

# Risk Based Auditing

with

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- 🦅 Your mission:
  - ∠ Have Fun!
  - ∠ Think
  - ∠ Ask Questions
  - ∠ Share something
  - ∠ Learn something



## Risk-Based Audit Standards

- **2010.A1** – The internal audit activity’s plan of engagements should be based on a risk assessment, undertaken at least annually.
- **2120.A1** – Based on the results of the risk assessment, the internal audit activity should evaluate the adequacy and effectiveness of controls encompassing the organization’s governance, operations, and information systems.



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## RISK & CONTROL CONCEPTS OVERVIEW AND REFRESHER



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## What is Risk?

- All businesses have risks
- Those risks must be identified and addressed
  
- Risk is the threat that an event, action, or non-action will affect an organization's ability to achieve its business objectives and execute its strategies successfully.

➤ "Risk blindness"



## Risk: Types and Assessment

- What types of risk are there?

∠ Inherent

∠ Residual

- How do we assess risk?

∠ Impact

∠ Likelihood



## **AUDIT PLANNING STEPS**



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## **Building a Risk Based Audit Plan**

1. Inventory the business processes or auditable entities
2. Correlate business processes with objectives or risks
3. Identify universal risk factors
4. Weight the risk factors
5. Create the risk profile for the organization
6. Select audits to be performed
7. Identify gaps and resource needs
8. Gain agreement from management



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## Risk Factors

- ↳ Transaction complexity
- ↳ Management stability
- ↳ Liquidity conversion
- ↳ Degree of automation
- ↳ Confidence in management
- ↳ Extent of major change
- ↳ Employee turnover
- ↳ Environmental factors
- ↳ Competitive pressures
- ↳ Control environment
- ↳ Time since last audit
- ↳ Continuous auditing results
- ↳ Degree of financial materiality
- ↳ Volume of transactions



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## Questions for Management

- ↳ What could go wrong?
- ↳ Who could we fail?
- ↳ Where are we vulnerable?
- ↳ What resources do we need to protect?
- ↳ What must go right for us to succeed?
- ↳ How could our operations be disrupted?
- ↳ What information must we rely on?
- ↳ What decisions require the most judgment?



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## Questions for Management continued

- What activities are the most complex?
- What activities are regulated?
- What is our greatest legal exposure?
- How could someone convert assets?
- How successful will be at managing change?
- How will we retain critical resources?
- What is the worst thing that happened in your department this year, last year, 5 years ago?



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## Engagement Level Risk Assessment (ELRA) / Risk Control Matrix (RCM)

- Start with business / process objectives
- Identify risks
- Assess risks
- Document scope considerations
- Identify controls
- Assess adequacy of controls
- Document effectiveness of controls
- Document audit findings



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## Prioritize Your ELRA

- Prioritize identified risks (risk matrix)
- For high risks, increase audit intensity
- Identify control attributes
- Prioritize your controls



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## Setting Objectives

- Preliminary (initial) objectives
- Type of audit
  - Operational
  - Financial
  - Compliance
  - Performance
  - IT
  - Others..
- Management objectives
- Refined objectives



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## Determining Audit Scope

- 🐦 Estimated time budget
  - Fixed, closed-end date driven
  - Hours
- 🐦 Impact of other audits
- 🐦 Audit intensity
- 🐦 Use of technology
- 🐦 Dependence on entity level controls
- 🐦 Types of audit tests
- 🐦 Sampling method



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...Intelligent Internal Controls vs. process ste  
...interviews, surveys, questionnaires, documentation  
reviews

## IDENTIFYING AND DOCUMENTING CONTROLS



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## Identify Controls

- Categories
- Experience
- Guidance material
- Other risk and control matrices
- Risk examples for others in industry
- Team effort
- Interviews / walkthroughs
- Process maps / flowcharts
- ICQs / Surveys



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## Basic Control Objectives

- Authorization
- Accuracy
- Completeness
- Existence
- Valuation
- Classification
- Timeliness / Cutoff
- Segregation of Duties (separate authorization, custody, and accounting)
- Safeguarding Assets



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## Key Controls

- Significant controls that both ensure and give assurance that the organization is achieving key business objectives.
- The control that management is most dependent upon to makes certain the right things get completed the right way.
- When the absence of that control would increase residual risk



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## Key Controls

...continued

- Controls for significant accounts and processes
- Transaction initiation, authorization, processing, and reporting
- Key check points for each transaction
- Controls designed to prevent or detect fraud
- Controls that management depend on
- Controls that show management C.A.R.E.S
- Controls that mitigate more than one risk



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...assessing adequacy of controls  
...testing effectiveness of controls

## TESTING ADEQUACY & EFFECTIVENESS OF CONTROLS



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## Control Adequacy

| Weaker              | Stronger               |
|---------------------|------------------------|
| Manual              | Automated              |
| Detective           | Preventive             |
| Single              | Multiple / Overlapping |
| Complex: Many steps | Single: One step       |
| High level          | Transaction level      |
| Uses sampling       | Done 100%              |
| Takes place later   | Done real time         |



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## Techniques to Test Control Effectiveness

- Surveys
- Control Self Assessment
- Continuous Monitoring
- Continuous Auditing
- Analytical Reviews
- Paper reviews
- Audits



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## CAATs Scope

- Know your data
- Know how to get your data
- Understand data warehouse
- Know what you need to get manually



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## CAATs Uses

- Substantive testing
- Compliance testing
- Financial testing (end-of-year transactions and balances)
- Analytical review
- Efficiency analysis
- System controls testing



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## Determining Sampling Sizes

- Identify your population 1<sup>st</sup>
- Base sample size on risk
- Consider transaction frequency
- Establish a sampling technique / process
- Consider the number of exceptions you expect to find (more exceptions = more samples) – set your error rate
- Ask your external auditor



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## Testing other controls

- 1<sup>st</sup> you must know a deficiency is still a deficiency even if a compensating control is present
- Test complementary and compensating controls as needed to assist with deficiency assessment
- Redundant controls are “redundant”



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...residual risk  
...what really matters?

## **COMMUNICATING RISK BASED AUDIT RESULTS**



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## What is a good audit report?

- ✦ Complies with communication standards of our profession
- ✦ Meets the needs of the target audience
- ✦ Maintains appropriate tone
- ✦ Helps the company mitigate risks and improve processes



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## Questions ?



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