Internal audit

Internal audit refers to the department located within a business that monitors the efficacy of its processes and controls. The internal audit function is especially necessary in larger organizations with high levels of process complexity, where it is easier for process failures and control breaches to occur. Internal audit is especially necessary in a publicly-held business, which must attest to the robustness of its systems of internal control. The internal audit staff is responsible for the following:

- Fraud detection
- Internal control assessments
- Legal and regulatory compliance
- Process assessments
- Risk assessments
- Safeguarding of assets

The internal audit manager schedules audit work, usually focusing on high-risk areas. Other examinations may be conducted as directed by the audit committee of the board of directors, or as requested by department managers. The areas being targeted for an examination are normally given advance notice, so that they can assemble all required documents for the internal audit team. In some cases where fraud is suspected, the audit team will appear without any prior announcement, in hopes of catching the perpetrator.

Internal audit is not simply a watchdog that monitors a business and flags problems. It can also act as an internal consulting department that adds value to company operations. It does so by highlighting opportunities for improvement and facilitating changes within the organization.

Ideally, the internal audit department reports to the board of directors or a committee of the board. By doing so, it remains independent of the management team, and so is able to investigate issues related to the team, reporting its findings back to the board of directors.

The industry entity most commonly associated with support of the internal audit function is the Institute of Internal Auditors.

External audit

An external audit is an examination that is conducted by an independent accountant. This type of audit is most commonly intended to result in a certification of the financial statements of an entity. This certification is required by certain investors and lenders, and for all publicly-held businesses.

The objectives of an external audit are to determine:

- The accuracy and completeness of the client's accounting records;
- Whether the client's accounting records have been prepared in accordance with the applicable accounting framework; and
- Whether the client's financial statements present fairly its results and financial position.

There are other types of external audits that may be targeted at specific issues concerning a client's accounting records, such as an examination that searches for the existence of fraud.

The difference between internal and external audits

There are multiple differences between the internal audit and external audit functions, which are as follows:

- Internal auditors are company employees, while external auditors work for an outside audit firm.
- Internal auditors are hired by the company, while external auditors are appointed by a shareholder vote.
- Internal auditors do not have to be CPAs, while a CPA must direct the activities of the external auditors.

- Internal auditors are responsible to management, while external auditors are responsible to the shareholders.
- Internal auditors can issue their findings in any type of report format, while external auditors must use specific formats for their audit opinions and management letters.
- Internal audit reports are used by management, while external audit reports are used by stakeholders, such as investors, creditors, and lenders.
- Internal auditors can be used to provide advice and other consulting assistance to employees, while external auditors are constrained from supporting an audit client too closely.
- Internal auditors will examine issues related to company business practices and risks, while external auditors examine the financial records and issue an opinion regarding the financial statements of the company.
- Internal audits are conducted throughout the year, while external auditors conduct a single annual audit. If a client is publicly-held, external auditors will also provide review services three times per year.

In short, the two functions share one word in their names, but are otherwise quite different. Larger organizations typically have both functions, thereby ensuring that their records, processes, and financial statements are closely examined at regular intervals.