

Audit Organizer

Internal Control

Objectives

Auditors are required to gather information about an organization's internal control. They will perform a wide variety of procedures to gather this information, which must be sufficient to allow them to evaluate the overall design of the system. This tool is designed to help small business owners and others put together their thoughts about internal control and any related documentation of the organization's policies and procedures. By going through this process, small business owners and others involved in the financial reporting process will:

- Gain a better understanding of the company's internal control, its strengths and its weaknesses
 - Be better able to make changes to internal control to improve the company's financial reporting process and reduce its vulnerability to fraud
 - Be prepared to help auditors understand the organization's internal control and contribute to a more efficient, less costly audit.
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Instructions

On the following pages are a few common sense questions you should answer about your organization's internal control. These questions have been grouped into five broad categories:

- Controls over significant business transactions
- Fraud risks
- The financial reporting process
- The organization's culture and its people
- Maintaining internal control effectiveness

Please consider each question and jot your thoughts down in the space provided. Auditors also are interested in any documentation you may have to support your answers. Write down all documentation you can think of that will help the auditors verify your responses. For example, if your organization has formal job descriptions, make note of these because they can help auditors better understand how you communicate with employees regarding their responsibilities.

To help you articulate your thoughts, each section of the organizer describes the main objectives of the auditor's testwork. For example, with regard to significant business transactions, the auditor is looking to gain an understanding of how those transactions are processed, the types of errors that could occur during that processing, and the controls the organization has in place to prevent or detect those errors.

Can others in the organization help with the answers?

Absolutely. Not only can they, they should help come up with the answers. Look to accounting and operational personnel and others in your organization who are involved in the financial reporting process. You may even wish to get together as a group to discuss these questions.

How formal should my answers be?

Not very. The purpose of this organizer is merely to gather your thoughts and your documentation. By doing this, you will be better prepared to help the auditor understand your organization's internal control. Do not think of this as something you must formally submit to your auditors.

Important note. This tool is not designed to answer all the questions your auditors may have about your organization's internal control. It covers only the most significant areas in somewhat broad detail. It is intended to help prepare you to respond more effectively to the auditor's questions about internal control. You should expect your auditors to ask additional questions and seek more documentation than what has been captured here.

Your auditors may have provided you with the pamphlet *Financial Reporting Plain English Guide: Understanding Internal Control*. When completing this organizer, you may wish to review that guide because it will provide additional background and insight into financial reporting controls.

What Your Auditors Will Be Looking for

As you collect your thoughts on these questions, it will help to understand the general requirements auditors must satisfy when gaining an understanding of internal control.

With regard to significant classes of transactions, auditors will want to know:

- How significant classes of transactions are processed.
- The types of errors that could occur and the reasons for those errors.
- The controls that address those errors.

Significant Classes of Transactions

Instructions

Identify the significant classes of transactions at your organization, for example, sales, cash receipts and disbursements, or payroll. (In most small businesses there usually are three or four classes of transactions that are significant.) For each transaction type, be prepared to answer the questions that follow.

Questions to Consider

1. How are significant classes of transactions authorized, captured and processed?
2. What are the most likely ways an error could be introduced into the processing of these transactions? To answer this question consider:
 - a. Errors that have occurred in the past. What was the cause of these errors? Has the source of the problem been corrected?
 - b. Any internal control deficiencies that auditors have identified in the past. What types of errors may occur as a result of these control deficiencies?
3. What are the key controls you rely on to either prevent or detect these errors?
 - a. If errors are detected, what is the process for correcting the accounting records?
4. How are the accounting records for these transactions reconciled to each other?
5. Who performs the key controls related to these transactions?
 - a. Do these individuals have the ability to authorize or enter transactions into the accounting system?
 - b. If so, then the company bears a risk of fraud in this area. How does the company mitigate this risk?

Notes About Significant Classes of Transactions

Documentation That May Support Our Answers About Significant Classes of Transactions

What Your Auditors Will Be Looking for

As you collect your thoughts on these questions, it will help to understand the general requirements auditors must satisfy when gaining an understanding of internal control.

With regard to fraud, auditors will want to know:

- How you identify and assess fraud risk
- The controls in place to specifically respond to fraud risk.

Notes About Risk of Fraud

Risk of Fraud

Questions to Consider

1. What frauds are most common for a business in your industry? What frauds are most likely at your organization?
2. What steps has the organization taken to mitigate the risk of fraud?
 - a. What is the thought process management follows when deciding how to reduce the risk of fraud?

Documentation That May Support Our Answers About Risk of Fraud

What Your Auditors Will Be Looking for

As you collect your thoughts on these questions, it will help to understand the general requirements auditors must satisfy when gaining an understanding of internal control.

With regard to the financial reporting process, auditors will want to know:

- The process the organization follows to prepare its financial statements from the accounting records.
- The controls over that process, including the oversight role of management and, if applicable, the organization's board of directors

Financial Reporting Process

Questions to Consider

1. What procedures do you perform that would allow you to identify material misstatements to the financial statements? Consider how you would identify material misstatements affecting:
 - a. Significant assets and liabilities (e.g., accounts receivable)
 - b. Total assets and liabilities
 - c. Revenue
 - d. Net income
 - e. Important financial ratios such as working capital or inventory turnover
2. What procedures do you perform that would allow you to identify all matters that should be disclosed in the notes to the financial statement? What procedures do you perform to make sure these items are properly described in the notes?
3. How do you identify transactions or events that are outside the normal business transactions and require special accounting consideration? What steps do you take to ensure that these transactions are accounted for properly?
4. How do you control the posting of journal entries and other adjustments to the general ledger to make sure they are authorized and proper?
5. How do you identify changes to accounting rules that affect your organization? If you do identify changes, what steps do you take to ensure you apply the new rules correctly?

Notes About the Financial Reporting Process

Documentation That May Support Our Answers About the Financial Reporting Process

What Your Auditors Will Be Looking for

As you collect your thoughts on these questions, it will help to understand the general requirements auditors must satisfy when gaining an understanding of internal control.

With regard to organizational culture and people, auditors will want to know:

- Management's attitude, awareness and actions relating to internal control and the financial reporting process.
- How management ensures that individuals in important financial positions have the requisite background, training, and skills.

Culture and People

Questions to Consider

1. Consider each of the following items. How high of a priority do you place on each of the them and why?
 - a. Preventing fraud
 - b. Creating and maintaining a system that provides timely and reliable information needed to manage the business
 - c. Providing timely, reliable and transparent financial information to creditors, regulators and other third parties
2. Do others in the organization understand how important each of the above items are to management? How is this sense of importance communicated?
3. How do you and your management team promote honesty and ethical behavior within the organization? What do you do to make sure others in the organization "get the message"?
4. What steps do you take to attract and retain highly qualified individuals in key positions?
 - a. How do you know what the job requirements are for each key position?
 - b. How do you make sure the people in those positions maintain the skills and have access to the resources necessary to perform their assigned functions?

Notes about Organizational Culture and Its People

Documentation That May Provide Support About Our Organizational Culture and People

What Your Auditors Will Be Looking for

As you collect your thoughts on these questions, it will help to understand the general requirements auditors must satisfy when gaining an understanding of internal control.

With regard to maintaining the internal control system, auditors will want to know:

- How management monitors internal control effectiveness and, if necessary, makes necessary changes or improvements.

Maintaining Internal Control Effectiveness

Questions to Consider

1. When you become aware of accounting errors, what steps do you take to investigate the underlying cause of those errors?
 - a. When addressing these underlying causes, how do you evaluate and, if necessary, make changes to your control system to reduce the risk that those same accounting errors will occur in the future?
2. When you become aware of weaknesses in your accounting system or internal controls, what steps do you take to correct these weaknesses?
 - a. What criteria do you use to determine whether to correct or “live with” systems or controls that are less than ideal?

Notes About Maintaining Internal Control Effectiveness

Documentation That May Provide Support About Our Process for Maintaining Internal Control Effectiveness