work done and checks applied by the field auditors. Independent commercial auditors and statutory auditors of the Auditor general of Pakistan may also examine the internal audit working papers when deciding about the extent of reliance they can place on the work of internal auditors.

Internal auditors are increasingly using electronic audit documentation. Electronic working papers can range from simple narratives and spreadsheets to fully integrated automated auditing software. Regardless of the methodology used for documenting audit results, the quality, techniques and types of working papers prepared should adhere to the professional audit standards.

Typically, the audit working papers should contain the following information:

- Audit planning information such as the size, organization, applicable laws and main functions of audited units.
- An assessment of the internal controls of the audited units.
- Audit program for each audit area such as cash book, payroll, inventory, etc.
- Details of the audit procedures performed by each member of the audit team.
- Evidence that the work of the audit team has been properly reviewed.
- A summary of audit findings.

### 8.2. Qualities of Good Working Papers

#### ☐ Complete

Working papers must be able to "stand alone." This means that all questions must be answered, all points raised by the reviewer must be cleared, and a logical, well-thought-out conclusion must be reached for each audit segment.

#### ☐ Concise

Working papers must be confined to those areas that serve a useful purpose.

#### ☐ Uniform

All manual working papers should be of uniform size and appearance. Smaller papers should be fastened to standard working papers, and larger papers should be folded to conform to size restrictions. Electronic working papers should be created and saved in formats readily accessible.



**❑ Neat**

Working papers should not be crowded. Enough space should be allowed on each schedule so that all pertinent information can be included in a logical and orderly manner. At the same time, working papers should be kept economical. Forms and procedures should be included only when relevant to the audit or to an audit recommendation. All schedules should have a purpose that relates to the audit procedures or recommendations, and unnecessary listing and scheduling should be avoided.

**❑ Electronic**

Electronic working papers are preferable to manual working papers because they are easily editable, can readily be transmitted via e-mail, and can efficiently perform complex calculations, analysis and sorts. Fully integrated automated auditing systems will usually provide automated progression tracking of the audit, allowing the Assignment Coordinator and supervisors to easily monitor the various stages of the audit. Such systems will also usually migrate audit findings from the basic working paper documentation stage to the end reporting stage, resulting in greater audit efficiency and organization.

### **8.3. Working Paper Techniques**

Planning is essential in the preparation of the working papers. Prior years' working papers should be reviewed to determine if improvements can be made in the presentation or format. The working paper package can be organized as soon as the audit program has been completed. A review of each of the audit elements in the audit program can result in the pre-preparation of the form of the working paper. This technique forces the internal auditor to think through the methodology for accomplishing each of the elements of the audit program at a time when audit steps can be integrated more efficiently into the entire program. At this time the auditors should also consult the permanent file and the preliminary survey documentation to determine changes that might have taken place in the organization or in the accounting or operational record-keeping structure. These changes could impact on the working paper format and the methods being used.

### **8.4. Descriptive Headings**

All working papers should include the title of the audit, title of the working paper, preparer's initials, date prepared, source of information, and purpose of the working paper. If applicable, the working paper should also include the audit stamp and or audit project number.

### **8.5. Tick Marks**

The auditors make frequent use of a variety of symbols to indicate work that has been done. These symbols are commonly referred to as tick marks. As these tick marks have no special or uniform meaning in themselves, an explanation of each tick mark should be made on the schedule on which it appears.



### **8.6. Cross-referencing**

Cross-referencing within working papers should be complete and accurate. Working papers should be cross-referenced to the audit findings. Audit findings should be cross-referenced to the exit conference memo and the audit report, to indicate final disposition of the item. Cross-referencing should be done in the margins of audit report drafts. These references readily provide direct access to the working papers. When utilizing electronic working papers, cross-referencing can often be accomplished using "electronic links" within the working paper. Automated auditing systems usually create such links for the user.

### **8.7. Indexing**

The system of indexing audit working papers should be simple, yet leave room for flexibility. A fully numeric indexing system using decimal positions for identifying different sections of the working papers file provides the greatest flexibility. This type of indexing allows insertion of new working papers without interrupting the numbering scheme.

### **8.8. Carry Forward**

The auditors should make full use of the working papers developed in the prior audit. Flowcharts, system descriptions, and other data may still be valid. Those papers that remain useful should be made a part of the current working papers. They should be updated with current information, renumbered, referenced, and initialed and dated by the current auditor.

### **8.9. Types of Working Papers**

All manual working papers should be maintained in binders. Schedules, analyses, documents, flowcharts, and narratives should be filed in a standard file binder or any other document file commonly used in the internal audit division. When utilizing electronic working papers, a separate directory should be created for each audit. Sub-directories should be used for each separate section of the audit, on pre-selected file saving preferences, established by the user or system administrator.

### **8.10. Schedules and Analyses**

Schedules and analyses are useful for identifying statistical trends, verifying the accuracy of data, developing projections or estimations, and determining if tasks or records have been properly completed. Each record review, data schedule, or analysis should include the following items:

- An explanation of its purpose (refer audit steps).
- The methodology used to select the sample, make the calculation, etc.
- The criteria used to evaluate the data.
- The source of data and timeframe considered.
- A summary of the results of the analyses.
- The internal auditors' conclusion.



### 8.11. Documents

Copies or actual samples of various documents can be used as examples, for clarification, and as physical evidence to support a conclusion or prove the existence of a problem. These documents can be memos, reports, electronic files, computer printouts, procedures, forms, invoices, flowcharts, contracts, or any of numerous other items. Any copied document should serve a useful audit purpose. The auditors should keep the following points in mind while preparing working papers by using documents:

- Indicate both the person and/or file that the document came from copy and insert only that portion of the report, memo, procedure, etc. which is needed for purposes of explanation or as documentation of a potential finding. Do not include the entire document in the working papers unless absolutely necessary. \_
- Fully explain the terms and notations found on the document, as well as its use. This is especially true when including maps, engineering drawings, or flowcharts in the papers. These explanations may be made on an attached preceding page or on the face of the document itself.
- Each document should be cross-referenced either to the page or separate analysis where it was discussed.
- No document should be included in the working papers without an explanation of why it was included.
- Electronic links to other files/documents should be identified.
- Documents larger than 8-1/2" x 11" should be reduced, when practicable.

### 8.12. Process Write-ups and Flowcharts

In many audits, it is necessary to describe systems or processes followed by the auditee. Describe such procedures or processes through the use of write-ups or flowcharts or some combination of the two. The choice of "which method to use" will depend on the relative efficiency of the method in relation to the complexities of the system being described.

Write-ups are often easier to use, and should be used, if the system or process can be described clearly and concisely. However, when write-ups would be lengthy, and description of related control points is difficult to integrate in the narrative, flowcharting (or a combination of write-ups and flowcharting) is an appropriate alternative. Flowcharts conveniently describe complex relationships because they reduce narrative explanations to a picture of the system. They are concise and may be easier to analyze than written descriptions.

### 8.13. Interviews

Most verbal information is obtained through formal interviews conducted either in person or by telephone. Formal interviews are most desirable because the interviewers know they are providing input to the audit. However, impromptu interviews, or even casual discussions can





often provide important information. Any verbal information that is likely to support a conclusion in the audit working papers should be documented. Interviews are useful in identifying problem areas, obtaining general knowledge of the audit subject, collecting data not in a documented form, and documenting the auditee's opinions, assessments, or rationale for actions. Interview notes should contain only the facts presented by the person interviewed, and not include any of the auditors' opinions.

In preparing working papers based on interviews, consider the following suggestions:

- Be sure to include the name, department and position title of all persons from whom information was obtained. This includes data gathered during casual conversations. Indicate when and where the meeting occurred.
- Organize notes by topic wherever possible.
- Identify sources of information quoted by interviewee.

#### **8.14. Observations**

What the auditors observe can serve the same purposes as interviews. If observations can be used to support any conclusions, then they should be documented. They are especially useful for physical verifications. Observations used as supporting documentation should generally include the following items:

- When was it observed?
- Where was the observation made?
- Who accompanied the auditor during the observation?
- What was observed?

When testing is involved, the working papers should include the sample selections and the basis of selecting the sample.

#### **8.15. Findings**

All audit findings should be documented in the working papers. Findings should be summarized in the working papers whether or not they are to be included in the audit report. The auditor discovering the situation should document all findings immediately.

Creation of a finding summary matrix will assist the auditor in keeping all findings organized. This summary should include for each finding the working paper reference, the finding and recommendation, the field auditor who discovered the finding, auditee response to the finding, and final disposal of the audit observation (reported, discussed, waived, etc.).

#### **8.16. Organizing Working Paper Files**

Audit working paper files should be organized in the following manner:

- i. Permanent Files.
- ii. Current Files.





**i. Permanent Files**

The contents of Master Files will differ with reference to scope of audit. For example, for a performance auditing assignment the Master File must have information on physical plans and actual achievements. But for financial auditing this may not be necessary.

The auditors should open a separate Master File for each Wing, Division or departmental unit.

**ii. Current Files**

Generally, instructions about Permanent Files are applicable to Current Files as well.

For each audit assignment a set of Current Files will be maintained. Generally, one Current File will deal with an audit assignment as a whole. There will be subsidiary files for the audit of each segment, if there is more than one segment in the audit assignment.

The Current File will have the following sections:

- a. Audit Planning
- b. Scope of audit, materiality level, sample size.
- c. Method of sample selection.
- d. Assessment of Inherent Risk.
- e. Assessment of Controls Risk from evaluation of controls.
- f. Decision about audit approach: DST vs. SBA.
- g. Field Work
- h. Audit Program
- i. Audit checks applied.
- j. Summary of audit findings.

**8.17. Custody**

The Permanent Files should remain in the custody of the Deputy Chief Auditor at the Internal Audit division. The field auditors will consult these files while planning the audit.

The Current Files should remain with the field auditors during the currency of audit. When they submit the audit report, they should hand over the files also to the Deputy Chief Auditor at the Internal Audit Division.



## 9. INFORMATION SYSTEM AUDITING

### 9.1. Verification of Computerized Data

#### 9.1.1. Introduction

The general audit methodology followed in reviewing a computerized system is no different than the one followed in manual systems. It passes through the same stages: planning, review, evaluation, verification and reporting. The planning for computerized audit requires the same approach as a manual audit.

#### 9.1.2. Assessment of risk through review and evaluation

As a result of risk assessment, the auditors may adopt Direct Substantive Testing (DST) or Systems Based Audit (SBA), depending on the extent to which the auditors can rely on the unit's internal controls. Whatever the approach, they now need to take up substantive testing. The present section will discuss the manner in which the substantive testing of computerized data is carried out and how the auditors can use the Computer-Assisted Audit Techniques (CAATs) for this purpose. Now more than ever before, these tools are being used to assist internal auditors in their search for irregularities in data files, to help internal accounting departments with more detailed analysis and to support the forensic accountant with extrapolating large amounts of data for further analysis and fraud detection. It is possible that the auditors obtain hard copies of the data or books of account and carry out manual checks. However, in most of the cases where computerized systems have been installed, this would be both cumbersome and uneconomical. The auditors can achieve their objectives with the help of CAATs in a much shorter time and with much less effort. However, for this purpose they require specialized training and the help of the Information Systems Auditor (ISA).

The ISA identifies the file that best represents the account balance to be audited. Many files will contain information that is not needed to proceed with the audit. It is the role of the ISA to liaise with the auditors and the audited unit to determine the data required. This liaison should carry through to the media on which the data should be supplied. The goal for the ISA is to arrange the correct files and media and to minimize the work required to create a file that is compatible with the relevant software.

The ISA should liaise closely with the auditors to determine exactly what is required of the CAATs. The ISA can advise the best approach to the interrogations and devise a sound specification for the CAATs. The ISA will develop and test the CAATs. It is possible that he will carry out the interrogations on behalf of the auditors or provide close support for the auditors running the CAAT. The role of the ISA may extend to training in interrogation software or file processing principles.

In many cases the ISA will be skilled in file downloading procedures and file manipulation



software. It is important for the ISA to manage any changes in file layout or CAATs specification on behalf of the field auditors.

## **9.2. Computer Assisted Audit Techniques (CAATs)**

Before the advent of CAATs, auditors performed all the work manually. Proving the completeness of financial information would involve the manual totaling of many paper transactions. Identifying problems in an account could take many auditors a great deal of time. Computers gave auditee units the opportunity to store their data in an electronic format. Programs allowed for greater checks and verification of data that entered into an account. Data entry and maintenance became easier and more cost effective. Computer Assisted Audit Techniques allow the auditors to perform many of the previously manually intensive tasks both quickly and efficiently, allowing savings in time and cost for the audit. The volume of tests necessary to prove the correctness of the audit file is reduced. It also became possible to perform more complex interrogations than before.

The prime objective in using CAAT is to assist in performing audit checks in the most effective and efficient manner. There are two types of CAATs:

- (a) Techniques for reviewing system controls look at the systems rather than the data processed through them. The internal auditors are concerned to establish whether or not controls exist and are functioning. However, the results from applying these techniques may lead the auditors to question the accuracy and integrity of the information produced by the system.
- (b) Techniques for reviewing data are all based upon the examination and extraction of operational data and manipulating it through audit programs. Such data is usually extracted from application systems but can also be extracted from system software and from logs such as the computer log.

## **9.3. Steps in the Use of CAATs**

Once the auditors decide to use CAATs, they should take the following steps for a systematic accomplishment of their objective.

### **9.3.1. Planning a CAAT**

It is essential to plan a CAAT properly before beginning development of CAATs software or to acquire off-the-shelf CAATs software. The CAAT needs to be looked at as part of the objectives of the audit. The objective of the CAAT is to assist the auditors in obtaining the assurances that the accounts balances are not misstated. It is vital for the auditors to select the most appropriate files for CAAT interrogations and care needs to be taken to investigate the data files that could be available. The auditors should make use of flow charts of the auditee's system to ascertain which files are being used. It is important to select data that is as close to the original data entry process as possible.

When the required data have been identified it is important to liaise with the auditee



management to arrange a suitable format for the data. The data needs to be in a format that is compatible with the interrogation software being used by the internal audit division or a format that can be easily converted by the CAATs specialist.

### **9.3.2. What Data are Available**

It is always necessary to determine the data files that are being used by the audited unit. This information is important for proper planning of a CAAT. The internal auditors or the CAATs specialist will need to know:

- i. The operating system used by the audited body. Different operating systems will be able to create different types of output files. A thorough knowledge of the operating system will allow the auditors or CAATs specialist to determine the most appropriate file type for their interrogation software.
- ii. The files created by the system. Detailed knowledge of the system will allow an informed decision to be made as to the most appropriate data to use for the audit.

There are various ways to gather this information:

- a. Discussions with the IT personnel of the audited unit.
- b. Study of installation and application reviews.
- c. Inspection of system flow charts.

### **9.3.3. Identifying the Files for Interrogation**

When the internal auditors are selecting a file for CAATs interrogations, it is always a good idea to select a file that is closest to the raw data or initial input file. In most cases this data is in its simplest format and therefore easier to import into a file interrogation package. If a file is created from several smaller files (feeder files) there has been some processing of the data prior to the creation of the file. If the internal auditors are confident in the data processing undertaken by the audited body through systems review, they may be satisfied to use the file with processed data. However, the data selected must be specific to the audit objective.

### **9.3.4. Specifying the information required for the CAAT**

When the most appropriate file for the audit has been selected, there may be additional questions that the internal auditors need to ask. In many cases the file will contain information that is not required for the audit at this stage of the audit. It is a good idea to specify only those fields that are required, as space will be saved on the PC and file processing may be quicker. It is possible that the data is not in an ideal form. For example a field may incorporate Account Code and Budget Code when only Account Code is required. The file may also be missing information that would be helpful to the internal auditor, for example, Budget Code. If information is not in the ideal format or key



information is missing it may be necessary to liaise with the unit or CAATs specialists to arrange some form of file manipulation such as an embedded audit module or a file interrogation program to produce the data in a more useful format.

#### **9.3.5. Specifying the format of the Data File**

When the most appropriate file has been selected for CAATs interrogation and the information required from that file has been specified, it is necessary to agree a format for the data and a method of storing that data. The data should be provided in a format that can be readily accessed by the PC used by the internal auditors. The data needs to be stored or supplied on a media that can be read by the hardware used by the internal auditors. The data needs to be in the simplest form possible; preferably, a form that can be linked directly to the CAATs software being used. If the audit file cannot be provided in a readily usable form it may be necessary to manipulate the data prior to interrogation. If this is the case the data should be provided in a format specified by the CAATs specialist. If the audited unit is unable to provide data in a format readily usable by the internal auditor it is advisable to ask for a report file. All computer systems are able to output some form of report. It is always possible to output the report to a CD or a USB drive. A report is fixed length in nature as it is bound by the size of the paper it is printed on. Today, many utilities exist that can manipulate report files to produce auditable tables.

#### **9.3.6. File Downloading and Conversion**

The CAATs specialist has an important role to play after the most appropriate data has been selected and provided in a format that is usable by the internal auditor. The CAATs specialist may:

- Download the data to the internal auditor's PC.
- Load the data into the internal auditor's CAATs package.

### **9.4. Ensuring Data Integrity**

When data is received from the audited unit both the internal auditor and the CAATs specialist have roles to play in ensuring the completeness of the data and file integrity.

- It is usually the function of the CAATs specialist to download the data to the internal auditors' PC. The CAATs specialist should check the data for viruses and calculate the number of records. This must always be carried out as the calculation is used to prove all of the records on the file have been converted or downloaded.
- If conversion routines are used, a count of records converted must be matched to the number of records. This is another action that needs to be performed by the CAATs specialist to assure that the data is complete.
- The CAATs specialist should scan the data for corruption. Again this is an action that



assures the data is complete and error free.

The CAATs specialist should reconcile the data/information to any documentation sent by the IT operators of the audited unit. It is the responsibility of the CAATs specialist to carry out as many checks as possible to prove the completeness of the file. If the audited unit provides a total value of the file, it is the responsibility of the CAATs specialist to prove that the total is correct.

### 9.5. Types of CAATs

CAATS can be split into two discreet areas of operation. CAATs can be used to validate the processes in programs and to analyze data files:

#### i. Program CAATs Software

The important questions that Program CAATs Software helps to get an answer to are as follows:

- Is the data being processed correctly? For example, are the payroll records being added to the overall account?
- Are records being processed correctly? For example, are all records being posted to the correct account areas?
- Does a file become altered during processing? Is some of the initial information posted to the accounts being changed in some way during the file processing?
- Are the run time and source programs the same? Is the correct generation of the program being run? For example, a program may have been upgraded but the newly compiled version has not been installed on the computer.
- Is the program or system being misused? Is the staff log in using other personnel's password or is unauthorized staff getting access to the system?
- Has the program been altered? Has some fraudulent code been added or has someone performed an unauthorized upgrade / amendment of the system?
- Is data entry properly verified? Are checks in place to prevent the entry of incorrect information into the system such as invalid account codes?

#### ii. Data Files CAATs

Data Files CAATs help in following audit tests:

- To determine completeness of files.
- To select a representative sample.
- To analyze data like totaling, searching for gaps in sequences or looking for duplicate payments, comparison of two files for differences.

For both types of CAATs, it is possible to purchase dedicated software or write in-house



programs for performing the interrogations or checks. In general the CAATs for programs or systems analysis are written in-house and the CAATs for file interrogation and data testing are bought off the shelf.

#### **9.6. Program CAATs Software**

There are several CAATs that help the auditors in checking the integrity of the computer programs. Some of the more common are as follows:

##### **a. Desk Checking**

In this technique the program code is reviewed to:

- ☐ Verify processing controls.
- ☐ Check adherence to programming standards.
- ☐ Check the accuracy of algorithms.

It gives the internal auditor a degree of assurance about the integrity and functional performance of the program. It has a psychological effect in deterring programmers from making unauthorized amendments. It facilitates checking of adherence to programming standards. However, it requires a high level of programming knowledge. It is extremely time-consuming and costly. It is tedious in nature and may result in it becoming ineffective. It is normally very difficult to confirm that the program being checked is the latest version and that the source code examined is the equivalent of the object code.

##### **b. Test Data CAATs**

Test data CAATs are of four categories:

1. Interrogation software.
2. Embedded audit data.
3. Parallel simulation.
4. Test data.

##### **1. Interrogation Software**

Interrogation software may be written directly in one of the programming languages. Whereas the high-level languages are general in application and tend to be supported by most manufacturers, the low-level languages tend to be specific to individual computer manufacturers, but they do allow more efficient manipulation of data. The merit of this software is that there are practically no restrictions on program logic, the types of file that may be accessed, or the output required. These techniques are efficient in terms of computer processing. However, the demerit is that these techniques require a high level of programming skill and technical knowledge; development takes longer and amendment is more difficult.





The most important feature of all interrogation software is the ability to select and retrieve data and then to manipulate it. Packages contain a number of subroutines to enhance their capability to do this, some of which are listed here.

**i. Integrity Routines**

These enable the auditors to test the integrity of data and files. They include tests such as duplicate testing; validity of data testing; missing records testing; alpha or numeric sequence testing; file or data comparisons.

**ii. Data and Time Routines**

These enable the auditors to convert formats of data and time and to calculate elapsed time and ageing of data.

**iii. Statistical Routines**

These enable auditors to use scientific or empirical bases for the selection of audit samples.

**iv. Test Generator Routines**

These enable auditors to generate test files and test data, both good and bad test data, to assist in testing systems.

**v. Encryption Routines**

These provide additional security for data being processed by auditors.

**vi. Interrogation Elements**

**- File**

This element defines the file or files to be used in the interrogation. It is essential that the internal auditors identify the correct file and the correct point in the processing cycle. For example, in an interrogation of a payroll system, the internal auditors may wish to search for any ghost employees. They must first decide precisely what information is to be tested. They must then define the requirement in specific detail and identify which of the files in the payroll cycle are to be interrogated and at what point in the cycle. It may be that the information required is created in a temporary file during the payroll cycle but not permanently recorded on the file. The auditors would then need to interrogate the temporary file and would have to ensure that this file is retained by the operators and not overwritten. They would also need to be certain of obtaining the correct version where a number of generations of a file exist.

**- Field**

Having identified the correct file, the auditors will need to determine which field or fields are of interest. It may be that the field of interest does not exist. For example, the auditors may be interested in the payroll of a certain category of personnel, like daily-wage employees. Furthermore, the auditors need to be vigilant about the date of the data. They may be out of date and thus be inaccurate.





#### **vii. Selection Criteria**

Having identified file and field, the auditors must decide how data are to be selected. For example, it could be every record; every 'n'th record; every record in excess of tx; or every record which exceeds a specified record by more than x%. Statistical methods may also be used as the basis for sample selection.

#### **viii. Calculations**

This element is optional. The auditors may be interested in a straight extraction only and therefore have no need of calculation. When the purpose is to check calculations in an operational set of programs, it is essential that the same criteria be used. For example, if the operational program codes treat arrears over 28 days as if over one month, then the auditors must use 28 days for checking the reported arrears. Alternatively, the auditors' purpose may be to evaluate the distortion caused by the 28-day convention adopted in the operational program when a calendar month would be the appropriate calculation factor.

#### **ix. Output**

This is, in many respects, the most important stage in writing an interrogation. It is important to think through the purpose for which the output is required. For example: the selection criteria for an exception report must be set to limit the output to a size that the auditors can use. Too many exceptions would be unusable. It is usually a good idea to limit an exception report printout to (say) 100 items to avoid excessive printing. In such circumstances, accumulating a count of occurrences enables the auditors to know how many there were in a particular file. The output should be structured in the best order to facilitate subsequent audit use. When the purpose of the program is to extract a sample for subsequent audit checking, the checking requirements must be considered at the design stage. Blank columns should be printed on the output report to facilitate recording the results of subsequent audit tests on the same document when appropriate.

#### **x. Interrogation Functions**

Whilst the number of different interrogations that can be processed against computer files, whether data files, programs, or computer logs, is limited only by the auditors' imagination, they do tend to fall into six main types:

##### **a. File Extractions**

This is the most common type of interrogation. Master files or transaction files are interrogated to extract a sample to provide the basis for subsequent audit examination. The sample may be selected as: every 'n' th item; at random; by statistical methods; proportional to size; or, indeed, any method favored by the auditors.

##### **b. Exception Reports**

In this type of interrogation, the auditor is looking for oddities and exceptions in master files or transaction files, as the basis of audit investigation. Examples are:



### Range Checks

- Employees over retirement age.
- Salary increases in excess of certain amount.
- Overtime in excess of certain number of hours.
- Ledger account balances with increase in excess of certain %age over previous year.

### Testing for Duplicates

- Employee names or numbers.
- National ID card numbers.
- Bank account numbers.
- Supplier reference numbers.
- Customer reference numbers.
- Invoice numbers.
- Identical cash payments.
- Bank account numbers in payroll compared with those in purchase ledger.

### Testing for Missing Fields

- No national ID card number or category code.
- No employee number or name.

### Testing Field Validity

- Alpha characters in numeric field and vice versa.
- National ID card number or category code not valid.
- Employee over retirement age.

### Testing for irregular Account Activity

- Excessive overtime bills.
- Excessive medical treatment bills.
- Disproportionate expenditure in a particular month.
- Excessive utility bills in a particular month.

### c. Analysis and Patterns

Master files and transaction files are analyzed seeking for patterns or areas of concern for specific investigation. Examples are:

- Frequency analysis of receipts or payments by amount, account or department.



- Distribution analysis of construction bills by projects.
- Analysis of cash versus credit purchases.
- Analysis of purchase ledger activity this year compared with last year.

**d. Control Totals**

In these interrogations, the auditors prepare totals of specific fields to prove those reported by the application system and also to check file totals against those reported on file headers. These check totals would also be used for confirming that the correct version of the master file was being processed in the audit interrogation.

**e. Process Logic**

These interrogations check the processing logic and algorithms in an application system. Examples are:

- Check the updating of stock fields on processing stock movement.
- Check Group Insurance contribution calculations.
- Check tax calculations in payroll.
- Check electricity sales invoice calculations.

**f. File and Program Integrity**

In this case, files are interrogated to check on their integrity. Examples are:

- Comparison of operational program with audit copy to check for differences.
- Comparison of operational files with the back-up copy to check for differences.
- Comparison of two generations of a file for subsequent verification of the differences.

**9.7. Embedded Audit Data**

Basically, these are variations of interrogation software where the program is embedded within an application either as part of the application software or the systems software. The embedded program may operate continuously or in response to specific parameters, for example, a specific transaction or an audit signal. It is suitable for real-time systems as it enables continuous monitoring of transactions being processed.

This technique facilitates concurrent auditing. It permits continuous monitoring of transactions. It allows immediate follow-up to control problems. It reduces the need for separate audit runs. It is particularly useful for very large files. It enables unusual transactions to be extracted for subsequent audit checking. However, it must be incorporated at system specification time. It normally has to be programmed by DP staff and this involves loss of auditors' independence. It involves high set-up and maintenance costs. Program maintenance is difficult. Processing overheads may be high.



### 9.8. Parallel Simulation

In this technique, auditors recreate all or part of a system by writing programs and then processing data through this parallel system to compare with output from the original system. This method is often used to recreate only the critical functions or controls. Comparison of output may be a manual task or may be achieved with a comparison program on the computer. All differences should be reported for further audit investigation. The simulation may usually be written using interrogation software. This technique tests the correct operation of specific programs with live data, whereas the test data method uses the auditor's data and the organization's program.

It offers simple positive verification of specific programs, programmed controls and data integrity. It uses live data files but does not corrupt them. The tests are repeatable. It can check all or part of a system. However, it may require considerable programming skills if the simulation is of a complex system. Detailed knowledge of the target system is required. It may be expensive to set up and maintain. Discrepancy between the live result and that simulated can be caused by error in the live system or in the simulation. It requires that changes to the live system and the parallel simulation must be synchronized.

### 9.9. Test Data

Test data is a technique in which the auditors submit data to be processed by the operational programs. Such data may be submitted in computer readable format or by the submission of input documents. In the latter case, the manual pro-input controls may also be tested. This technique uses fictitious data and in this respect differs from parallel simulation in which the auditor tests the processing of live data through the operational programs. The technique enables auditors to evaluate system controls and procedures including the algorithms used. Test data can be used for many purposes such as the following:

- a. To test control procedures for input and output. The data can be submitted on normal input documents following normal routines for the purpose of checking the effectiveness of those procedures. The auditors can also check whether all the expected output from the system has been received.
- b. To test controls over data input. Normal and abnormal data, including nonsense data, can be submitted in order to test the data validation and update procedures.
- c. To test processing logic in order to confirm that the master files contain validly processed data.
- d. To test algorithms within programs to check their accuracy and consistency.



## 10. STANDARD AUDIT TOOL KIT

The internal audit function shall be responsible for the review and examination of financial, operational accounts and related records of all formations and projects of WAPDA's water, power and coordination wings irrespective of the financial limits. The internal audit shall also include physical verification of stocks held at various stores, checking of payments made to consultancy services engaged on development projects and special audit as per directives of the Authority.

The WAPDA Internal Audit Manual shall be supported by the Standard Audit Tool Kit that will provide the internal auditor with practical tools for conducting audit. This Tool Kit shall be a generalised set of forms, checklists, audit programs and control questionnaires designed to help each internal audit team perform audit in compliance with the principles set out in the Manual. The Standard Audit Tool Kit shall be prepared to assist the internal audit teams to apply the forms, checklists, etc to a specific type of audit.

The Standard Audit Tool Kit shall also be a set of standard operating procedures which the internal auditors may adopt to accomplish each audit assignment in a professional manner. In order to achieve the objectives of internal audit, the internal auditor shall follow certain procedures, perform tests, obtain information, and reach conclusion after examining financial, operational accounts and related records of WAPDA formations/projects.

For each audit assignment, the field auditors shall establish specific objectives within the framework of the general objectives listed in the manual. The basic operations required to be performed in achieving specific audit objectives established on specific assignments shall consist of an integrated combination of gathering information, verifying the information, and assessing the accuracy and adequacy of the information.

In order to achieve the audit objectives, the Standard Audit Tool Kit shall be designed to provide practical guidance to the internal auditors on the processes/phases through which an internal audit assignment will pass. This internal audit process has been appropriately described in the manual and includes the following broad phases of work:

- Audit office planning phase.
- Assignment planning.
- Review phase.
- Evaluation phase.
- Verification phase.
- Reporting phase.

What shall be covered in each phase is described in chapter 4 of this manual which may be consulted for guidance by the internal auditors before performing the tasks described in each phase. However, the Standard Audit Tool Kit has been designed to guide internal audit teams through these phases in a structured manner.



The Standard Audit Tool Kit shall contain detailed audit programs, control questionnaires, checklists and information gathering forms specifically designed to provide guidance to the internal auditor to document all matters that are important to plan the audit assignment, support his conclusions and findings and to assist the internal auditor to carry out his responsibilities in an effective and professional manner. Each form or checklist included in the Tool Kit shall incorporate notes on how to use the form for guidance of the internal auditor. These notes shall be printed in italics to differentiate them from other material on the forms/checklists. Once completed and supplemented with information gathered during the course of internal audit, these sets of forms, checklists, audit programs and questionnaires shall represent a working paper file that will document the audit activities performed and support the conclusions reached on the audit assignment.

The internal auditor shall be required to complete the forms and checklists, perform the audit procedures described in the audit programs and control questionnaires, evaluate the results and report his findings which shall all be documented in the working paper file.

The Standard Audit Tool Kit shall be adapted and updated by the Chief Auditor WAPDA on a recurrent basis in the light of ground realities, scope of each audit assignment, expertise of internal auditors, new and improved internal audit methodology, and availability of sophisticated auditing tools.

**Sample of forms, checklists, control questionnaires and audit programs are given below to give the internal auditors a brief insight of what shall be contained in the standard audit tool kit and tasks that will be performed on each internal audit assignment.**



## ANNEXURE

### AUDIT WORKING PAPERS

#### Permanent Files

- The contents of Permanent Files will differ with reference to scope of audit. For example, for a performance auditing assignment the Permanent File must have information on physical plans and actual achievements but for audit of financial information this may not be necessary.
- The auditors should open a separate Permanent File for each Wing, Division or Department.
- Every Permanent file should have the following information on its title cover:

- a) Name of the Internal Audit Division
- b) Name of the Audit Entity/Unit
- c) Name of Audit Unit shown as follows:

Permanent File of \_\_\_\_\_

- d) Period covered: Starting year \_\_\_\_\_ Updated to \_\_\_\_\_
- e) Index Number: Each audit office should devise the index number in the following sequence:
  - Audit Entity/Audit Unit/Year/Volume in which opened.
- f) Section of the audit office
- g) Person (s) responsible for preparing and updating:

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- Each Permanent file should be divided into following parts:

- a) File Index
- b) Basic information:
  - Name of Unit
  - Controlling Authority / Division
  - Location



Head of the unit:

- Name
- Addresses / Phones /fax, E-mail
- DDO
- Budget & Accounts Officer
- Organization Chart
- Budget for last 3 years

c) Previous Audits: (i.e. Last three reports)

- Audit Observations                      No.                      Amounts
- Outstanding audit findings in the audit report:

d) Reported frauds in external and internal audit reports during the last 3 years.

### Current Files

- Generally, instructions about maintaining Permanent Files are also applicable to Current Files.
- For each audit assignment Current File(s) shall be maintained for the audit of each auditable area/segment.
- The Current File shall have the following sections:
  - a) Audit Planning
    - Scope of audit
    - Materiality level, in case of audit of financial information
    - Sample size
    - Method of selecting the sample
  - b) Assessment of *Inherent Risk*.
  - c) Assessment of *Controls Risk* from evaluation of controls.
  - d) Decision about audit approach: DST vs. SBA
  - e) Field Work
    - Audit team composition
    - Period of audit
    - Dates of fieldwork (location-wise)
    - Individual responsibilities of team members.
  - f) Audit Programs
    - Audit checks applied
    - Summary of audit findings.





## 1. Forms



**FORM**

**Audit Entity Overview**

<b>Assignment Code:</b>	<b>Assignment Coordinator:</b>
Name of the Audit Entity	
Location:	
Offices/Formations:	
Applicable Laws:	
Size:	
Organization head: (attach organization chart)	
Head of Finance:	
Mandate	
Mission	
Objectives	
Operational data (key financial data, books, records, vouchers, etc.)	
Main programs	
Main internal controls	
Main points in the last internal audit and follow-up	
Main points in the last external audit and follow-up	



Form

**Staff Performance Appraisal Form**

[To be filled in by the senior auditor at the conclusion of each assignment]

Name of the Auditor: \_\_\_\_\_

Name of Assignment: \_\_\_\_\_

Assignment dates from: \_\_\_\_\_ to: \_\_\_\_\_

Scoring scale: Excellent (Ex): 8-10, Very Good (VG): 7-5, Fair (F): 2-4, Unsatisfactory (US): 0-1, N/A: Not applicable. While calculating percentage marks, this column would be ignored in reaching the total score:

	<u>N/A</u>	<u>Ex</u>	<u>VG</u>	<u>F</u>	<u>US</u>
<b>A. Planning:</b>					
1. Understanding of procedures and problems relating to the activity under examination	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
2. Conformance to the instructions provided by the departmental manual.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
3. Organizing and programming.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
4. Nature and extent of planned tests.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Score sub-total					
<b>B. Field Work:</b>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
5. Accuracy of working papers – computations, references, statistical analyses.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
6. Thoroughness of examination.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
7. Appropriateness of tests to the transactions reviewed.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
8. Adequacy of documentation for work performed – showing nature, scope, and results of examination.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
9. Summarization of findings – to facilitate review	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
10. Evaluation of findings in forming conclusions – judgment in assessing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>



significance of findings.

11. Care in preparing and organizing working papers – properly indexed, cross-referenced, initialed, dated.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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12. Completion of required fieldwork – leaving no loose ends.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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Score sub-total

**C. Report Draft**

13. Adequacy of support for report statements – ability of findings to withstand challenges.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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14. Proper treatment of findings according to relative significance.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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15. Organization – presenting material in a logical and orderly sequence.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
---	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

16. Compliance with departmental instructions.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

17. Clarity and appropriateness of report language – making findings clear to non-technical readers.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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18. Accuracy in preparation and review.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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Score sub-total

**D. Oral Expression**

19. Clarity and conciseness	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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20. Persuasiveness/effectiveness	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
----------------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

Score sub-total

**E. Administration**

21. Meeting budget of the assignment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------------------	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------

22. Meeting schedule of the assignment.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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23. Coordination with other auditors	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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24. Alertness, energy, and initiative.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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25. Pleasantness, open-mindedness, tact, and	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--	--------------------------	--------------------------	--------------------------	--------------------------	--------------------------



cooperativeness.

26. Work habits – diligent application of effort to the job, and observation of office working hours. ☐ ☐ ☐ ☐ ☐

27. Job performance in stressful situations. ☐ ☐ ☐ ☐ ☐

28. Attitude toward assignment. ☐ ☐ ☐ ☐ ☐

Score sub-total

Total Score:

Percentage of the total score attained:

### Summary of Assessment

Segment	Maximum score	Score attained	Percentage
A			
B			
C			
D			
E			
TOTAL			

Conclusion: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Signatures:

Senior Auditor: \_\_\_\_\_ Date: \_\_\_\_\_

Deputy Chief Auditor: \_\_\_\_\_ Date: \_\_\_\_\_



## 2. Checklists



**Annexure**

**Audit Assignment Planning Checklist**

Audit assignment title: \_\_\_\_\_

Targeted start date: \_\_\_\_\_

Targeted completion date: \_\_\_\_\_

	W/P Ref.	Done by:
1. Review the prior audit report to determine and document any specific follow-up steps required.		
2. Review the audit time summary from the prior audit versus the findings and conclusions actually reported. Document your observations regarding scope adjustments, if any, driven by past audit results.		
3. Document any changes you would currently make to the assessment of audit risk set forth in the prior audit working papers.		
4. Discussions with the Members Finance, Power and Water and General Managers Finance of respective wings/divisions to determine if they have any specific concerns about this audit or any specific audit tests they want internal audit to perform.		
5. Summarize the audit objectives in writing to focus efforts toward meeting objectives and to later facilitate evaluation of whether or not the audit accomplished the purpose intended. As a guide, audit objectives can generally be summarized regarding the evaluation of: <ul style="list-style-type: none"><li>• Reliability and integrity of information of recorded transactions.</li><li>• Compliance with policies, directives, procedures, plans, laws or regulations.</li><li>• Safeguarding of assets.</li><li>• Economic and efficient uses of resources.</li><li>• Accomplishment of established goals and objectives for projects or operations.</li></ul>		
6. Prepare and mail (electronic or otherwise) an audit notice advising all who need to know about the audit, its timing, and the audit objectives.		



## Annexure

### Audit Assignment Completion Checklist

Assignment title \_\_\_\_\_ Assignment Code # \_\_\_\_\_

	Date	Initials
<b>PLANNING</b>		
1. Prepare assignment form.		
2. Review previous audit report, auditee's replies, and working papers.		
3. Prepare summary of prior audit findings and note corrective action set forth in auditee's replies.		
4. Review last Audit Assignment Completion Checklist.		
5. Set Audit Assignment Objectives and scope.		
<b>PRELIMINARY SURVEY</b>		
1. Conduct an opening conference to discuss auditee's concerns and revise initial audit objectives as appropriate.		
2. Familiarize yourself with departmental objectives, how they are attained, how they are monitored, and how results are determined.		
3. Familiarize yourself with the activities carried out by the department and review the system of control provided over those activities.		
4. Obtain copies of written procedures and, if necessary, update them. If there are no written procedures, document the practices followed in the working papers.		
5. Observe and document the flow of information and reports.		
6. Obtain general background information (number of documents handled, amounts and source of funding, number of employees, etc.)		





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	<b>Date</b>	<b>Initials</b>
7. Identify any relevant account or fund numbers and record financial data for review and testing.		
8. Draw preliminary conclusion as to the adequacy of the system of control and the effectiveness of the operation.		
9. List areas of risk.		
10. Revise initial audit objectives and scope.		
11. Prepare audit program		
12. Obtain Deputy Chief Auditor's approval of preliminary survey and audit program.		
<b>FIELD WORK PHASE</b>		
1. Perform and document the reviews and tests set forth in the audit program and analyze results.		
2. Be alert for opportunities for cost reduction and system improvements.		
3. Review and document status of prior audit findings.		
4. Prepare summary of findings, review with auditee and record auditee comments and corrective actions planned or taken.		
<b>FINAL PHASE</b>		
1. Review working papers for completeness		
2. Obtain Deputy Chief Auditor's approval of working papers.		
3. Prepare report draft and submit for review of Deputy Chief Auditor.		
4. Obtain approval for auditee's review.		
5. Review the report draft with auditee.		
6. Modify report draft, if necessary, submit revised draft for review of Deputy Chief		



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	Date	Initials
Auditor and obtain approval for final editing.		
7. Proof read and reference final report.		

Senior Auditor

Deputy Chief Auditor



## ANNEXURE

### Audit Working Papers Review Checklist

Audit Assignment \_\_\_\_\_ Assignment Code # \_\_\_\_\_

Reviewed by \_\_\_\_\_

Date \_\_\_\_\_

	Deputy Chief Auditor		Senior Auditor	
	Yes/no	Comments	Yes/no	Comments
1) Has every detailed audit program step been completed and initialed to indicate completion?				
2) Are the reasons for omissions of audit steps clearly documented?				
3) Are the reasons for omissions justified?				
4) Was the omission of each audit step approved by the senior auditor / Deputy Chief Auditor?				
<b>Audit Findings</b>				
5) Do all audit findings indicate: <ul style="list-style-type: none"><li>• Date?</li><li>• Working paper reference?</li><li>• Who prepared it?</li></ul>				
6) Is there evidence supporting each finding and re commendation?				
7) Does each finding adequately analyze the cause of the finding?				
8) Do all findings contain adequate quantification regarding the effect of the subject being addressed?				
9) Are all data sheets complete as to Criteria, Condition, Cause, Effect,				



Recommendation and Response?				
10) Are findings treated as “less significant” appropriately classified?				
11) Are there findings not classified as “less significant” that should be classified as such?				
12) Where all data sheets given to responsible management on a timely basis?				
13) Do all data sheets indicate with whom the finding was discussed?				
14) Are the data sheets clear, concise and do they reflect proper objective tone?				
<b>Detailed Working Papers</b>				
15) Do all pages include: <ul style="list-style-type: none"> <li>• Proper numbering, pages not used accounted for?</li> <li>• Date(s) prepared?</li> <li>• Preparer's initials?</li> <li>• The proper header and reference to audit step number?</li> <li>• Source(s) of data/information?</li> <li>• Basis of selection?</li> <li>• Tick mark legend?</li> <li>• Adequate conclusions?</li> <li>• Adequate cross-referencing?</li> <li>• Indication of review by the</li> </ul>				



senior auditor?				
16) Were all findings in the working papers adequately resolved?				
17) Do all working papers appear responsive to the detailed audit program step as to the extent of testing and audit scope?				
18) Were the audit working papers prepared efficiently using available data/information so as not to waste time creating what already exists?				
19) Do the working papers contain any extraneous or unnecessary pages or documentation?				
20) Are the working papers legible, neat, and logically arranged so that information flows from summary to detail?				
21) Have the carry-forward files been appropriately updated and has the senior auditor signed for the update?				
22) Have unnecessary miscellaneous working papers been purged from the files?				
<b>Overall Audit Evaluation</b>				
23) Is the draft copy of the audit report cross-referenced to the applicable audit finding?				
24) Does it appear that the audit was performed objectively and independently?				
25) Did the audit accomplish the written audit objectives established before the audit began as part of the audit planning				



process?				
26) Are there changes that should be made to the detailed audit program before a similar audit is performed again? Have they been documented?				
27) Are there any areas of noteworthy exposure that were not addressed by this audit but should be considered as a part of the unit/department's on-going risk assessment? Have they been documented?				
28) Does the draft audit report reflect the proper tone, i.e., an improvement – not criticism?				
29) Was audit time consistent with the audit plan, or was a budget variance explanation necessary and provided?				
30) Did the auditor(s) effectively use available computer hardware and software?				
31) Were any new macros, templates, standard schedules or work sheet innovations made?				
32) Should these innovations be passed on to other audit staff members?				
33) Have work papers created via computer been copied to floppy diskettes, and have they been properly labeled and indexed?				
34) Have all "to do" list items and review notes been satisfactorily resolved?				



## ANNEXURE

### Review of Audit Assignment by the Deputy Chief Auditor

Audit Assignment \_\_\_\_\_ Assignment Code # \_\_\_\_\_

Reviewed by \_\_\_\_\_ Date \_\_\_\_\_

S. No.	Auditor Performance Standard	Yes/No	Comments/ ref to w/p
1	Was the audit plan consistent with the strategic plan of the auditee unit?		
2	Did an advance letter about the audit sent to auditee management?		
3	Was a meeting held with auditee management to explain the audit objectives, scope and requirements of the audit team?		
4	Did the Senior Auditor review past audit work papers and other materials as applicable?		
5	Was there a walk-through prior to the start of the audit?		
6	Were the walk-through procedures documented?		
7	Did the actual time requirements planned and the staff assignments reflect the information gained from walk-through procedures?		
8	If the audit requirements were different from the strategic plan, were differences discussed with the Deputy Chief Auditor?		
9	If specialized audit resources were needed, were arrangements made prior to the start of the audit?		
10	Did the Senior Auditor adequately supervise audit fieldwork?		
11	Were all issues resolved in a timely manner?		
12	Did the Senior Auditor review the working papers over the course of the audit? Is there evidence for that?		
13	Were the preliminary audit findings discussed with the audited unit?		
14	Did the Senior Auditor review all documentation?		



## ANNEXURE

### QUALITY ASSURANCE REVIEW QUESTIONNAIRE

S. No.	Question	Yes/No or N/A	Comments / Ref
<b>I</b>	<b>Independence</b>		
1	Is the internal auditing activity organized in a way that allow for internal audit division's independence?		
2	Are you satisfied that the internal auditors are objective in performing audits?		
3	Are you satisfied with the method and the frequency of reporting to the head of the unit or the respective General Manager Finance?		
<b>II</b>	<b>Professional Proficiency</b>		
4	Were the technical proficiency and the educational background of each internal auditor appropriate for the audit being performed?		
5	Does the internal audit activity as a whole possesses the knowledge, skills, and disciplines necessary to carry out its audit responsibilities?		
6	Does the internal auditing activity use consultants where special disciplines are required?		
7	Are you satisfied with the amount of supervision given to audits? Do you consider it necessary for the review team to evaluate this area?		
8	Do the internal auditors comply with professional standards of conduct? Are you aware of exceptions by any person who is a member of the staff?		





9	Do you believe that each internal auditor possesses the knowledge, skills and disciplines that are essential in performing internal audits?		
10	Are the internal auditors' skilled in dealing with the people and in communicating effectively?		
11	Do the internal auditors maintain their technical competence through continuing education?  Are records maintained?		
12	Do you believe that each internal auditor exercises due professional care in performing audits?		
<b>III</b>	<b>Scope of Work</b>		
13	Do the internal auditors review the reliability and the integrity of financial and operating information and the means used to identify, measure, classify; and supporting this information?		
14	Do the internal auditors review the systems established to ensure compliance with those policies, plans procedures, rules, regulations and orders that could have a significant impact on operations and reports?  Do the internal auditors determine whether the organization is in compliance?		
15	Do the internal auditors review the means to safeguard assets?  Do they verify the existence of such assets?		
16	Do the internal auditors appraise the economy and the efficiency with which organizational resources are employed?		



17	Do the internal auditors review operations or programs to ascertain that: <ul style="list-style-type: none"> <li>Results are consistent with established objectives and goals?</li> <li>Operations or programs are being carried out as planned?</li> </ul>		
<b>IV</b>	<b>Performance of Audit Work</b>		
18	Are internal audits planned in advance?  Are you involved in the planning process?  Are you satisfied with the planning process?		
19	Do the internal auditors adequately collect, analyze, interpret, and document information to support audit results?		
20	Do the internal auditors adequately report the results of their audit field work?		
21	Do the internal auditors adequately follow up to ascertain that appropriate action is taken on reported audit findings?		
<b>V</b>	<b>Management of the Internal Audit Division</b>		
22	Do you have a statement of purpose, authority, and responsibility (charter) for the internal auditing activity?		
23	Do you have established plans to carry out the responsibility of the internal auditing activity?		
24	Are plans based on criteria such as financial exposure, potential loss, risk, etc?		



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25	Have you provided written audit objectives and procedures to guide the audit staff?		
26	Do you have a program for selecting and developing the human resources of the internal auditing activity?		
27	Do you coordinate internal and external audit efforts?		
28	Do you have and maintain a quality assurance program to evaluate the operations of the internal auditing activity?		



### 3. Control Questionnaires



**ANNEXURE**

**Assessment of Internal Controls**

**Audit Segment:** Payments / Expenditure

**Audited Unit:**

**Audit Period:**

**Prepared by:**

**Date:**

**Reviewed by:**

**Date:**

**Objective:** *To ensure the adequacy of the system for processing transactions in the account area*

Control question	Comments / reference
1. Are there defined and authorized procedures for processing transactions?	
2. Are transactions required to be authorized?	
3. Is there adequate separation of duties between the initiating, authorizing and processing phases of the system, including adjusting transitions?	
4. Are there procedures to ensure completeness of processing (e.g. batch controls, management review at authorizing points, etc)?	
5. Is there periodic bank reconciliation to ensure completeness of processing?	
6. Are there supervisory checks to ensure the accuracy of processing (e.g. management check of (e.g. management check of accuracy of invoices)?	
7. Are standing data periodically checked to independent sources?	
8. Is financial stationery properly controlled?	
9. Are relevant suspense accounts properly controlled?	
10. Has the preliminary examination of computer application controls been completed?	
11. If so, does it: (a) Confirm the adequacy of the computerized elements of the system? (b) Reveal any specific risks?	
12. Is there an adequate audit trail?	



## ANNEXURE

### Fraud risk Associated with Payroll

How fraud could be committed?	Examples of suggested controls
Creating fictitious employees whose pay is then obtained by the fraudster or by someone in collusion, or obtaining pay which is not consistent with employee grade.	<ul style="list-style-type: none"><li>• All updates to the payroll system should be validated, logged and authorized.</li><li>• Access controls should ensure that only authorized personnel are able to update the payroll system.</li><li>• Controls to ensure the payroll, or individual records on it, cannot generate more than one payment for each period.</li><li>• Checks should be carried out on starters and leavers to ensure that they are correctly added to or deleted from the payroll.</li></ul>
	<ul style="list-style-type: none"><li>• Budget holders should be provided with sufficient and timely information to enable them to monitor staffing costs against budget.</li><li>• There should be segregation of duties between those responsible for authorizing appointments and changes to standing data and sanctioning payments.</li></ul>
Making false claims for allowances and travel and subsistence	<ul style="list-style-type: none"><li>• The claimant should submit claims in writing.</li><li>• All claims should be checked to vouchers and any other supporting documentation prior to authorization.</li><li>• Claims should be checked to ensure that the correct subsistence rates have been used.</li><li>• Any alterations to claim forms should be countersigned.</li><li>• Claims should not be returned to the claimant after they have been countersigned.</li><li>• Signatures of authorized counter-signatories should be checked before payment is made.</li><li>• The accounts officers passing the bill for payment should be provided with sufficient information to enable them to monitor travel costs against budget.</li></ul>



**ANNEXURE**

**Assessment of Internal Controls**

**Audit Issue: Receipts / Budgetary Funds**

**Audited Unit:**

**Audit Period:**

**Prepared by:**

**Date:**

**Reviewed by:**

**Date:**

**Objective: *To ensure the adequacy of the system for processing receipts/budgetary funds.***

Control question	Comments / reference
<ol style="list-style-type: none"><li>1. Are there defined and authorized procedures for handling receipts including post-opening and prompt banking?</li><li>2. Is there regular reconciliation of moneys banked with record of sums received?</li><li>3. Is there adequate separation of duties between demands submitted and receiving moneys?</li><li>4. Have all potential receipt types and locations been identified?</li><li>5. Are receipts significant individually, by type or in total in relation to the account?</li><li>6. Are the records considered adequate to uncover the completeness objective?</li><li>7. Are relevant suspense accounts properly controlled?</li><li>8. Has the preliminary examination of computer application controls been completed?</li><li>9. If so, does it:<ol style="list-style-type: none"><li>(a) Confirm the adequacy of the computerized elements of the system?</li><li>(b) Reveal any specific risks?</li></ol></li></ol>	



**ANNEXURE**

**Fraud Risk associated with Budget Funds**

<b>How fraud could be committed?</b>	<b>Examples of suggested controls</b>
Budget funds are misappropriated	<ul style="list-style-type: none"><li>• A list of approved budget allocations and their recipients should be maintained together with the terms of each individual budget approval.</li><li>• Authorities for both the approval and payment of budget should be established.</li><li>• Records supporting budgetary claims should be adequately authorized.</li><li>• Reports of budget payments should be regularly scrutinized to ensure that only approved budgets have been paid out and that they have gone to the correct recipients.</li><li>• Systems operated by the recipients should be reviewed to ensure that the spending of budget allocation monies is adequately controlled.</li></ul>





## 4. Audit Programs



## ANNEXURE

### Audit Programme: Contract Management

Audit Procedure	Done By	WP Ref.
<p><b><i>Unrealistic estimation of works</i></b></p> <p>Check that the survey report is prepared and approved by the competent authority.</p> <p>Check that the work and estimates are sanctioned and approved by the competent authority as per book of financial powers.</p> <p>Check the tenders and ascertain whether the estimates represent the probable cost of the execution of works.</p> <p>Check drawings, work specifications and site survey reports to ascertain whether the project is carried out in accordance with the requirements.</p> <p>Check that the estimates are based upon prevailing market rates.</p> <p>Check that the actual expenditure over the approved cost of estimate is within the limits approved by the competent authority. In case of variation over the limit, ascertain whether approval has been obtained from the competent authority.</p> <p>Check that the rates used in the estimate are in accordance with the rates specified in WAPDA Schedule of Rates or approved price bulletin.</p>		
<p><b><i>Non-transparency in tendering of works, procurement of goods/material and hiring of consultancy services</i></b></p> <p>Check that the tender is announced publicly in accordance with the policy of the government/PPRA Rules/WAPDA Purchase Procedures and foreign agencies guidelines (where applicable).</p> <p>Check that envelop is attached with all the bidding applications.</p> <p>Compare the contents of tender with the estimates.</p> <p>Check that the cost of administrative and technical sanction is recorded in the tender register.</p> <p>Check that the bidding applications of potential suppliers are recorded in the tender register.</p> <p>Compare bidding applications and tender register to ascertain the accuracy of particulars (e.g. rates, quantity etc) quoted by the applicants.</p> <p>Check that there are no interpolations, and corrections are made to the tender. Check that all the changes are approved by the competent authority.</p> <p>Check that the comparative statement of all the bid applications is</p>		



<p>prepared in the tender register.</p> <p>Check the basis on which bidding applications were accepted or rejected.</p> <p>Check the arithmetic accuracy of the calculations made in the tender and estimates.</p> <p>Check the attendance sheet of potential bidders to ascertain the participation of all the bidders.</p>		
<p><b><i>Violation of PPRA rules, WAPDA purchase procedures and Authority instructions</i></b></p> <p>Check that all the tenders are generated in accordance with the provisions of PPRA rules, WAPDA purchase procedures and authority instructions issued from time to time.</p>		
<p><b><i>Modification in standard clauses of contracts/ supply orders</i></b></p> <p>Check that all the tenders and changes thereon are approved by the competent authority as per book of financial powers.</p> <p>Compare the terms of actual contract with bidder and tender. In case of any variation, investigate the matter.</p>		
<p><b><i>Non-imposition of liquidated damages in late completion of works/ supply of goods</i></b></p> <p>Check the works register, progress report and stock register with contract entered with the supplier.</p> <p>In case of delay in the execution of contract, or supply of material, check that the liquidated damages (LD) charges have been recovered in accordance with the provisions of WAPDA purchase procedures and book of financial powers.</p>		
<p><b><i>Failure and termination of contracts/ supply orders</i></b></p> <p>Check the civil works register and stock register and compare it with the purchase order to identify differences in the pending civil works and quantity of material due to be received.</p> <p>In case of non compliance with the terms and conditions of the contract, check whether the contractor is penalized in accordance with the provisions of the contract/ purchase order.</p>		
<p><b><i>Repeat Contracts</i></b></p> <p>Check the contractor register and ascertain whether the repeat contract is not entered into with the same supplier/ contractor over the ceiling limit specified in WAPDA purchase procedures/ Bidding Documents.</p> <p>Check the rate analysis including current and previous year rates and identify variation in prices. In case of any downward movement in</p>		



<p>prices, investigate the matter.</p> <p>Check that the repeat orders are issued within 6 months of the initial purchase order. In case of civil works, ascertain whether variation orders are booked in accordance with the provisions of the book of financial powers.</p>		
<p><b>Extra financial assistance to the contractors</b></p> <p>Check contract agreement and compare it with payment vouchers through which payment was made to the contractor.</p> <p>In case of any deviation from the contract agreement, record the instances and probe into the matter.</p>		
<p><b>Escalation claim of the contractors</b></p> <p>Check the escalation provisions of the contract agreement and compare them with the payment voucher(s).</p> <p>In case of deviation, record the instances and probe into the matter.</p>		
<p><b>Variation/ change orders in original contracts/ work orders</b></p> <p>Check that the variation order is approved by the competent authority according to the book of Financial Powers.</p> <p>Check that variation was recommended by the engineer / consultant of the contract.</p> <p>Check that the cost of variation order was prepared in accordance with the terms and conditions of the contract agreement or prevailing market rates.</p>		
<p><b>Measurement of works</b></p> <p>Check the measurement book and ascertain whether the measurements are recorded in chronological order.</p> <p>Check the arithmetic accuracy of the calculations booked in the measurement book and ascertain the aggregate measurements do not exceed the estimated quantities as mentioned in the Bill of Quantity (BoQ).</p> <p>Identify the cases of excess measurement from the measurement book and check that proper action has been taken against the responsible officials.</p>		
<p><b>Violation of contract clauses</b></p> <p>Check the provisions of the contract agreement and compare it with the payment vouchers.</p> <p>Identify the instances of violation and work out the financial impact of the violation.</p>		



***Non-recovery/adjustment of loans and advances to contractors/ suppliers/ departments/ employees***

Check that the loans and advances issued are approved by the competent authority.

Check that loans and advances issued to the suppliers are in accordance with the terms and conditions of the contract.

Check the accurate recording of all loans and advances in the books of accounts.

Check the progress reports, contract/ pay bills and ascertain whether the loans and advances are recovered in accordance with the terms and conditions of the agreement.

***Non-encashment of performance bonds/bank guarantees***

Check that the performance bonds/ bank guarantee received from the supplier/ contractor are in accordance with the terms and conditions of the contract.

Check the authenticity of the performance bonds/ bank guarantees being submitted by the contractors/ suppliers.

Check the guarantee register and ascertain the completeness and safe custody of the bonds/ guarantees.

Check that the bonds/ guarantees are en-cashed in accordance with the provisions of the contract.

***Unsanctioned work***

Check that administrative and technical sanction of work has been made for all the contracts and projects.

Where no approval has been obtained, identify its causes.

***Inventory of assets with contractors/ consultant***

Check that the lump sum BOQs is in accordance with the clauses of the contract agreement duly approved by the engineer.

Upon completion of the project, check that all the equipment mentioned in the breakdown of contract agreement is handed over to the employer.

Check that any deviation/ shortage from the approved breakdown have been charged to the contractor.

Check that vehicles purchased by the contractor at the cost of employer are returned to employer upon completion of the project. In case of non submission, ascertain whether due action has been taken.



## ANNEXURE

### Compliance Test Programme for Contractors Bills

Program Objective	Procedure	Ref To W/P	Completed by/ date
<b>Completeness:</b>  Are controls to prevent and detect payments being made without being recorded, operating effectively?	Re-perform the year-end reconciliation with the Bank to ensure that there has been a proper reconciliation between the unit's and the Bank's records.		
<b>Occurrence:</b>  Are controls to prevent or detect payment transactions being recorded which relate to goods or services that have not been received, operating effectively?	Select a representative sample of invoices relating to contract payment and check there is documentary evidence of certification by the appropriate senior engineer.		
<b>Measurement:</b>  Are controls to prevent payment of an incorrect amount being made, operating effectively?	For each selected invoice in the sample check the amount payable is arithmetically correct and agrees with the invoice		

<b>Level of Reliance</b>	<b>Possible Confidence Level</b>
<i>High level reliance on the specific internal control (control risk set at low – 20%)</i>	95%
<i>Moderate level of reliance on the specific internal control (control risk set at moderate – 50%)</i>	90%
<i>Low level of reliance on the specific internal control (control risk set at high – 80%)</i>	80%



**ANNEXURE**

**Fraud Risk Associated with Use of Contractors**

How fraud could be committed?	Control Activities
	<p><i>Some General Preventive Controls</i></p> <ul style="list-style-type: none"><li>• An approved suppliers list should be kept. This list should be updated on a regular basis and any amendments appropriately authorized.</li><li>• Clear and unambiguous tendering procedures should be established. Adherence to these procedures to be monitored closely.</li><li>• Tenders should be delivered to those responsible for selection without interference.</li><li>• Late tenders should not be accepted.</li><li>• Staff should be required to declare any personal interests they may have which may affect the tendering process.</li></ul>
Payments made for work not carried out as a result of collusion between the contractor and official.	<ul style="list-style-type: none"><li>• Invoices are paid only when accompanied by independent certification that work has been satisfactorily carried out.</li><li>• There is a register of contracts in progress</li><li>• Contracts are only added to the contract register when properly approved and authorized.</li><li>• Contract variations are documented; variation orders are sequentially numbered, produced in an agreed format and authorized before payment.</li><li>• Checks are made against budget and planned expenditure prior to approval of payment.</li></ul>

*This is a sample compliance test programme. The internal auditor should add further compliance test procedures in line with the requirement of internal audit.*



## ANNEXURE

### Guidelines for Materiality

Type of Account	Base	Very Large Entities	“Average” Entities	Very Small Entities
Receipts and Payments	Gross Expenditure and Receipts	1/2 %	1/2 % - 2 %	2%
Accrual	Normal Net Surplus	5 %	5 % - 10 %	10 %
	Gross Income / Expenditure, Total Assets, Total Turnover, Net Assets	1/2 %	1/2 % - 2%	2 %