

Auditing and assurance (individual case study assignment)

[Finance](#)



Auditing and Assurance: Individual Case Study Assignment Word Count:

1842 (7 pages Referring to the work performed by the audit senior, Michelle O'Loughlin and other relevant background information, determine whether the business risks for each of the 10 segments (accounts) identified in the memorandum would be significant (or insignificant). Justify your evaluation based on the information provided. [350 words] Business risks identified in the memorandum seem to be potential problems, but that is just the tip of the proverbial iceberg of the problems that are wrong with this company.

First of all, the salaries for the people at the two top levels are Tony Lockett and Peter Roos. If one is not mistaken, Tony Lockett's salary increased from about \$240K to at least \$300K or more from 2009 to 2010. That raises a red flag, first of all, because—no matter how stressful or important Mr. Lockett's job is—he should not necessarily be pulling in a salary of over \$200K just for being a head manager of everything. If anyone, it seems that Li Wong, the accountant for the company, should be making more money. However, there are significant problems with the way this company's resources are being used. Therefore, it is recommended that whoever is the accountant be paid according to his or her worth in the company—and not because of race or gender. It was noted that the top two females in positions of power at the Sealant company are paid only \$40K or so in 2009, and then up to \$60K in 2010—while their overseeing manager made at least 5 times the lowest salary of the women in 2009. Something is savagely inequitable about this fact, as well as the fact that the only Asian person in the company is making about the same as what the flunky office workers are making (around \$40K). This is not sufficient income for the job that Mr. Wong should be doing. Right

now, he is not at his optimal performance and so are several other employees. Therefore, some human resources decisions need to be made—i. e., deciding to fire and rehire someone. “ Employment at will is the fundamental law in [almost all states excepting Montana]...Employers should work hard to preserve the at-will nature of the relationship” (Muller, 2009, pp. 231). Employers should use progressive discipline in order to help their employees improve, “...a series of attempts [to help] poor-performing employees...” improve performances (Falcone, 2002, pp. 141). Part 1

SEGMENT BUSINESS RISK JUSTIFICATION 1 Credit sales cycle and trade receivable Significant The percentage change of trade receivable is 74% is lot more than sale revenue 19%, and the risk of processing error exists in sale transaction. Sales transaction processing is growing, increasing the risk of processing errors. And the company is current lack of written procedures, it might lead to trade receivable recorded does not exist, or part of the credit sales was replicated or missing. Therefore, trade receivable is overstated or credit sale is understated.

2 Cash receipts and payment Significant Cash is easily to be stolen, made payment to unauthorised or non-existent persons, and the balances could be manipulated and covered up by fraudulent of bank reconciliations. Overstatement of cash receipt will occur. Moreover, the company is not using hedging transaction; so there is a significant risk of exchange rate gain and losses. It will lead to the over- or understatement of cash payment to US supplier.

3 Purchasing cycle and inventory balances Significant The inventory is recorded before SP receives it, and the lead time in receiving the raw materials may increase the risk of inventory shortage. The inventory maybe overstated.

4 Investments Significant Securities is

similar to cash, they are susceptible to theft. The percentage change of marketable securities is 525% and treasurer may use his knowledge to misappropriate the securities so investment may be overstated. 5

Prepayment Insignificant The low volume and complexity of transactions reduce the risk of misstatement. And accounting staff is familiar with such prepayments. 6 Property, plant and equipment Insignificant PPE is difficult to steal, and very low volume and complexity of transactions reduce the risk of misstatement. Although, the determination of capitalise or expense might increase risk of misstatement, but the nature of the classification issues is unlikely to lead to a material error. 7 Trade payables Significant There is a significant risk of failure to record liabilities, and the potential for miscoding of accounts. And the new assistant is not familiar with SP procedures, there is an opportunity that liabilities may be omitted, therefore, trade payable may be understated. 8 Accrued liabilities/ payroll Significant A fictitious employee could be included on the payroll master list, the accrued payroll maybe overstated. There is also the potential for contingent liabilities, legal issue about unfair dismissal, would not be recognized; it may understate the accrued liabilities, which maybe material to the financial statement. 9

Borrowings Significant SP has had to borrow significant amounts, and it requiring present value calculations, which involve subjective estimation, it may increase the risk of misstatement of borrowing. 10 Equity Significant These entries require subjective estimates, complex, and are normally very material. Therefore lack of knowledge will increase the risk of misstatement.

1. With reference to the background information available: a) List internal control strengths for credit sales (2 strengths) and trade receivables (2

strengths). [1 mark] [75 words] The two strengths that credit sales department has is that its manager, Chris O'Brien, is very much in control of what goes on in the department. Additionally, it seems that credit sales is one of the more reliable departments. Trade receivables has the strength that Jessica seems like a capable enough manager, and an additional strength is that she has all of the necessary paperwork available (including a manual) to help her do her job. Additionally, the credit controller needs to: 1) approve all the orders and sales manager respectively to certify orders are correctly authorised; and 2) make sure all the invoices are sequentially numbered to allow physical control of the documents. b) Describe 3 significant internal control weaknesses and strengths over trade receivables. [40 words] Three significant internal control weaknesses include the following items: 1) there is no formal budget; 2) anyone has access to the books; and 3) Jessica is not that experienced, and so Mary Bayes handles the financial reports due each month. Internal control strengths are the following. The debtor ledger is reconciled to the general ledger control account and all the accounts are aged monthly to make sure that everything should be recorded properly. The trade receivables clerk will send notices to those debtors who are not paying within 30 days and call customers for payments. c) For each weakness identified in b), outline a possible error that may result. [150 words] The result of there being no formal budget means that the company can get loans for various items, make purchases, and so forth—but there is no real forethought on the part of the future of the company. If the company wants to stay in business to pay the bloated salaries of its workers, it must have a budget—because without a budget the

company will go bankrupt. The second issue is that, allowing everyone to have access to the accounting books, someone could change or switch the numbers, thus committing fraudulent activity. Of course, it's probably not likely to happen if everyone is doing what they are supposed to be doing, but it's not a good scenario. Jessica is not that experienced, so having Mary Bayes to prepare the financial reports is not a good idea, especially if the company depends on her for everything regarding the company's finances.

d) Describe a substantive test that would assist in possible detection of the error, assuming the required information is available to you. [5. 5 marks for b), c) and d)] [91 words] A substantive test that would assist in possible detection of error would be looking over the accounts receivable and the accounts payable (AR and AP). Basically, this would require possible detection of errors in the accounting in either department. Since this company basically has no budget, this means that there must be some kind of balancing of the accounts—with, hopefully, more revenue coming in than money going out. This is going to take some careful planning, but it can be achieved with an accountant reviewing and auditing the company's finances.

2. Outline your overall assessment of internal controls over trade receivables and whether you plan to perform tests of control. [1 mark] [60 words] I would probably recommend much more to focus on trade receivables (i. e., the revenue), versus the assessment of internal controls. This is because the biggest issue is with trade receivables not having a reliable enough system as to what money is coming in. Internal controls are still important—just not as problematic as what's going on with the trade receivables. There are three identified control weaknesses that will lead to a material misstatement.

As a result, internal control cannot be measured as effective and reliable, therefore, substantive tests should be carried out, and a test of the control is not suggested.

WEAKNESS	POSSIBLE RESULTING ERROR	SUBSTANTIVE TEST TO DETECT ERROR
1 Trade receivable clerk is responsible for both postings and adjustments to debtors' subsidiary ledger, and prepare cash receipts list. There is no segregation of duties. Trade receivable clerk will have opportunities to manipulate debtors' account by not recording the actual payment, so the payment can be stolen.	1. Independent 3rd party confirmation, send confirmation statements to selected debtors, or requests for confirmation of recorded data	2. Subsequent review of individual receipts
3 The company does not require any security procedure in accounting ledgers and journals accessibility. There is no physical control of documents, therefore all staff can easily access to those accounting records such as trade receivable. Information leakage and account detail can be deleted or changed without noticed. As the supervisor has password access to all functions of the system, including adding and modifying account details.	1. Select sample from different documents such as sales invoice, cash receipts and delivery dockets, matching of independently generated document, to find out the missing item.	2. Comparison with independent 3rd party information, bank reconciliations with general ledgers and journals.
4 Creditor controller can writes off bad debts, by signing the ' Potential Bad Debt' form, but without double checking. It is improper authorisation for require one person signature and without physically checking the bad debts. Trade receivable clerk can steal cash by writing off the bad debt even it has been actually received.	1. Send confirmation statements to selected bad	

debts that have been written-off to confirm whether the amount has been paid or not 2. Subsequent review of individual receipts BIBLIOGRAPHY

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