There are few words for an accountant, which cause as much concern as the word ‘audit’. Audits, whether internal or external, carefully study the accountants work and identify any errors or abnormalities.

In large firms audits are often used as a control for the work of the accounting department, in these firms the accounts departments may deal with millions of dollars a month and without a control process in place there would be no way of verifying that the information produced was correct and that the company wasn’t being defrauded.

These internal audits can take one of two forms, either being carried out by the CFO and his team or by a specially commissioned external firm of auditors. The second option is by far the most popular as it ensures objectivity in the audit.

In either of these forms, the auditors are responsible for confirming the validity of the records produced by the accounting department. This can be done by cross-checking the accounts workings with the source information, although in larger firms this can be too time consuming. In these cases statistical sampling, in which a random sample is checked can provided reasonable proof of accuracy.

These audits may be financial or managerial in nature, in that they can confirm the workings of the financial accounts or of management accounts.

The primary function of these audits is to demonstrate that the company is following all expected standards whether they be accounting or production. Each department can be audited to confirm that they adhere to set procedures and to ascertain that each process is as described.

As the auditors are acting on behalf of the management board of the entity all findings are kept in strict confidence and are only shared with the management board and any stakeholders, who then interpret the results and act on the recommendations of the auditors.

External audits confirm the entity’s legal obligation to pay certain taxes and duties. In the US this may be done by the IRS.

These audits cause both accountants and senior managers large amounts of stress as the outcome of the audit can determine the future of the company being audited. Of course, not all companies are audited every year.
The IRS choose the companies and individuals to be audited based on a series of indicators including the level of income with both very high and low levels of income having the potential to cause an audit, comparative studies of your past years return and that of your competitors, dramatic changes in income, incomplete or sloppy tax returns, and a high number of itemizations or charitable contributions.

Once a company has been chosen for an audit, you are notified by mail informing you of the type of audit: mail by post, office at an IRS office or field in the tax payer’s premises. You will also be informed what documentation will be required.

The auditor’s duty is to confirm that the information which was submitted in the tax return is true and that the methods of accounting comply with accounting standards. The auditor’s findings are then shared with the IRS who will act on it.

Publicly traded companies are treated slightly differently in auditing. The focus is on providing transparency to ensure investor confidence; this is done by imposing criminal status to the filing of incorrect financial documentation.

In the US, government auditing is not only a process of confirming a tax liability but also a method of establishing the performance of a non-profit organization (NPO). These performance audits may include such checks as whether the NPO is making sound investments, purchasing the correct goods and a fair price and that employees of the NPO conduct themselves in a way reflecting the organizations best interests.

**Discussion Questions**

Why are internal audits so important to large corporations?

Why do you think so many people fear being audited?

What kind of source information would auditors need for: An internal audit? An external audit?