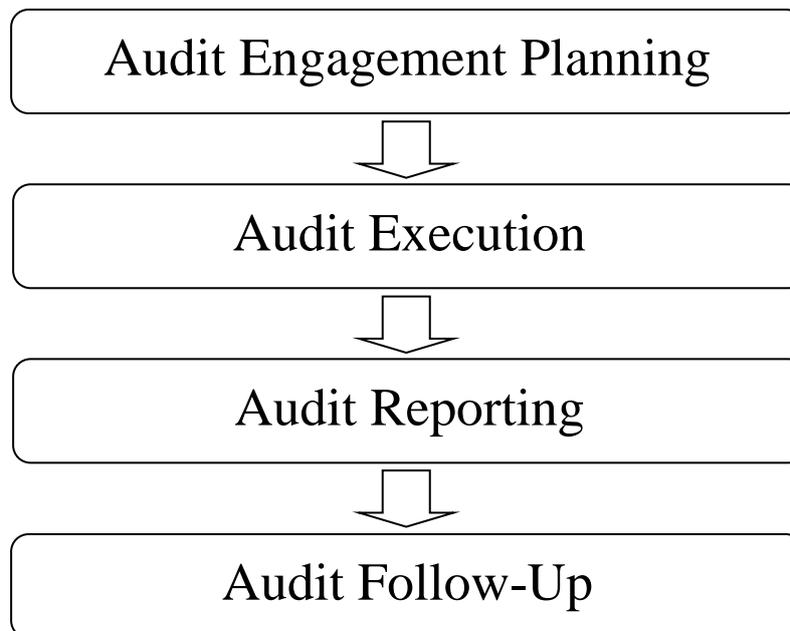




## 1. The Audit Process

The audit process is divided into four phases, namely: audit engagement planning, audit execution, audit reporting, and audit follow-up. (See Figure 3)

*Figure 6: The Audit Process Flow Diagram*



### 1.1 Audit Engagement Planning

- Audit requires good planning. Planning entails familiarization with the objectives, processes, risks and controls of the auditee and activity to be audited, and developing a strategy and approach in conducting the audit. It is the most important part of the audit as the success of the audit depends on how well it has been planned.
- Planning is an iterative process with the following important steps:
  - a. Understanding the control environment and the organization;
  - b. Outlining the scope and objectives of the audit;
  - c. Establishing the basis for budgeting (time, cost, personnel);
  - d. Identifying the evidence required to develop the audit findings;
  - e. Assisting in choosing/determining the audit procedures (nature, extent, and timing) ; and
  - f. Establishing the basis for coordinating the staff.
- Audit engagement planning is the third stage of planning, after strategic planning and annual work planning. It involves the listing down of audit activities per audit engagement based on the AWP. The results of the strategic planning shall be



validated to determine if there are relevant changes in the control component, systems and processes.

- A key aim in planning an audit should be to complete the audit in the least time necessary, without comprising its quality. The following summarizes the steps involved in Audit Engagement Planning:

A. Document Understanding of the Program and Project

- It involves the selection of specific internal controls and focusing on the degree of compliance with laws, regulations and policies of specific program/project/system/process for evaluation; evaluation of the control effectiveness; and determination of whether or not operations are conducted economically, efficiently, ethically and effectively.
- A program refers to the functions and activities necessary for the performance of a major purpose for which the company is established.
- A project means a component of a program covering a homogenous group of activities or processes needed that result in the accomplishment of an identifiable output to be carried out within a definite time frame.

B. Determine Audit Objective, Scope, Criteria and Evidence

- An audit objective is what the audit aims to accomplish. This is critical in establishing the scope, criteria, evidence and approach of the audit. It is normally expressed in terms of what questions the audit is expected to answer about the performance of an activity. Ideally, an audit objective would be consistent with the achievement of the objectives of the organization.
- Determining the audit objectives involves the following activities:
  1. Preliminary gathering of documents/information;
  2. Identifying the focus of the audit and the aspect of performance to be examined; and
  3. Determining the type of audit to be performed: (a) compliance with laws, regulations and policies; (b) evaluation of control effectiveness; or (c) determination of whether or not operations are conducted economically, efficiently, ethically and effectively.
- Audit scope is the framework or limits of the audit. It is normally defined by stating what the audit intends to cover and the relevant timeframes.
- The steps in determining the audit scope are as follows:
  1. Define the parameters and nature of the audit work to achieve the audit objectives;
  2. Determine the audit tools, techniques and methodology to be utilized; and
  3. Select the sampling method to be utilized.
- Audit criteria are reasonable standards against which existing conditions are assessed. They reflect a normative condition for the subject of the audit. These

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are expectations of the program or project as to what should be. It includes statutory and/or managerial requirements; process requirements; and citizen's requirements, needs and expectations. In order to come up with sound criteria, auditors must:

1. Gather/identify the standards (laws, regulatory policies) for audit evaluation;
2. Set reasonable and attainable standards of performance, statutory and managerial policies for evaluation; and
3. Identify pieces of audit evidence required by law and standards and the approaches to be utilized in obtaining them.

**C. Determine the Resources Required for the Audit and the Target Dates**

- Careful planning involves the determination of the overall resource requirements to accomplish the planned audits. This involves assessing the current staff capability/capacity; technological resources (e.g., computers, software); financial resources (budget requirements), among others.
- Target milestones/dates for the completion or accomplishment of critical elements during the audit process should be established to keep track of the progress of the engagement and check on the quality of the outputs.

**D. Develop the Audit Plan and Audit Program**

- An audit plan is a document that provides the main guidance of the whole audit process in order to achieve the audit objective in an efficient and effective way. It provides an integrated description of the auditee and the audit by serving as a guide for the whole audit.
- The audit work program or audit program contains the audit objective, the step by step audit procedures to accomplish the audit objective, the auditor responsible to perform the procedures, and the specified timeframe.
- Audit programs are guidelines for action during the execution phase of the audit. These set out the detailed audit procedures for cost effective collection of evidence. These are the detailed listing of steps to be taken by the internal auditor when analyzing samples to achieve an audit objective. It describes the details of the planned audit and enumerates the processes or methods and tools for identifying, analyzing, and recording information gathered during the engagement.

**E. Determine Key Performance Indicators (KPIs) of the Audit Engagement**

- KPIs are performance measures that are utilized to assess the outputs/outcomes contributing to the overall organizational efficiency and effectiveness. In evaluating performance, KPIs are employed to gauge the IAS's accomplishments and to determine whether or not:

1. Audit objectives are met as reflected in the audit findings and



- recommendations;
  - 2. Findings and recommendations are based on facts, substantial evidence and in compliance with relevant laws, rules and regulations;
  - 3. There is compliance with Internal Auditing Standards under COA/DBM rules and regulations; and
  - 4. Findings and recommendations promote the adequacy of internal control under COA rules and regulations.
- It is important that the KPIs for internal audit are aligned with the internal audit strategic plan and annual work plan and help drive the performance that the organization expects from the IAS. It is incorporated in the audit plan to guide the auditors during the execution of the audit engagement.

F. Approval of the Audit Plan, Audit Work Program and KPIs

- The audit plan, audit work program and KPIs are submitted by the internal auditor to the Audit Committee for review and approval prior to the commencement of the audit execution. The Audit Committee will evaluate the documents to assess the relevance, significance, auditability and other factors affecting the conduct of the audit.
- After the documents have been approved, management should be informed about the approved audit plan, audit program and the KPIs. The audit plan and the KPIs should be discussed with management but the audit work program should not be shared.

## **1.2 Audit Execution**

- Execution of the audit is initiated with an entry conference to discuss the focus, requirements and timelines of the audit. It involves performing the audit techniques and procedures enumerated in the audit work program to gather data and pieces of evidence, to achieve the stated audit objective/s. During audit execution, if the auditor finds a need to revise the audit work program, the revision should be submitted to the Audit Committee for approval.
- At any point during the audit and during the conduct of the baseline assessment of the ICS, when significant risks/issues arise, the internal auditor shall prepare interim reports (I.e., quarterly Audit Committee Meeting) to address findings, issues and problems that may affect the conduct of the audit and may expose the organization to considerable risks. The audit execution is conducted with the following activities:

A. Entry Conference

- The initial conference aims to discuss the plans for the conduct of the audit as well as to obtain the audited entity's views and expectations for the overall framework for the conduct of the audit. Matters arising from the entry conference must be recorded and should be considered during the conduct of the engagement planning.

**B. Conduct Compliance Audit**

- Compliance audit is the evaluation of the extent or degree of compliance with laws, regulations, managerial policies and operating processes in the agency, including compliance with accountability measures, ethical standards, and contractual obligations.
- The IAS should focus on the organization's compliance taking into account the existence of irregularities/inconsistencies of transactions in dealing with regulatory measures either external (i.e., government compliance) or internal (i.e., company policies) in nature. The IAS should record relevant information to support the audit results upon gathering of evidences (i.e., working papers) and determining probable causes on the non-compliance.

**C. Conduct System/Process Audit**

- Operations process audit is designed to evaluate the effectiveness, efficiency, ethicality and economy of operating systems selected for audit. On the other hand, management process audit aims to evaluate control effectiveness.
- This step involves the documentation of the process or system under audit, identification of the control procedures, verification and validation on whether or not such control procedures are complied with and are working effectively, as follows:
  1. Gather and analyze evidence to establish the condition;
  2. Compare conditions with standards to draw conclusion;
  3. Determine root causes. (Root cause is a structured investigation that aims to identify the true cause of a problem and the actions necessary to eliminate it);
  4. Prepare the working papers to support the audit results; and
  5. Integrate audit findings and prepare a summary to list down the findings/observations, audit recommendations and corresponding actions to be taken/status.

**D. Audit Conference/Committee Meeting**

- The purpose of the conference is to discuss the highlights of the audit findings/observations with the Management (auditee). It also provides the auditee's comments and insights about the significant audit issues as a way of validating the findings/observations. Management's comments should be taken into consideration (documented in the audit report) so as to arrive at workable/attainable/flexible recommendations and obtain the auditee's commitment towards performing remedial actions.



### 1.3 Audit Reporting

- Audit reporting represents the culmination of the audit execution and the associated analysis and considerations made during the audit. The audit report sets out the findings in appropriate format; provides the pieces of evidence gathered to arrive at the audit findings, and the recommendations, as follows:

#### A. Develop Audit Findings

- The audit findings can be developed by analyzing the pieces of evidence gathered for each of the audit elements. Evidence may be categorized as physical, documentary, testimonial, analytical or electronic. Evidence should be sufficient and appropriate (substantial), component, and relevant. Audit findings provide answers to audit objectives.
- Once the audit finding has been identified, two complementary forms of assessment take place: (1) the assessment of the significance of the findings and the determination of the probable cause/s and the root cause/s. In fine, all audit findings should be formulated based on the four Cs defined as follows:
  1. Criteria – the standards against which a condition is compared with (i.e., laws, regulations, policies)
  2. Condition – a fact, backed up by substantial evidence. (current/existing condition)
  3. Conclusion – the evaluation of the criteria and the conditions that could either result in compliance or non-compliance with laws, regulations and policies, as supported by substantial evidence; control effectiveness; determination of adequacy or inadequacy of controls; determination of the efficiency, effectiveness, ethicality, and economy of the company's operations.
  4. Cause – the immediate and proximate reason/s for the condition for which substantial evidence will be used as basis of the audit recommendation. It is a structured investigation that aims to identify the true cause of a problem and the actions necessary to eliminate it.
- The audit findings should align with the audit objectives and should be rational and based on specific standards and criteria. Audit findings on probable cause of illegality of a transaction constitute a violation of law, while irregularity constitutes a violation of regulations.

#### B. Develop Audit Recommendations

- Audit recommendations are management/legal remedies to avoid occurrence (prevention action) or avoid recurrence (corrective action) of control weaknesses and incidences.
- The issues to consider in developing recommendations are as follows:
  1. Recommendations are submitted to the Audit Committee as the official primary



responsible. The recommendations should identify the probable/root cause of the gaps or deficiencies/breakdowns. The IAS should not address the probable/root cause; instead, it should recommend courses of action wherein the responsible units will take preventive (avoid occurrence) and corrective (avoid recurrence) measures.

2. Recommend courses of action to indicate what needs to be done (management's responsibility), but not how to do it.
3. The circumstances that aid or hinder the organization in achieving the criteria should be identified.
4. The feasibility and cost of adopting a recommendation, with the benefit of a recommendation outweighing the costs.
5. Alternative courses for remedial actions.
6. Effects of the recommendation (positive and negative).

#### C. Prepare the Draft Audit Report

- The draft audit report is prepared by laying out and analyzing the pieces of evidence gathered to arrive at preliminary audit findings and recommendations.
- When preparing a draft report, the auditor should:
  1. Delineate the objectives and scope and report within that scope, unless other issues of substance are identified;
  2. Identify all criteria;
  3. Report significant matters – positive or negative
  4. Describe the context and background of the reported matter only as far as is necessary to provide an understanding of the issue;
  5. State initial findings as well as the management comment's comments, if any;
  6. Present the audit findings in a manner that is concise, fair and objective; and
  7. State the recommendations so that they indicate what needs to be done but not how to do it.

#### D. Update the Audit Committee

- The Audit Committee should be updated on the results of the audit engagement through Audit and Risk Management Committee meetings held every quarter of the year. The meeting is composed of the three (3) Audit Committee members, one (1) Corporate Secretary, one (1) Management representative and the Internal Audit Specialist (who shall present the audit agenda).

#### E. Prepare the Final Audit Report

- The draft report may then be finalized integrating the following as parts of the final report:
  1. Table of Contents;
  2. Minutes of Meeting of the Previous Audit Committee Meeting;
  3. Detailed Audit Findings;



4. Management's Comments, if any;
  5. Monitoring and Feedback of Prior Audit Findings Issued to Management, if any;
  6. Recommendations;
  7. Appendices/Supporting Documentations, if any.
- The final audit report should be presented to the Audit Committee who decides on the distribution of the audit report based on the recommendation by the Internal Auditor. The latter then proceeds to follow-up on the audit recommendations.

#### **1.4 Audit Follow-up**

- Follow-up is a monitoring and feedback activity undertaken to ensure the extent and adequacy of preventive/corrective actions taken by the Management to address the inadequacies identified during the audit. It aims to increase the probability that recommendations will be implemented.
- Activities conducted on audit follow-up, to wit:

##### **A. Monitor Implementation of Approved Audit Findings and Recommendations**

- The benefits of internal audit report recommendations are reduced, and deficiencies remain, if recommendations are not implemented within the specified timeframe. It is management's responsibility to implement approved findings and recommendations, but the internal audit is in a good position to monitor the progress of implementation of the recommendations.

##### **B. Resolve Non-Implementation/Inadequate Implementation of Audit Recommendations**

- The IAS recommends appropriate legal and/or management remedies (alternative courses of action) for non-implementation of recommendation and inadequate preventive/corrective actions due to reasonable causes affecting the organization's operations.

##### **C. Prepare Audit Follow-Up Report**

- Results of the audit follow-up should be recorded and reported in order to apprise the Audit Committee of the status of actions on the approved recommendations. The reasons for the lack of action or non-completion of action on any recommendation should be documented and further action considered on significant recommendations that have not been acted upon.
- Follow-up of audit recommendations serves to increase the effectiveness of audits, to assist the company, to evaluate the IAS performance, and to create incentives for learning and development.



## 2. Gathering and Analysis of Evidence

Under the execution phase of the audit, the audit work program is executed to gather more evidence and draw the audit findings. Audit evidence covers all the information used by the auditor in arriving at the audit findings and audit report. Sources of information include sampling results of accounting records (books of entry, checks, invoices, contracts, ledgers, journal entries, etc.); minutes of meetings; analyst reports; controls manual; information obtained from such audit procedures as inquiry, observation, and inspection; and other information developed by, or available to, the auditor that permits him to reach conclusions through valid reasoning.

### 2.1 Sufficiency and Appropriateness of Audit Evidence

- In the test of controls, the internal auditor obtains sufficient and appropriate evidence to support the initial findings.
- What is sufficient and appropriate is the result of the auditor's sound evaluation and is dependent on: (a) Nature of the control deficiency; (b) Materiality; (c) Source of information and evidence; (d) Prior audit experience; and (e) Results of other audit procedures.
- The sufficiency and appropriateness of audit evidence are interrelated. Sufficiency is the measure of the quantity of audit evidence considering the concepts that: The higher the impact of control deficiencies, the more audit evidence is like to be required. The higher the quality, the less audit evidence may be required. While the appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance and reliability in providing support for the audit findings.
- The reliability of audit evidence that is generated internally is increased when the related concerns, including those over its preparation and maintenance imposed by the entity, are effective. Likewise the reliability of the audit evidence is increased when it is obtained from independent sources outside the entity and it has been validated.
- Materiality relates to the degree of audit evidence required to obtain a certain level of confidence that the information is reliable and not misstated.

### 2.2 Types of Audit Evidence

- Overreliance on any one form of evidence may impact on the validity of the findings. The IAS should gather a wide variety of evidence for purposes of using multiple forms of diverse and corroborating (including alternative evidences) types of evidence. This is to check the validity and reliability of the findings, to wit:

#### A. Physical evidence

- This is obtained by direct observation (i.e., physical verification of cash, site visits to projects and verification of inventory).
- This type of evidence can be obtained from the following sources: observation of processes and procedures; site visits to gain personal knowledge of the practicality



and the physical state of work as they are at a point in time; and physical verification of assets, etc. Said evidence may require proof of another evidence thus, documentary or photographic evidence can support the physical evidence.

B. Testimonial evidence

- This is obtained from others through oral or written statements in response to inquiries or through interviews with interested parties. It can be documented in the form of interview notes, recorded conversations, or corroborated evidence or testimonies from other people that have knowledge of the issue at hand.

C. Documentary evidence

- This consists of files, reports, manuals, and instructions. This is the most commonly used source of evidence (i.e., manuals, files, reports, instructions, contracts, invoices, and vouchers).
- This evidence may be obtained through solicitation or elicitation. Independent external (third party confirmation) evidence may be more reliable than internally provided evidence. Evidence obtained by the auditor directly (third party confirmation direct to/from auditor) is more reliable than internally provided evidence. Documentary evidence is more reliable than oral representations. Internal evidence is more reliable when related internal controls are satisfactory.

D. Analytical evidence

- This is built-up by analyzing the information obtained from other resources. The most common is the cost-benefit analysis. This type of evidence may not be easily available in a ready-made format. Most of this evidence is developed by the auditor.

E. Electronic evidence

- This type of evidence may include: hardware and network diagrams; operating systems software; network and communications software; journal and activity logs; application programs; and flow diagrams. Collecting such evidences requires careful planning and execution, preferably by experts.
- This evidence may be challenged on the basis of unreliability. Such challenges may be encountered if it can be shown that controls are in place. Thus, the auditor should exercise due care to document such controls if electronic evidence is going to be used.

### **2.3 Audit Approaches and Techniques in Gathering Audit Evidence**

- In selecting audit techniques to be used, the IAS should first determine what needs to be done and what pieces of evidence to obtain. There are a number of audit approaches and techniques that can be adopted in gathering audit evidence. These include interviews, document reviews, sampling, testing of controls, policy study,



review of management information, review of processes, and output-input evaluation.

- Some common approaches are detailed as follows:

#### A. Inquiries and Interviews

- This is basically a question and answer session to elicit specific information. The entire spectrum of inquiries is used, from fact-finding conversations and discussions, through unstructured interviews, to structured interviews that follow a list of closed questions:

1. Preparatory interviews;
2. Interviews to collect or validate material information; and
3. Interviews to generate and assess facts and pieces of evidence.

- Inquiry is a way of gathering facts and information and gaining support for a variety of arguments, but one cannot rely solely on interviews.
- The results of the interviews must be compiled and documented in a way that facilitates analysis and reliability of information.

#### B. Sampling

- This is a scientific method of selecting the transactions to be subjected to audit. It promotes efficiency and economy in the audit process. Sampling allows the auditor to test less than 100% of the population to form audit findings. The assumption is that the sample selected is representative of the population.

#### C. Computer-Assisted Audit Techniques and Tools

- Computer-Assisted Audit Techniques and Tools (CAATTs) are computer tools and techniques in performing various auditing procedures and improving the effectiveness and efficiency of obtaining and evaluating audit evidence.

### **3. Root Cause Analysis**

#### **3.1 Root Cause Analysis Techniques**

##### A. Root Cause Analysis (RCA)

- This is a method that is used to address a deficiency to determine the “root cause” of the problem. It is used to correct or eliminate the cause and prevent the problem from recurring.
- The basic steps in conducting the RCA relating to non-compliance of management controls are:
  1. Establishing the scope and objectives of RCA;



2. Gathering data and evidence relating to the non-compliance;
  3. Performing a structured analysis to determine the root cause; and
  4. Developing solutions and making recommendations.
- There are various RCA techniques that can be used, as follows: (1) 5 Whys Technique – inquiries/confirmations; (2) Failure mode and Effects Analysis; (3) Fault Tree Analysis; (4) Fishbone or Ishikawa Diagrams – Cause and Effect Analysis; and (5) Pareto Analysis – Statistics Analysis.

#### **4. Perform Substantive Tests on the Samples**

Performing substantive tests on the samples selected is a comprehensive analysis by using ratios, analytical procedures, inquiries, confirmation, and other tools and techniques. It is the execution of the audit procedures enumerated in the audit work program on samples selected. The procedures seek to provide evidence as to the various control attributes/features established during the planning stage of the audit, e.g., existence, occurrence, completeness, validity, adequacy, efficiency, effectiveness, economy, etc. Where necessary and possible, this process fully quantifies the audit elements such as criteria, cause, and conditions, which include the effects or consequences, of transactions covered in audit.

#### **5. Use of Work of Other Experts**

When there is a need to make use of other experts' work to corroborate or substantiate the facts/evidence gathered by the internal auditors, they remain responsible for its use. Experts are those who have acquired special knowledge, skill, experience or training in a particular field other than auditing. The auditor may use the work of an expert as evidence but the auditor retains full responsibility for the contents of the audit report.

The steps the auditor should take are:

- a. Obtain information on the qualifications, competence or specialization of the experts and the context of their assignment, e.g., in certifying an opinion on a Registered Civil Engineer, Land Appraiser, Real Estate Broker or a BOA-accredited Certified Public Accountant with profound expertise;
- b. Consider the nature, complexity and materiality of the matter, assumptions used, and corroborative evidence available;
- c. Consider the objectivity of the expert; and
- d. Advise the expert on what the work is being used for and the purpose.

#### **6. Integration and Preparation of Highlights of Audit Findings**

In the preparation of audit findings, the conditions, conclusions and the causes must be supported by sufficient audit evidence. The quantum of evidence required to support an audit finding is substantial evidence. Such substantial evidence would lead to the determination/finding of a probable cause or a prima facie case and would draw a reasonable conclusion that more likely than not, a non-compliance or failure of



control/supervision was established, and that an offense may have been committed.

- a. "Substantial Evidence is more than a mere scintilla of evidence. It means such relevant evidence as a reasonable mind might accept as adequate to support a conclusion, even if other minds equally reasonable might conceivably opine otherwise."
- b. A finding of a probable cause for non-compliance needs only to rest on evidence showing that more likely than not the act/s or omission/s of the person responsible had caused the non-compliance with laws, regulations and managerial policies and operating procedures in the agency, including compliance with accountability measures, ethical standards and contractual obligations, which may warrant the conduct of administrative proceeding by the disciplining authority. It must be noted that to come up with the determination of probable cause/s, the IAS must be able to establish, not only the facts and circumstances, but also the why's, the what's and the how's of the non-compliance.
- c. "Prima facie requires a degree or quantum of proof greater than probable cause. It denotes evidence, which, if unexplained or contradicted, is sufficient to sustain a prosecution or establish the facts as to counterbalance the presumption of innocence and warrant conviction." The audit findings supported by substantial evidence are deemed admitted by the auditee if not controverted by any evidence to overcome the same. In this case, the burden of proof now lies with the auditee. "Burden of proof is the duty of a party to present such amount of evidence on the facts in issue as the law deems necessary for the establishment of his claim."