

5. Special Audit Techniques

Techniques normally use for collection audit evidence

1. Confirmation

- Confirmation it is a method of collecting audit evidence which consists of the response to an inquiry to corroborate information containing in the accounting records.
- Recommendation a outline of a confirmation are as under
 - i. The confirmatory letters should be sent out within a period of 15 to 21 days of the end of the year, even with the audit is take up much later in respect of balance either as at the date of balance sheet or as at another selected date before the close of the year.
 - ii. If the number of balance is large, letters may be issued only in respect of major debtors and creditors, selecting according to some system.
 - iii. The statements of account prepared by the client should be compared by the auditor with the balances of debtors and creditors. Therefore, he should be maintaining control over them until they are posted.
 - iv. Either each statement of account should contain a request of confirmation of the balance shown therein or it should be forwarded with a separate letter by the auditor or the client, as may have been mutually agreed upon.
 - v. Letters or statements should be posted under the supervision of auditor.
 - vi. In cases where replies are not received within a time, a reminder should be sent out by the auditor.
 - vii. On receipt of replies from parties, it should be verifies either the balance have been confirmed can be satisfactory reconciled with the balances shown by the books of account of the client.
 - viii. If the difference is the result of some dispute or claim for allowance or return, etc., not afforded to party, it should be confirmed that there exist a provision equal to the difference which ultimately may have to be credited to him.

2. Inquiry

- SA 500 mentions inquiry as one of the methods of collecting evidence by seeking appropriate information from knowledgeable persons inside or outside the entity.
- Responses to inquiries may provide the auditor with information which he did not previously possess or may not provide him with corroborative evidence.

3. Observation

- Observation consists of looking at a process or procedure being performed by others, for example the auditor's observation of inventory counting by the entity's personnel, or of the performance of control activities.
- Observation provides audit evidence about the performance of a process or procedure, but is limited o the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedures is performed.

4. Analytical Review procedures

- Analytical review procedures may be defined as substantive tests of financial information made by a study of comparisons and relationship among data.
- Analytical procedures are used for the following purpose
 - i. to assist the auditor in planning the nature, timing and extent of other auditing procedures.
 - ii. As a substantive test to obtain evidential matter about particular assertions related to account balances or classes of transaction.
 - iii. As an overall review of the financial information in the final review stage of the audit.
- The reliability of data is influenced by its source and nature and is dependent on the circumstance under which it is obtained.

Statistical sampling in auditing

- Statistical sampling in auditing stands for the technique of forming an opinion about a group of items on the basis of an examination of a few of the items.
- There are some shortcomings of the test check technique as a basis for forming opinion about the accounts under audit, statistical sampling technique may be considered as a refined application of the test check technique which has all the advantages of the latter with the shortcomings removed.
- The greatest merit of statistical sampling technique lies in its being based on the statistical theory of probability. It is however, not as simplistic as the test checks.

a. In designing the audit sample, the auditor has to consider the following

1. *Audit objectives*: when designing an audit sample, the auditor's consideration includes the specific purpose to be achieved and the combination of audit procedures that is likely to best achieve that purpose.
2. *Population*: the auditor determines that the population from which he draws the sample is appropriate for the specific audit objectives. For example if the auditor's objective were to test for overstatement of accounts receivable, his population could be defined as the accounts receivable at trial balance. Such selection should therefore be entirely random, and for this purpose number tables are often used.
3. *Confidence level*: confidence level is conventionally expressed as a percentage. The confidence level is therefore seen to be complementary to risk.
4. *Precision*: the precision may be defined as with which we can describe the attributes of a given population. The degree of precision will depend on the materiality of the items in questions.

b. Defining misstatement

- the auditor must determine the significance of potential mis-statement as it will determine the way in which tests should be conducted. Tolerable mis-statement is the maximum mis-statement that the auditor would be willing to accept and still concludes that the result from the sample has achieved his audit objective.
- The smaller the tolerable mis-statement, the larger the sample size the auditor will require.

c. Sample Size

- The level of sampling risk that the auditor willing to accept affects the sample size required. The lower the risk the auditor is willing to accept, the greater the sample size will need to be.

d. Sampling risk

- Audit sampling enables the auditor to obtain and evaluate audit evidence about some characteristic of the items selected in order to form or assist in forming a conclusion concerning the population from which the sample is drawn.
- Sampling risk can be lead to two types of erroneous conclusion
 - i. The auditor is primarily concerned with this type of erroneous conclusion because its affects audit effectiveness and is more likely to lead to an inappropriate audit opinion.
 - ii. This type of erroneous conclusion affects audit efficiency as it would be usually lead to additional work to establish that initial conclusion were correct.

Statistical sampling procedures

- i. Decide on the relevant confidence level and precision limits;
- ii. Calculate the sample size using an appropriate formulae or tables designed for the purpose.
- iii. Select the sample using random methods
- iv. Carry out the necessary tests
- v. Appraise the results.

Selection with aid of the computer

The auditor may use a computer to render considerable assistance in the performance of statistical sampling tests, employing the following methods:

- a. **Interval sampling:** the computer is programmed to select every n th item stored on magnetic tape, and the items so selected can be copied on to a separate tape and printed out in the form required by the auditor.
- b. **Random number selection:** the technique of random number selection can be computerized, the random numbers being stored on tape or generated by the computer separately for each application.
- c. **Random interval selection:** the dangers of selecting biased example by the use of a uniform interval can be avoided through the use of random variation of the interval between successive items.

Selection of the sample

- i. Random selection
- ii. Systematic selection: in which the number of sampling units in the population I divided by the sample size to give a sampling interval. When using systematic selection, the auditor would need to determine that sampling units within a population are not structured in such a way that the sampling interval corresponds with a particular pattern in the population.
- iii. Monetary units sampling: is a type of value-weighted selection in which sample size, selection and, evaluation results in a conclusion in monetary items.
- iv. **Haphazard Selection:** in which the auditor selects the sample without following a structured techniques. Although no structured technique is used, the auditor would nonetheless avoid any conscious bias o predictability. And thus attempt to ensure that all items in the population have a chance of selection. Haphazard selection is not appropriate when using statistical sampling.
- v. Block Selection: involves selection of a block of contiguous items from within the population. Block selection cannot ordinarily be used in audit sampling because most population are structured such that items in a sequence can be expected to have similar characteristics to each other, but different characteristics from items elsewhere in the population.

Audit risk

Audit risk is the risk that an auditor may give an inappropriate opinion in financial information that is materially misstated. Such risk may exist at overall level or while verifying balance sheet items and verifying various transactions.

Components of audit risk

1. Inherent risk (risk that material errors will occur)

- Inherent risk is higher for some assertions and related classes of transaction, account balances, and disclosures than for others. External circumstances giving rise to business risks may also influence inherent risk.

2. Control risk (risk that the client's system of internal control will prevent or correct such error)

- Control risk is a function of the effectiveness of design, implementation and maintenance of internal control by management to address identified risks that threaten the achievement of the entity's objectives relevant to preparation of the entity's financial statements.

3. Detection risk (risk that any remaining material errors will not be detected by the auditor)

- For a given level of audit risk, the acceptable level of detection risk bears an inverse relationship to the assessed risks of material misstatement at the assertion level.
- For example, the greater the risks of material misstatement the auditor believes exists, the less the detection risk that can be accepted and of its application by the auditor.

Risk based audit

Risk based audit Is an approach to audit that analyses audit risks, set materiality thresholds based on audit risk analysis and develops audit programmers that allocate a larger portion of audit resources to high-risk areas.

Risk based audit is essential element of financial audit both in the attest of audit of the financial statements and in the audit of financial systems and transaction including elation of internal control. It also provides indicators of risk as a basis of opportunity for improvement of auditee risk management and control processes.

This affords an opportunity to the auditee to improve its operation from recommendations on risks that do not have a current impact on the financial statements but impact the audited entity's operational strategies and performance over the longer term.

Audit risk analysis

The auditor should perform an analysis of the audit risk that impact on the auditee before undertaking specific audit procedures

Audit risk is brought about by error and fraud. The auditor has the responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free material misstatement, whether caused by error or fraud.

An error risk may arise from an error n principal, estimate, critical information processing, financial reporting process or disclosure.

Fraud risk involves manipulation, falsification of accounting records, or misrepresentation in the financial statements of events, transaction or other significant information, or misapplication of accounting principles or misappropriation of fraud.

Steps for conduction risk based audit

1. Understand auditee operations to identify and prioritize risks
2. Assess auditee management strategies and controls to determine residual risk
3. Manage residual risk to reduce it to acceptable level
4. Inform auditee of audit results through appropriate report