Purpose of an audit?
This note describes the purpose of auditing and contributes to an understanding of how the individual organisation can actively use the audit action for organizational development.

**What is an audit?**

An audit is an independent examination of records, procedures and activities of an organisation, resulting in a report on the findings. There are two main types of audit:

* **Internal Audit** – undertaken for the benefit of those inside the organisation, i.e. trustees, members and management.
* **External Audit** – primarily for the benefit of those outside the organisation, e.g. stakeholders and funding partners.

Audits are important for DPOs as they demonstrate a commitment to transparency and accountability and bring credibility to the DPO.

It is also a legal requirement in most countries to have the financial statements reviewed by an independent auditor once a year. This will be a core cost paid by the organisation, unless otherwise agreed to be apportioned in a fair and justifiable way across all cost centres.

The audit should be a positive experience and not one to be feared. Use the auditor to discuss ways of improving accounting systems and procedures.

**Internal Audit**

**Internal audit** involves a structured review of systems and procedures, as set by the Board and managers, to ensure efficient and effective practices. It is not an internal ‘policing’ function, rather an opportunity to improve systems and build internal capacity. It may be carried out by someone within or outside the organisation.

The independent review will include a range of checks, including:

* Financial accounting systems and procedures,
* Management accounting systems and procedures,
* Internal control mechanisms.

The ‘Three E’s’ influence an internal auditor’s approach:

* *Economy*: paying no more than necessary for the resources needed.
* *Efficiency*: getting the greatest benefit with the fewest resources.
* *Effectiveness*: how successful we are at meeting objectives or ‘doing the right thing’.

The internal auditor’s report will highlight their findings to the governing body and management and make recommendations for action, where needed. This could include a more detailed investigation, changing a procedure or training a staff member.

**External audit**

An **external audit** is an independent examination of the financial statements prepared by the organisation. It is conducted according to globally recognized audit standards (e.g. INTOSAI/IFAC).

External auditors may also be engaged to do other specific assignments, (e.g. a fraud investigation).

Although an auditor’s independence must be respected and observed at all times, they are nonetheless providing a service for a fee – you have a right to expect value for money. The audit must contribute to a sensible and appropriately organized operation of the organization.

Purpose

The purpose of external audit is to verify that the annual accounts provide a true and fair picture of the organisation’s finances, and that the use of funds is in accordance with the aims and objects as outlined in the constitution. The purpose of an **external audit is NOT**:

• To act as a fraud investigation,
• To prepare the accounts,
• To provide a certificate to say “there are no problems”,
• Proof that internal control systems are effective,
• Evidence that accounts are 100% error free.

Although it is not the prime role of the audit to detect fraud, this may of course come to light during the checks that take place. Auditors have thus been described as ‘watchdogs not bloodhounds’.

Appointment

An external audit can be conducted either as part of the annual review of accounts or as a dedicated project review (or as a special review by a donor agency). It is conducted by a firm of accountants with recognised professional qualifications, and the firm must be approvable by the Danish auditor.

Auditors are appointed by the Board of Trustees (or Annual General Meeting) or by a funding partner for a special audit like a fraud investigation or a project audit; the primary purpose of such a project review is to check that grants are being used as intended and in accordance with the budget in the original funding agreement.

They are independent of the organisation employing them. The auditor must not have been involved in keeping the accounting records and is not personally connected in any way with the organisation being audited.

What is involved?

Auditors only have a limited time in which to complete their work, so they concentrate on testing the validity of a sample of transactions and results rather than vigorously checking everything.

Sampling involves checking a selection of records, for example, a range of high value purchases or one month’s worth of transactions or a random set if transactions, based on auditors planning.

Note that if there are errors or fraudulent behaviour, due to the sampling process, the auditor does not guarantee to detect these.

The audit report

An external audit results in a report addressed to members, usually presented and approved at the annual general meeting. The report gives an audit opinion on ‘the state of affairs of the organisation and operations for the period’.

Reviewing your own or a partner’s financial statement, it is worth looking closely at the auditor opinion to see what it says. Everyone hopes for a ‘clean’ audit report – that is where the auditor confirms that the financial statements fairly represent or give a ‘true and fair’ view of the organisation’s financial statements.

Management letter

Auditors often provide a Management Letter after the audit is completed. This is separate to the audit report and is addressed to management. The report highlights weaknesses identified in the internal control systems and makes recommendations for improvements.

Managers have an opportunity to respond to the findings outlined in the management letter and explain what action they will take, inside the Management Letter.

The Management Letter is a key document in understanding the audits and the organisation.