

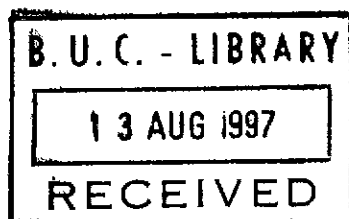
LEBANESE AMERICAN UNIVERSITY

**COMPARATIVE STUDY BETWEEN
EXTERNAL AUDITORS & INTERNAL
AUDITORS**

By

John Fouad Wanna

June, 1997



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COMPARATIVE STUDY BETWEEN
EXTERNAL AUDITORS & INTERNAL
AUDITORS

A RESEARCH TOPIC
PRESENTED TO BUSINESS SCHOOL
LEBANESE AMERICAN UNIVERSITY

IN PARTIAL FULFILLMENT
OF THE REQUIREMENT FOR THE DEGREE
MASTER OF SCIENCE IN BUSINESS MANAGEMENT

BY
JOHN WANNA

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APPROVAL OF RESEARCH TOPIC

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**TITLE OF RESEARCH TOPIC: COMPARATIVE STUDY
BETWEEN EXTERNAL
AUDITORS & INTERNAL
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**THE FOLLOWING PROFESSORS NOMINATED TO
SERVE AS THE ADVISORS OF THE ABOVE
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Abstract

The purpose of this research is to find if there is a difference between external and internal auditors, and if they are properly performing their duties in Lebanon.

The paper is organised as follows:

Chapter I defines auditing, its types, and the structure of each type. It presents the historical background of auditing. It also gives an idea about the certificates that auditors may hold and the associations they belong to.

Chapter II describes the responsibilities, objectives, and functions of both external and internal auditors.

Chapter III deals with the different phases of performing an audit task that includes planning, scope of work, performance of work, communicating results, follow up, and evaluation of work. It also explains the relationship between external and internal auditors.

Chapter IV highlights the methodology used in conducting the research.

Chapter V presents the results of the questionnaires and of the interviews.

Chapter VI states the conclusion and offers recommendations that might help overcoming the problems identified in the previous chapter.

Chapter I

Auditing: Development, Definition, and Types

I. 1. Development:

There is historical proof that auditing as a profession, was conducted in ancient times.

With the development of professions and the specialization of tasks, progress has been made in auditing.

I. 2. Purpose:

There are four conditions that create the demand for auditing:

- A) Conflict between managers and owners, managers and creditors, or managers and other third-party groups can result in biased information.
- B) Information can have substantial economic consequences to a decision maker. For example the total debt, or uncollectible loans may affect the riskiness of the organization.
- C) Expertise is often required for information preparation and verification. For example, the preparation of income statement and balance sheet should follow certain standards.

D) Users are frequently prevented from directly assessing the quality of information.

I. 3. Definition:

Auditing is broadly defined as a systematic process of objectively obtaining and evaluating evidence regarding assertions about certain actions and events to ascertain the degree of correspondence between these assertions and established criteria and communicating the results to interested users. It is a continuous, full-time, independent activity. (Taylor & Glezen, 1994, p.2)

I. 4. Types:

Auditing can be classified into many forms or types according to the objective of function performed, or to the affiliation of individuals or groups that perform the audit.

<i>By Objective</i>	<i>By Individuals</i>
Financial Statement Audit	External Auditors
Operational Audit	Internal Auditors
Compliance Audit	Governmental Auditors

I. 4-1

According to the objective of audit performed, there are three types:

1. Financial Statement Audit: It is the process of gathering evidence of financial statement assertions of an entity and using such evidence to ascertain adherence of the assertions to GAAP and giving an opinion on them. As well, it includes analysis of economic activity of an entity as measured and reported by accounting methods. (Taylor & Glezen, 1994, p.3)
2. Operational Audit: It is a systematic comprehensive review of unit activities, systems and controls within an enterprise, in relation to specific objectives for the purpose of assessing performance, identifying opportunities for improvement, and developing recommendations to reach economy, efficiency, and effectiveness in the use of resources. Operational audit includes: (Taylor & Glezen, 1994, p.3)
 - a. Functional Audit: It is an audit that follows a process from beginning to end, crossing organizational lines. It tends to concentrate more on operations and process to determine the effectiveness of interface and co-operation.
 - b. Organizational Audit: It is concerned not only with the activities performed within an organization, but also with administrative controls used to make sure they will be carried out.
3. Compliance Audit: It is the review of both financial and operating controls and transactions to determine how well they conform with established standards.

Also, it is adapted to find whether a person or an entity has adhered to laws and regulations. (Taylor & Glezen, 1994, p.3)

I. 4-2

According to the individuals who perform the audit, there are three kinds:

1. External auditors: They are public accountants, not employees of the organization being audited, offering services on contractual basis. Among these services, an examination of the financial statements to reach an opinion of their fairness in conformity with GAAP. (Taylor & Glezen, 1994, p.5)
2. Internal auditors: They are employees of the organization whose activities they appraise. They usually have opportunities to see many aspects of the company very quickly, get broad exposure to management, and apply a wide variety of accounting, auditing, and personal skills. (Taylor & Glezen, 1994, p.5)
3. Governmental auditors: They are members of local and governmental units who audit various organizational functions to determine whether taxes have been collected and calculated correctly. (Taylor & Glezen, 1994, p.5)

I. 5. Structure:

External auditors may practice Auditing with Certified Public Accounting (CPA) firms that take the

form of sole proprietorships such as Yafi Bros., partnerships such as Sidani & Co., or corporations such as Horwath Abou Chakra. These are independent companies who offer full range of services such as performing financial statement audits, maintaining accounting records, preparing tax returns, and consulting of management information. These services are done for other non-related companies.

Internal auditors, on the other hand, are organized in a department within an organization. The importance of the internal audit function increases as organisations grow larger and more geographically disbursed. The establishment and support of an internal audit department should be stated within the company's policy statement. It conducts an independent appraisal function to examine and evaluate the company's activities as a service to management and board of directors (B.O.D.).

Internal auditors are independent concerning the reporting line within the organization. They have neither the authority nor the responsibility to set objectives, goals, or standards for operating people.

I. 6. Certificates and Associations:

I. 6-1 Certificates:

I. 6-1-1

Certified Public Accountants (CPA's) are individuals who have been licensed by various states in U.S.A. to provide accounting services. (Arens & Loebbecke, 1991, p.51)

In order to hold the CPA degree, certain requirements should be met. These are:

- 1- An education requirement, as a college degree with equivalent of an accounting major. Some U.S. states require an equivalent of a masters degree.
- 2- An experience requirement. The type and length of experience required depend on the U.S. state's requirement.
- 3- A testing requirement. A CPA holder must have passed a written examination that tests his ability in several accounting areas.

A uniform examination is prepared and graded by the American Institute of Certified Public Accountants (AICPA), and the results are furnished to the respective U.S. states. The test is administered twice a year, in May and November in U.S.A. It lasts two days and covers the following four points:

1. Auditing

2. Accounting and reporting
3. Law
4. Financial reporting

However, in Lebanon a Certified Auditor (CA) degree is granted from the Lebanese Association of Certified Public Accountants (LACPA). The requirements for holding such a degree are:

- 1- An education requirement, as college degree.
- 2- A three years experience requirement, preferably in an audit firm.
- 3- A testing requirement. A CA holder must have passed a written examination that tests his ability in several accounting areas.

The exam is prepared and graded by the LACPA. It is administered once a year. The date of the exam is set by the LACPA. The subjects covered by the exam are:

1. Accounting
2. Auditing
3. Law
4. Taxation

I. 6-1-2

Certified Internal Auditors (CIA's) are individuals who have been licensed by the Institute of Internal Auditors (IIA) to perform operational audit. ^{(Sawyer, 1988,}

p.44)

In order to hold the CIA degree, certain requirements should be met. These are:

- 1- Actual audit experience of at least two years.
- 2- An advanced academic degree.
- 3- A testing requirement. The CIA holder must have passed a written examination that tests his ability in several subjects.

The exam is administered in the U.S.A. and other countries in May and November of each year. The IIA prepares and grades the examination and gives successful applicants "CIA" designation. The test lasts two days and covers the following four parts:

1. Theory of Internal Auditing
2. Practice of Internal Auditing
3. Management, quantitative methods, and information systems
4. Accounting, finance, and economics

In Lebanon there is no degrees granted to internal auditors yet.

I. 6-2 Associations:

I. 6-2-1

CPA holders may be members of the American Institute of Certified Public Accountants (AICPA). This institute is one of the most influential accounting organizations in U.S.A.. It sets:

- 1- The Code of Professional Conduct (including Code of Ethics)
- 2- Generally Accepted Audit Standards (GAAS) and Procedures

In Lebanon, CA holders may be members of the Lebanese Association of Certified Public Accountants (LACPA). It has been formed in August 1st, 1995. Till now it did not set any standards.

I. 6-2-2

CIA holders may be members in the Institute of Internal Auditors (IAA). This institute is a professional association that disseminates information about internal auditing. It sets:

- 1- Code of Ethics
- 2- Statement of Responsibilities of Internal Auditors
- 3- Standards for the Professional Practice of Internal Auditors

Internal auditors do not have till now any association in Lebanon. However a group of internal auditors is working seriously to establish an association for them.

Chapter II

Objectives, Responsibilities, and Functions

II. 1. Responsibilities:

Concerning external auditors, the Lebanese Laws do not require the auditor to ensure or guarantee the infallibility of audit or audit opinion. However, they do require that an audit be performed with due care, with the same degree of skill, judgement, and knowledge possessed by other auditors. So external auditors are penalized if they failed, intentionally or through gross negligence, to obligations defined in the Lebanese Laws. Their liability is towards clients and injured third-parties. Sanctions may bar them from practicing the profession, either temporarily or permanently. Therefore, the auditor should design the audit to provide reasonable assurance for detecting material errors, irregularities, illegal acts, and fraudulent financial reporting.

The statement of responsibilities of internal auditing holds that internal auditing is a control that functions by measuring and evaluating the effectiveness of other controls. It added, internal auditors are to have no authority for the activities they audit.

Usually, the board of directors sets the statement of responsibilities for the internal audit department. Such statement holds him responsible for: ^(Sawyer, 1988, p.756)

- 1) Establishing policies for auditing activity and directing its technical and administrative functions.
- 2) Developing and executing a comprehensive audit program for the evaluation of management controls provided over all company activities.
- 3) Examining the effectiveness of all levels of management in their stewardship of company resources and their compliance with established policies and procedures.
- 4) Recommending improvement of management controls designed to safeguard company resources, promote company growth, and ensure compliance with government laws and regulations.
- 5) Reviewing procedures and records for their adequacy to accomplish intended objectives, and appraising policies and plans relating to the activity or function under audit review.
- 6) Authorizing the publication of reports on the results of audit examinations.
- 7) Appraising the adequacy of the action taken by operating management to correct reported deficient conditions and accepting adequate corrective action.

Other characteristics required by auditors are:

A) Independence, integrity, objectivity, and honesty.

Independence should be in fact (mental attitude) and in appearance (the image projected to the public) so that work will be carried out freely and objectively.

As for internal auditors, independence can be strengthened by the following:

- 1) The director should have direct and unrestricted access to the B.O.D.
- 2) Independence should be formally stated in the charter.
- 3) Independence is enhanced when the B.O.D. concurs in the appointment or removal of the director of the internal audit department.
- 4) Internal auditors should not hold any operational responsibilities.

Objectivity emphasises the importance of being free of conflicts of interest and not knowingly misrepresenting facts or subordinating judgements to others.

B) Loyalty and prudence in the use of information acquired in the course of their duties.

C) Exercise competency and due professional care in performing audits.

II. 2. Objectives:

The external auditors' objective as set by The American Institute of Certified Public Accountants

(AICPA) is mainly to express an opinion on the fairness with which financial statements have been prepared such as: ^(Thomas & Henke, 1983, p.38)

1. Ownership of assets and liabilities
2. Completeness of financial statements
3. Proper presentation of amounts in financial statements
4. Necessary disclosures required by GAAP.

The internal auditors' objective as set by The Institute of Internal Auditors (IIA) is: ^(Sawyer, 1988, p.16)

1. Examining and evaluating the adequacy and effectiveness of the organisation's system of internal control
2. Examining and evaluating the quality of performance in carrying out assigned responsibilities.

II. 3. Functions:

Usually, external auditors perform financial statement auditing, whereas internal auditors perform operational and compliance auditing. But neither one is bounded to only one type.

The main professional services performed by external auditors are: ^(Arens & Loebbecke, 1991, p.12)

A) Attestation services: It means rendering an opinion on the fairness of representations by management, the financial position, and results of operations.

- B) Review services: It means reviewing financial statements, making inquiries, and performing analytical procedures to express limited assurance that the statements present what they purport to present.
- C) Tax services: It means preparing tax returns and advising management on the tax consequence of various alternative courses of action and tax planning.
- D) Accounting services: It ranges from maintaining accounting records to performing compilations, as preparing financial statements.
- E) Management services: It means advising management on controls, design, and installation of systems and programs. It also can provide cost analysis on new products, and financing alternatives. The external auditor can also be consulted in the establishment of budgeting procedures, variances from budget, proposed mergers, pension plans, stock, and option plans.

A new service offered by external auditors nowadays is the Electronic Data Processing (EDP) Audit. The standards for EDP auditing are in the process of development. However they will cover the design and development of new data processing systems, their modification, general controls, and application controls.

The internal auditors' work includes the following: ^(Sawyer, 1988, p.1151)

- A) Reviewing the means of safeguarding assets and verifying the existence of such assets.
- B) Reviewing the integrity and reliability of financial and operating information and the means used to identify, measure, classify, and report such information.
- C) Appraising the economy and efficiency with which resources are employed.
- D) Reviewing established systems to ensure compliance with those policies, plans, procedures, laws, and regulations which could have a significant impact on operations and reports, and determine whether the organization is in compliance with them.
- E) Reviewing operations or programs to ascertain whether results are consistent with established objectives and goals, and whether operations or programs are being carried out as planned.
- F) Management studies: This can be performing special assignments, making evaluations, or offering recommendations for improving areas of business.

Few internal auditors in Lebanon are playing the role of management control, where they set certain procedures and enforce certain circulars or decisions trying to eliminate the weaknesses realized.

It should be clear that auditing can not be considered a guarantee of the exactness or accuracy of the work done. This is due to the following:

- 1) Many audit conclusions are made on the basis of examining a sample evidence.
- 2) Reliance on management representations in some matters.
- 3) Human weakness, that can cause auditors to draw wrong conclusions.

Chapter III

Phases of Performing an Audit

For any auditor to be able to perform an audit assignment, certain fieldwork standards should be met, as:

- 1) The work is to be adequately planned.
- 2) A sufficient understanding of the internal control structure is to be obtained.
- 3) Information should be collected, analyzed, interpreted, and documented.
- 4) Results should be communicated through issuing a report.
- 5) The audit work should be evaluated.

III. 1. Planning phase:

The planning phase for external auditors differs from that of the internal auditors as follows:

<i>External Auditors</i>	<i>Internal Auditors</i>
Evaluate and accept client.	Establish plans consistent to the company's charter and goals.
Obtain background information by assessing inherent risk, relying on internal control structure, and establishing materiality borders of certain accounts.	Obtain background information by preparing preliminary surveys, assessing inherent risk, and establishing materiality borders of activities to be audited.
Develop an audit strategy.	Management sets the policy statement for internal audit department.
Prepare audit program.	Prepare audit program.
Schedule the audit work.	Obtain approval for the audit work plan.

III. 1-1

The planning phase for external auditors should start by evaluating and accepting client, as to size, reputation, and kind of audit requested. Then an engagement letter is prepared and signed by both parties. It is necessary to mention that if a successor

auditor did exist, the predecessor auditor should communicate with him about certain audit issues. However, the Lebanese Laws do not require the successor auditor to communicate with the predecessor. So auditors can be changed in Lebanon simply according to client's satisfactions.

As to the internal auditors, they should directly establish plans consistent to the company's charter and goals.

III. 1-2

The next step is obtaining background information about the accounts or activities to be audited.

For external auditors, they should:

- 1) Assess inherent risk for the accounts to be tested.
- 2) Estimate the reliance they may place on the internal control structure.
- 3) Establish materiality borders in the total financial statements and for individual accounts. (Materiality means the magnitude of an omission or misstatement of an important information).
- 4) Identify potential problem areas in the financial statements where errors may exist.
- 5) Perform certain analytical procedures for unusual transactions.

The internal auditors, on the other hand, obtain background information by:

- 1) Preparing a preliminary survey in order to obtain necessary information. Also questionnaire may be distributed.
- 2) Assess risk to determine areas of special emphasis.
- 3) Determine the resources necessary to perform the audit.
- 4) Communicate with all who need to know about the audit.

III. 1-3

The third step for external auditors is developing an audit strategy. This strategy identifies primary risk areas and considers matters indicating:

- 1) Unreliable accounting estimates.
- 2) Management predisposition to distort financial statements.
- 3) Constant crisis in accounting areas.
- 4) Lack of controls or inadequate security of data or assets.

The internal auditors here do not set an audit strategy. It is clear that top management sets the policy statement for the internal audit department.

III. 1-4

After that, the external auditors prepare the audit program.

The same thing applies here for internal auditors. They now design the program that usually varies from audit to audit and from location to location due to changing of operations and circumstances in case of operational audits.

III. 1-5

The last step in the planning phase is for external auditors scheduling the audit work.

As for internal auditors, they should obtain approval of the audit work plan.

It is necessary to state here that internal auditors review the activities continually, where as external auditors review records periodically. Usually external auditors review the accounts of the last year, where as internal auditors review the current operations as well as the previous ones.

III. 2. Examining and evaluating information:

At the end of the first phase, auditors by now should have determined the scope of their work. Now the audit team is assigned and it sets the procedures to be followed. It's clear that no standard list of audit procedures can be used on each audit, because the

nature of accounts, their risk, and materiality varies. The steps under this phase apply to both internal and external auditors while performing their work.

III. 2-1

The evidence gathered should be sufficient, competent, reliable, relevant, and useful. The evidence may be physical, testimonial, documentary, or analytical. The auditors rely mainly on factual, adequate, and persuasive evidence. But the auditors should take into consideration, the cost of obtaining their evidence.

III. 2-2

For cost / benefit considerations, sampling techniques are employed. Auditors should first define their population, decide on the sample size, and decide on the method of selecting the sample. However, they must consider the risks that may result from choosing the sample, using the incorrect audit procedure, misapplying an audit procedure, misinterpreting an audit result, or that sample results will not be representative.

III. 2-3

Certain techniques for examining and evaluating the information may apply. These include mainly observation, verification, analysis, calculation, inspection, investigation, questioning, and evaluating. (Taylor & Glezen, 1994, p.480)

Proper observation: as watching and noticing the performance of some function, is very difficult and depends on experience since it implies a careful knowledgeable look and evaluative sighting at people and things.

Verification: is a means of confirming the accuracy or validity of something.

Analysis: implies a detailed examination to reach an audit judgement in determining the relationship between individual parts.

Calculation: auditors recompute certain account balances to check its correctness.

Inspection: means examining documents relating to transactions or balances.

Investigation: applies an inquiring aimed at uncovering hidden facts.

Questioning: requires interviewers to be skilled in dealing and communicating with people in order to obtain information.

Evaluation: means weighing what has been analyzed and determining its adequacy, efficiency, and effectiveness in order to reach conclusions.

III. 2-4

All the work done by auditors should be recorded on working papers to support their understanding, evaluation, and tests performed. Auditors agree on certain tic-marks and indexing to be used. The working papers must document the procedures and tests performed, work audited, extent of tests applied, period covered, and information obtained. Working papers may be in different forms of paper, tapes, disks, diskettes, or films. They should be reviewed by supervisors. Then working papers for each audit project are kept in *Current Audit Files* that contain in addition to that, evidence gathered, conclusions reached, memoranda of audit performed, audit program, audit problems, kind of audit, year audited, and other data.

Also there should be a *Permanent Audit File* that includes mainly historical information, procedures, controls, operations, and contracts of the audited company, and audit plans, programs, and procedures performed.

III. 3. Communicating results:

If the auditors find deficiencies during the course of audit review, these reportable conditions should be communicated orally as soon as they are found. Auditors should report the results of their audit work by issuing a signed written report. In order to eliminate any misunderstanding or misinterpretations, auditors discuss conclusions and recommendations with auditees. Then a clear, concise, constructive, and timely report is issued. The report should inform, persuade, and get results. This usually applies for both external and internal auditors.

III. 3-1

As for external auditors, the summary report is addressed to the Board of Directors (B.O.D.) and stockholders. As for the banking sector in Lebanon, extra copies are sent to Central Bank of Lebanon and to The Banking Control Commission. The report usually consists of: ^(Thomas & Henke, 1983, p.317)

A) Opening paragraph: It states the period and the financial statements that were audited. It clarifies the point that the financial statements are responsibility of the company's management, and the auditors' responsibility is expressing an opinion on them based on their audit.

- B) Scope paragraph: It states that Generally Accepted Auditing Standards (GAAS) were followed during the audit. It also describes the nature of the procedures employed and that they were employed to obtain reasonable assurance if the financial statements are free from material misstatement. The paragraph ends with a statement that the auditor believes that his audit provides a reasonable basis for his opinion.
- C) Opinion paragraph: The auditors start with: "In our opinion", then the auditors opinion on the financial statements and continues: "the financial position of X Company as of the audited period, and results of its operations and its cash flows for the year then ended in conformity with GAAP".

The internal auditors report format and content may vary by organisation or type of audit. It is addressed to the head of the audited unit, and a summary report to the audit committee or to higher management levels as executive vice president, chairman of the board, or general manager. Reporting strengthens the internal auditors' independence if they directly communicate with powerful individuals in the company who can interfere in management operations. But it usually contains the following: ^(Sawyer, 1988, p.629)

- A) Purpose statement that should describe audit objectives, present background information, and may

when necessary inform the reader why the audit was conducted and what it was expected to achieve.

B) Scope statement should identify the audit activities and include, where appropriate, supportive information such as period audited. The nature and extent of audit performed also should be described. Related activities not audited may be identified if necessary.

C) Results of the audit may include summary of audit findings, conclusions, opinions, and recommendations. It also may include auditee accomplishments in terms of improvements since the last audit.

III. 3-2

The opinion expressed in reports varies between external and internal auditors.

The external auditors' opinion can be classified as follows: ^(Arens & Loebbecke, 1991, p.528)

A) Unqualified opinion: It means that the financial statements are fairly presented, in all material respects, and in conformity with GAAP.

B) Qualified opinion: It states that except for the effects of the matter to which qualification relates, the financial statements are fairly presented, in all material respect, and in conformity with GAAP.

Reasons for qualification may be :

1. A material departure from GAAP.
 2. Informative disclosures in financial statements have not been made.
 3. Certain circumstances prevent the auditor from performing all necessary audit procedures.
- C) Adverse opinion: Where the report states: “Because of a very material departure from GAAP, the auditor’s opinion is that the financial statements are not fairly presented in conformity with GAAP”.
- D) Disclaimer opinion: where the auditor doesn’t express an opinion on the financial statements due to:
1. Unavoidable circumstances and client’s imposed restrictions on evidence that prevent him from gathering all necessary evidence.
 2. Uncertainty having serious potential impact on financial statements.

However, the internal auditors’ opinion varies from that of the external auditors’. It ranges between excellent, satisfactory, fair, poor, and unsatisfactory, depending on the seriousness of the deficiency findings. ^(Sawyer, 1988, p.731)

- A) Excellent opinion: It is given when the activities are operating well, and no deficiencies are found. An example of it may be as follows:

“Based on the results of our review, we believe that an adequate system of control has been established over the activities of the purchasing department and that the department’s assigned responsibilities were being carried out effectively and efficiently”.

- B) Satisfactory opinion: It states that except for some minor matters, they’re doing a reasonably good job. An example of it:

“In our opinion, the activities concerned with the layoff and recall of employees were controlled and, except for inadequate explanations for monetary settlements of grievances, were performed effectively and efficiently.”

- C) Unsatisfactory opinion: It is given when the management is doing poor job, because it failed to accomplish major missions of the activity. An example of it:

“In our opinion, the system designed to ensure the timely calibration of test equipment was inadequate because no provision had been made to identify all of the equipment subject to calibration.”

III. 3-3 Follow up:

This is done to ascertain that appropriate corrective action is taken on reported findings.

For internal auditors, the follow-up activity is part of the audit process. However, if their suggestions for taking a corrective action are not implemented, their responsibility is normally discharged. In Lebanon, many internal auditors, instead of performing follow up review, are directly involved in implementing the recommendations suggested.

The follow-up step for external auditors also is considered a part of the audit process, where points raised in the current mission are watched in the next audit assignment. However if certain significant matters are found, the follow-up activity takes place after giving the client a time limit to correct them.

III. 4. Evaluation of work:

The auditors' work should be evaluated at the end.

Concerning internal auditors, a quality assurance program should be established and maintained. The purpose of this program is to find if the audit work conforms to the objectives, policies, procedures, and standards. This program includes supervision of work, internal reviews, and external reviews. This is usually applied in U.S.A.

As for external auditors, there is a self-regulatory practice. This practice is having CPA firms visiting other CPA firms periodically, interviewing the supervisors, and reviewing their working papers. This also applies in U.S.A.

III. 5. Relationship between external and internal auditors:

Although external and internal auditors pursue different objectives, owe a different accountability, possess different qualifications, and engage in different activities, they still have mutual interests which call for co-ordination of their talents for the benefit of the enterprise. Such co-ordination is important because it increases the economy, efficiency, and effectiveness of the total audit activity.

For such co-ordination to be a success, both groups should:

- 1- Be able to demonstrate to each other that they are able to meet certain criteria of professional qualifications, of objectivity, independence, and professional competence.
- 2- Accept each other's work, and the perceptions of each other's needs.
- 3- Complement each other. The work of either group cannot be subordinated for the work of the other.

By relying on internal auditors, the value to external auditors can be pointed out in the following:

- a- A source of general information about the nature of the organization and how to help resolve audit queries.
- b- A guide to the nature of existing control systems, especially those systems which have been recently introduced or amended.
- c- They are allowed to concentrate on more significant areas to rotate audit emphasis.
- d- Client relations are improved because of a feeling of involvement through cooperation of effort.

By relying on external auditors, the value to internal auditors can be pointed out in the following:

- a- Interchange of new and different audit techniques, procedures, ideas, and information.
- b- Identification of risk areas within the organization, identification of procedures for accomplishing that work, and indication of the risk assessment methods used.
- c- Comment and guidance on content and scope of internal controls.
- d- The external auditor's appraisal on the effectiveness of internal audit functions can be helpful.

The benefits that can be observed from such co-ordination are:

- 1- Identifying more cost-effective methods to reduce duplication in total audit coverage.
- 2- Each group's audit results are made available to the other group, on time and as needed.
- 3- Both audit staffs could be viewed as one pool of auditors available for assignment to a given audit under the supervision of either an external or an internal auditor.

Chapter IV

Methodology

IV. 1. Research design:

The research conducted is descriptive in nature. The objective is to find out the difference between external and internal auditors, and if they are performing their duties in Lebanon. The research is also qualitative, since the data gathered is not quantifiable. It consists of facts to be presented rather than statistical data to be analyzed.

IV. 2. Data collection method:

Data was collected by means of:

- A) Secondary data: These are usually historical data previously collected and assembled for some project other than the one on hand. (Zikmund, 1994, p.40)

Advantages of secondary data:

- 1) Obtaining it is less expensive than acquiring primary data.
- 2) It can be obtained quickly, thus saving time.

Disadvantages of secondary data:

- 1) It was not designed specifically to meet the researcher's needs.
- 2) It may contain outdated information.

The secondary data used in this research consists of books that are reliable enough because:

- 1) They are issued by standard setters and professionals.
- 2) They describe the most recent practices.

B) Questionnaire: Relevance and accuracy are the two basic criteria to be met if the questionnaire is used to achieve its purpose. (Zikmund, 1994, p.322)

A questionnaire is relevant if all necessary information is collected, and the information needed to solve the problem is obtained.

Accuracy means that the information is reliable and valid.

Advantages of questionnaires:

- 1) Geographical flexibility, thus reaching a geographically dispersed sample simultaneously.
- 2) Respondent convenience, so that questionnaires can be filled out by the respondent whenever he has time. And the respondent can take time to think about his replies.
- 3) Cost: Questionnaires are relatively low cost as compared to personal interviews.

Disadvantages of questionnaires:

- 1) Speed of data collection.
- 2) Respondent co-operation.
- 3) Possibility for respondent misunderstanding.

C) Personal interviews: It is a direct communication process where a two way conversation takes place. Personal interviews were done in parallel with the questionnaires to make sure that the information collected is reliable and valid. (Zikmund, 1994, p.194)

Advantages of personal interviews:

- 1) Respondent's opportunity for feedback.
- 2) Clarification of complex answers.
- 3) Increasing the likelihood of responding.

Disadvantages of personal interviews:

- 1) More expensive.
- 2) Appearance that may affect the respondent's answers.

IV. 3. Sampling:

The sampling process involves any procedure choosing a small number of items or parts of the whole population to make conclusions regarding the whole population. The reasons for sampling are the budget and time constraints. If samples are properly selected, they provide reliable results, not precise as testing the whole population. (Zikmund, 1994, p.48)

A *population* or *universe*, is any complete group of people, that share same set of characteristics.

IV. 3-1. Target population:

The target population is the specific complete group relevant to the research project.

In this research, the target population is the auditors in audit firms as external auditors, and internal auditors in any institution, performing their audit in Lebanon.

As to external auditors, the sample was chosen from CPA firms in Lebanon, that are subsidiaries of one of the six largest public accounting firms in U.S.A. They are operating in Lebanon for more than 15 years. Their sizes, according to their market share, ranges between big and middle sizes. As to the employees in such organizations it also ranges between big, as more than 50 employees, and from 11 to 50 employees in middle ones. All of the respondents hold a B.S. degree, while 18% hold an M.B.A. degree, and one has a CPA degree.

The internal auditors' sample, on the other hand, was chosen from different sectors including banks, production companies, and non-profit institutions in Lebanon. The internal audit departments in our sample were newly developed and their life is less than 10 years. The companies may have different namings to such departments as Internal Audit Department or

Internal Control Department but their function is mainly the same. Their size according to the number of auditors in that department is considered small to medium, in that it ranges between 4 and 15. The educational background of the internal auditors is university level, where all of the respondents hold a B.S. degree, 15% have an M.B.A. degree, and one has a CPA degree. It is important to mention here that two of the internal audit staff in production companies are engineers.

** Please see attached a List of Respondents, to the interviews and questionnaires, at the end of this research.

IV. 3-2. Sampling technique:

I chose the nonprobability sampling where the units of the sample are selected on the basis of personal judgement or convenience. This is used in order to choose well-known and experienced individuals who can provide us with reliable information.

IV. 4. Interpretation of results:

Since the research is descriptive and qualitative in nature, results were interpreted through:

- 1) Comparison between data gathered from the questionnaires and interviews with data gathered concerning standards of audit practices in Lebanon.

2) Comparison between data gathered from the
questionnaires and interviews with secondary data.

Chapter V

Results of the Research

V. 1.

This chapter is divided to certain topics, and I will present the results relating to each.

V. 2. Objective:

The first issue tackled was the objective of both types.

V. 2-1

According to the external auditors, the replies were as follows:

- 90% replied that it is to: “ Express an opinion on the fairness of financial statements and if they are presented according to GAAP and International Accounting Standards”. However one of the interviewees added: “ Access the reliability of internal control procedures”.
- 8% replied that it is: “ Meeting the client’s service objective”.
- 2% replied that it is: “ To ascertain that the organization follows applicable laws and regulations”.

V.2-2

The internal auditors' responses were as follows:

- 40% replied that it is: " To ascertain that the internal control policies and procedures are properly followed".
- 35% replied that it is: " To find new ways to develop and enhance the control systems and give suggestions".
- 25% replied that it is: " Fair presentation of the financial statement accounts and proper compliance with laws and regulations".

Moreover, one of the interviewees said that they see their audit goal is preventive and suggestive to improve the efficiency of operations.

V. 3. Standards, policies, and procedures followed:

The result of the questionnaires and interviews proves that 100% of external auditors follow the International Standards on Auditing. In addition to that, all the respondents replied that they follow the common procedures and policies set by their company.

As to internal auditors, the results show that 100% of internal auditors responded that they follow the International Standards on Auditing (ISA). However most of them abide by plans set by the manager or the

whole team, follow certain procedures and programs inspired the ISA, the Banking Control Commission Circulars, and the company's manuals.

V. 4. Type of audit:

From the interviews and the questionnaires, the responses show that 100% of external auditors perform financial audit, and in addition 82% perform compliance audit , 35% perform operational audit, 18% perform special assignments, taxation, and consultation.

Concerning internal auditors we noticed that 100% of them perform operational audit, 80% perform compliance audit, 80% perform financial audit, 40% perform EDP audit.

V. 5. Means used for gathering evidence:

The questionnaire included a question about the means used by auditors to gather evidence.

External auditors' means are presented from the most to the least applied ones:

Examinations, confirmations, inquiries, and observation.

The internal auditors' ranking was different from that of external auditors, and it as follows:

Observation, inquiries, examinations, and confirmations.

V. 6. Characteristics of auditors:

The main characteristics that the external auditors believe should possess follow the following order:

Independence, due professional care, objectivity, and integrity.

The internal auditors results did show the same ranking of characteristics mentioned above.

V. 7. Reporting:

Based on the results of reporting, all external auditors' reports are addressed to the shareholders or investors. In case of non-profit institutions, the B.O.D. benefits from the external auditors reports. Concerning banks, copies of the report are sent to The Central Bank of Lebanon and The Banking Control Commission as required.

The results based on internal auditors' responses show that 71% of them address their reports to either the general manager, president of the company, or the chairman of the board. The other 29% said they address their report to the B.O.D.

V. 8. Implementing recommendations:

V. 8-1

Based on the questionnaires and the interviews with external auditors, 52% of them said that the recommendations they give are implemented. However 38% replied that recommendations they suggest are not always implemented. 10% said implementation of recommendations depends on cost-benefit considerations.

One of the interviewees realized a greater concern nowadays, among managers of the audited companies in listening to them while discussing the points raised in the Letter to Management. They are becoming oriented towards improvement.

Another interviewee said he remembers that the Letter to Management presented included the same points from year to year ; those points were not resolved, on the contrary they were increasing. He said that they were not taken seriously.

V. 8-2

The results of internal auditors responses demonstrate that 57% of them saying that their recommendations are not always implemented. The remaining 43% said that their recommendations are usually implemented.

It is worth mentioning that an interviewee said if a discussion takes place with the auditee and the last agrees, suggestions would be implemented; otherwise the internal auditor can do nothing but report the case.

Again another interviewee said the companies in Lebanon, other than banks, are not obliged to have internal audit department. Unless managers are convinced of the importance of the department, they establish such a department and listen to the recommendations and suggestions and find ways to implement them.

V. 9. Review of work:

As to work review and evaluation, the following has been realized:

V. 9-1

The external auditors answers are summarized as follows:

- 44% said that their manager reviews their work.
- 37% said that the partner in charge reviews their work.
- 19% said that a peer review is performed by the mother firm.

Two interviewees expressed their knowledge about this question. The first said usually in accounting

firms, a hierarchical review is done on the audit work, starting by the senior, then the manager, ending by the partner. The final step is having a manager from the mother company, coming from abroad, and making a last review of certain audit jobs.

The second interviewee said that you can judge on the work of external auditors by counting the number of complaints raised against them.

V. 9-2

The internal auditors' answers to this question are also summarized as follows:

- 40% said their work wasn't evaluated by anybody.
- 40% said their work was evaluated by the department's manager.
- 20% said their work was evaluated by external auditors.

Again two interviewees expressed their opinion about this issue. One of them said if the B.O.D. realizes there are problems arising, this means the internal auditors' work is neither effective nor efficient.

The other interviewee said the chairman of the board evaluates the work. This revision is based on watching the savings accruing from the internal auditors' recommendations that justify their work.

V. 10. Co-ordination of work:

Based on the questionnaire responses, the following results were noted:

V. 10-1

Concerning external auditors, 64% of them audit companies having internal audit department while the remaining don not. 85% of those who audit firms having internal audit departments, said there is co-operation with such department.

However, all of the rspondents believe that co-operation with internal auditors may be productive. The fields they think, internal auditors may help in are:

- 50% think that internal auditors can perform tests of controls, compliance and substantive tests, test control procedures, and be sure that efficient internal control system is in place.
- 38% say that they can depend on internal auditors in supplying them with necessary data and financial information, determining the scope and nature of the audit approach, and coordinating with the company departments.
- 12% say that internal auditors may send, on behalf of them, confirmations to clients and follow up pending matters.

One of the interviewees said before relying on internal auditors, external auditors should first determine the competency, independence, level of education, experience, kind of work done, and review working papers, memos, and reports prepared by internal auditors. Then if they pass all these, external auditors can depend on internal auditors in certain issues.

V. 10-2

As to internal auditors, they responded as follows:

- 67% said that they have direct contact with external auditors of their company.
- 33% said that they do not have any contact with external auditors of their company.

However 100% of internal auditors believe that co-operation with external auditors may be productive. According to the fields, they believe that co-operation may be efficient, they stated:

- 64% said that co-operation may be enhanced by providing and exchanging information between them such as the internal control procedures and the standards followed by the company. Also activity reports should be available for both parties.

- 24% said that external auditors can help by highlighting any risks occurred during the year.
- 12% think that performing certain tests for each other may help being efficient.

One interviewee said co-operation is necessary but it should be clear that co-operation doesn't mean having internal auditors perform duties on behalf of external auditors.

Another interviewee said if co-operation does add value to avoid problems, it should be enhanced to maximum levels.

V. 11. Organization of the profession:

The next question was: " Do you see your audit profession is well organized in Lebanon? Why do you think so?"

V. 11-1

The external audit responses came as follows:

- 90% responded negatively. The cause for disorganization covered different points. Many traced the cause to old fashioned Lebanese Standards. Some said we are in need for more professionals. Others said that: " Lack of truly professional Institute of Accountants to constantly revise, modify, and keep up with the latest International Standards" is the reason.

Few related the matter to credibility and misunderstanding of the profession among clients. The rest said that the political views dominating inhibits organizing a proper syndicate.

- 10% said it is organized to certain extent and the reason for their answer is providing regulations regarding acceptance of Lebanese Association of Certified Public Accountants is the basis. But conflicts between international audit firms and local firms is what restricts such organizing.

One of the interviewees said the profession is not yet organized. However, the newly developed Accountant's Syndicate is trying to enhance the profession and organize it. Concerning the Lebanese Commercial Law and other laws, he said: "The external auditors can be sued for is gross negligence."

Another interviewee said Lebanese Laws must be modernized. Some regulations are presented in The Code of Money and Credit. But we still need more.

As to Code of Ethics followed by external auditors, 73% said they abide by the code set by LACPA, and 27% said they do not abide by any. Those who don't

abide by any code said they think it is necessary to properly organize the profession in Lebanon.

One interviewee said that there should be a code issued or approved by the LACPA to oblige members follow it or be punished.

V. 11-2

The internal auditors' response was as follows:

- 40% said the internal audit profession is not yet organized in Lebanon. The reason for that covered many points. Many said that it is still a new profession in Lebanon and the need for it is not yet clear for some. Others said that there must be reorganizing of the whole audit profession in Lebanon to really clarify the objectives for each type.
- 40% said it is organized to some extent and more than average.
- 20% see the internal audit profession well organized and the reason as they say is Banking Control Commission on one side, and the good experience along with the good background for most internal audit managers.

An interviewee said the banking sector is having a great shift in its internal audit departments due to the

obligatory regulations imposed by Central Bank of Lebanon and Banking Control Commission.

Another interviewee said the internal auditors are in the process of establishing an association in Lebanon.

However neither of the respondents realized any liability or responsibility stated under their organizations' rules and regulations other than those applying to any employee.

As to following any Code of Ethics during their work, 60% said they do follow International Code of Ethics. 40% said they do not follow any, but they did realize its importance in improving the internal audit profession.

V. 12. Importance of foreign certificates:

The last topic raised was finding if foreign certificates related to auditing do benefit or apply in the Lebanese audit society.

V. 12-1

The result of the questionnaire proves that:

- 91% of external auditors do consider the CPA or any equivalent degree necessary in Lebanon. Some said that it gives a better view of their responsibilities and their audit work. Many believe that it gives them better understanding

of complex accounting issues which they can apply in their work. Others regard the CPA as an added value degree and a high degree of professionalism.

- 9% said it does not feed our society.

An interviewee, who holds a CPA degree, said holders of such a degree are subject to continuous training. Also they are always kept updated concerning any new improvements.

Another one said there is no use for it in Lebanon. It mainly applies in U.S.A.

V. 12-2

Based on the questionnaire, internal auditors' responses were as follows:

- 80% consider CIA or any equivalent degree necessary in Lebanon. Many said that it gives more skills to holders of such certificate. Others believe it adds value to their profession.
- 20% do not see any value of such degree in Lebanon.

Both interviewees agreed on the importance of CIA or any other equivalent certificate saying it should

apply in the Lebanese society because internal auditors must apply the same practices wherever they are.

Chapter VI

Conclusions and Recommendations

VI. 1. Conclusions:

As a conclusion we can say that although internal and external auditors belong to the audit profession, still several differences exist between them. These differences may be summarized under the following points:

<i>Internal Auditor</i>	<i>External Auditor</i>
An organization's employee.	An independent contractor.
Serves the needs of the organization.	Serves third parties who need reliable financial information.
Reviews all operations and controls in an organization for efficiency, economy, and effectiveness.	Reviews principal balance sheet and income statement accounts. Reviews operations and internal controls to determine scope of examination and reliability of financial data.

Is directly concerned with the prevention of fraud in any form or extent in any activity audited.	Is incidentally concerned with the prevention and detection of fraud in general, but is directly concerned when financial statements may be materially affected.
Is independent of the activities audited, but is ready to respond to the needs and desires of all elements of management.	Is independent of management and the board of directors both in fact and in mental attitude.
Reviews activities continually.	Reviews records supporting financial statements periodically - usually once a year.

Other realizations found concerning the Lebanese society and audit practices in that society are:

- As to co-ordination between external and internal auditors, the conclusion is that it is done at a random basis, where no real plan for co-ordination between them exists.
- As to reporting the notice is that internal auditors did not communicate with an audit committee, since it is not found in Lebanese companies.

- Concerning recommendations implementation, a big percentage of clients do not take the external auditors recommendations seriously, and do not implement them as realized.

The same case applies to internal auditors, since their job, as they say stops at this point. They have no power to interfere directly in operations.

- Evaluation of work did not always depend on clear basis. Every CPA firm has its own review policies, that may not be secure.

Internal auditors answers also were not convincing. This is due to lack of knowledge about the topic.

- As to profession organizing, none of the two groups did show his satisfaction. Both considered that it is not yet organized and not performing what is desired from it.
- Both groups expressed their interest in holding international professional degrees.
- As to the Lebanese laws and regulations, external auditors, asked for updating them.

VI. 2. Recommendations:

In order to overcome the above mentioned points affecting the auditing profession in Lebanon, we recommend the following:

- Rewriting the Lebanese Laws: The Lebanese laws should be updated in order to compete with the new advancements related to the audit profession. But such law must be discussed with professionals before being set.
- Finding productive and effective associations: There should be external and internal associations practicing their work . These organizations must be organized in a way that protects them against all kinds of pressures enforced on them. They have to study the International Laws, compare them with our regulations, and issue standards to be implemented in our society. Also it should approve certain control measures as Code of Ethics. This will lead to professionalism in work if it sets certain obligations on its members. On the other hand, it acts as a protector for its members from any interference in their work and it increases their independence.
- Continuous professional training: Auditors should be subject to continuous training and should attend seminars in order to strengthen their knowledge and their relationships. By this, they can discuss confusing matters, listen to updated information about the audit profession inside and outside Lebanon.

- International Certificates: The certificates honored from other countries should be encouraged since they give an added value and a professional level for auditing in Lebanon. The newly established audit associations should either encourage the auditors holding international audit degrees or try to give an equivalent competent degree.
- Plans and procedures followed: Each audit firm or audit department should, as an internal control measure, set plans, procedures, and programs to be followed continuously. This will give more credibility to their work. The plans and procedures should be based on the standards set by the audit associations.
- Co-ordination of work: In order to increase the economy, efficiency, and effectiveness, co-ordination of work should be based on respect and mutual competence of each group. This can be achieved by:
 1. Periodic meetings to discuss matters of mutual interest as audit activities planned.
 2. Access to each other's audit programs, working papers, and viewpoints.
 3. Exchange of audit reports, management letters, and recommendations.

4. Common understanding of audit techniques, methods, and terminology.

- Work peer review: The auditors work should be reviewed continuously. As for external auditors, revision of work should be done internally by the partners and managers from the mother firm, and externally by having CPA firms reviewing the work of each other. For internal auditors, the work could be reviewed internally by their manager and audit committees of their companies, and externally by external auditors.
- Taking recommendations into consideration: The recommendations and suggestions should be studied carefully before being given by auditors. Clients must, at first, be fully knowledgeable about the objective of external and internal auditors so that they can later understand the auditors' views. Also management should be educated in order to understand the benefits of the recommendations. The laws should exert certain penalties on organizations that do not implement the auditors' recommendations. After reaching this level, I think there will be no problems in discussing and implementing recommendations.

Finally we must say each audit approach is necessary and significant. They both represent separate essential services that complement each other.

So by updating our laws and organizing both professions, internal and external auditors can work together in harmony for the benefit of the whole country.

APPENDIX I QUESTIONNAIRE

Dear Respondent,

I am an MBA student at the Lebanese American University (formerly BUC). In partial fulfilment of the requirement for the MBA, I am conducting this survey to find out the difference between external and internal auditors.

In answering the parts of the questionnaire, please try not to miss any part. Thank you for your time and effort.

Your co-operation is highly appreciated.

Sincerely Yours,
John Wanna

QUESTIONNAIRE (For Internal Auditors)

PART I

1. What is the nature of your company's business?

- Manufacturing
- Educational
- Financial Services
- Insurance
- Merchandising
- Other (specify)-----

2. What is your level in the organisation hierarchy?

3. The number of employees in your internal audit department is between:

- 1-3
- 4-10
- 11-15
- More than 15

4. According to the organization's hierarchy, to whom do you report?

5. For how many years have you been employed in the audit department?--

6. What is the level of education you have completed?

- High school
- Bachelor's degree
- Graduate degree
- Others (specify)

7. What is the minimum required education level for internal auditors?

- M.S. Degree
- B.S. Degree
- T.S. Degree
- Other (specify)

8. What is the experience period necessary for internal auditors?

- 0-2 years
- 2-5 years
- More than 5 years

PART II

1. The main characteristics that internal auditors should have are: (please rank the following in terms of importance)

- Objectivity
- Integrity
- Independence
- Due professional care

2. What type of audit do you perform? (you can choose more than one.)

- Financial
- Operational
- Compliance
- EDP Audit
- Special Assignments
- Others (specify)-----

3. The means used for gathering evidence are mainly:

- Observation
- Inquiries
- Confirmation
- Examination

4. Please state the main objectives of your audit.

5. Do you abide by any of the following? (you may choose more than one)

-- Audit Plan -- Audit Program -- Audit Procedures

6. Who set the following for your department?

- Audit Plan
- Audit Program
- Audit Procedures

7. Please state the standards that you follow while performing the audit.

8. What is the internal auditor's liability under your company's charter?

9. Please state 3 important responsibilities the internal auditor should take into consideration while performing the audit.

10. To whom do you address the reports you issue?

- Investors
- Management
- Board of Directors
- Others (specify)-----

11. Does your opinion affect the views of those concerned?

-- Yes -- Not always -- No

12. Are your recommendations implemented appropriately?

-- Yes -- Not always -- No

13. Has your work been evaluated?

-- Yes -- No

14. If yes, by whom? -----

Part III

1. Is there any direct contact with external auditor for your company?

-- Yes -- No

2. If yes, at any level the co-operation with the external auditor has been found?

3. Do you think co-operation with external auditors may be efficient?

-- Yes -- No

4. If yes, please state in what fields (which procedures you perform on behalf of them).

5. If no, please give 2 reasons for your opinion.

Part IV

1. Do you see that the internal audit profession properly organised in Lebanon?

-- Yes -- No

2. If yes, what are the basis for such organising?

3. If no, what restricts such organising?

4. Do you consider the Certified Internal Auditor (CIA) or any Internal audit designation necessary in Lebanon?

-- Yes -- No

5. Do you abide by any Code of Ethics during your conduct?

-- Yes -- No

6. If yes, who set this Code in Lebanon?

7. If no, do you think it is necessary?

-- Yes -- No

8. Why do you think so?

Thank you for answering all questions.

APPENDIX II

QUESTIONNAIRE

Dear Respondent,

I am an MBA student at the Lebanese American University (formerly BUC). In partial fulfilment of the requirement for the MBA, I am conducting this survey to find out the difference between external and internal auditors.

In answering the parts of the questionnaire, please try not to miss any part. Thank you for your time and effort.

Your co-operation is highly appreciated.

Sincerely Yours,

John Wanna

QUESTIONNAIRE (For External Auditors)

Part I

1. What is your level in the organisation hierarchy?

2. The number of employees at your company is between:

- 1-10
- 11-30
- 31-50
- More than 50

3. For how many years have you been employed in this organisation?-----

4. What is the level of education you have completed?

- High school
- Bachelor's degree
- Graduate degree
- Other (specify)-----

5. Do you hold any professional degree such as:

- CPA
- CIA
- CA
- Other (specify)-----

Part II

1. The main characteristics that external auditors should have are:

(please rank the following in terms of importance.)

- Objectivity
- Integrity
- Independence
- Due professional care

2. What type of audit do you perform? (you can choose more than one)

- Financial
- Operational
- Compliance
- Others (specify)

3. The means used for gathering evidence are mainly:

- Observation
- Inquiries
- Confirmation
- Examination

4. Please state the main objective of your audit.

5. Please state the standards that you follow while performing the audit.

6. What is the external auditor's liability under the Lebanese Law?

7. Please state 3 important responsibilities the external auditor should take into consideration while performing the audit.

8. Who benefits from the reports you issue? (rank in order of importance)

- Investors
- Management
- Creditors
- Board of Directors
- Others (specify)-----

9. Does your opinion affect the views of those who are concerned?

-- Yes -- Not always -- No

10. Are your recommendations implemented?

-- Yes -- Not always -- No

11. Who evaluates your work?

Part III

1. Is there any internal audit department in the companies you audit?

-- Yes -- No

2. If yes, is there any co-operation with such department?

-- Yes -- No

3. Do you think co-operation with internal auditors may be efficient?

-- Yes -- No

4. If yes, please state in what fields.

5. If no, please give 2 reasons for your opinion.

Part IV

1. Do you see the external audit profession is well organised in Lebanon?

-- Yes -- No

2. If yes, what do you think are the basis for such organising?

3. If no, what restricts such organising?

4. Do you consider the Certified Public Accountant (CPA) degree is necessary in Lebanon ?

-- Yes -- No

5. Why do you think so?

6. Do you abide by any Code of Ethics during your audit?

-- Yes -- No

7. If yes, who set this Code in Lebanon?

8. If no, do you think it is necessary?

-- Yes -- No

9. Why do you think so?

Thank you for answering all questions.

APPENDIX III

“ EXTERNAL AUDITOR’S QUALIFIED REPORT”

(Appropriate Addressee)

We have audited the accompanying balance sheet of X Company as of December 31, 199x, and the related statements of income , retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with International Standards on Auditing. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of December 31, 199x, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

(Auditor's Name)

DATE

ADDRESS

APPENDIX IV
“ INTERNAL AUDITOR’S SATISFACTORY
REPORT”

DATE

TO: (Appropriate Addressee)

FROM: Director of Internal Auditing

SUBJECT: Buying Controls and Advertising Allowances -
Automotive

We have completed an audit of Buying Controls and Advertising Allowances. Our audit objectives and findings are summarized below. The detailed report was discussed with and issued to division management.

PURPOSE AND SCOPE

Our purpose was twofold: First, to review the procurement procedures and practices used in product and vendor selection and in the ordering of selected products. Second, to review procedures designed to ensure the receipt and timely recording of co-operative advertising revenues.

SUMMARY OF AUDIT RESULTS

Procedures and practices employed in both the procurement of automotive products and in the receipt and recording of co-operative advertising revenues were in compliance with Company and Division objectives. Some conditions required improvement, however. These included excessive slow-moving items, lack of procedures for regular competitive price checks and returns of superseded lines of merchandise, and the lack of segregation of duties for billing, accounting, and collecting advertising allowances.

These conditions, along with some administrative weaknesses and our recommendations on corrective action, were discussed at our closing conference. Division management agreed with our findings and recommendations and plans to reply to our report by January 31, 199x.

OPINION

In our opinion, the established system of control was adequate over the buying and advertising activities, except for inadequate conditions.

cc: Chairman of Audit Committee

Chairman of the Board

President of Corporation

President of Division

LIST OF RESPONDENTS

* Questionnaires were distributed between May 1, and May 15, 1997 to auditors in the following companies:

External Audit Firms:

- Deloitte & Touche
- Arthur Anderson & Co.
- Peat Marwick

Internal Audit Departments in the following organizations:

- PepsiCo Inc.
- Indevco Group
- Banque Beyrouth pour le Commerce
- Saudi Lebanese Bank
- Lebanese American University

* Interviews were conducted during the first week of May 1997,
with the following:

- Mr. Naji Medlej, Financial Controller at L.A.U.
- Mr. Marwan Abd El-Malak, Financial Controller at PepsiCo Inc.
- Mr. Joe Atallah, Internal Audit Manager at PepsiCo Inc.
- Mr. Antoine Yaccoub, Internal Audit Manager at Indevco Group

- Mr. Zuhair Churaiki, CPA holder, Manager at Deloitte & Touche

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