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Theory and Practice

Combining the Efforts of Internal and Independent Auditors

Using EDP to Maximize Audit Resources

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By Charles M. Boughton

Increasing pressure to expand the scope of annual audit coverage and yet include overall audit fees makes the issue of cooperative auditing of timely importance. This article attempts to review this issue and to examine an area of cooperation between internal and independent auditors that has yet to be explored: joint utilization of client computer resources.

A Review of the Issues

Ward and Robertson [1980] and Clark [1981a and 1981b] discussed what elements must be present in an internal audit department in order for CPA firms to rely on this department's work and remain in compliance with SAS No. 8. In a 1984 article in *Harvard Business Review*, Wallace points out the cost savings a client can enjoy from cooperative audit efforts.

In recent years, attention has become focused on the cost and coverage of annual audits. Company management is greatly concerned about adequate audit coverage and cost containment. Wallace [1984] indicates that the internal billing rate for internal auditors was approximately \$18 compared with \$25, \$35, or more for the independent auditor's junior staff. The comparison is justifiable given that the junior staff does the work on the audit — sampling, compilations, file footing, and workpaper preparation — that the internal auditors could supply.

Wallace suggests that there are five areas in which the internal audit department can assist their external counterparts. These include organizational support, review assistance, technical assistance, footnote preparation, and general assistance.

Bridges [1986] adds three more ideas to the areas in which internal and independent auditors could serve complementary functions. Those areas indicated by Bridges for potential cooperation are benefit plans, inventory, and acquisitions.

Internal Audit Involvement

To some extent, internal auditing has undergone recent changes as a result of the Foreign Corrupt Practices Act. These changes, along with an increased emphasis on professional certification, professional development, and advances in the techniques of operational auditing, have lent credibility to the internal audit function.

The Certified Internal Auditors (CIA) program has caused many companies to recruit internal auditors directly from college into entry level staff positions. For the junior-level internal auditors, as well as for internal auditors recruited from within the company, participation in the annual audit broadens their view of the organization as a whole; it also exposes them to the financial auditing techniques that contrast with the operational auditing emphasis of many internal audit departments.

This exposure should serve to both "round-out" the junior or new auditor and broaden his or her perspective of the organization's overall operations.

As a word of caution, many internal auditors may feel that the work transferred to them by the independent auditor — file footing, workpaper preparation and photocopying documents — is "busy work" or work customarily performed by the independent auditor's junior staff members. Thus, the independent auditor should consider the type of work delegated to internal audit and broaden the scope of the work when possible.

Cooperative Auditing and Client Computer Resources

It seems that the main selling point of cooperative auditing from the perspective of the independent auditor is the efficiency gained through access to client computer resources. This access may also indirectly provide independent auditors with a measure of "job security" by more fully integrating them into the ongoing business. This integration can be achieved without the loss of independence necessary to the independent auditor.

Cooperative auditing can be extended to client computer resources in several areas. First, much of the work done by the junior CPA staff could be prepared by the internal audit staff. The information could be extracted from the client's corporate database or corporate applications data sets with the assistance of a generalized audit software package. Second, micro-computers and electronic spreadsheet packages such as VISI-CALC or LOTUS 1-2-3 could be utilized to prepare working papers that would support and eventually lead to the preparation of the corporate financial statements. Finally, the internal auditor could assist in the introduction and application of text processing in the preparation of audit workpapers and reports.

Most internal auditors recognize the advantages of using a generalized audit software package for internal audits; the auditor can independently review computerized files, prepare workpapers, foot files, and select samples, etc. What may not be apparent to most auditors is that this very same generalized audit soft-

ware package could be of tremendous use in preparing and performing the annual independent audit as well. The same statistical sampling methodologies useful to the internal auditor can be used by the independent auditor. This is also true when the independent auditor performs such tasks as file familiarization, file footing, exception analysis, summary analysis, account agings, or file matching, i.e., checking for duplicated names, addresses, etc. Generalized audit software seems to be an area of great potential for maximizing corporate audit resources through internal and independent auditor cooperation.

Audit Software Packages and Spreadsheets

Some of the advantages of generalized audit software include the availability of statistical sampling methodologies for use by both internal auditors and independent auditors. These software packages are often transportable. This is a plus for a decentralized or multi-facility firm. Most generalized audit software packages have security procedures that prevent accidental or unauthorized modification (such as modification by the auditor) of data files being audited. Many generalized audit software packages are backed up by the vendor's personnel. And many larger metropolitan areas have user groups formed by professionals who use these packages within their own firms.

Electronic spreadsheet programs have gained wide acceptance for audit use in the past few years. Packages such as Visi-Calc, Lotus 1-2-3 and Multi-Plan have proven their worth, reliability, and adaptability for audit use. Figure 1 presents a list of tasks to which electronic spreadsheets have been applied.

Figure 1: Ways to use electronic spreadsheets in auditing:

- Maintaining time budgets
- Working or audit trial balances
- Consolidations
- Tax provision calculations
- Financial statement analysis
- Depreciation schedules
- Staff schedules
- Present value computations
- Lease computations
- Confirmations
- Partnership income schedules
- LIFO computations

- EPS computations
- Loan amortizations
- Statements of changes in financial position
- Trend analysis
- Debt allowances

Source: Golden & Golden

Internal Audit Activities Throughout the Year

Perhaps the greatest potential benefit to the company being audited exists because internal audits are performed throughout the year. Communication to the independent auditor about the areas scheduled for internal audit allows the independent auditor to have input regarding perceived control weaknesses. Internal audit could upgrade internal controls in these areas to a point where compliance testing can replace the much more expensive substantive tests that might otherwise be prescribed. Thus, the internal audit staff can greatly reduce the total cost the client will incur for the annual audit.

Top Management Support

If the internal staff is to be successfully integrated into the annual audit process, there exists a definite need for top management support of the process and communication of this support to the external auditors. The process of communication and coordination between internal audit management and independent auditors must include advance communication of internal audit programs, communication of the integrity, reliability and professionalism of the internal audit staff, and communication of client management's support of cooperation between the independent and internal auditors.

To make cooperative auditing work and to reduce annual audit costs, independent auditors must commit to cooperative auditing; they must coordinate the annual review, work cooperatively with internal auditors, and use the workpapers prepared internally as part of the annual review.

A by-product of this cooperative effort is effective follow-up on management letter comments. The internal audit department is an excellent group to monitor the various operating departments affected by open points in the management letter. With the internal audit depart-

ment's becoming responsible for the review and evaluation of internal controls, this department becomes the most logical place in the organization for coordination and follow-up on such open points. Since the management letter normally points out control deficiencies in accounting and operating departments, follow-up and corrective action taken by those departments can be overseen by the internal audit department.

The Bottom Line

An effective, competent internal audit staff coordinating with the independent auditor on the annual audit also produces an intangible benefit. The independent auditor will be able to perform more of the cost-effective compliance audit tests rather than the expensive and time-consuming ones of a substantive nature. Ω

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