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## There are Audits ... and Audits

Robert J. Antonides  
*South Dakota State University*

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# Economics Newsletter

Editor:  
Robert J. Antonides  
Extension Economist

Economics Department

South Dakota State University

Brookings 57006

(605) 688-4141

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## There are Audits ... and Audits

If you are the owner, or a stockholder, director, manager, or creditor of a business or other type of corporation, it is in your best interest to see that all of the decisions, policies and records of the organization correctly reflect its activities. Those records that involve financial transactions will be discussed here.

This concern also applies to public activities. Certainly you care how your tax dollars are spent and want to know that they are used in the best way possible and for the reasons they were collected.

If you aren't interested in any of these, creditors, bankers and others with a legitimate concern are. And, they like to know that the figures shown to them are true and accurate. It isn't that they don't trust you or your bookkeeper, but you may be asking them to loan you considerable sums of money or give you credit on the basis of financial statements that may contain misleading information.

If the books and records have been audited - certified - by an outsider who has an impartial interest in what they show and who is sworn to present his findings as clearly, accurately and impartially as possible, they will feel more comfortable. Sometimes such a person or company will be asked to prepare financial statements and, perhaps, to make some analysis of them. Sometimes, they just prepare the statements.

In a letter of transmittal, the auditor will set out in clear language what he was hired to do and what he found from his work. If he merely inspected the accounts and statements prepared for him, he will say so. This

is called a qualified audit. He can't say that everything is as it should be because he wasn't hired and paid to do all that work. Only if he thoroughly examines all of the accounts and VERIFIES their accuracy, can he give an unconditional, or unqualified, audit.

Consider for example the cash account. Usually it contains such items as currency in the cash drawer, checks, travelers checks, IOU's of some sort and credit card tickets. Various bank accounts may even be included under "cash". Obviously, some of these items are more liquid than others. The checks aren't really cash until they have been cleared and deposited to the business's account. The credit tickets aren't really cash until they have been accepted by the credit company and reimbursed to the business, usually some weeks later.

It is always possible, of course, that for any number of reasons an actual tally of all the cash items will not correspond exactly with what the account says should be there.

Depending on the business, a large proportion of the sales may have been on credit. In the records of the business, the sales were recorded as income for the year with a corresponding notation that particular sales were not for cash but were charged. Then it becomes important to know how long these "accounts receivable" have been on the books. If they have been there too long "good old Charlie" may be one that decides not to pay. In this case, the income shown on the profit and loss statement was actually too high, the account was no good and what the business man showed as his net worth on the balance sheet was too high.

If the business has a policy of charging goods for 30 days, the auditor will likely say so and that some accounts are long past due - perhaps three months, perhaps a year or more. He won't point a finger at any particular one, but the implication is that while he respects your concern for the "good old Charlies" who promise (again) to pay next month, it has nothing to do with good business practice. The good intentions of your customers do not pay your bills.

There are literally hundreds of other, usually more complicated, items in the books that the auditor performing an unqualified audit will look at. One common item is a depreciation schedule for equipment, machinery and buildings. He will be interested in whether proper account has been made for them, that their true values are neither over- nor under- stated on the balance sheet, and how much of their cost has been deducted from income as an expense.

In addition to the cover letter, words to this effect can often be found at the bottom of a page: "Prepared from

the books without audit". To the reader, that should be warning enough that the person or firm that prepared the statement did not look into the accuracy of the figures - because he was not asked to make a complete audit, he wasn't paid to, and he didn't. Because he didn't he isn't willing to stake his reputation on the figures he hasn't verified.

This is the traditional time of the year to check up on all aspects of the business. For reasons noted earlier, usually an independent third party is engaged to do the work and to express a professional opinion about your records and your business. Sometimes he may say things that seem derogatory, but then he wasn't hired to tell you how good things are, but to tell the story of the business as he sees it.

Usually, these third parties are Certified Public Accountants or accounting firms licensed to perform these services for you much as doctors and lawyers have been found competent in their fields. A good, complete, unqualified audit will cost some money; but the lack of one can cost a lot more!!

Robert J. Antonides, Extension Economist--Marketing

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