What is an Audit Trail? And Why It Is Important in Finance



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Whether you're using a manual recordkeeping system or an automation accounting solution, you'll need to maintain an audit trail.

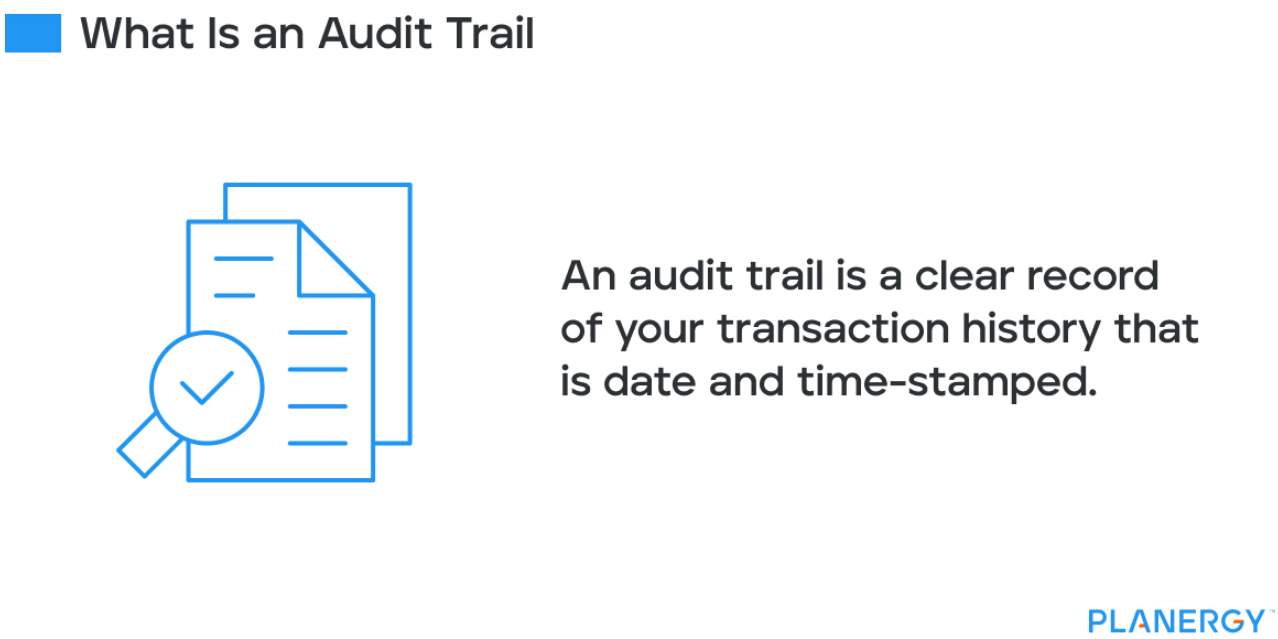
A more difficult task for those managing business finances manually, most accounting software solutions offer some level of audit trail capability.

Though primarily used for financial purposes, the healthcare industry also relies

on an audit trail to track patient health information and remain in compliance with HIPAA regulations.

But what is an audit trail and why is so important for your business that you maintain one?

What Is the Purpose of an Audit Trail?



An audit trail is a clear record of your transaction history that is date and time-stamped.

Even though businesses use financial statements to provide a summary of financial activity for an accounting period, an audit trail provides the behind-the-scenes details on your financial statement totals.

There are numerous types of audit trails, but we'll concentrate on a financial audit trail, which provides proof that the transactions posted to your system are both accurate and necessary.

A proper audit trail also offers details on who made changes to financial data, when the change was made, and includes any related backup details to verify that the transaction was warranted.

It’s important to distinguish between an audit log and an audit trail.

An audit log is a record provided by your accounting software application that details any changes made to your system, while an audit trail is the backup documentation that verifies the authenticity of any transaction that is posted.

When used together, they provide a safety net for businesses that work to hold staff accountable for any posted transactions.

Audit Trail Example

One of the machines on your assembly line unexpectedly stops working.

To keep production levels up, you need to replace the machine as quickly as possible.

The procurement department issues a purchase order for a replacement machine, and when the machine arrives, there is a packing slip included with the shipment.

Days later, the invoice arrives, where it is matched with the purchase order and packing slip, and then sent for approval.

Once the invoice is approved and paid, the purchase order, packing slip, invoice, and payment details (check, ACH transfer, etc.) are attached and filed as backup for audit purposes.

If an auditor requests details on the purchase, all of the necessary documentation is in one location and serves to verify that the purchase is authentic.

What Does an Audit Trail Report Show You?

An audit trail report, often referred to as an audit log, provides a chronological record of all user activities displayed in real time.

Audit logs help pinpoint potential issues, and can help point managers in the right direction if issues occur.

While audit logs can pinpoint potential problem areas, an audit trail provides the

detail needed to ensure that all accounting transactions are done for a legitimate reason.

For example, you review the audit logs for last week and see that one of your accounting staff repeatedly posted changes in the general ledger.

In most cases, this would not be cause for alarm, but the employee in question does not normally post journal entries.

For instance, when notified of the changes made by the employee, you research the transactions.

During your research, it’s determined that the employee in question is covering for another employee on vacation and is able to provide sufficient backup information for all of the journal entries that were posted.

How Do I Get an Audit Trail?

Audit trails always start with a source document or an original document.

The document could be a request for purchase, a purchase order, an invoice, or a receipt.

Any transactions that are directly related to the original source document become part of the audit trail.

For example, if you are writing a refund check for a customer who overpaid, the audit trail should consist of the following documents:



- The original sales document
- The invoice sent to the customer
- The payment the customer made
- The credit balance on the customer's account
- The payment issued to the customer for the credit

Having all of this documentation in place indicates that the refund was legitimate and not an instance of fraud.

What Is an Audit Trail in a Computer System?

An audit trail provided by your computer system is considered an audit log. An audit log provides a detailed sequence of events for every user ID.

This includes sensitive information such as user access and data security levels, the level of data access controls currently in place, and any data deletions made.

A computerized audit trail can help management track unauthorized access, track potential security breaches, and view which electronic records or other sensitive data has been accessed.

What Are the Benefits of an Audit Trail?

Keeping track of your financial transactions is an important part of your managing your business.

But having a proper audit trail in place also provides you with a host of benefits, including:



Fraud Prevention

Having an audit log and maintaining the proper audit controls makes fraudulent activities a lot more difficult.

Being able to detect suspicious activity at the source makes it easier to spot and halt any suspected fraud before it can damage your business.

Makes Audits a Lot Easier

Both internal and external audits are easier and less stressful when a proper audit trail exists.

The use of a proper audit trail ensures that every transaction examined has the proper documentation in place to solidify its authenticity.

It also makes the audit a lot easier for the auditing firm when business

processes and system activities are recorded properly, resulting in a quicker audit process and lower audit fees for your business.

- ### Keeps Your Business in Compliance

  If your business is publicly owned, you need to have the proper audit trail in place to remain compliant.

  However, even small businesses that are not required to be GAAP compliant will benefit from having the proper audit trail in place.

- ### Provides Reassurance to Investors and Lenders

  Having the appropriate audit trail in place gives investors and lenders alike the confidence they need to invest in your business, either as a shareholder or a lender.

- ### Lowers the Number of Errors

  Not every red flag is fraud. Mistakes happen. But even mistakes can cost a company in terms of profit and credibility.

  Using an audit trail allows businesses to spot small mistakes before they become big ones.

What Are the Challenges of Keeping an Audit Trail?

Even though the benefits of maintaining an audit trail far outweigh the challenges, being aware of the challenges lets you manage them better.

One of the biggest challenges is time. This is particularly true for those using a manual accounting system since a proper audit trail consists of managing receipts, purchase orders, invoices, packing slips, bank statements, and other related documents.

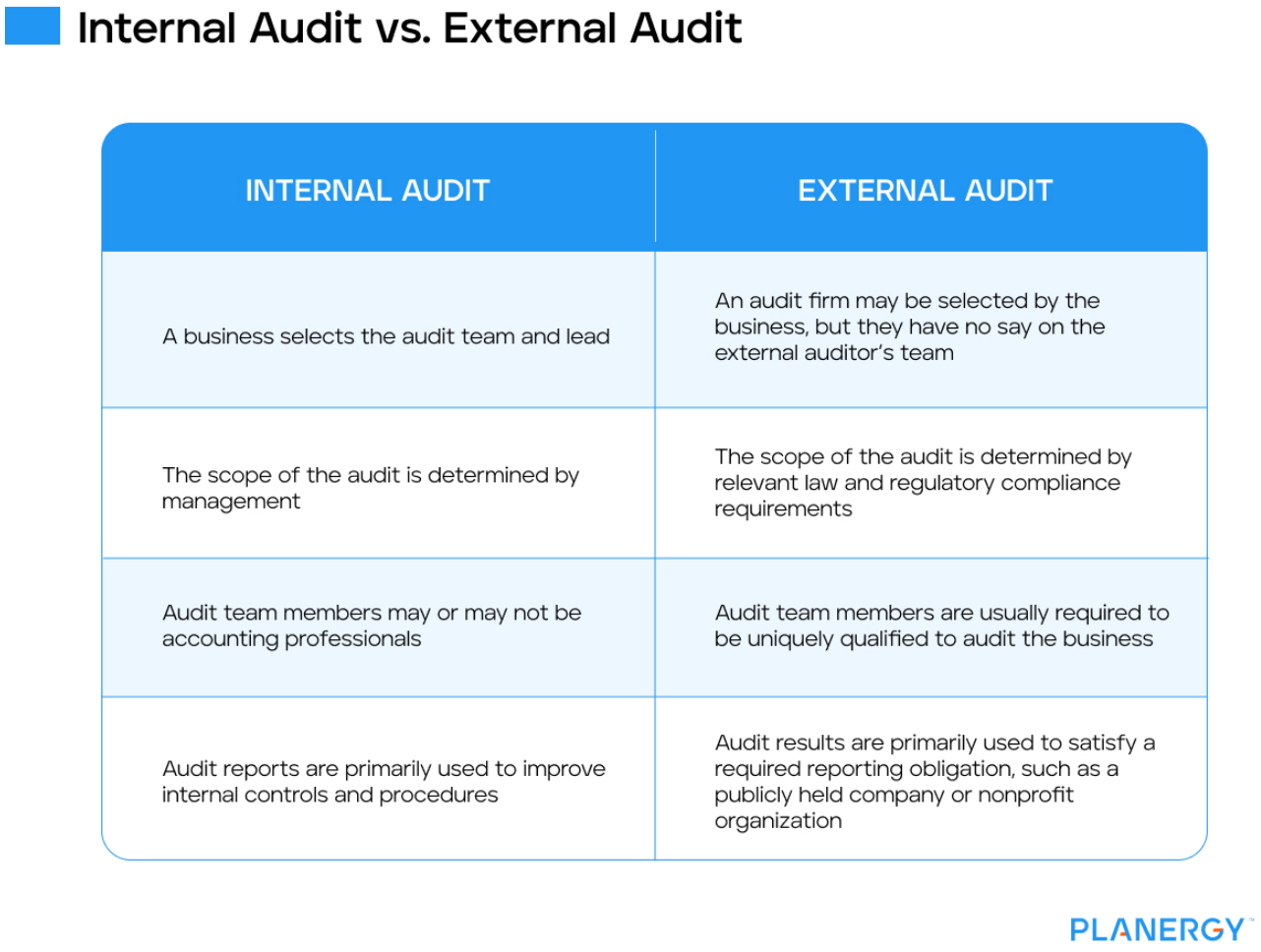
Another related challenge is the proper storage of all of the documents.

If you're using paper documents, you'll need to store and file multiple documents for a single vendor payment otherwise, you won't have reliable audit trail data.

Internal Audit vs. External Audit

Internal audits and external audits have the same goal in mind; to analyze the internal processes and procedures in place, identify areas of weakness, and make recommendations on improving processes.

However, there are some differences between these two types of audits.



Internal Audit	External Audit

A business selects the audit team and lead	An audit firm may be selected by the business, but they have no say on the external auditor's team
The scope of the audit is determined by management	The scope of the audit is determined by relevant law and regulatory compliance requirements
Audit team members may or may not be accounting professionals	Audit team members are usually required to be uniquely qualified to audit the business
Audit reports are primarily used to improve internal controls and procedures	Audit results are primarily used to satisfy a required reporting obligation, such as a publicly held company or nonprofit organization

An internal audit is usually viewed as less formal than its external counterpart, with an internal audit used by management to identify and improve weak areas while an external audit often focuses on regulatory requirements such as those instituted by the Sarbanes-Oxley Act and is typically used by those outside the business.

What Is Materiality in Auditing?

Materiality is a financial reporting concept rather than an auditing concept and refers to the importance of a specific area of financial reporting.

However, materiality does play a role in financial statement auditing, when auditors are tasked with determining the authenticity of financial statements.

Materiality is the basis used to determine whether a discrepancy, omission, or misstatement will have a significant impact on management's decision-making.

For example, a discrepancy of $1 in financial statements is considered irrelevant, but a discrepancy of $100,000 would significantly impact the decision-making of financial statement users.

If your financial statements show assets $100,000 higher than they actually are, you may decide to fund a new project or hire an additional employee.

If your financial statements reflect $100,000 less in assets than what is accurate, you may forego upgrading equipment or adding an employee.

The Best Solution to Implementing an Audit Trail

Improving processes, reducing fraud, and eliminating errors are just a few of the benefits of maintaining an audit trail.

The best way to implement an audit trail is to use an automated accounting software application like PLANERGY that streamlines the entire audit process, whether internal or external.

Having an automated system also reduces the amount of time needed to complete an audit, resulting in lower audit fees.

Stop wondering if your team is doing things the right way. By instituting a proper audit trail for your business, you'll be confident that they are.

What's your goal today?

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