

# Ocean manufacturing as an audit client

Finance



5(a) Prepare a memo to the partner making a recommendation as to whether Barnes and Fischer should or should not accept Ocean Manufacturing, Inc. as an audit client. Carefully justify your position in light of the information in the case. Include consideration of reasons both for and against acceptance and be sure to address both financial and nonfinancial issues to justify your recommendation. MEMORANDUM To: Jane Hunter From: Corrine Subject: Ocean Manufactory Should be Accepted Date: February 3, 2012 Ocean Manufacturing, a medium-sized manufacturer of small home appliances, is our prospective client.

First, we should decide whether to accept this client. The purpose is to minimize the likelihood that our auditors will be associated with clients who lack integrity. We can reduce the risk that material misstatements may exist and not be detected by the auditor. Therefore, we need to investigate the client and obtain certain information that we need. The first step to evaluate the client is to confer with the predecessor auditor. The client granted me permission to contact the previous auditor and he indicated the problems the firm had with Ocean: (1) complexities and problems with Ocean's new IT system 2) management's tendency to aggressively reflect year-end accruals in order to meet creditors' requirements As far as we know the company switched to a new system in 2011 and the transition to the system was not well managed. The company was working to modify the system to make it better. Also, our local office's IT team is fairly confident they will be able to diagnose Ocean's control weakness and help Ocean overcome current difficulties. Therefore, the system is not an obstacle for our firm to accept the client.

To meet creditors' requirements, the management inappropriately reflected year-end accruals. The information reflected on the integrity of management, which might be a risk for us to accept the client. According to the predecessor's assertion, the reason for the change of auditor is a disagreement over the fee. And the president of Ocean Manufacturing indicated that the main reason for the switch is to build a relationship with a more nationally established CPA firm. Whatever the true reason is, neither will be serious problem regarding accepting the client.

We can refer to the fee in the engagement letter before all the auditing work begin. We don't have a client in the home appliance industry and the industry has been growing at a steady pace. Therefore, the engagement will be a great opportunity for our company to enter a new market. According to the financial reports, we can get some information: On December 31, 2011, the financial report indicates a net profit of \$3.4 million and the net earnings are increasing steadily from 2009 to 2011, which means the company has potential to some extent.

According to all the information, we find that the client is able to be accepted. 5(b) Prepare a separate memo to the partner briefly listing and discussing the five or six most important factors or risk areas that will likely affect how the audit is conducted if the Ocean engagement is accepted. Be sure to indicate specific ways in which the audit firm should tailor its approach based on the factors you identify. MEMORANDUM To: Jane Hunter From: Corrine Subject: the Risk Areas if the Ocean Manufactory is Accepted Date: February 4, 2012 Ocean Manufactory is a potential company and so is the industry.

<https://assignbuster.com/ocean-manufacturing-as-an-audit-client-research-paper-samples/>

When our firm accepts the client, we will have an opportunity to explore the new market. Nevertheless, we cannot ignore the risk we face. There are some risk areas we should consider since they will likely affect how the audit is conducted. The risk areas are as following:

**Home Appliances Industry** The home appliance industry is a new industry for our firm and we have never had a client in this field. That means we are not familiar with this industry and lack the necessary expertise. In order to solve this problem we need specialists who do have the necessary expertise. The specialists' work in this field can be used by our auditor to obtain sufficient audit evidence.

**Management** The company experiences a significant management turnover. The new controller has little relevant experience and is not familiar with the company's IT system. In this situation, the new controller can attend relevant training and talk to people who have more knowledge about the system to be more familiar with the system as soon as possible.

**Accounting and Control System** The new accounting system which maintains inventory, accounts receivable, accounts payable and so on was not well managed.

Some problems will exist in balance sheet account classification and inventory tracking due to untrained personnel. Employees should obtain some training on the new system to help them work efficiently and effectively. Besides, our local office's IT team can diagnose the control weakness and help them to overcome the difficulties.

**Internal management** Some important reports like internal management budget reports and receivable billings are often late and inaccurate. The weak management will result in many serious problems.

The Ocean Manufactory should strengthen the internal management and improve the effectiveness of the risk management control. Only in this way, the accountants can get the accurate and timely reports which is significant to our auditing process. 5. According to the previous auditor, the management tends to reflect the accruals aggressively in order to meet the creditors' requirement. Facing the situation, we should try to talk to the management to figure it out. If the statement of the previous auditor is true, we will suggest the management to reflect the accruals accurately.