

Week 5 Assignment Ch. 11 & 13 Textbook Exercises

Learning Check 11-6

a. Briefly describe three strategies for testing internal controls when information technology is used for significant accounting processing.

1. Planning for a low control risk assessment based on application controls. These are automated controls, in which auditors test the manual follow-up of exceptions noted by application controls, test the computer general controls, and test the computer application controls.
2. Planning for a high risk assessment based on general controls and manual follow-up which gives emphasis to tests of details. Auditors learn about the effectiveness of the testing and design of application controls when they tests general controls. Identifying exceptions through inquired of knowledgeable individuals who perform manual follow-up procedures auditors are able to make inferences about the effectiveness of application controls.
3. Assessing control risk based on user controls. If user controls exist, for example, a user in a department comparing computer-generated output with source documents supporting the transaction, auditors can test the controls directly.

b. Identify two strategies that might be used to support a low control risk assessment. Discuss the difference between the two strategies.

According to the SBA web site “The auditor might assess control risk as low based on two of the three above strategies, assuming that the evidence shows that the controls are effectively designed and placed in operation. First the auditor can assess control risk as low based on user controls, such as effective performance reviews by management. Second, the auditor can assess control risk as low based on effective computer application controls”. In addition, “this strategic also involved effective manual follow-up of exceptions noted by application controls”.

c. Discuss a third audit strategy that might be used to assess control risk at a high level. Explain why this strategy will not support a low control risk assessment.

A third audit strategy that is able to produce competent and sufficient evidence to allow the auditor to assess control risk at a high level is the General Control and Manual Follow-Up Procedures. On the other hand, the problem with this strategy is that it does not supply satisfactory, competent evidence to allow for a control risk assessment of low or moderate. On the contrary, the use of computer-assisted audit techniques to test programs would be better to assess control risk as low or moderate.

Learning Check 11-8

What are the advantages and disadvantages of the computer-assisted audit technique known as parallel simulation?

One of the advantages of the computer-assisted audit technique known as parallel simulation is that the auditor can run the test independently. Another advantage is that the size of the sample can be greatly expanded at relatively little additional cost. A third advantage is that the auditor can verify the transaction by tracing them to the source documents and approvals due to the fact that real data are used.

According to the SBA web site among the disadvantages you have “the fact that the auditor may need special training to understand the client’s program and develop a program that simulates the client’s program. The auditor must also take care to determine that the data selected for simulations are representative of actual client transactions”. Also, the scope of the test is limited to the auditor’s selections, test is only the presence and functioning, computer operators know tests are being conducted, and test are conducted only at specific times.

Learning Check 11-9

a. What is the difference between the conventional test data approach and the integrated test facility approach?

The conventional test data approach uses dummy transactions made ready by auditors. These dummy transactions are processed by the client’s computer program under auditors’ control. The test data consist of one transaction for each invalid and valid condition auditors elect to test. The results are then compared with auditors expected output to decide conclusively whether the controls are operating effectively. On the other hand, the integrated test facility approach uses small subsystem within the regular IT system. This is done by appending dummy master records or creating dummy master files to client files. Test data codified to match dummy master files are bring into the system mixed with actual transactions. Test data includes exceptions and transactions errors that may be encountered. By doing this the test data is subjected to the same programmed controls as the actual data. A disassociated set of outputs is generated for the dummy files or the subsystem. Results are then compared with those expected by the auditor.

b. In lieu of traditional testing, what approaches can be used in on-line entry/on-line processing systems?

In on-line entry/on-line processing parallel simulation approach may be used. However, generalized audit software that simulated on-line real-time processing is very limited. Continuous monitoring approach can also be used in which an audit routine is added to the client’s processing programs. Transactions entering the system are sampled at random intervals, and the output from the routine is used in testing the controls.

Learning Check 13-8

List the steps involved in selecting and evaluating a nonstatistical or a statistical sample for tests of controls. Identify the professional judgments that must be made associated with each step.

Step 1. Determine the test objectives.

Professional judgments should be employed by auditors to identify the test objectives and how these objectives related with the financial statements assertions.

Step 2. Determine procedures to meet objectives.

Professional judgment should be employed to identify procedures to meet objectives. This helps will show the way the internal controls are design and how they are operating as well. This will require inquiring and observing staff performance as well as inspection of documents, etc.

Step 3. Make a decision about the audit sampling technique.

The main task here is to apply professional judgment in selecting the use of nonstatistical or statistical sampling.

Step 4. Define the population and sampling unit.

Populations are affected by the control being tested and in many cases several ways exist to identify different sampling units for the same control, for example, each item on a report. Consequently, a professional judgment is employed here in deciding to treat some segments as one population or as dissociated population.

Step 5. Determine the sample size.

Certain professional judgment need to be made before identifying the sample size. There are many factors that influence this, such as the frequency of operation, tolerable deviation rate, nature of control, population size, etc. For example, staff errors, and the type of control been automated or manual, should be tested to identify the effectiveness of their functionality.

Step 6. Select a representative sample.

Selecting a representative sample requires the use of professional judgment. This is required to select a sample that serves as a typical example of the operation of the control at the time the period is tested.

Step 7. Apply audit procedures.

Once the representative sample has been chosen, auditors must apply audit procedures to identify whether its control operates effectively and whether it has been regularly enforced.