

ARE YOUR AUDITING SKILLS UP TO PAR

Welcome to the 21st Century! Technology, including business technology, is advancing at an unprecedented rate. The average family car has an electronic control and monitoring system with more computing power than the Apollo spacecraft that landed on the moon. Your kid's XYZ-WE box for video games would put building size computers of the 1960's to shame. And the standard for business transaction recording is online, real time, point-of-sale, and precise perpetual inventory control with GPS enabled micro-chips.

And that use of and reliance on technology has seamlessly transferred itself right over to our auditing practices...right? Right?

A few years back, most of the regionals and a few of the next tier firms switched to the paperless environment. Larger local firms are now venturing forth as well. Firms are seeing savings in their audit time in the second year. The feel-good part of the move was you were updating your technology! Sure we've traded in our 13-column green-bar paper and our red pencils for spreadsheet software. But, only the storage box changed, the approach to the audit didn't. Unless you are with a national CPA firm or some regional firm with an exceedingly high concentration of computer geeks, you're probably not using the advanced computer technology at your disposal to perform any actual auditing. Furthermore, what's required by professional literature is a need to change the way we audit and not just the form of work paper we store it in.

Look at your clients. Your average client has also embraced technological advancement. Their transaction volume has increased with their growth while our ability to understand how that transactional data is processed, bifurcated, allocated, prorated, authenticated, and recorded has become more obscured.

And let's face it. We all want to continue to audit "around the box." We audit what goes into and comes out of the magical black box. We take for granted that if it comes out of the computer, "it must be right." Everything must foot. Everything must be correctly posted. We have been doing the audit for years so we assume controls are adequate to assure that no garbage, errors, or irregularities found their way into the omnipotent computerized black box.

So, our clients have become more sophisticated, their IT departments have grown; yet as our clients moved from the old green-bar paper reporting to today's paperless system, we didn't adapt. We didn't change our methodology and yet we have the tools to adapt available to us. What you need to do TODAY is find out about – CAATT (Computer Assisted Audit Tools and Techniques) software. Today's CPA firm is not using the tools that would permit a more effective and efficient audit and that's problematic for the profession. With our emphasis on A&A, technical pronouncements, interpretations, and staff bulletins, somewhere we forgot the basics of HOW TO AUDIT. Remember the old days when there were hand-posted ledgers or records neatly printed out on "Green Bar"? Auditors would scan ledgers and journals, foot and cross foot on a test basis, trace postings from subsidiary journals to the general ledger. We acquired a knack of spotting

exceptions and items that stuck out. You can't do that any more. How do you scan a disk? How do you audit a paperless environment?

Even control testing consisted of looking at stamps on a voucher package, three sets of initials meant someone tested the mechanical calculations, someone verified it was ordered and received, and someone approved payment. All done, controls working! Move on. What happened? Client controls over financial reporting became highly computerized, transaction volume increased, the computer reports, when available, were probably not "friendly" enough to do the scans for unusual items, the complexity of systems obscured posting sources, and because of sheer volume mathematic accuracy is taken for granted. All this has contributed to the expectation gap between the profession and users of the financial statements with respect to errors, irregularities, and fraud. Today information technology plays such a large part in procedures and controls, how can we possibly perform an efficient and effective GAAS audit without using computer assisted auditing tools.

Professional Guidance weighs in on the use of CAATTs:

SAS 106 recommends use of CAATTs

- Paragraph 10 - in some situations the auditor may determine that additional audit procedures are needed. For example, these additional procedures may include using computer-assisted audit tools and techniques (CAATTs) to check the accuracy of the summarization of the file.
- Paragraph 38 – Recalculation can be performed through the use of information technology; for example, by obtaining an electronic file from the entity and using CAATTs to check the accuracy of the summarization of the file.
- Paragraph 39 – Re-performance is the auditor's independent execution of procedures or controls that were originally performed as part of the entity's internal control, either manually or through the use of CAATTs – for example, re-performing the aging of accounts receivable.
- Paragraph 41 – Scanning includes searching for large or unusual items in the accounting records (ex: nonstandard journal entries), as well as in transaction data (ex: suspense accounts, adjusting journal entries) for indications of misstatements that have occurred.

AICPA's Report, "Information Technology Considerations in a Risk-Based Audit"

- The new standards recognize the pervasive nature of IT in financial processes and that IT increasingly represents both a primary source of financial control risk and financial controls. Understanding the impact of IT on inherent risk and control risk can lead to a more effective and efficient audit plan.

Data analysis and mining software can assist auditors in almost every facet of the audit engagement.

In Preliminary Analytical Review, data analysis and statistical analysis can assist in developing expectations, and data mining queries can assist in assessing management explanations.

CAATTs can assist immensely in audit requirements under SAS 99 “Consideration of Fraud in a Financial Statement Audit” and the older SAS 54 “Illegal Acts by Clients”. SAS 99 requires the auditor to design testing to detect material misstatements caused by error or fraud. We have too often relied upon analytical procedures or the preliminary meetings and discussions that invariably lead to the question – “So Mr./Ms. Controller, are you aware of any fraud?” “Heavens no!” So there is no fraud in the Company unless it is stumbled upon. We’ll know it when we see it won’t work in today’s electronic environment. Too many are relying upon “analytical analysis” instead of looking at the detail. How do you catch the controller who has consistently committed fraud and actually budgets in the extra expenditures?

Data analysis can assist in the identification of unusual ledger postings as well as potential management overrides through journal entries. It can point out transactions at unusual times, by non-regular personnel, split transactions/multiple transactions just under approval thresholds or other curious circumstances; and, most importantly, it can sort data and transactions in such a way to make anomalies stick out, (just like the old days).

Requirements contained in the eight “Risk Based Suite” pronouncements SAS 104 to 111, require auditors to assess the risk of material misstatement. This risk based approach is difficult and the authors would contend impossible to achieve in many of today’s complex electronic environments without the use of CAATTs software as CAATTs can assist the auditor in identifying abnormalities.

Another source weighing in is the documentation required by SAS 103, where a CAATTs memo will document the specific files and specific parameters selected. Here you can pretty well document that your criteria encompassed the universe of items and not just items selected by “a larger item on every 17th page”.

OK, so everyone wants to see some practical applications. Here are some of the practical applications we have used at QRG, LLP. We have used CAATTs in both DOS and Windows based environments, for both custom and off the shelf applications. Some up-front time is needed in the first year (remember the difficulty of the move to paperless in that first year!) but the confidence in your approach and savings in auditing time with experience with the software and your particular client’s system result in savings in following years exams. We have our CAATTs specialist make selections prior to starting the field work allowing the audit team to start right in on testing. Further, certain required testing such as footing, selection of material items, are ready to go. CAATTs can be used in all of the business cycles; sales and collection, acquisition and payment, payroll and personnel, inventory, and capital acquisition and repayment. It can do testing

judgmentally or statistically. Before you go and think it does everything consider what it doesn't do:

- Replace audit judgment
- Decide the materiality or level of testing
- Perform the task of inspection
- Determine assertions to test
- Determine criteria for testing

What it can do: keep in mind it is a data based mining tool. It can array by set parameters such as size, select based upon criteria, apply statistical sampling, provide judgment sampling (based upon your inputted parameters). It can foot and identify missing items among others... get the idea? Most selection and mechanical functions done in the audit can be done using CAATTs.

Our applications have been straightforward thus far. Foot the general ledger, select larger entries, select receivables for confirmation, select items for sales testing, compare disbursements to approved vendor lists, look for duplicate address in payroll master and vendor files, look for missing checks, select all disbursements (non payroll) over materiality, and inventory price testing among others. We find it particularly helpful in compliance testing for A-133 engagements.

There are new tools coming on line each day. One we are starting to work with does more than analyze just client computer records, it compares client data against outside source data such as bank statements. Now were starting to get somewhere!

You may have heard about CAATTs but figured it was for the larger national firm or you had to have a client with sales greater than \$100 million. Think again, the sophistication of our client environments and the professional literature both demand you consider this tool for you.

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