

# [Auditing- nice on pty ltd](https://assignbuster.com/auditing-nice-on-pty-ltd/)

[Finance](https://assignbuster.com/essay-subjects/finance/)

Q1.

Overlooking of the internal control system and the accounting function is a business risk and that is why it led to a 40% drop in the company profits. The managers of Nice On Pty Ltd has focused more on marketing and business development activities which has made them to overlook the control of the company’s internal operation and accounting function.  As a result the company’s internal control system is weak and the possibility of material misstatements in the financial accounts is very high (Luis Puncel, 2007). When the internal control system is weak inherent risks and control risks are very high since the internal policies are unable to detect or prevent the occurrence of a material misstatement (Bahram S. 2007). Therefore, the occurrence of material misstatement in the financial accounts of Nice On Pty Ltd leads to inherent and control risks which will make me as the auditor to give an unqualified report. This business risk in Nice On Pty Ltd has therefore increased the chances of an audit risk.

The employment of few and unqualified personnel by the directors of Nice On Pty Ltd is a business risk since this leads to high chances offailureto comply with the accounting standards in the reporting of the companies accounts. For example the company Fiona Li to look after payroll, accounts payable and accost payable yet he does not have enough or adequate accounting skills. It has also employed Jason who has little knowledge in accounting knowledge.  Due to his inadequacy, Jason has commanded that no password be used in the accounting information system which makes him to have an access to the management accounts and profit statements. It is a business risk for Nice On Pty Ltd to let its accounting information system to be accessed by unauthorized people since they may change the account details.  Unauthorized access to companies accounting system together with having unqualified personnel in the company trigger financial misstatements which increase the chances of audit risks (Luis Puncel, 2007).

Employment of fewer employees by the company directors with the aim of obtaining high profits is also a business risk. This is because it will be strenuous for the available employees and they will tend to work under pressure. People working under pressure are likely to make errors which are material misstatements in the company accounts hence increasing the chances of audit risks (Bahram S. 2007). It is as a result of the few employees that there are supplier invoices which have not been entered into the system. This increases the chances of an audit risk since some invoices may be unsorted by the end of that current year and hence material misstatement in the financial accounts.

The company valued its inventory at cost rather than at the net realizable value. All intangible assets should be valued at their net realizable value failure to which there will be high chances of inherent risks which make the auditor to give an unqualified opinion.  Also the fact that Mr. Sherk had not done an impairment test regarding the intangible asset recognized on the balance sheet face is a business risk since the company will find itself declaring untrue profits. This also increases the inherent risks for the company and any audit evidence obtained will show that the company’s reports are not true hence an unqualified opinion (Larry E. et. al 2009). The accounts payable control system of Nice On Pty Ltd is a bad since it is left under the control of one person who is also not experienced. The weakness of this control system is that it lacks supervision.  For example Fiona is fully in charge of the accounts payable system and he attaches remittance advice to cheques and sends them off to the suppliers. In this case, a supervisor should have been employed to verify the cheques and attachments before they are send to the suppliers to ensure that they are true as per the accounts payable details as this will reduce any chances of material misstatements in the financial accounts.

The fact that supplier invoices were sitting on Fionas desk since they had not been entered into the MYOB is an indication that the account payable may not be reflected in the books of account at that particular accounting or financial year. This therefore shows the inefficiency of the accounts payable system. This system also lacks a clear definition of duties which is experienced due to lack of enough personnel. Use of IT controls by Nice On Pty Ltd will be able to reduce material misstatements since the cheques will be send to the suppliers electronically and this will avoid any occurrence of errors and frauds (Larry E. et. al 2009). Through IT controls, the supplier details will be keyed into the system immediately a transaction is and this will save the company of unsorted invoices.

Even though the audit risks for Nice On Pty Ltd is high, there are high chances that the auditor will not detect some material misstatement in the financial accounts of the company.  For example there is a high detection risk in Nice On Pty Ltd concerning the fleet of 12 trucks used by the company.  From Mr. Sherks statement, it is clear that no financial records have been done on the amortization of the leased trucks and as a result no material misstatement will be detected. In my audit, I would use a substantive testing approach to obtain audit evidence concerning these trucks (Richard C. and Sandy 2007). Since the company has a weak internal control system, I would use a Substantive Test of Detail in which the lease agreement document will be checked against the financial report so as to give the auditor hard evidence.  Form this document, the auditor will be able to obtain information regarding the lease agreement. He will also obtain information concerning the amortization of the lease throughout its useful life from the company’s accounts from which he will give an opinion.

Q2.
Independence of auditors makes them to be objective in their professional judgment. That is, auditors should only have regard to relevant considerations to the client (Larry E. et. al 2009). Being a shareholder in the clients company compromises the independence of an auditor.  Therefore, allowing the accountant who owned shares in Nice On to be part of UCP’s auditing teams could lead to self-interest as a potential threat to the auditors. This type of threat arises when an auditor acts in accordance to his or her emotions for financial and other personal gains from the client. The ethical principles which govern the professional responsibilities of all auditors call for independence of thought and action (Ronald F. &Brenda S. 2003). That is the auditor should not provide any other service to the client apart from auditing. If UCP’s could have allowed the auditor to join them, then they would have compromised their independence which is a fundamental ethical principle to all auditors: all auditors should be free of any self interest which may seem to be incompatible with objectivity and integrity.

The exclusive rights from Intellectual property gives the owner the mandate to enjoy the benefits derived from them. If an auditor owns part of the intellectual property of his or her client, then this becomes a threat to his or her independence (Larry E. et. al 2009). If the auditor owns the company’s intellectual property, then it means that he is also helping in the running and management of the company. The auditor’s independence says that an auditor should not offer any other service to the client outside auditing (Larry E. et. al 2009). This poses a self-interest threat since the auditor acts in accordance with his emotions with the am of gaining form the client.

As a result independence of the auditor as a fundamental ethical principle will be compromised or will be at risk. When an auditor compromises his or her independence, then the credibility of his or her financial reporting is questionable.

To eliminate this potential threat, UCP should not let the auditor to join the auditing team. That is it should only ensure that only the auditors who are kept their professional ethical principles join the team (Ronald F. &Brenda S. 2003).

A potential safeguard that UCP could implement to reduce the occurrence of a similar risk in future is to prohibit nay of its team’s members from owning any shares or properties o f the audit client. It should also ensure that all the audit reports done by the auditor who is not independent are reviewed by another auditor.  The team should also do a thorough evaluation of the existing clients to assess any potential threat towards their independence or integrity. If any of the clients is found to exhibit a threat to their independence, then the team should either know how to mitigate the threats or stop auditing for the firm depending on the magnitude of the threats (Stefan Bode 2008)

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