

# Module 3 - Independent Monitoring

- Need for Monitoring by Independent parties
  - Because accounting involves estimates and judgment, management has an opportunity to influence the outputs of the accounting process
  - Have incentive to prepare financial statements as favorable as possible



# Independent Monitoring

- Auditors check to make sure
  - accounting system is running as designed
  - resulting financial statements fairly present the financial performance of the company
- Two types of auditors
  - Internal Auditors
  - External Auditors



# Auditors

## ■ Internal Auditors

□ Independent group within the organization who:

- Monitor operating results and financial records
- Evaluate internal controls
- Assist with increasing the efficiency and effectiveness of operations



# Auditors

## ■ External Auditors

- Independent CPAs who are retained by the organization to perform audits of financial statements
  - Determine if they are prepared according to GAAP
  - Provide **reasonable assurance** that significant fraud or misstatement is not present in the financial statements
  - Review the internal controls to be sure they can be relied upon



# What do auditors do?

- Auditors use several different processes
  - Interviews
  - Observation
  - Sampling
  - Confirmation
  - Analytical procedures



# Are Auditors Independent?

- Huge debate on this topic
- Former chairman of the SEC Arthur Levitt felt that the auditor independence had been compromised by non-audit services provided by auditing firms to customers they audited



# SEC – Securities and Exchange Commission

- Government body
- Responsible for regulating the financial reporting practices of publicly traded companies in connection with the buying and selling of stocks and bonds



# SEC

- Securities Act of 1933
  - Companies planning to issue new debt or stock securities to the public to submit a registration statement to the SEC for approval
- Securities Exchange Act of 1934
  - Requires all public companies to file detailed period reports with the SEC
    - 10-K – filed annually within 90 days of the close of the fiscal year
    - 10-Q – filed quarterly

