

Economics management questions and answers

[Finance](#)



Week 7 You Decide Course Project Keller Graduate School of Management

Question 1 The Securities and Exchange Commission (SEC) would only have influence over Smackey Dog Foods, Inc. if they are a publicly listed company or if they register to become a publicly traded company. The SEC assists investors by providing reliable information to investors so they can make informed investment decisions. If Smackey Dog Foods, Inc. becomes a public company, they would need to provide financial statements along with an opinion about the financial statements by an independent public accountant along with the registration statement and subsequent financial reports (Arens, Elder, and Beasley, 2010). Question 2 There are four things involved in the initial planning of an audit. According to Arens, Elder, and Beasley, 2010, they are: 1. “ The auditor decided whether to accept a new client or continue serving an existing one, 2.

The auditor identifies why the client wants or needs an audit, 3. To avoid misunderstandings, the auditor obtains an understanding with the client about the terms of the engagement, and 4. The auditor develops an overall strategy for the audit, including engagement staffing and any required audit specialists. ” In relation to Smackey, Keller CPA’s need to make the decision as to whether or not they want to take Smackey on as a new client. Once that decision has been made, Keller needs to understand why Smackey wants or needs the audit.

Smackey needs the audit in order for the bank to grant a new loan for expansion. Keller will now need to meet with Smackey’s managers to discuss and document what services they are going to be providing. Once that is determined, Keller will need to plan the audit strategy and determine if they

are going to need to hire additional staff or any specialty staffing. Since they have no experience auditing a dogfoodcompany, Keller may need to bring in an auditor who has experience in this type of manufacturer.

Question 3 According to Ayers, et al, 2010 the four phases of the audit are “ plan and design an audit approach, perform tests of controls and substantive tests of transactions, perform analytical procedures and tests of details of balances, and complete the audit and issue an audit report. ” In the plan and design stage of the audit, the auditor needs to understand the business and itsenvironment, understand internal controls and asses control risks and risk of material misstatement (Ayers, et al, 2010).

The second stage of the audit is where the test of controls and substantive tests of transactions are completed. In the third stage, analytical procedures and tests of details of balances are accomplished. In the fourth and final stage, the audit has been completed and the auditor comes to an overall conclusion and issues the audit report (Ayers, et al, 2010). In the first phase of the audit, Keller is going to have to gain an understanding of Smackey.

They can do this by researching dog food manufacturing businesses and the industry as a whole. If necessary, they can hire an auditor who has experience in the industry to assist with the audit. One of the internal controls Keller needs to look at is the adequate separation of duties. In the warehouse, one person monitors production and shipment of their regular line of dog foods and is also responsible for preparing and approving all inventory records. Another control that needs to be examined is independent checks on performance.

Since the sales manager is afraid to fly and can't really drive, there is nobody checking on the performance of the sales people. With no monitoring of the sales people and their commission being paid in advance based on projections, close monitoring of sales should be accomplished. In performing a test of controls, the physical control over assets and records will need to be done. How the waste and returned dog food is being handled should be reviewed. Seeing the employees taking bags of dog food that have been thrown away is a red flag for fraud by the employees.

Examining documents related to the inventory will need to be done as all inventory records are prepared and approved by one person with little inventory left in the warehouse but a lot of returns left on the shipping dock. This can lead to an understatement of inventory, understatement of sales returns, and overstatement of accounts receivable which is the proposed collateral for the new loan. Analytical procedures should be applied to the determination of commission that is being paid to Smackey salespeople.

The commissions on the average are off by 11 percent showing that they may not be reasonable. The auditors also need to perform the analytical procedures for inventory to determine if the inventory is being misstated. This would be a concern due to the amount of waste and returns. The test of details of balances will need to be done on the accounts receivables to determine if they are properly stated. Question 4 Keller needs to discuss the weaknesses in Smackey's internal controls with Sarah as the president and manager of operations.

The internal control issues that need to be pointed out are the lack of separation of duties in the inventory production and records, the improper
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classification of accounts receivables, and improper checks on performance of the sales personnel. As soon as Keller became aware of the significant deficiencies in the internal controls of Smackey, they are required to notify in writing to the governing bodies of Smackey. A management letter should also be written giving suggestions for ways to make improvements in the internal controls (Arens, et al, 2010).

Question 5 There are several types of confirmation Keller can use to verify Smackey's accounts receivables. They are positive confirmation which is some type of communication sent to the account holder requesting they directly confirm whether the balance on the request is correct or incorrect (Arens, et al, 2010). There are two types of positive confirmation, a blank confirmation form where the recipient is asked to fill in the balance of the account or an invoice confirmation which is where an individual invoice is confirmed instead of the entire account.

There is also a negative confirmation where the recipient is only requested to respond if the balance is incorrect (Arens, et al, 2010). Due to the fact that Smackey's accounts receivable is a large part of the assets and they aren't writing off any bad debt, Keller should use the blank confirmation form to determine if the balances of the accounts are correct. Question 6 The major factors that affect the sample size for confirming accounts receivable are the weakness in internal controls within the sales department, and the improper statement of accounts receivable.

With no control over the sales department, there is a higher risk of fraud by collusion between the salespeople and the companies that owe money to Smackey. With almost 20 percent of the receivables classified as 90 days or

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older, there is a higher risk of accounts receivable being overstated by uncollectable accounts leading to a possible material misstatement in the financial statements. Question 7 The concern about the possibility of legal encumbrances on verifying the ending balance in property, plant, and equipment comes from the lawsuit filed by the employee who was fired for not owning a dog.

In order to determine the likelihood of the employee winning the suit, Keller will need to send a confirmation request to the lawyer handling the lawsuit for Smackey. The request will need to ask what is the probability of the ex employee winning the lawsuit. If there is a high probability, then the confirmation needs to include the possible amount of the award against Smackey. Question 8 With controls over inventory being deficient, Keller will be present at the year-end inventory. The auditors will physically observe the counting of the inventory that is in the warehouse and on the shipping dock.

The auditor will also observe to ensure the waste isn't included in the physical inventory count. If the sales returns aren't able to be resold, then the auditor needs to ensure they aren't counted in the inventory. The observation is necessary to ensure the inventory isn't overstated with what has been wasted or understated by not counting the sales returns that can be resold. Question 9 Inventory control weaknesses that exist in the inventory and warehousing cycle include controls over the physical count of inventory and pricing and compilation controls. Smackey should have documents that show the reporting of the inventory that is waste and the sales returns. There should also be a review of the inventory documentation

but with Kim being busy with the Best Boy Gourmet line, she hasn't been focusing on the regular product line. There should be documentation to show the sales returns being returned to inventory and there should be confirmation of the inventory documentation by Kim. Henry shouldn't prepare and approve the documentation one of those functions should be done by someone else. Question 10 Pete is breaking Rule 301 Confidential Client Information by discussing some of the details of the audit with Alan over beer.

Rule 301 states, " A member in public practice shall not disclose any confidential client information without the specific consent of the client (Arens, et al, 2010). " Smackey didn't give Pete consent to discuss the audit with his friend who also happens to be working for the bank Smackey is trying to get the loan from. Because Pete isn't aware of Alan's relationship with the bank, he isn't violating Rule 101 - Independence. If none of the auditors obtain adequate understanding of the industry or business, they will be in violation of Rule 201 - General Standards, A. Professional Competence.

Question 11 If Keller makes an intentional mistake, they can be held liable to Smackey or to the bank. If the intentional mistake results in Smackey not receiving the loan, they could sue Keller for negligence. The type of mistake would determine the degree of negligence. In an unintentional mistake, Keller could still be liable but could possibly defend themselves based on nonnegligent performance. Legal liability concerns regarding the Professional Rule violations are if the auditor doesn't maintain independence, follow the requirements for technical standards, and doesn't maintain confidentiality.