

This book is about commercial and government audit principles.

What Makes a Good Audit?

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What Makes A Good Audit

For auditors, auditees and all others interested in auditing

Dennis AuBuchon

What Makes a Good Audit
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Chapter 1

Good Audit Principles and Characteristics

Good audit principles and characteristics are important in the audit process if it is ever to have reliable results. To begin an audit is defined as an examination of an organization or individual's account to check their accuracy. Audits must be methodically performed by examining and reviewing the requirements and the actions being performed against them. Audits are essential not only for the individual or company, they are essential to protect those who have a vested interest in the operations. This can be from buying stock or actually having a contract to manufacture a product.

Audits amount to an examination of procedures, processes, system requirements and contractual requirements. In examining the elements noted in the previous sentence records must be reviewed and verified against requirements. This is essential to determine whether a company is in compliance to any requirements in place.

The terms identified in the preceding paragraphs will be discussed individually in the subsequent paragraphs of this chapter. This discussion will be in relation to the audit process as some terms may be applicable in other situations. Each of the terms has various meanings and their impact is dependent upon the type of audit being conducted. Below are paragraphs identifying and discussing these characteristics.

Examination

The term examination is defined as the act of examining something closely (as for mistakes). We are all familiar with the term physical examination. When applied to the audit process however the term examination takes on a different perspective. Performing an examination in the audit process involves the analysis of data to determine the compliance or noncompliance to established requirements. These

requirements can be identified in contracts signed between a company and a customer. This aspect requires the creation of procedures and instructions if not already in existence to ensure the applicable contractual requirements are in place and being applied.

It is also important that when procedures are created or revised that the content be reviewed to assure contractual requirements have not been changed or eliminated. This is why it is an important aspect of conducting an audit. It is also important to note that in reviewing procedures there should be some correlation between the procedure and what initiated the requirements. Traceability is the key in this aspect as there needs to be some connection between contractual requirements and the procedures/instructions that implement them.

Connecting requirements from contracts to procedures, planning and work instructions are not hard tasks to accomplish. Sometimes the connection may involve specific instructions tied directly to a customer and their unique requirements. Other times it is a matter of connecting general requirements which are common to multiple customers. In this respect the reference can be a simple statement.

There are times where contractual agreements use terms and language that do not clearly state the required actions for verification of compliance. Terms such as reasonable effort, payment on acceptance, and good faith are open to interpretation by either party. What may be considered reasonable effort by one may not meet the expectation of the other party to the contract. The term payment on acceptance can also present problems in determining what constitutes acceptance. Acceptance can sometimes be receiving the material or actually signing a statement on the paperwork that the product has been accepted. This term needs to be defined between the parties to prevent confusion and conflict. The last term good faith is also open to interpretation and can cause confusion. What constitutes good faith must or should be defined between the parties to

eliminate conflict with respect to the efforts made by a company to contractual requirements. Though requirements such as those above may be vague they are in effect contractual requirements.

Another aspect involves the term physical examination. Physical examination in reference to the audit process involves a physical examination of any facility, product or service. Examination of a facility may involve such things as verification of compliance to environmental or safety requirements. Another example of the term examination involves a physical examination of products to confirm compliance to drawing and/or contractual requirements.

Examination in the true sense can involve both a physical examination of a product, examination of a procedure or examination of a facility. Physical inspection of products involves taking measurements and comparing the results to process requirements, drawing requirements or requirements identified in contracts. Physical inspection of a facility involves assessing the safety and environmental aspects involved and compliance to laws in place from all levels. In this aspect it is important to know the applicable laws in place for the location where the audit is to be conducted. These can be local, state or federal.

Review

The term review is defined as an act of evaluating the content of an operation, document or anything that involves information/data. This term has some commonality to the term examination and involves some of the same characteristics. Review can be considered an examination dependent upon what is being accomplished. Reviewing contractual terms in a contract amounts to identifying the requirements. An examination of the terms would involve a detailed analysis of the requirements in relation to the system in place to implement them.

Contractual documents must be reviewed to determine if we want to accept the conditions identified. In any business

it is important when contracts are initiated by two or more parties that they completely understand the details and know what is expected. Vague terms such as those identified above should be clarified so there is no difference in interpretation. This makes it a more viable contract and also creates a condition in verifying compliance.

Auditing a process or operation amounts to a review of what is being accomplished and comparing the actions to the requirements. Reviewing a process involves witnessing the operation as it is being conducted and examining and/or comparing the actions to contract or process requirements. In terms of auditing a specific process it is important to know upfront the basic requirements for processes involved to establish the audit requirements. This is the only way a true and reliable analysis can be made for determining compliance or noncompliance. This can sometimes be accomplished prior to an audit being conducted if it is external and a process is common among manufacturers. One example is welding. Basic requirements exist for this process and usually established acceptance procedures are also in existence. In terms of internal audits these should be readily available for auditors assigned to conduct audits of specific processes.

At this point it is important to identify what constitutes an internal audit. It is an audit by a company on themselves. This can be an established process from the management level or it can be a self-audit at a department or process level. The key point is it is not an audit conducted by outside individuals or organizations.

The main difference in the concept of internal audits and external audits is where and who is conducting them. In terms of a prime contractor (those who have suppliers) they are audits performed at the location of one of their suppliers. In terms of a prime contractor it is an audit performed by an outside entity not connected with the company. These audits are conducted to do two things. The first is to verify the system has identified all the contractual and applicable process requirements. The second is to verify or validate

that what they say they are doing is actually how the operations are being accomplished.

The purpose of audits identified in the preceding paragraph is the basic philosophy of audits. Many times those performing the work are more knowledgeable about an operation than those who write the procedures or instructions. Those who perform an operation must be heard in terms of identifying the system requirements to assure there are no requirements that do not agree with the capability of the process. Sometimes processes have limitations or specific requirements such as certification. Certification can involve both performing the process and validating the results as compliant to applicable requirements. These requirements must be validated through reviewing documentation and assuring it is from a reputable source for the certification.

Records

Records in the auditing process are critical and it is important that they be understood as to what constitutes a record. A record is to set down for preservation in writing or other permanent form the details of actions having been completed or decisions that have been made. Records can be on paper, in a spreadsheet or an Internet file. Anything that is documenting an action or a statement of fact as with meetings is considered a record. Another example is a recording of a conversation between individuals. The recorded information is a record of what has been said. This kind of record can and has been used in court cases to provide documentation of statements made between the parties involved. Records are critical in the audit process as they are the key documentation to support the facts and conclusions of an audit. If no records exist of decisions made it is a deficiency. Records should identify what has been done, when it was done, who has done them and who was involved in the action. The details required are a matter

of contractual or procedural language. The key is traceability.

Procedures

Procedures are those documents which define and explain the management philosophy through a structured process. This information is usually divided into segments of an organization such as inspection, auditing, work instructions, manufacturing instructions and how they are all approved and kept current. Sometimes, and it is becoming more prevalent, these aspects are depicted through flow charts to support the written word. It is sometimes hard for people to understand the flow of a process without a picture.

A flowchart can be part of a procedure or a supporting document placed in areas where work is performed. The flow chart can help to project processes so individuals performing them can better understand rather than resorting to the written word. It must be understood that a flowchart is not a procedure but the picture of a process of how specific operations or procedures work. A flow chart also helps to present to those involved with an operation or process where they fit in the overall sequence in completing a product or process.

A flowchart is a great tool that companies use to depict their operations or portions of them to help their employees better understand the requirements. They should always agree with the written procedures that the flowchart is documenting. The principle to be applied in preparing for an audit is comparing the flowchart with the procedures affected by it. The main principle is making sure the written documents flow together and do not disagree. Documents within a system must agree with each other if there is an interrelationship. .

There are several principles that should be a part of any audit that takes place regardless whether it is internal or external. Internal audits for those unfamiliar as mentioned before are those conducted by a company on itself. These

are usually conducted as part of the management philosophy in making sure they are in compliance with their contractual and/or procedural requirements. The basis for an audit is left up to management. Some internal audits are required as part of contractual commitments and are sometimes audited by customers.

Again to explain what constitutes an external audit the following information is presented. External audits are those performed by prime contractors (those who have subcontractors or contributors of products and/or processes to the end product). The word external means that the audits are performed away from the primary company or being performed at a prime company from an outside source. External audits are also what are typically called a third party audit. These audits are sometimes performed by customers either on the prime contractor or one of their suppliers. These are conducted to bring confidence in what is being made to their established requirements. These audits are also sometimes performed as a result of problems with products being shipped to various customer locations.

As previously mentioned there are several principles which must or should be a part of any audit. These principles are: honesty, accuracy, reliability, and completeness. The subsequent paragraphs will discuss these principles.

Honesty

The first principle is an important one, honesty. Honesty is important in any aspect of our daily lives but it is critically important in the audit process. Honesty must exist in the audit process from beginning to end or the results and the documentation to support them will be questioned. Without honesty in the audit process bad decisions can be made which can have far reaching effect. The honesty of audits conducted depends in large part upon the honesty of the person (s) doing it. This is not to say that those being audited have no responsibility to be honest in their answers.

Auditors must make sure that all applicable information is properly evaluated and that the data is not altered. Altering of data can amount to leaving something out which affects the conclusion (s) being made. It can also involve drawing a conclusion that is not supported by the facts.

Sometimes audits that are scheduled or generated may have pre-conceived conclusions. This sometimes occurs based on the data available in relation to the purpose for some audits. When the reason for an audit is the result of product deficiencies pre-conceived conclusions may be made based on the discrepancy. Discrepancies can point to a specific operation that has an impact on the deficiency. What must be realized is that other factors can play a part before the product reaches the operation suspected of being the cause.

Audits can be a matter of procedure or contractual requirements and may not have problems to analyze. An auditor should never have pre-conceived ideas about an entity to be audited. While this may be hard for some individuals it is something that must be in place. Pre-conceived ideas sometimes occur or exist based upon data which is the result but not the cause. Honest effort must be taken to be open in discovering the true cause of any problems which may surface in the manufacturing of a product. Sometimes there are multiple causes each with a relationship to the outcome.

Data collected is another area that auditors must be careful. While information relative to an organization or a product may suggest specific areas to be audited it should not rule out other areas. This is where the honesty factor comes into play. An auditor or audit team must have an open mind to collect all the data available to determine the problem related to a deficiency. Honesty by an auditor, an audit team and the organization or person being audited is critical to the completion of a quality audit. .

Organizations get audited and do audits all the time. Audits sometimes bring back memories of bad experiences but those experiences sometimes are the result in how they

were conducted or how the questions were answered. Organizations or departments being audited must truthfully answer questions and only respond to what the auditor is asking. It is up to the auditors to ask the right questions, this includes follow-up questions to obtain clarification on responses. An auditor and an audit team must be honest in attempting to obtain complete and accurate data to substantiate the results of an audit.

Conducting an audit involves analyzing data and asking questions relative to the data before drawing conclusions. The data will determine compliance or noncompliance. When an entity being audited is not truthful in their responses it is a matter which lacks integrity. Integrity in any organization is important in society today and if an organization lacks integrity it will be discovered and have repercussions to their reputation and their profits.

Accuracy

Accuracy is another important quality of a good audit. All records and information must be accurate. Records may be accurate for their content but if they do not contain all applicable information then they are incomplete and unreliable. As previously stated bad decisions can be made on bad data. An auditor must put themselves in the position of an employee of an organization or department being audit. The auditor must ask themselves if they would be comfortable with the data and conclusions made if it affected you as an individual. Data that is inaccurate or incomplete may affect the stability and security of the audited organization and may in fact affect the employment numbers,

In terms of accuracy it is also important that the information not misrepresent the facts which can occur if information is missing, misquoted or is presented in a way that paints a different picture than the data suggest. If all applicable facts are not presented as part of audit conclusions there is a misconception about the true status of a company

and its operations. A company should want an accurate picture of their operations so they can become more efficient and profitable. This is accomplished by making sure all the applicable requirements are enforced and completed as required.

Reliability

In relation to the characteristic of accuracy data that is accurate can be considered reliable. Reliability is a factor upon which companies must base decisions. Reliable sources of information or documentation means the data or source can be trusted. If a source or data cannot be trusted decisions should not be made. Basically it means that the information should be verified to be accurate. Audits and the documentation from them should be in the position to be trusted. Without this reliability the information is not worth the paper it is printed on or any method in which it is documented.

Completeness

Completeness in the audit process is a characteristic which means that documentation of the facts is complete. Many times there is so much information on an issue or area that it may be difficult to determine when enough information is enough. The key question to be asked when considering this characteristic is whether there is anything being omitted that could impact decisions to be made. Providing information relative to both sides of an issue provide the option of analyzing the data and drawing a conclusion. Another point to consider is whether all information you as an auditor would consider necessary in making a decision is being provided.

Part of the audit process also involves various conditions and actions which must be in place. The aspects discussed and presented in the subsequent paragraphs are an integral part of the audit process.

Qualifications

Another good audit principle involves the qualifications of individuals conducting an audit. Some may say that formal training is necessary to conduct an audit while others learn by doing under the watchful eye of an experienced auditor. There are situations where formal training is necessary not only to perform an audit but to be recognized as having the qualifications to conduct specific ones. A person who has basic audit training can conduct most audits. This does not imply that anyone can do an audit that has no background or experience in auditing principles.

The process of auditing involves a variety of situations to which auditors must be able to recognize and work through. Some audits are specific as to detailed requirements and those performing them must have the knowledge and understanding of them before they can be properly evaluated. Reading requirements involves more than just reading. The content of the requirements must be understood to make a comparison of the operations to the requirements. This involves specialized training in some cases and may even involve certification requirements. There are many organizations which offer training for specific areas and specialties. One of these is the American Society for Quality located in Milwaukee, Wisconsin.

Another good point to make involving qualifications is that individuals who perform specific duties have the basic knowledge of what needs to be done and how things can be masked or hidden from the eyes of auditors. Those who have the experience for certain topics or functions can better understand the process involved and what to look for. This combined with some auditing techniques provide valuable resources in conducting specific audits. One example would be the process of welding. Having the knowledge of welding either through actually performing weld operations helps those auditing this process to recognize when problems exist.

Training

Examples of areas which require training and/or experience before being qualified for an audit are financial or special processes. These areas involve complex requirements and those who perform audits of them must be qualified in the subject. One option to help with qualifications may be that you have held a position which involves these commodities. Having knowledge of how these areas operate can help an auditor better understand the requirements and compare them to what is being accomplished. This is necessary for any findings to have reliability. In cases where a qualified auditor is not available, a qualified individual must be available to answer questions regarding specific issues. This may not be acceptable in all cases and should be used sparingly. Any auditor and the team must be able to understand the information involved, capable to do a review and draw conclusions based on the evidence.

System audits are those that examine a company system to determine if it complies with any contractual requirements. It also encompasses an evaluation of how well the system in place agrees with how the operations are performed. It is important for any auditor who performs this type of audit that they understand what a system audit is and how the system to be audited has been generated. Each company has their own system they have put in place and each has their differences. Auditors must understand the purpose of the system to properly evaluate it. The methods necessary to conduct an analysis or audit of the system must be understood to accomplish the task. This involves the ability to ask the right questions, to research the applicable aspects of the system and to make decisions based on complete and accurate information.

Training and/or experience in management philosophy is a plus for those performing management evaluations as part of a system audit. Understanding the connection between

management and floor operations is the key to addressing the interrelationship between them.

The management of a company or organization also plays an important roll in any system generated as it should be one which can be easily understood. It is important not only for those performing audits from outside entities to understand the system but also those within the company. A well designed system adds to the quality and reliability of a good audit. The impact of a well designed system adds credibility to the company or organization and provides a good impression of the company.

Corrective Action

The principle of corrective action involves the process of taking action to address issues that surface as a result of an audit. Making the right decision involves identifying the cause of issues and taking steps to either reduce or eliminate the impact of the problem on the product being manufactured.

Corrective action is the responsibility of the department or company being audited not the auditor to make suggestions. Companies must take responsibility for corrective action to resolve discrepancies identified during an audit. The only exception to making recommendations is when you are performing a review as a consultant. Consultants perform reviews and give recommendations to improve a system to make it better. This is what they are getting paid for. An auditor or auditor team must remain impartial. Making suggestions for corrections leaves the auditor and the organization conducting it open to absorb the cost if the recommended correction does not solve the problem.

Being prepared to do a proper audit involves the need to identify needed resources associated with the requirements. Auditor qualifications must meet or exceed the need to audit specific operations with specific requirements. If an auditor does not have the needed qualifications then the availability

of applicable expertise should be in place. Preparation is not something that can be ignored. It is another critical aspect of an audit which affects the performance and completion. More details of this aspect will be covered in a later chapter.

Findings

Another important audit principle is valid and authoritative interpretation of vague requirements. Without this findings against vague requirements can be refuted by the organization being audited. A finding is a valid deficiency against requirements and observations do not represent a violation. If a recognized interpretation of vague requirements is available prior to an audit it is important to obtain it in writing. Having a recognized interpretation of vague requirements is important when findings are generated and there is disagreement. The availability of recognized interpretations helps to diffuse disagreements. This helps to evaluate the performance parameters for the organization or individual being audited. Trying to interpret vague requirements during an audit will only add potential for disagreement. This is why it is important to identify these areas prior to an audit being conducted. Everyone has their interpretation as to the requirements of vague language.

Observations

Contents of audit findings should be kept confidential and only authorized persons or organizations should have access to details of the audit. These organizations should be identified at the beginning of the audit so there is no misunderstanding of who has access to the results. The organization conducting the audit and the organization audited are the primary sources for the information in the final report. If there is any other entities which it is felt needs the information it should be coordinated with the group conducting the audit and the organization audited.

Final Report

The results of audits and all their details must be documented in the final report. References can be made to additional documents but the basic content of what was reviewed and the results must be included. The basic information to be included will be discussed in a later chapter. However examples of information include the time period for the audit, the audit team, scope of the audit, personnel contacted and the results/conclusions. Without proper documentation the results of any audit will be subject to question if future problems arise for conditions not identified in the audit.

Staying on Schedule

Another good audit principle is to stay on schedule and only change if conditions warrant such action. Sometimes a nonconformance in an area requires more time be allotted. This may be needed to adequately address critical or major issues identified. The schedule should be then modified to address the situation. If an audit does not stay on schedule it may be impacted by not completing the assigned responsibilities. Auditors must stay focused to use their time wisely and complete their assigned tasks. An auditor must stay focused on their assigned responsibilities to assure a proper evaluation and review is conducted. If time is spent that is not focused on the aspects of the audit, the audit itself will be subject to criticism.

Cooperation

The last audit principle that must be in place is an auditor should not be combative to any auditee. This hampers the cooperation needed in performing the audit. There must be a working relationship between the auditor and the auditee so it can be completed properly with no restrictions as to information or personnel needed to review requirements.

The concepts identified above will be discussed in further detail in subsequent chapters of this book.

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