

The audit of smackey dog food, inc. essay sample

[Finance](#)



The Smackey Dog Food, Inc. is a family owned business. It was started by three sisters, Sarah, Kim and Jillian, in the kitchen of their home. They lived in a suburban area of Chicago, Illinois. Their business is making all natural dog food. After using their own dogs and the neighbor's dogs as test subjects, it was discovered by local vets, pet stores and grocery stores. These local places began to distribute the dog food. The demand for their food began to increase and they moved their business to a larger facility and hired additional workers. As compared to competitors, Smackey Dog Food, Inc., began to rise significantly. Due to the increase in sales, the sisters decided to expand and add a new division called Best Boy Gourmet. In order to secure an additional loan for their expansion, the bank has requested an audit of the current financial statements. Sarah, the President and General Manager of the company is sure the company will be able to get the loan based on projections from Jillian and her sales team.

Keller CPA's was hired to perform the audit. My team and I will create a plan for the audit and form an opinion about the financial statements which will be reviewed by the bank in order to get the \$150, 000 loan. Q1. Discuss how the SEC has influence (if any) over the audit of Smackey Dog Foods, Inc. The SEC (Securities and Exchange Commission) has influence over this audit because Keller CPA's have to meet the required standards as set by AICPA Code of Professional Conduct. The auditors have to make sure they can maintain independence, responsibilities, the public interest, integrity and objectivity. Independence and integrity may become a problem due to the relationship between Pete and Alan. If this were to prove a problem, the SOX regulation would come into play. Q2. Discuss the essential activities involved

in the initial planning of an audit. How do these all specifically relate to the Smackey Dog Food client? The essential activities involved in the initial planning of an audit that are specifically related to the Smackey Dog Food client are the following: 1. Understanding the business.

Keller's CPA's admit to not knowing too much about the dog food business. They will have to rely on any knowledge they have from other food manufacturing companies and adapt it to Smackey's Dog Food. 2. Assess the business risks. Waste is one the factors that can cause major material misstatements. Also the problem they have with restocking in a timely manner. This may have a major effect on Smackey's objective to expand. 3. Perform preliminary analytical procedures. In order to show where there might be a risk of misstatements, Keller CPA's would have to compare Smackey's with other dog food manufacturers. 4. Set materiality and assess acceptable audit and inherent risk. Since materiality is a relative rather than an absolute concept, the auditor would have to use his/her own judgment in order to assess any acceptable audit and/or inherent risk. 5. Develop an overall audit plan and program. The audit team needs to develop a plan to reach audit risk objectives in order to provide a reasonable basis for the audit's report and opinion. Q3. Discuss the 4 stages of the audit and how each applies to the Smackey Dog Foods: 1. Planning is the first stage of the audit.

The auditor needs to understand how business is done. In this case, they need to know how Smackey Dog Food operates and how it compares to other dog food manufacturers. They would need to figure out why Smackey's business is booming while their competitors are failing. In this stage, they

<https://assignbuster.com/the-audit-of-smackey-dog-food-inc-essay-sample/>

also need to list what documentation they would need, look at previous audits and request the necessary statements. They also have to create the scope of the audit and set the objectives. 2. The next stage is Preliminary Review. This is when the auditor has to take a look at the company's internal controls. The auditor has to make sure that he can perform the audit as planned or he may have to make changes in order to accommodate for any differences between the ways he believed the company is run compared to how it is actually run. In this stage, the auditor should meet with company heads and discuss the processes of the internal accounting and also accept any recommendations from the organization. 3. The third stage is Fieldwork. During this stage, the auditor should observe firsthand how the company operates.

They need to check out all the areas that are less effective to the welfare of the company's finances. In the case of Smackey, the auditor would note about all the returned dog food from their specialty line that is just sitting on the loading dock. They also noticed that the dog food is being thrown out and then taken back and loaded into Henry's trunk (possible misappropriation). 4. The final stage is the Audit Report. This is when all of the above come together to create the report. This report will list any recommendations that the auditors feel are areas in need of changes. In regard to Smackey's, the auditors would recommend that Kim have more interaction with Henry. She needs to know more about what is happening at the loading dock. Kim needs a firsthand look at the loading dock and the paperwork. They would address the fact that Jillian puts too much trust in her sales team and is unaware of actual projections. Because of her lack of

accounting knowledge, she has allowed too much commission to be paid to the team instead of waiting for actual numbers or even adjusting commissions after receiving the actual numbers. Q4. Describe Keller CPA's responsibilities related to communications regarding internal control matters. What internal controls issues do you identify?

As designated by GAAS, Keller CPA's created a list of internal control problems. They presented them to Smackey's management in writing as follows: 1. As stated above, the sales commissions are being paid on an estimated sales basis and not on actual sales. This is financially hurting the company because the sales people are possibly being overpaid and not refunding any differences. Could be a form of embezzlement. 2. There were no set rules for the handling of returns. There was only one person in charge of handling the warehouse records which opened the door to misappropriation of goods for example Henry putting cases of dog food in his own car. 3. There are also no set rules for inventory management. Again, there is only one person in charge of production and inventory. There needs to be a segregation of duties. 4. There are no set guidelines and procedures for the Accounts Receivable. Although their major buyer, Pup Stores Inc., usually pays within 30 days, Pup Stores, Inc. are facing a major lawsuit from an animal rights group which is reducing the company's cash reserves. This could cut in on their timely payments. They need to reexamine payment terms.

Q5. You decide that you will address Smackey Dog Food, Inc.'s accounts receivables through confirmations. Discuss the various types of confirmations and what forms you will implement and why. There are two <https://assignbuster.com/the-audit-of-smackey-dog-food-inc-essay-sample/>

kinds of confirmation forms. They are positive and negative forms. The positive forms are usually requests of verification of the information stated. Sometimes a blank form will be sent asking the recipient to fill in the blank in order to compare the information. The negative forms request the recipient to respond only if they disagree with the information listed. In the case of Smackey's, I would recommend the positive form of confirmation. The auditor should request verification of the information they were given by the company.

Q6. What are the major factors affecting sample size for confirming accounts receivable? There are five important factors affecting the sample size in confirming accounts receivable. They are as follows:

1. Materiality – the opinion of the auditor that financial statements were prepared according to GAAP.
2. Inherent Risk (size of accounts receivable, the total amount of accounts, comparing to past years and expected misstatements)
3. Control Risk – a probable misstatement due to a lack of controls
4. Achieved detection risk – using a large sample size
5. Type of confirmation – positive confirmation usually needs a smaller sample size.

Q7. A major issue in verifying the ending balance in property, plant and equipment is the possibility of legal encumbrances. Discuss what specific concerns you have. Describe the procedures your firm will perform to obtain evidence about existing legal encumbrances. The procedures that would be used to obtain evidence about existing legal encumbrances are:

1. Check over the notes from the property, plant and equipment inventory.
2. Look over the minutes of the meetings.
3. Speak to the people involved with the property, plant and equipment.
4. Look at all lease agreements and contracts for property, plant and

<https://assignbuster.com/the-audit-of-smackey-dog-food-inc-essay-sample/>

equipment 5. Research the lawsuit of Pup Stores, Inc.

6. Look over the hiring requirements because of the employee who lost her job because she did not have a dog. These procedures are necessary to make sure there are no possible legal problems that could affect the audit.

Q8. The client wants to know if you will be present at the year-end inventory.

What is your decision and why? What role or actions will you take at the inventory if you decide to attend the inventory? Why? My team and I would definitely be present at the year-end inventory. It is our responsibility to make sure that the inventory is being done correctly and thoroughly.

We would have to oversee the correct counts especially when it comes to the waste products sitting on the loading dock. Q9. Considering the general six functions that make up the inventory and warehousing cycle for Smackey Dog Foods, Inc., identify the related documents and/or records that would be used. From your analysis of the internal controls related to the inventory and warehousing cycle of Smackey Dog Foods, Inc., what internal control weaknesses exist? Looking at the general six functions that make up the inventory and warehousing cycle are:

1. Processing purchase orders and processing quotes from vendors.
2. The receipt of the raw materials
3. Storing the raw materials
4. Processing the goods
5. Storing the finished goods
6. Shipping the finished goods

The internal control weaknesses that exist at Smackey's are as follows: 1.

They have no detailed regulations for returned goods. They leave the returns

<https://assignbuster.com/the-audit-of-smackey-dog-food-inc-essay-sample/>

sitting on the loading dock when they should be putting them back into inventory and shipping them out immediately. 2. There is no segregation of duties. Henry is in charge of everything. He receives the purchase orders, processes the goods and is in charge of shipping. He also handles all returns and any documentation. This creates an opening for misappropriation and/or errors. Q10: Discuss if Keller CPAs or its auditors are breaching any Professional Rules of Conduct and why or why not? I believe that Pete is definitely violating the code of confidentiality (Rule 301). He should not be discussing any part of this audit with anyone especially someone who has personal affiliation (in a roundabout way) with an employee of the company. In this case, Alan was married to one of the owners (Kim) but is no longer married. Because he is breaking confidentiality over a few beers, Pete is also putting a strain on his own integrity.

I don't believe the crush that Ben had on Anita is a violation of anything in itself. However, it could lead to a violation because he didn't reveal it and it could hurt his independence status and his objectivity. Q11. Discuss the CPA firm's legal liability concerns for this audit if they make a material unintentional or intentional mistake. Include any other legal liability concerns regarding possible Professional Rule Violations. " CPAs have an obligation to their clients to exercise due professional care. With an engagement letter, it provides the client and other third parties with rights of recovery. Therefore, if the CPAs are not performing within the agreement set forth in the contract this will be considered a breach of contract. The clients may also claim negligence against the CPAs if the work was performed but contained errors or was not done professionally."

This would probably refer to any unintentional or intentional mistakes Keller CPA's could make. It would probably refer to the concealment of Pete and Alan's impropriety questioning Pete's integrity. It could also refer to the nondisclosure of Ben's crush on Anita, the bookkeeper. Since the bank is involved in a financial way to this audit, the bank could withdraw any funds it may have issued to Smackey Dog Food, Inc. to help it expand. This could hurt Keller CPA's reputation and open them up to a lawsuit regarding breach of contract.

Works Cited

http://clubs.cob.calpoly.edu/~cmiller/446_01/Handouts/05%20overview%20of%20Legal%20liability%20of%20cpa.pdf