

Internal control and deontology

Chapter 9: External audit

1. Types of audits

- Financial audit (external audit)
 - Of interest to a wider group:
 - ✓ Not only the individual company/organisation
 - ✓ Also of interest to employees, customers, suppliers, banks, creditors, government, etc.
 - Assessing the level of internal control is a step in the external audit process
- Operational audit
 - Assessing the efficiency and effectiveness of processes, working methods, departments,
- Compliance audit
 - Are the rules (internal, external, legal, ...) rules being followed?
 - Example: Valipac / Fost Plus / Bebat audit

Link between internal and external control

- the better the ICS, the more assurance there is for the external auditor that the financial statements are correct
- the less the external auditor has to investigate/check/test...

Differences?

- Independency
- Knowledge
- Working method

2. What is an external audit?

Accounting = generating the FS
External Control/Audit = Checking/revising/approving FS
Financial analysis = using FS

Legally obliged for large companies – an external auditor has to check whether the FS meet the conditions below and thus can be approved by the auditor:

- Reasonable
- existence
- Completeness
- Ownership
- valuation
- Classification
- Timeliness
- correctness (mathematically)
- disclosure

2. What is an external audit?

The (registered) accountant has to perform control activities to gather evidence for his statement. Herefore he has to follow the GAAS (Generally Accepted Auditing Standards).

The standards indicate the procedure(s) that have to be followed by the auditor to be able to deliver a high quality audit statement.

- Standards on the quality and objectiveness of the auditor (see also chapter 10)
- Standards regarding the execution of the audit assignment
- Standards regarding the audit opinion

2.1 Standards regarding the execution of the audit assignment

The auditor should perform all necessary control activities to obtain reasonable assurance regarding the absence of material errors/misrepresentations in the financial statements.

Control activities can be: observation, recalculation, reconciliation of documents/postings, external confirmations, etc...

The auditor should make an audit program before starting the audit assignment. The audit program lists the control activities to be performed, the timeframes that will be used and the auditor(s) responsible for the control activity.

2.1 Standards regarding the execution of the audit assignment

All evidence found should be kept in the so called working papers. The working papers consist of 2 parts:

- Permanent file: containing all the information on the company that does not change frequently (charter/rules of the company, procedures, contact data, organization charts, large contracts, ...)
- Actual working papers: containing all data regarding one FS (of one particular year) – data is organized based on the balance sheet and P&L

2.2. Standards regarding the audit opinion/report

4 types of audit opinions possible:

Unqualified Opinion (clean opinion):

- The auditor determines that each of the financial records provided by the company is free of any misrepresentations.
- In addition, an unqualified opinion indicates that the financial records have been maintained in accordance with the standards known as Generally Accepted Accounting Principles (GAAP). This is the best type of report a business can receive.
- Typically, an unqualified report consists of a title that includes the word “independent.” This is done to illustrate that it was prepared by an unbiased third party. The title is followed by the main body. Made up of three paragraphs, the main body highlights the responsibilities of the auditor, the purpose of the audit and the auditor’s findings. The auditor signs and dates the document, including his address.

2.2. Standards regarding the audit opinion/report

Qualified Opinion:

- In situations when a company's financial records have not been maintained in accordance with GAAP but no misrepresentations are identified, an auditor will issue a qualified opinion. The writing of a qualified opinion is extremely similar to that of an unqualified opinion. A qualified opinion, however, will include an additional paragraph that highlights the reason why the audit report is not unqualified.

2.2. Standards regarding the audit opinion/report

Adverse Opinion:

- The worst type of financial report that can be issued to a business is an adverse opinion. This indicates that the firm's financial records do not conform to GAAP. In addition, the financial records provided by the business have been grossly misrepresented. Although this may occur by error, it is often an indication of fraud. When this type of report is issued, a company must correct its financial statement and have it re-audited, as investors, lenders and other requesting parties will generally not accept it.

Disclaimer of Opinion:

- On some occasions, an auditor is unable to complete an accurate audit report. This may occur for a variety of reasons, such as an absence of appropriate financial records. When this happens, the auditor issues a disclaimer of opinion, stating that an opinion of the firm's financial status could not be determined.