AUDITING

5th SEMESTER

TOPIC:

AUDIT AND CONTROL

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Types of Internal Control System

Preventive Controls: These controls are introduced in the firm to stop errors and irregularities from taking place.

Detective Controls: These controls are implemented to reveal errors and irregularities, once they take place.

Corrective Controls: These controls are designed to take corrective action for removing errors and irregularities after they are detected.

The type of internal control system implemented in the organization will be based on the company's nature and requirements.

Internal Control System is important for every organization, for efficient management as well as it also assist in the company's audit. It includes all the processes and methods to help the company in reaching its ultimate objective.

Importance of Audits of Internal Controls

Internal control over financial reporting ("ICFR") attracts much attention.

- And it should. When ICFR is effective, it helps companies make sure that they produce reliable financial statements that investors can use to make investment decisions. When it is not, it can damage the integrity of financial reporting that is the very foundation of the capital markets. Deficiencies in audits of internal control also can affect the audit of the financial statements. In integrated audits, auditors often rely on controls to reduce their substantive testing of financial statement accounts and disclosures.

Thus, deficiencies in testing and evaluating internal control can lead to inadequate testing of accounts and disclosures in the financial statement audit.[1] This means that investors may not have the same level of assurance that an audit should provide about the financial statements upon which they are relying.

At the PCAOB, our focus remains clear. We are here to protect the interests of investors. Our inspectors – who are very seasoned and experienced professionals with an average of 17 years of audit experience — perform risk-based inspections of audit firms

Our collective goal is to ensure that the audits of public companies are performed in accordance with PCAOB auditing standards and that firms have designed and implemented systems of quality control that would result in the performance of high quality audits. Our inspections are designed to identify and address weaknesses and deficiencies related to how a firm conducts audits.

To achieve that goal, our inspections evaluate a firm's performance in selected audit engagements, as well as the design and operating effectiveness of a firm's own quality control policies and procedures.[2]

Today, I would like to provide a perspective on the state of the audit work we see through inspections.

Types of Internal Audit Controls

Detective

Just as it sounds, this type of control is designed to detect any errors that may have occurred. With this analysis, you can discover discrepancies in your financial reports. This type of control identifies problems that already exist. In fact, when an audit is performed, it is an example of a **detective control**. So, let's say your manufacturing business is going to audit payroll reports to look for any discrepancies. This is a type of detective control.

Corrective

In this audit, you found a discrepancy in the payroll report and now you need to prevent a recurrence of this error. You have noticed that one of your payroll employees continually has typing errors that result in employees being paid an incorrect amount. Now you need to speak with the payroll associate to address this problem and perhaps provide additional .

Training to prevent future discrepancies. You have now performed a **corrective control**. You have made a plan to correct these errors that result in employees being paid incorrect amounts.

Preventative

After you have performed your audit and corrected the current discrepancies, you can now put controls in place to prevent future errors. With **preventative controls** you are now designing controls to help prevent errors from occurring in the future.

Perhaps you have decided that you will now require this payroll associate to require an approval on the payroll report before submitting it until there are no more discrepancies with payroll. You are segregating duties, requiring a different employee to authorize and record transactions.

Objectives

The objectives of each audit may be different. An objective is a desired goal or condition for that specific event. This is a list of common internal audit control objectives.

Authorization: ensures that all transactions are authorized and approved by a responsible associate before that transaction is recorded

Completeness: ensures that your records are not any missing entries

Accuracy: ensures that your transactions have been entered correctly and in a timely manner

Validity: ensures that your transactions are lawful in nature and do not contain any misrepresentations

Physical Safeguards & Security: ensures that physical assets are safely guarded and only authorized personnel may access them

Error Handling: ensures that when errors are discovered management is notified and the errors are corrected in a timely manner

Segregation of Duties: ensures that no one individual is reporting, collecting, and processing a single transaction

What Is a Sale?

A sale is a transaction between two or more parties in which the buyer receives tangible or intangible goods, services, and/or assets in exchange for money. In some cases, other assets are paid to a seller. In the financial markets, a sale can also refer to an agreement that a buyer and seller make regarding the price of a security.

Regardless of the context, a sale is essentially a contract between the buyer and the seller of the particular good or service in question.

How a Sale Works

A sale determines that the seller provides the buyer with a good or service in exchange for a specific amount of money or specified assets. To complete a sale, both the buyer and the seller have to be considered to be competent enough to make the transaction.

They also have to be in agreement regarding the specific terms of the sale. In addition, the good or service that is being offered has to actually be available to purchase, and the seller has to have the authority to transfer the item or service to the buyer.

To be formally considered a sale, a transaction must involve the exchanging of goods, services, or payments between a buyer and a seller.

If one party transfers a good or service to another without any receiving anything in return, the transaction is more likely to be treated as a gift or a donation, particularly from an income tax perspective.

What is the definition of purchase?

A purchase is a routinely operation carried by both individuals and corporations. The purpose of this financial transaction is to transfer the ownership of a piece of property physical, intellectual, virtual or else.

By purchasing the property, the owner has the right to use it or dispose of it according to his will and purpose.

The purchase activity is normally a formal procedure when it comes to company purchases. Smaller purchases are more commonplace than larger purchases. As such, they require less analysis and thought.

Purchases can be made in cash or credit. Both typically transfer ownership when the transaction is initiated even though the latter doesn't pay cash for good or service until some date in the future

Example:

Inspiration Clothing Co. is a company that sells apparel for women. The company business model is fairly straightforward; they have a supplier based in Los Angeles, called Wholesalers, Inc., that provides all the merchandise for Inspiration. The company has a purchasing department that deals with Wholesalers, Inc. and places purchase orders to keep the company stores fully inventoried. They have a pre-negotiated credit period of 15 business days after the order is received. When is this purchase actually made?

According to our concept, a purchase is a financial operation where goods and services are exchanged for consideration. In this example, there are two crucial moments, the moment in which a purchase order is issued by Inspiration and the moment in which that order will be paid for. In this case, Inspiration takes ownership of the goods and gives Wholesalers consideration in the form of a receivable or IOU. Thus, the transaction actually takes place when Inspiration receives the goods.

What Is a Fixed Asset?

A fixed asset is a long-term tangible piece of property or equipment that a firm owns and uses in its operations to generate income. Fixed assets are not expected to be consumed or converted into cash within a year. Fixed assets most commonly appear on the balance sheet as property, plant, and equipment (PP&E). They are also referred to as capital assets.

How a Fixed Asset Works

A company's balance sheet statement consists of its assets, liabilities, and shareholders' equity. Assets are divided into current assets and noncurrent assets, the difference for which lies in their useful lives.

Current assets are typically liquid assets which will be converted into cash in less than a year. Noncurrent assets refer to assets and property owned by a business which are not easily converted to cash.

The different categories of noncurrent assets include fixed assets, intangible assets, long-term investments, and deferred charges.

A fixed asset is bought for production or supply of goods or services, for rental to third parties, or for use in the organization. The term “fixed” translates to the fact that these assets will not be used up or sold within the accounting year.

A fixed asset typically has a physical form and is reported on the balance sheet as property, plant, and equipment (PP&E). When a company acquires or disposes of a fixed asset, this is recorded on the cash flow statement under the cash flow from investing activities. The purchase of fixed assets represents a cash outflow to the company, while a sale is a cash inflow. If the value of the asset falls below its net book value, the asset is subject to an impairment write-down.

This means that its recorded value on the balance sheet is adjusted downward to reflect that its overvalued compared to the market value.

When a fixed asset has reached the end of its useful life, it is usually disposed of by selling it for a salvage value, which is the estimated value of the asset if it was broken down and sold in parts. In some cases, the asset may become obsolete and may no longer have a market for it, and will, therefore, be disposed of without receiving any payment in return. Either way, the fixed asset is written off the balance sheet as it is no longer in use by the company.

THANK YOU