

Particularities of Profit and Loss Account Audit and the Production Process in Constructions

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Abstract

The activity during the process of building is strongly influenced by the particular elements that support it, by the direct and indirect building costs.

A well-controlled activity from the view point of execution, building site organisation, as well as ensuring the specialised human resource may lead to reaching the objectives set: finalising the building with minimum costs and a high level of the income statement.

The financial audit of the profit and loss account is subsequent and implies a scheduled verification after the end of the financial year and submission of yearly statements to financial administration, as a confirmation that this activity was efficient, did not result in frauds. It thus follows that there is a direct relationship between the initial control proposed at the beginning of the building project and the final verification materialised through the annual financial audit.

Key words: assets, risk, control, objectives, fraud

J.E.L. Classification: M40, M41, M42

1. Introduction

The profit and loss account contains all expenses incurred during the building process and the subsequently generated income through selling the building, following the materials consumption, as well as human, of the entities specialised in building residential and non-residential constructions.

The auditor, based on the audit objectives, ensures that all income is included and all real expenses are analysed correctly and whether any extraordinary elements were identified. Most part of the control of the income and expenses accounts is ensured either by sampling the internal audit, either together with control of corresponding entries in the balance sheet (Munteanu et al,2012,p.189).

One particularity of the construction field is that of a great diversity of building objectives on the one hand, and the conditions under which they are executed, on the other hand. For this reason, intuition and experience are not sufficient in order to solve the current problems of management and organisation in execution. This shortcoming may be hedged by employing modern management and organisation models, particularly operational research models. Also, the cost risk or the market price risk, having a great materials variety, they automatically come from various markets with quality and prices that are hard to guess during projection or offering, hence the frequent overdraft of costs in constructions (Postavaru et al,2014,p.235).

An entity in the constructions field also may be confronted with the risk of adequate promotion, if done wrong the entity will suffer, its image will be blurry for the potential buyers. In the constructions field the entity must strive to improve, to develop facilities so that it is one step ahead competition and, more than anything, to satisfy the final consumer so that he pays the acquisition price.

The literature also mentions the idea of uniqueness of a building, resulting from the fact that each objective of a new building is realised on a different location: various residential areas, various industrial areas, various geographic areas, such as mountain, see etc.

Also, both the building entity and the financial auditor who is coming to verify and to confirm the profit and loss account may be confronted with the “new” risk. The time, the place, the location, the new materials, sometimes the hidden costs may incur a high level of uncertainty and the need that the financial auditor who is not also a constructor to turn to specialists in the field in order to understand the originality of the construction and for a detailed explanation of the estimate for construction works, which comprises a detailed description by expense chapters for the following expense types: materials, labour, transportation. Thus it can lead to the need for and importance of a relationship between leadership and management.

Even though leadership is similar to management, there are several differences that must be taken into account. They must be regarded as distinct and complementary activities. On the one hand, management seeks to control the complexity and to diminish uncertainty, on the other hand leadership tries to bring useful changes in the organisation. To control the complexity means to create order in the organisation, to solve the problems and to ensure continuity. Performant organisations have both performant management and performant leadership. The managers focus on the inanimate aspects of the activity (Postavaru et al,2014,p.240):

- Budgets;
- Yearly financial statements up for auditing;
- Organisational structures;
- Forecasts and sales analysis;
- Reports regarding the company’s productivity and solvability;
- The decision-making model and establishing their fulfilment criteria, starting from the labourer and master, to inspector and financial department;
- Scheduling meetings, trainings and tasking work on the building site etc.

It is also worth mentioning that during the first part of the financial audit the accounting expert or the financial auditor determines the nature and the elements of expenses, as well as the way they are recorded in the entity’s registries: manual or digital, in order to schedule and require the financial-accounting department the data needed, namely:

- End of year inventory;
- Warehouse inventory records from the 3rd class accounts;
- Estimates for construction works and their annexes with quantities necessary for executing the project;
- The recording of proceedings for the final reception of the building, if it was finished;
- Verification of the documents regarding construction structure and authorisation and urban certificate;
- Analytic balance sheets;
- Documents for authorising outputs from records, consumption notes based on documents regarding needs by execution stages;
- Annexes with approximate values and quantities consumed during each execution stage.

2. Audit objectives regarding the profit and loss account in entities from the construction field

For the expenses accounts, as they are regulated through OMFP 1802/2015 : Oficial Gazzete,2015,Part 1, [online] Available at: <http://www.cabinetexpert.ro/2015-10-14/omfp-1198-2015-modificare-omfp-1802-2014-reglementari-contabile.html> [Accessed 3 May 2016] , audit has the following objectives:

- All expenses were included in the financial statements;
- All expenses and incomes were correctly added and registered;
- The expenses and the acquisitions were real transactions and they belong to the audited entity;
- The amounts in the financial statements correspond with accounting technical instruments;
- All acquisitions and expenses are for the current financial year;

All expenses and acquisitions are compliant with accounting rules and principles (Munteanu et al,2012,p.189).

3. Audit proofs in the case of auditing a construction entity regarding the profit and loss account

The auditor abstracts the test on control procedures, the list of tests on balances and accounts cash flows, of analytic procedures and details tests, with the view to take into account the fraud risks that may be incurred in relation with creditors and suppliers (Stoian et al,2001,p. 140).

Generally, the financial auditors compile spreadsheets and compare various expenses categories from human resources to raw materials and obtained incomes with previous financial year expenses. Following this analysis, the financial auditor explains the differences that may occur and plans the control activity according to the normal or abnormal variations of these indicators.

1. To begin with, the income and expenses are centralised on three components:
 - Operation activity
 - Financial activity
 - Extraordinary activity
2. A sample of bills is verified, starting from their record in primary registry, in the journal registry and sales journal; it is possible to use the correspondence between the total of the journals, the balance sheet and the D300 VAT report.
3. A sample from the profit and loss account regarding sales is verified. This may be done by selecting a reference month, with the highest sales volumes, and to check the amounts with significant impact, verify if the invoices were correctly made and registered in accounting registries and if they were paid. To this purpose, the auditor will check both the cash register and the bank statements.
4. All cash sales are examined, taking into account that starting from 01.05.2015, according to Law 70/2015 regarding enforcement of financial discipline for cash collection and payment, it is not possible to collect or pay from and to private individuals, amounts above 50.000 lei/per transaction/month ,exemple: Cash collection and payment operations between private individuals, others than collection and payments through institutions that provide payment services authorised by the National Bank of Romania, according to the law, made following the transfer of property rights on goods or rights, service provision, as well as those representing granting/payment of loans, may be done within the limit of 50.000 lei/transaction. It is forbidden to divide cash collection and payments for payments above 50.000 lei, as well as fragmenting a transaction above 50.000 lei.

To this aim the auditor crosschecks the sales lists and the receipts, cash register receipts and sales contracts authenticated by a notary.

The integrity of the collected amounts is verified and detailed tests are carried out regarding cash outflows towards and from the cashier. This way, the correspondence with bank accounts is monitored, as well as whether the cash transfer documents have the official signatures approved by the respective entity's management.

Cancellations are checked – emission of cancellation invoices has a direct impact on the profit and loss account, and the invoices and accounting notes must be authorized in order to prevent fraud in relationships with customers or hiding possible taxable income and avoidance of state taxes and leverages payments.

Also, the incoming and unsettled orders may be analysed, this being another indicator of inefficiency in increasing sales and turnover.

The financial auditor may, during the verification process, analyse the buying with VAT registers, which may provide important information for finding possible errors, including the analytic verification of acquisitions by using the analytic analysis procedure, which is also an important stage of the audit process.

The International Auditing Standard (IAS) nr. 510 regulates the fundamental procedures and principles and their application regarding opening balance in the first audit at an enterprise or when

the yearly financial statements of the previous year were audited by another auditor. In initial audit missions, the auditor must find sufficient and adequate proofing elements and to ensure that:

- The opening balance does not contain abnormalities that significantly influence the financial statements of the current financial year;
- The closing balance of the previous financial year were correct or, in exceptional cases, were retroactively adjusted;
- The accounts closing policies and the evaluation methods used were constantly applied, or they modification was correctly recorded and described in the annexed notes.

Findings regarding the contents of a determined evaluation, of which results:

- The erroneous calculation of data (for example, a lot that was registered twice in the inventory);
- Divergences regarding certain data evaluation (for example, the auditor estimates that the provision of a debt should have been 85% of its value and not 50%, as the enterprise considered it);
- Using an accounting procedure that does not correspond to the accounting principles (for example, the stocks are evaluated at their selling price, and not their real value, or the acquisition value of an upgrade for immobile goods was registered as expense);

The criterion of real operations implies that all material elements in the registers correspond to those physically identifiable and that all actives, liabilities, incomes or expenses reflect real values, not fictive or that do no concern the enterprise; in other words, all information presented in the financial statements must be justifiable and verifiable.

Moreover, the auditor must ensure that the format of the profit and loss account is according to the legislative framework.

4. Conclusions

Auditing was almost always associated with detecting fraud. The following remarks must be made:

The managers, the management, are the ones who are firstly and to the highest degree responsible for detecting frauds, errors and misreports, as part of their management roles.

The auditor is responsible for planning, conducting and evaluating the audit, so that he can reasonably hope to find the declarations.

The auditors must pay attention to the way in which they present publicly any doubt they might have regarding the principle of continuous activity. The continuity of an enterprise also depends on the fact that the public does not know there are doubts regarding the continuity status of an enterprise (for example, if the auditor reports that the enterprise maintains its continuity if the bank will continue to finance its credit lines for the proposed investments, it is possible that the next day the bank will stop financing the enterprise).

The auditors must test the view points of the management regarding continuity and solvability. The responsibility of the management is continuous, while the opinion of the auditor is based on a situation seen at a certain moment.

The Directive 95/26/EC, adopted in June 1995 shows that the statutory auditor of a company has the duty to promptly report to the competent authorities any fact or decision regarding the respective company that might:

- **constitute a serious violation of law;**
- **affects continuous functioning;**
- **leads to the refusal to certify the accounts or to express reserve.**

To conclude, any person interested in the result of the financial audit expects that the fraud possibilities are minimised. The management of the company must take measures to organize and maintain the internal control systems that diminish the possibility of fraud. The statutory auditors must confirm in the audit report that such an internal control is in place and to establish whether it is working.

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