Audit Report with Memos

Name

Instructor

Course

Date

**Audit Report with Memos**

**Draft of Procedures**

**How the Audit Process is Conducted**

There are various processes involved in conducting an audit. They include initial audit planning, seeking external expertise, identifying and testing control activities, reviewing and communication of results, and preparing the audit report. The first process in conducting the audit process is the initial audit planning. It involves preliminary planning and gathering of information. The auditor determines the audit objectives and the scope of the audit. The auditor reviews the results of the last audit and the area in which the past audit was conducted. Before conducting the audit, the auditor should determine whether the audit is approved as part of the internal audit plan (Xiao, Geng, & Yuan, 2020). The auditor should also consider how the audit plan supports the organization’s goals and objectives. In case of Amazon, the company has an objective of being the everything store (McGurl, 2016). Therefore, the audit process should identify weaknesses and vulnerabilities in the organization’s internal systems and controls. The auditor should also determine the enterprise risks addressed by the audit plan. Lastly, the auditor should review the results of previous audits and determine whether there have been significant changes in the auditing process.

The second process when conducting audit reviews is seeking external expertise. It is necessary to seek external expertise due to constant changes in the business landscape. According to Xiao, Geng, and Yuan (2020), auditors should consult subject matter experts to evaluate the design of the auditing process. Subject matter experts can be sourced from other auditing firms or they can be independent consultants. The auditor may also undertake research by examining recent journals published by auditing periodicals. The auditor meets with the organization’s management to establish the scope of the audit and the timing of the whole process. Once the internal and external resources have been leveraged, the auditor builds an audit plan based on industry best practices.

The next step involves identifying and testing control activities. The auditor gathers pertinent information and performs the audit tests to gain understanding into the internal controls implemented by the organization. The auditor collects information involving policies and procedure documents, key applications used in the auditing process, and master data for the processes being audited. The auditor examines documents and other records of evidence to establish whether effective internal controls are in place. Auditors also perform the testing of the transactions to determine compliance with the company’s internal policies and relevant external regulations. Thereafter, auditors review the controls implemented to ensure that the system complies with data integrity and completeness (Xiao, Geng, & Yuan, 2020). The auditor may also request for additional information if needed. When conducting auditing work, various risks are classified as low, moderate, or high. The risk assessment is necessary to determine whether the controls are effective, and if corrective actions are needed to mitigate the risks.

After the testing of the control activities has been performed, the next phase involves the review and communication of the results. Areas of concern identified during the auditing process are communicated to the management. The auditor presents information concerning violations in policy or procedure and/or control weaknesses. The auditor discusses the observation with the management to ensure the management fully understands the issues identified during the auditing process. the auditor may provide recommendations on how the management may rectify the identified issues or risks. Recommendations are discussed and agreed upon by the auditor and the management to ensure that they are relevant and reasonable (Xiao, Geng, & Yuan, 2020). Once the results of the audit are confirmed, they are communicated to in the audit report.

The final phase in the auditing process is the preparation of the audit report. The management reviews the audit issues and recommendations and prepares an audit plan based on the results of the audit. The audit report should include process risks, process objectives, controls mitigating the process risks, and testing procedures. For procedures that have not been audited before, they should be subjected to multiple levels of review before being finalized (Xiao, Geng, & Yuan, 2020). The audit report should be conveyed in form of written documents and charts to enhance understanding.

**Procedures needed to Review High-Risk Business Transactions for Cash and Revenue**

Revenue is a significant account exposed to numerous risks. Therefore, the auditor needs to have adequate understanding of the organization’s processes, gather appropriate evidence, test controls over revenue, and evaluate potential misstatements. The auditor must gather information on the types of revenue earned by the organization and determine whether the organization has applied appropriate accounting principles for revenue recognition (Cody, 2017). At Amazon, the revenue-related activity that is high-risk is a large number of homogenous products sold to different customers, which increases the likelihood of fraud and uncertainty. Internal auditors also need to review the organization’s cashflow information. Requirements needed to perform high-risk business transactions include previous financial information, current financial information, receipts of all cash transactions, and receipts of all revenue. The auditor makes comparisons between actual receipts and the amount recorded in the financial statements (Louwers et al., 2018). The auditor should place more focus on reviewing cash and revenue amounts contrary to the management’s projections. Cash and revenue transactions are evaluated to ensure that they are fairly stated.

**Test to Assess appropriate assertions for High-risk Business Transactions**

A test of controls would be appropriate to determine whether the organization has put appropriate measures in place to assess whether high-risk financial transactions information is reliable. The test of controls includes an assessment of Amazon’s high-risk transactions. The auditor would collect information pertaining to Amazon’s cash and revenue transactions for the current financial year. According to Ulrich and Blouch (2018), the test of controls includes a 5-step process. The first step involves observation, where auditors would observe the cash and revenue transactions to make sure that the transactions exist, and that the right procedures and policies were applied. Thereafter, the auditors would perform inspection, which includes a review of documents and financial information and making comparisons to the revenue and cash transactions included in the financial statements. The third step is reperformance, where auditors reperform the controls performed by customers. Auditors then recalculate the financial transactions and do a confirmation test where they test whether the cash or revenue accounts exist.

**Draft of Risk Factors**

**Analysis of Income Statement for Risk Factors**

Performing analytical procedures is necessary to establish unusual or unexpected relationships that may indicate misstatement s due to fraud. As a result, a comparison of sales volume with expenses was performed to establish the accuracy of the financial information. An increase in sales volume goes hand in hand with an increase in expenses. Similarly, Amazon’s sales increased from $232,887 in 2018 to $280,522 in 2019. Similarly, operating expenses increased from $220,466 to $265,981 during the same period (Sec.gov, 2019, p. 38). It is also necessary to evaluate certain classes of classifications that have high levels of inherent risk as they are susceptible to manipulation by the management. The report provided by the public accounting firm indicated that auditors were unable to calculate the net profit for orders on consumer products for certain individuals located in Iran. The entities purchasing the products are covered by the Iran Threat Reduction and Syria Human Rights Act. (Sec.gov, 2019, p. 72). Therefore, auditors were unable to determine whether the financial information provided by the management was accurate.

**Analysis of Balance Sheet for Risk Factors**

The analysis of the balance sheet demonstrates inherent risk, particularly in the determination of the value of certain assets. Items are said to have a high level of judgment risk if they rely on estimates made by the management’s judgment (Simon, Smith, & Zimbelman, 2018). The management of Amazon has the discretion to determine the fair value of financial instruments. The management describes fair value as the price at which an asset would be sold, or a liability transferred between market participants at the measurement date. The management identifies three techniques used to determine the fair value. One of the techniques is the valuation based on quoted prices for similar prices in active markets. The second method is the valuation based on observable inputs other than quoted prices. The third method, which is under contention, is the valuation based on unobservable inputs. The valuation method is based on the assumption of the management as well as the assumption made by other market participants. As a result, it is hard to determine the value of the assets whose value is determined by the management’s assumption (Sec.gov, 2019, p.45). Nonetheless, there is no significant variation between 2019 and 2018 results.

**Analysis of Cash and Revenue for Potential Risk Factors**

Cash and revenue require considerable judgment to record the account balances and transactions correctly. An analysis of Amazon’s cash and revenues does not showcase any potential risk factors. According to Murdock (2016), the four processes to evaluate the company’s cash and revenues include existence, completeness, accuracy, and valuation. Amazon’s cash and revenues exist, are compete, are accurate, and are valued fairly. Amazon uses software to track billings, which minimizes manual input and enhances the accuracy of the financial statements. However, cash and revenue information are consistent with the company’s performance in the previous year.

**How the Audit Population was Identified**

The population was identified using the stratified random selection method. According to Kocevska and Dimitrova (2018), the rule of thumb in determining the population for the audit sample is selecting 10% of the population. Amazon has numerous items, and as a result, it would not have been possible to examine the entire population. The sampling technique included categorizing the entire population into subgroups and performing a random selection from each of the subgroups. Similarly, when performing the audit, transactions were randomly selected from each of the financial statements for review. The sample population under examination was representative of the entire population.

**Sampling Program for the Population**

Systematic sampling is a technique that involves the use of a rational technique to pick a sample from a population. The systematic sampling method ensured a higher likelihood of the sample being a representative of the general population (Abidin, 2017). The method involves starting sampling from a particular point and selecting items after a certain interval. For instance, when the organization has numerous invoices needed to be audited, every tenth invoice should be selected. Invoices should be selected after getting to the 10, 20th, 30th, 40th invoice, and so on.

**Audit Testing Procedure**

The most preferable audit testing procedure that could be used to test the sampled items is test of controls. The technique includes a 5-step process. The first step involves observation, where auditors observe the cash and revenue transactions to make sure that the transactions exist, and that the right procedures and policies were applied when making the transactions. The second step involves performing inspection, which includes a review of the actual documents and financial information. The results from the review are compared with the revenue and cash transactions recorded in the financial statements. The third step is reperformance, where auditors reperform the controls performed by customers. For instance, the aging of the accounts receivables would be reperformed to determine if the process would provide similar results as those indicated in the financial records. Auditors then recalculate the financial transactions to determine if they tally with the values indicated on the financial records (Ulrich & Blouch, 2018).

**Draft of Memos**

MEMORANDUM

From: The Chief Financial Officer

From: Internal Auditor

Date: 16 November 2020

Subject: Summary of the Audit Process

Conducting an audit provides information on the organization’s effectiveness in providing reliable information to stakeholders. Amazon is an international organization whose financial transactions are relied on by investors, customers, suppliers, regulators, and communities all over the world. Therefore, conducting an internal audit is aligned with the company’s objective to provide accurate and reliable transactions.

The auditing process is a five-phase exercise that includes initial audit planning, seeking external expertise, identifying and testing control activities, reviewing and communication of results, and preparing the audit report. Auditors evaluate the reliability of the organization’s financial statements to provide accurate and complete financial information. However, it is not possible to audit all the financial transactions in the financial records. Therefore, systematic sampling is applied to pick a sample population. The population is consequently tested, and the results represent the entire financial records.

To mitigate potential risk factors for major business transactions, it is important to change the technique used to determine the fair value of items. Currently, the valuation of unobservable inputs depends on the management’s opinion. Such a valuation method is subjective and undermines the accuracy and reliability of financial statements. The management should also improve internal control mechanisms to ensure that all revenues are accounted for. The analysis of the 2019 financial statements revealed that it was challenging to determine revenue earned from a number of sales. The management should implement measures to ensure the availability of financial information associated with the sales, costs, and revenues for all items.

MEMORANDUM

To: The Board of Directors

From: The Chief Financial Officer

Date: 16 November 2020

The auditing process provides crucial information concerning the organization’s ability to provide accurate, complete, and reliable information. Part of my duty as a CFO is ensuring that measures are put in place to enhance the accuracy of information. Recently, the internal auditor conducted an audit that evaluated the organization’s effectiveness in implementing measures to provide accurate and complete information.

The audit established that Amazon has put in place necessary measures to ensure the collection of accurate and complete information in all areas of its supply chain. However, the report highlighted two areas that limit the organization’s attainment of 100% accurate and complete information. One of the shortcomings identified by the auditor is the valuation method used by the organization. The fair value valuation depends on the discretion of the management. The valuation method is subjective and may not be reliable. Another shortcoming identified in the audit is inefficiency in internal control methods to assign revenues to all items. Auditors were unable to calculate the net profit for orders on consumer products for certain individuals located in Iran. The inability to calculate net profits for all items undermines the collection of complete financial information and sheds doubt on the reliability of the financial information.

To enhance accuracy and reliability, external experts should be included in the fair value determination. The external experts would enhance the objectivity of the valuation process. The company should hire expert valuers and consultants when determining the fair value of unobservable inputs. Secondly, Amazon should implement internal processes that capture the net profits for all items, including those that are shipped out to areas such as Iran. The company should review the laws and regulations in different countries and ensure its shipping policies comply with the regulations.

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