Accounting audit: case study

The inventory valuation is done on cost basis, while the NRV (Net realizable value) is 10% below the cost. As per the accounting standards in Australia governed by the AASB, the inventory valuation is done based on the basis of lower of cost or realizable value, whichever is lower, which is as per the guidelines laid down under the provisions of AASB 102.

However, since the cost is of higher value in comparison to the realizable value, the system followed here reflects the inventory at higher value, which is not the fair value of inventory and contravenes AASB 102. This is the just and fair opinion of independent auditor. In view of this, the audit opinion expressed is fully justified. The inventory should reflect the fair value of the inventory and the cost basis does not reflect the fair value of the inventory as per acceptable accounting principles. Hence the system of accounting followed should be subjected to fair audit, and corrective measures should be taken for rectification. Further, the opinion expressed by the auditor should be an adverse opinion, since the accounting systems and practices followed by the company contravenes the principles and concepts of accounting and the provisions as per AASB and the Corporations Act, 2001 given the materiality of the information and facts reported by the company and the fairness in the reporting of the financial statements.

The client has entered into a real estate contract of purchasing some property and developing shopping complex, and further selling the same to an unrelated third party at a “ profit-based” (cost-plus) basis of settlement price. As the real estate markets fell and the rates had dropped, the purchaser sued the client on the basis that as he relied on markets and rates forecasted by the client, he was not getting the forecasted prices in the market because of recessionary conditions in the market.

In view of the uncontrollable market conditions resulted due to no fault of the client, the auditor opined that the client need not pay any damages as he is not liable for any loss due to uncontrollable factors in the market over which client has no control. In view of this, the opinion of the auditor is just and fair. Moreover, when the transaction that has taken place between the purchaser and the client, the client is supposed to have information about the risks such transactions are exposed to. The market risk is covered under AASB7, which deals with the various risks arising under financial transactions. In view of the above, the auditor's opinion with regard to client liability for loss is fair and fully justified. However, sensitivity analysis has to be conducted with respect to the variable parameters and the methods followed for the sensitivity analysis. The impact of the price analysis or forecasting is studied on the basis of the changes in these variables. In this case, as the client is not part of the final transaction pertaining to the sale after the completion of the deal, the client and its management is not liable. The entire risk in this case is to be borne by the purchaser himself who has to bear the entire market risk. Market risks are not part of any deal between parties. Hence, the auditor's opinion that the client is not liable for the damages legally is fair and correct. Moreover, since there is always the probability of (market) risk involved due to price fluctuations, it is the presence of market forces which could have gone either way.

The probability of loss to the client in the event of the markets falling could not be underestimated. Hence, the opinion here of the auditor should be a disclaimer opinion (a category of Qualified opinion) since the best forecast of the estimates could go wrong and hit either side and the auditor could not be held liable for the estimation or forecasting based on market factors (external), given the information and facts available to the auditor for forming an opinion about the company's accounting policy.

(iii)

In this case, there is a small NFP or Not-for-profit organization, which can be characterized by a high % (completion) of total revenue and, in such a organizational framework, the internal control degree is low. In view of this, the % completeness of revenues and the risks associated with auditing are also high. Larger the size of the NFP organization, lower the completion % of total revenue and better control over internal control and in turn, lower the risks associated with

As the degree of internal controls is low, the auditor's assertion of poor audit evidence and lack of control over the revenue completeness is correct and fair. Hence, the opinion issued by the auditor is one of disclaimer type in view of the limited scope or horizon and the limitations of the auditor in terms of the audit evidence provided or made available to the auditor to give the fair and independent opinion and the materiality of the information given. So there is a limitation of scope of the auditor's examination.

(iv)

The company is follows the accounting policy of not disclosing the director's fees in its financial reports.

Since the disclosure of director’s fees is mandatory as per Corporations Act, 2001, (Australian corporation and securities legislation, 2001), the assertion and opinion of the auditor with regard to the materiality or otherwise of the fees does not hold well. The Materiality arises when it affects (i) decision making with regard to resource allocation (ii) accountability of management. The point of materiality is covered under AASB 1031 of the Australian Accounting Standards Board. Since as per the Govt. of Australia’s guidelines issued with respect to disclosure of director’s fees is mandatory, non-compliance with the same or non-disclosure may lead to penalties for non-compliance on the part of the management and the auditors of the violating company. Hence, in view of contravention and non-compliance with the acceptable financial reporting policies, the auditor needs to give a qualified report.

(v)

The management of the company estimates the provision for bad debts at $550000. The audit arrives at the fair and reasonable estimate at 655000. The management of the company has refused to accept the figures of estimated given by the company for it would reduce the ne profit to the extent of $105000. Bad and doubtful debts are classified into recoverable and irrecoverable debts. Under the accounting norms for bad debts as per the Corporations Act, 2001, the irrecoverable debts are written off. The recoverable debts are those which are likely to be recovered and provision in respect of which is make in the financial statements of the year. Provision for Doubtful debts is under Section 237 of the Corporations Act, 2001 and AASB 124. In the Income Statement, the provision for doubtful debts is shown as a loss, while in the Balance Sheet, the provision is reduced from the Trade debtors as Net Debtors and is shown under current liability on its own (Current liabilities and provisions). Audit of accounting estimation follows the procedure – collection of audit evidence, ascertaining and assessing the reasonability or otherwise of the accounting estimates, revising and renewing the estimates, and reviewing the subsequent events. As the materiality factor is involved in the accounting for the estimated figure of provision for doubtful debts, the report would not give a fair view of the financial report for the period and hence the auditor should give an adverse report indicating that the accounts do not reflect fairness in its state of affairs and financial position.

(vi)

In the case, the company has cash balances maintained in a foreign bank account situated in a foreign country or location.

In this case, since there is no substantial audit evidence to enable the auditor to form an unbiased, independent opinion, the auditor can only give a subjective, qualified (limited scope) opinion on the reasonable grounds of his best professional expert judgment and experience, which may even be based on reasonable assumptions born out of facts available. Since the materiality figure is given, and the cash balance in the foreign account is just close to that figure, quantitative figures of materiality in the case do not hold good. Hence, the classification by the auditor of the entire cash balance held in the foreign account in the foreign location as current asset (asset required to meet short term obligation) is fully justified and the opinion given by him would be classified as disclaimer opinion, since the opinion does only reflect the best under the given circumstances and the facts.

PART- B

Introduction

The auditor gives opinion of three types, in case of audit reports, namely, adverse, disclaimer, and qualified opinion in respect of the company's accounting norms, procedure and systems. Further, the audit of accounting estimates of the company's accounting procedure and practices would be generating modified, unqualified and qualified audit reports

Executive Summary

Under this report, we shall locate three annual reports from the appropriate sources mentioned in respect of three Australian companies listed in the ASX (Australian Stock Exchange) and also available in the CQU website. In these audited reports, the auditor's opinions – qualified opinions, unqualified opinions, and modified opinion with a " Matter of emphasis" as expressed by the auditors in these reports are shown. The detailed opinions are written in respect of the three companies' annual reports considered for reporting on the " Audit analysis of the financial reports of companies". Finally, conclusions are drawn based on the analysis of these reports.

Report

Now let us discuss the various opinions expressed by the auditors in respect of the three annual reports of the companies (Refer Appendix) as under:

QUALIFIED OPINION:

A Qualified opinion may be issued where there is a disagreement with management concerning appropriate accounting policies, a conflict between applicable financial reporting frameworks, or a limitation on the scope of the audit. A Qualified opinion can be used only when the auditor believes that the overall financial report is fairly satisfied. (Arens, at. al, 2010)

I have found the following company with the Qualified Audit opinion.

Gerard Lighting Group Ltd:

Gerard Lighting is a listed Australian Company in the power sector. As it is the major company in its product line, I have taken this company as an assignment subject so that the company’s accounting policies and practices, a strong company in the infrastructure sector can be thoroughly studied and reviewed.

The annual report of the company for Year ended 2009 has been studied and the features of its auditor’s report are as under:

Audit of its accounting estimates of expenses (Fielder, 2010) incurred during the period.

Evaluation and assessment of efficiency and adequacy of its processes and controls

Independence of the external auditor has been certified and ensured despite the auditor being engaged in the non-audit professional activities

A review of the director’s forecast (historical), historical pro-forma financial statements and best estimates assumptions, based on external factors (judgmental and subjective) beyond one’s control and scope, has been carried by the auditors, which is done as per the audit evidence and financial data available to the auditors which is insufficient for the purpose of audit, hence the auditors clearly state that this is just a review of the management activities and forecasting based on its core performance factors, not a complete full-fledged audit. Hence there is no opinion made by the auditors on the audit report in view of insufficient audit evidence with the auditor as per information provided by the company for the purpose of audit which indicates that the auditor does not undertake any responsibility and the auditor’s opinion is known as disclaimer opinion, (Arens, et. al, 2010) a classification of qualified opinion, having insufficient audit evidence to form unbiased, clear opinion.

The independent external auditor KPMG of Gerard Lighting Group Ltd has expressed their satisfaction over the financial report prepared and presented by the board of directors. The auditors have assessed and verified the statement of comprehensive income of the group, change in equity and statement of cash flow on date of year ending as well as the summary of all the significant accounting policies that has been followed by the company and the notes presented by the company. The auditors have found that the board of directors has discharged their duties in fair way. They have ensured that company follows the appropriate policies. As an overall view of the auditor this report is true, fair and free from any material misstatement.

UNQUALIFIED OPINION:

An Unqualified opinion is the most common type of auditor's report. An unqualified opinion is issued when the independent auditor believes that the company's financial statements are sound; that is, the statements are free from material misstatements. This is different from a qualified opinion which is issued when the independent auditor discover something in the financial statements that is subject to major concern.

Harvey Norman Holdings

This is a leading Australian listed company in the product segments – integrated retail, banking and franchise. As a company based on very sound policies, principles and practices, we have considered it for the study. The annual report of the company for the Year ended 2009 have been studied. The features of its annual report are as under:

The audit of the financial position for the year has been made as per the audit procedure and carried in terms of provisions laid down under the Corporations Act, 2010 (Australian corporation and securities legislation, 2001)and the Australian Accounting Standards Board.

The independence of the auditor being certified and ensured despite the auditor engaged in non-audit professional activities.

The compliance with the standards and opinion about the fairness of the financial position by the auditor.

Given the sufficiency of audit evidence and financial information, the audit carried represents a full and fair position of the financial standing of the company, in the opinion of the auditor with regard to the auditor's report.

This is an unqualified report expressed with regard to the unbiased independent opinion of the auditor on the financial position of the company.

Finally, the auditor gives an unconditional, unqualified opinion based on data made available for forming an independent opinion and has classified the reports as unqualified reports

The Independent auditor Ernst and Young of Harvey Norman Holdings have found that the financial report for the year ending 30 June 2009 has been satisfactory under various rules and have expressed an unqualified opinion on the report. The auditors have found enough audit evidences from various judgments and procedures that the financial report prepared and presented by the management is true. As a whole the auditors has expressed their opinion that this financial report is true, fair and free from any material misstatements and has been prepared by complying with all the relevant rules and laws of land.

MODIFIED OPINION:

An Unqualified audit report with an emphasis of matter is appropriate for an audit with satisfactory results and a financial report that is fairly presented, but where the auditor is required to provide additional information (Arens, et. al, 2010)

The company with Modified opinion with an emphasis of matter

AXA Asia Pacific holdings:

This is a major listed Australian company in the financial (insurance) sector and is considered for the purpose of the study due to its key market position and sound financial practices. The annual report of the company for Year ended 2009 has been studied and following are the features of its auditor's report are:

Audit of its accounting systems and procedures.

Evaluation and assessment of sufficiency of audit evidence.

Independence (Roebuuck & Martinov-Bennie, 2010) of the external auditor has been certified and ensured despite the auditor being engaged in the non-audit professional activities.

The auditor has expresses an unqualified report on the financial position and expressed compliance with the AASB1039 (Australian accounting standards board). (Audit of Accounting estimates issued by AARF on behalf of ASCPA & ICAA – AUS516, 1995)

Materiality (Pflugrath, 2010) with regard to the facts and figures presented has been checked and ascertained by the auditor and their conformance with the Australian accounting standards has been ensured. The forecast data based on judgmental assumptions and the subjective decisions made by directors of the company have not been reviewed or subjected to any kind of review. Hence, this is an aspect of a modified opinion with matter of emphasis.

Considering the adequacy of sufficient information for giving true position of the financial state of affairs of the company, unqualified opinion has been given in the auditor's report.

The auditor Price Waterhouse Cooper has expressed their satisfaction over the independence of the external auditors and the financial reports of the AXA Asia Pacific prepared by the management under the Corporations Act 2001 and Australian accounting Standards as well as International Financial Reporting Standards. The auditors has found enough auditing evidences those indicates that this financial report of AXA Asia Pacific is true and has been complied with all the ethical and regulatory norms stated under Corporation Act 2001, Australian Accounting Standards while preparing financial reports. The auditors have said that this report is free from any material misstatement.

On overall basis the auditors have found the financial report true, fair and free of any material misstatement and has complied all the rules and laws that governs and are relevant for a corporation having business in Australia (Annual Report, 2009 AXA Asia Pacific Holdings Limited).

Conclusions

We have studied a report based on the audit opinions expressed by the auditors regarding the accounting records based on the sufficiency of the audit evidence supplied and the audit plans carried out by the auditor. In all the cases, to the extent of the information supplied, they (auditors) have made independent opinions with regard to compliance with the Accounting standards of Australia (AASB) and compliance with the Corporations Act, 2001 and have qualified their opinions to the extent of the forecast and best estimates made by the management based on their subjective judgment and perception and also made opinions with regard to the fairness of these financial reports.

From the analysis and review of the above companies, we can draw the following brief inferences with regard to Qualified, Unqualified, and Modified reports:

GLG – Qualified opinion

HRH – Unqualified opinion

AAPH- Modified opinion with matter of emphasis.