

# [Financial reports audit](https://assignbuster.com/financial-reports-audit/)

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Introduction Audit is a general regular inspection of company’s financial procedures with an aim to ensure that they meet general requirements as well as stipulated laws. A regular audit of company’s financial proceedings is crucial for a number of reasons.

First, audit helps reveal common calculation errors that may have occurred in the course of a financial procedure. When such mistakes are realized, they can easily be corrected to prevent problems that may have arisen as a result of these errors. Secondly, auditing ensures that it keeps company’s staff vigilant and cautious when performing any financial procedure. It, therefore, prevents laxity and ensures efficiency of staff’s performance. Therefore, audit remains a trustworthy working tool in all company’s financial ventures.

Lastly, audit helps maintain high level of confidence in company’s financial procedures by creditors and share holders of the company (Collard, 2002, pp. 5-6; Pratley, 2010, p. 12). This paper describes the essence of carrying out audit as well as discusses basic issues and concepts that audit entails in the process of creating financial reports. Audit is based on four factors: objectives, assertions, opinions, and evaluation of financial statements. The core reason for carrying out audit is to determine whether there are any illegal practices or management practices that contravene basic guidelines and regulations.

Therefore, whereas an auditor relies on assertions made by the management, it is his or her responsibility to find out whether these assertions are true. This can be done through gathering information from other parties such as creditors, staff, and customer records. Secondly, an auditor must deliver an opinion after composing a general financial report. Usually, opinions are either ‘ qualified’ or ‘ unqualified’. A qualified opinion implies that there are several outstanding issues that contravene stipulations asserted by the Generally Accepted Accounting Guidelines (GAAP). On the other hand, an unqualified opinion implies that financial statements of an organization comply with country’s set standards without any reservations whatsoever.

However, an auditor may state his or her opinion as adverse, where evaluated financial statements are grossly misrepresented and manipulated, or a disclaimer of opinion, whereby an auditor declines to deliver an opinion. Thirdly, a general financial audit report must entail management assertions (financial statements). Therefore, audit of financial statements includes evaluation of the balance sheet, cash flow statement, and income statement. The balance sheet represents organization’s health and net worth. It is a record of assets (firm’s liquidity, which can be used to meet liabilities in the short-term or long-term) versus its liabilities (organization’s outstanding debt) (Rusell, 2003, pp. 16-17).

Cash flow statement and income statement show firm’s current net income and retained earnings. These are geared towards paying off debt, dividends, or re-investment. Therefore, financial statement audit report shows whether a firm is in a position to meet all its financial obligations (Internal Association of Insurance Supervisors, 2009, pp. 11-15). Audits can be of two types: internal audits and independent audits.

Internal audit is carried out internally by company’s auditors. On the other hand, independent audit is performed by an independent third party such as a professional auditing firm (Struckman, 2012, pp. 1-2). The firm is, therefore, allowed to access all financial documentation of the company on audit including bank statements, ledgers, payrolls, invoices, tax information, accounts payable and accounts receivable, and any internal financial reports. The audit firm is then expected to give a comprehensive report on these findings. This is done on final official report where all findings are reported.

Any kind of audit is expected to be honest and without bias regardless of whether it is internal or independent. However, independent audits are more recommended for companies in fear that internal audits are prone to influence of various parties in the company. Corrupt bosses, for instance, can easily threaten to fire a subordinate internal auditor forcing him or her to overlook embezzlement of funds or misuse company’s resources when conducting an audit. On the other hand, independent audit is less likely to face this challenge. Despite all these challenges, the auditor is required to give a formal general report based on his findings in company’s financial documentation (Gray & Manson, 2007, p. 23).

Basic Requirements and Issues There are several factors, concepts, and formats that audit on financial report must adhere to in order to be considered valid. Audit must meet various legal requirements and standards as stipulated under various laws and regulations in different countries. These standards are geared towards establishing uniformity and guidance in order to achieve the following goals. First, audit laws provide a basic guideline on qualitative features that a general purpose financial report audit must possess. Secondly, laws and standards stipulate the form, content, scope, and depth of information that must be covered within the report. For instance, auditing process in the United States is regulated by Government Finance Officers Association (GFOA) and Government Accounting Standards Board (GASB) that specify that policy statement must achieve five crucial goals.

These are content (general financial report must be complete and concise), currency (the underlying information has to be up-to-date), timeliness (the capacity to act as soon as the report is tabled), accuracy (the information generated is reliable), and ease of access (the information presented is available to individuals who may need it). Thirdly, standards and laws establish basic elements that must be identified and explored during the audit process. The audit process of a general purpose financial report is done in several stages: internal controls, management letter, acceptance of annual financial audit, and identification of the role of an external auditor in preparation of all crucial financial statements. Finally, standards and laws establish whether there is a need for the formulation of a modified audit report in order to either put emphasis on an issue or deliver a qualified opinion on the subject matter (Defoe, 2004, pp. 3-4).

All business organizations, government institutions, and commissions are required to conduct an audit of their generaal financial statements. A single audit or an expanded audit can be conducted. Institutions that receive financial assistance, e. g. from the state/ federal government or well wishers, are required to perform a single audit as stipulated in the Single Audit Act. This audit can be conducted by a qualified external financial auditor or a licensed third-party auditor.

When conducting an audit, the auditor must bear in mind that the essence of the process is to provide a review of the state of organization’s financial statements from an external source. This must be done in accordance with laws and regulations established by relevant auditing authorities such as GAAP. After evaluating these financial statements, an auditor must deliver an opinion, which is either ‘ qualified’ or ‘ unqualified’. There are four crucial requirements of audit on a general purpose financial report. First, there are several internal controls. These involve basic issues such as existence of a regular and formal auditing process, segregation of duties, internal mechanisms that identify and deal with incidences of non-compliance, fraud, and intentional negligence.

In case audit detects any issues, these must be included in the audit report in order to notify the management. Secondly, during the auditing process the auditor(s) must be provided with a means of communication via writing management letters. This provides auditors with a means with a help of which they can share their concerns, raise issues, and provide recommendations to the management on specific issues. Some issues are not of deep concern to the extent that the auditor can change his/her opinion. Nonetheless, the management must take note of all issues and attempt to fix them in the next fiscal year.

Thirdly, the management must express in writing their acceptance and admission of the need to fix any upcoming issues. This is done through the ‘ acceptance of annual financial audit’ report which is written after a review of the audit report and in-depth discussion of all relevant internal controls, reportable issues, and management issues. The management must then accept and approve the audit report in which the issues to be addressed are identified and the associated corrective actions are proposed. Finally, an audit report must outline the extent as to which an external auditor was involved during the preparation of organization’s financial statements. Preparation of financial statements by an auditor may compromise their independence.

Therefore, the law prohibits auditors from preparation of financial reports but allows them to use balanced trial balance and information that has been approved by the management in order to ensure that audit reports are not compromised. Therefore, auditors cannot be a part of organization’s internal control mechanism. For instance, the United States auditors are prohibited from participating in firm’s control mechanism under SAS 112 (State of Minnesota, 2008, pp. 1-3). In conclusion, financial statement audits are crucial in determining whether a firm is solvent. They identify various outstanding issues and present viable management solutions to existing problems.

Therefore, auditing process provides organizations with invaluable tools with a help of which they can conduct an investigation about the state of their financial affairs.