

Auditing smackey's dog foods inc

Finance



The Sarbanes-Oxley Act of 2002 contains eleven titles that deal with regulations of public auditing and accounting standards in the United States. The second chapter is concerned with external audit independence to limit conflict of interest, new auditor approval requirements, audit partner rotation plus auditing reporting standards. The nine sections also limits auditing firm from providing non-audit services to the same client. The regulatory and oversight watchdog is the Securities and Exchange Commission. The relationship between an auditor (Ben) and audit client's employee, Anita violates the act and thus professional objectivity of Ben in carrying out his audit task might be impaired. The SEC will, on receipt of such information, declare the audit report prepared as unprofessional. Thus further legal measures may be undertaken to ensure total integrity of the audit report. The audit manager, Pete, in his talk with audit client general manager's former husband, Allan, over the audit details, violates the legal barrier that exists between the auditing firm and the audit client. Since these two incidences violate the accounting role or financial reporting oversight role of the act, the SEC will need to evaluate such a process and attest to its integrity (Kuschnik, Bernhard, 2008)

For every auditing firm, prior to undertaking the audit process, there are essential preliminaries that the firm undertakes before auditing a client.

- Client acceptance or continuation. Whether there is an audit task for an existing or new client, the auditing firm determines if it should accept the task or not. The audit firm assesses whether it would be in the best interest to associate itself with the new client or whether the benefits associated with the existing client outweighs the challenges. XYZ CPAs will therefore,

evaluate the past financial disclosures of Smackey Dog Foods, Inc and weigh the risks to its reputation.

- The audit firm should promptly determine the reason for the auditing process. For an auditing firm, clear details on the auditing need to be established so that it is known early whether the audit report is for securing credit facilities from a bank or not.
- Obtain an understanding with the client. This is essential in minimizing misunderstandings between the concerned parties. It is a legal requirement that auditors obtain an understanding with the client in a written form.
- Develop an overall audit strategy. For XYZ CPA, this strategy will involve assessing where the risks seem to be concentrated, estimating the resources needed for the exercise and number of audit staff required.

When such initial evaluations have been carried out, XYZ CPA, in carrying out its auditing, will follow the four phases. Phase one involves acceptance of the audit engagement. After evaluating the audit risk, auditor business risk and the client business risk, the auditing firm accepts the engagement. This acceptance may also depend on integrity of client, assessment of competence to perform the tasks, evaluation of independence plus the timing of auditing. Last step in accepting the engagement involves the drafting of the engagement letter, which serves as the contractual agreement between the auditor and the client. This letter involves the financial statements to be audited, professional standards to be followed by the auditor, the basis for computation of fee payable plus other billing arrangements.

The second phase of audit process is planning the audit. This planning depends on size and complexity of the client plus. Also past knowledge and experience with the client also hastens this phase. Steps in this phase include obtaining an understanding of the client business. This involve structure of management, businessgoals, tour of Smackey Dog Foods, Inc's premise, other interested parties to the business and the core process and operating cycle. Management will also be expected at this phase to furnish the audit firm with all the entity resources plus the associated customers, markets and the source of competition.

Third phase involves the auditing itself. This involves performing analytical procedures, which is the evaluations of financial information made by a study of plausible relationships among both financial and nonfinancial data. Involves deciding which calculations will be made like ratio analysis, comparison of closing balances with previous balances. It also involves development of expectations based on trend analysis. Smackey Dog Foods, Inc, the audit firm will look at the accounts receivable and other accounts like the return inwards to check how projected sales are falling and why internal control weakness like the gap that is left by allowing Ken to monitor and supervise himself

Phase four is the reporting of the findings to the client, which forms the end of the attestation period. The draft report if presented to the client for response, which will be included in the final report. This report contains all the scope of the exercise. When the auditing is forensic related, the report includes details of suspected culpable individuals.

On identification of internal control flaws in the financial statements, the audit firm will communicate to the client whenever there is deficiency, significant deficiency or material weakness in the internal controls. This deficiency will be communicated by XYZ CPA to the management in writing. Internal control process charges staff and management with provision of assurance towards an entity meeting its objectives in financial reporting, effectiveness and efficiency of operations and guarding of assets against unauthorized acquisitions, use or disposal. First internal control problem relates to the prepayment of sales commissions.

The projected sales are always off by 11% which means that revenue and associated expenditure are not matching and hence Smackey Dog Foods, Inc is paying for more than it should. Secondly, the unauthorized acquisition of bags of the premium Best Boy Gourmet dogfood by Henry is a serious case of theft that the management should be concerned with. Such practice eats into the revenue of the company.

In auditing the accounts receivable, various confirmation tests will be run. The confirmation types consist of positive and negative confirmations. For positive, the recipient is required to respond to the audit query whether the balance of account is correct or incorrect while in negative, the recipient responds only if balance is incorrect. Positive confirmation is the best type as it excludes any ambiguity that arises due to unanswered questions. Confirmations that are to be made are for those accounts with old unpaid items, which follow the aging schedule. with those that are in arrears for over 120 days first followed by 90-120 days, up to the current one that has just gone into arrears. Also accounts written off during the year under review

plus those that registers zero balances will need confirmation details. A schedule of accounts to be confirmed is prepared which shows confirmation number, name of account, address of account, receivable balances, balance confirmed, the difference plus the reason for the balance, if any. Such ways ensures that reliability of revenue figure can be established and return inwards, if any calculated.

For auditor choosing a sample size, the most important factors to consider includes, the level of tolerable misstatement, the inherent and control risk associated with such a choice, achieved detection of risk from such procedures and type of confirmation that is to be adopted by the auditor.

In dealing with real assets with the legal encumbrances, auditors need to have a confirmation of all the information and details over items and rights over them. These assets should be studied in detail to establish whether they are being used for the purpose they were meant for. The main concern is whether such encumbrances have been treated as assets or expenses in the appropriation account, but when the legal matters are settled, the value for such should be checked in relations to the accruals in purchases.

Attestation of the client's inventory is very important to the validity of any auditing report. This inventory can be compared with the closing stock to establish the correct value of sales revenue. Such practice will help the auditor verify in there has been any cases of unauthorized access to an entity's products.

Among the documents that would used in the auditing of the inventory and warehouse cycle includes the purchases ledger, to determine the true cost of

the raw materials, invoices, to show the correct quantities of raw material bought. Also, all the documentation that pertains storage of the raw material, processing of goods, the storage of final goods and the shipment of goods produced. The biggest internal flow is that only one person is dealing with the production and shipment of Smackey Dog Food's regular line of product, which gives him the chance to defraud the company.

The relationship between an auditor (Ben) and audit client's employee, Anita makes the professional conduct of the entire audit process doubtful, which might be challenged especially when an adverse report is prepared. The auditing firm is fully liable before a legal system, whenever mistakes that border on professionalism are detected in their reports which might give ground for litigations.

Reference

Kuschnik, Bernhard ;(2008) The Sarbanes Oxley Act: " Big Brother is watching" you or

Adequate Measures of Corporate Governance Regulation? Rutgers Business Law

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