

Week 3 - DQ 2

Why do auditors have to consider the internal controls of the organization? What are some key elements of internal control? Which are the most important? How will the auditor have to modify the audit program if the internal controls are deemed inadequate to support management assertions?

Response #1

Auditors have to consider an organizations internal control so the audit will be effective, efficient, and so they will have awareness of where misstatements might occur. An auditor must understand the procedures and policies and the length of operation per each component of internal control; control environment, risk assessment, information and communication, control archives, monitoring, and antifraud programs and control.

The key elements of internal control are:

1. Identify the types of potential misstatements that may occur
2. Understand the factors that affect the risk of material misstatement
3. Design further audit procedures (Boynton and Johnson, 2006, p. 422).

The most important of the elements is designing further audit procedures. The first two elements feed to the point, they will tell if the auditor has adequate information to assess material misstatement per management's assertions. The audit program would be modified if the auditor finds inadequacies within any of the internal control components. For an example, if there is no supporting documentation in the control archives (log book or some sort of tracking), how would the organization know they have accurately archived all files correctly and to 100% of their item list. The auditor would have to conduct more tests in that specific component to reveal a more thorough evaluation at greater detail. But, the auditor has to draw a line as to when to stop testing, has anyone experienced this with an auditor?

Response #2

Auditors must consider the internal controls of an organization because internal auditing provides the basis for determining the efficiency and effectiveness of operations as well as the ability of an organization to maintain compliance requirements. Internal control is established and maintained by management with the intention of aiding and insuring that the organization's risks are managed in a systematic, disciplined manner.

The key element of internal controls is to provide assurance to management, the oversight body, as well as external stakeholders that the organization's risks have been properly assessed and mitigated. However, because of certain inherent limitations, internal control may not detect all misstatements. Auditors, therefore, must consider whether misstatements have occurred, identify the factors that influenced the misstatement, and design additional procedures to evaluate any additional errors. If the auditor deems that internal controls are inadequately supporting management's assertions, the auditor must construct and implement further tests to provide an in depth analysis of each component, thereby illustrating in greater detail any misstatements that may have occurred.

Response #3

An internal control "is 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 reliability of financial reporting, compliance with applicable laws and regulations, and effectiveness and efficiency of operations" (Boynton and Johnson, 2006, p. 391). In that definition lies the answer as to why auditors have to consider internal controls; reasonable assurance that the organization is complying with laws and to assure the reliability of financial statements. Some components of internal controls are the control environment, risk assessment, control activities, information and communication, and monitoring. The most important to an auditor would be monitoring and control activities which would pertain to the reliability of financial reporting. Auditing the monitoring and control function would show if management was properly overseeing their departments to

make sure things were being done correctly. In addition, when it comes to accounting, even if you are a senior accountant, there needs to be someone monitoring you to ensure the financial statements are reliable and accurate. If an auditor found that the accountant in charge of preparing the financial statements was flying solo, they might need to address that lack of monitoring in their notes. The auditor would use the internal control knowledge to determine if he or she needs to perform additional risk assessment procedures.

Response #4

Assessing an organization's internal control is a very important element in conducting a successful audit in giving reasonable assurance. The main objectives of internal controls are to give reliability in financial reporting, identify the effectiveness and efficiency of the organization's objectives, and to confirm the organization is complying with the laws and regulations. Human error and deception can occur in an organization. Because internal controls are people orientated, auditors need to identify and assess whether the organization's policies and standards are being employed. The Committee of Sponsoring Organizations (COSO) recognized five components of internal control: control environment, risk assessment, control activities, monitoring, and information/communication. I believe the control environment of the organization is the most important internal control because it sets the tone for each of the other components. Once an auditor evaluates the company's control environment, further examinations of the other components can be appraised. The auditor attempts to gain an understanding of the organization's policies and procedures. The auditor's attempts to identify the types of misstatements that can occur, understand the risk of material misstatements, and design further audit procedures. By designing further audit procedures, the auditor will perform substantial tests and tests of controls.