**Week 1**

Audit and Controls

1. Introduction

Audit and controls refer to the processes and procedures that are put in place to ensure the accuracy, completeness, and reliability of a company's financial reporting and operations.

The purpose of these processes is to provide assurance that the company's financial statements are free from material misstatement, and that the company's assets are protected from fraud, theft, and misuse.

**Audit** refers to the process of reviewing and evaluating a company's financial records, operations, and internal controls to ensure that they are accurate, reliable, and in compliance with applicable laws and regulations. An audit may be conducted by an internal auditor who is employed by the company, or by an external auditor who is independent of the company.

**Controls** refer to the policies and procedures that are put in place to prevent or detect errors or irregularities in the company's financial reporting and operations. These controls may include segregation of duties, access controls, physical security, and other measures designed to minimize the risk of fraud or errors.

Types of Audits:

**External Audit** – An independent review of a company's financial statements and records by a third-party auditor to provide assurance to stakeholders that the financial information presented by the company is accurate and reliable.

External auditing is performed by a third-party company that is independent of the company being audited.

The government performs external audits to provide assurance to stakeholders, such as taxpayers, legislators, and creditors, that the financial information presented by the government is accurate and reliable.

The results of the external audit are included in the government agency's annual report, which is made available to the public.

Example: *Government, Banks and etc.*

**Internal Audit** – Independent and objective assurance and consulting activity designed to evaluate and improve an organization's operations.

Reason’s why they perform Internal Audit:

1. **Improving Operations -** Provides independent and objective assurance that the organization's operations are effective and efficient. It helps identify process inefficiencies, gaps in internal controls, and areas where improvements can be made to enhance organizational performance.
2. **Risk Management** - It helps the organization identify and manage risks that could impact the achievement of its objectives and also avoid or minimize losses resulting from fraud, errors, or other types of risk.
3. **Compliance** - Ensures that the organization complies with applicable laws, regulations, and internal policies and procedures.
4. **Financial Reporting** - Provides assurance to management and the board of directors that the financial information reported by the organization is reliable.
5. **Governance** - Ensures that the organization's governance processes are transparent and accountable and that the organization's resources are being used efficiently and effectively.

**Internal Revenue Service Audit (IRS)** – Review/examination of an organization's or individual's accounts and financial information to ensure information is reported correctly according to the tax laws and to verify the reported amount of tax is correct

**Example**: Bureau of Internal Revenue **(BIR)**

1. Origin and Evolution

**(Timeline: Ancient Periods)** — Auditing has a long history dating back to ancient civilizations, where it was used to detect errors and fraud in financial records, countries like Mesopotamia, Greece, Egypt, Rome, UK and India were using auditing since then.

**(Timeline: 18th and 19th Century)** — The concept of auditing evolved rapidly during the industrial revolution in the 18th century, with the rise of joint stock companies and the need for independent oversight of financial statements. The objective of audit shifted and audit was expected to ascertain whether the accounts were true and fair rather than detection of errors and frauds.

**(Timeline: 20th Century - Present)** — In India, the Companies Act of 1913 made an audit of company accounts compulsory and prescribed the qualification of auditors. Standard accounting and auditing practices have been developed by the IASC (International Accounting Standards Committee) to guide accountants and auditors in their day-to-day work.

**(Timeline: Present)** — Today, the use of computers in accounting and auditing is one of the latest developments in the field of auditing. Auditing plays a critical role in corporate accountability and is essential for demonstrating compliance with accounting and financial reporting standards.

*(True and Fair Vs. True and Correct)*

**True and Fair** - stands for what has been established by the rules, law and made to be the benchmarks

**True and Correct** - stands for what can be made out of common sense or company internal practices

1. Benefits of Auditing

* **Satisfaction of Owner -** Owner will be satisfied about the business operations and working of its various departments.
* **Detection and Prevention of Errors and Frauds -** The errors whether committed innocently or deliberately are discovered by the process of audit and its presence prevents their occurrence in the future. No one will try to commit an error or fraud as the accounts are subject to audit and hence, they will have a fear of being detected.
* **Verification of Books -** Another advantage of audit is the verification of the books of accounts, this helps in maintaining the records up to date at all times.
* **Independent Opinion –** If the accounts are audited by an independent auditor, the report of the auditor will be true and fair in all respects and it will be of extreme importance for the management of the company.
* **Moral Check -** The process of audit will establish a check on the minds of the staff working in the business and they will not be able to commit any irregularity, as they will have a fear and will also be aware that the accounts will be examined in the near future and that action would be taken against them if any irregularity is discovered. Thus, the audit prevents the happening of any irregularity before it starts and the staff hence becomes more active and responsible. The fear of their getting caught act as a moral check on the staff of the company.
* **Reliance by Outsiders -** Outsiders like creditors, debenture holders and banks etc. will rely on the books of accounts and financial statements of the business if they are audited by an independent authority (external auditor).
* **Ensures Compliance with Legal Requirements -** Audited statements are necessary to fulfill certain legal requirements e.g. listing requirements of stock exchange etc.
* **Reinforce and Strengthen Internal Control -** Since auditing exercise involves the review of internal control system, an auditor will identify the gaps in internal control system and can suggest the necessary change in the internal control system.
* **Loan Facility -** Money can be borrowed easily on the basis of audited balance sheet from financial institutions. If accounts are audited the true picture will be visible to banks and it will be easy for them to issue loans as early as possible.

1. Importance of Auditing
2. **Ensuring accuracy and reliability of financial statements** - Auditing provides assurance that the financial statements of a company are accurate, complete, and reliable. This is important for stakeholders, such as investors, creditors, and regulators, who rely on these statements to make decisions about the company.
3. **Detecting and preventing fraud** - Auditing can help to identify potential instances of fraud or financial irregularities, and can help to deter fraud by ensuring that proper controls and procedures are in place.
4. **Compliance with regulations and laws**: Auditing can help to ensure that a company is complying with applicable laws and regulations, such as tax laws, accounting standards, and industry regulations.
5. **Improving operational efficiency** - Auditing can identify areas where a company can improve its operations and internal controls, leading to greater efficiency and effectiveness.
6. **Building trust and confidence** - Auditing can help to build trust and confidence among stakeholders, such as investors, creditors, and customers, by providing assurance that the company's financial reporting and operations are reliable and trustworthy.
7. How auditing is performed?

Auditing is the process of reviewing and evaluating a company's financial records, operations, and internal controls to ensure that they are accurate, reliable, and in compliance with applicable laws and regulations

1. **Planning** - The auditor determines the scope of the audit, identifies the key areas to be examined, and sets objectives and timelines.
2. **Gathering information** - The auditor collects and reviews relevant documentation, such as financial statements, account balances, transaction records, and internal control procedures.
3. **Assessing risks** - The auditor evaluates the potential risks and vulnerabilities in the company's financial reporting and operations, and identifies areas that require further scrutiny.
4. **Conducting tests** - The auditor performs various tests to verify the accuracy and completeness of the company's financial statements and transactions, such as analyzing account balances, reviewing journal entries, and testing internal controls.
5. **Analyzing results** - The auditor evaluates the results of the tests performed and draws conclusions about the accuracy and reliability of the financial statements and the effectiveness of the company's internal controls.
6. **Reporting** - The auditor prepares a report that summarizes the findings and conclusions of the audit, including any deficiencies or weaknesses identified, and provides recommendations for improvement.
7. **Follow-up** - The auditor may follow up with the company to ensure that any recommendations for improvement are implemented and to assess the effectiveness of the company's corrective actions.