

The Influence of Available Cash Evaluation in the Issuing of Financial Auditor's Opinion

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Abstract

In the present context of globalization, providing information that reproduces the true image of an entity, represents one of the main objectives aimed for by the economical-financial entities. To achieve this objective entities use the process of evaluation in order to ensure the real value of the patrimonial elements presented within the financial situations and regarding their certification, the audit process is used, having the aim to obtain a reasonable assurance that the economical-financial information used in the different decisional processes do not contain significant denaturation due to fraud and/ or to error.

Key words: auditor's opinion, financial statements, available cash, evaluation.

J.E.L. classification: M41, M42.

1. Introduction

The audit of financial situations and the necessity to offer an assurance regarding the fact that these display real economical-financial information, which are clear and complete, represent in the actual context of globalization, one of the main preoccupations of entities. A preliminary and mandatory phase when elaborating the financial situations which assures the fact that financial accounting information is presented at fair value, is the evaluation of patrimonial elements.

The entities, indifferent of their organizational form, appeal to the evaluation instrument, respectively to the re-evaluation. The evaluation is considered to be a procedure of the accounting method intended to assure the faithful, clear and complete representation of the patrimony, of the financial situation and of the obtained results of the enterprise. In this regard, the operation is considered to be an assessment which quantifies the size of the property or of patrimony elements in their entirety, in natural expression and this size is expressed using standard or monetary value. Regarding reassessment, this means assessing again, as a general rule updating a pre-existing value. (Todea, 2004, p. 3)

In order to obtain a reasonable assurance, regarding the information issued for the users, the entities appeal to the audit of financial statements. The financial audit represents a subject which outside the accountancy sphere of influence implicates juridical information, knowledge regarding the economic and financial analysis, mathematics, computer science and...ethics. The explication of the pluridisciplinary financial audit is given by the fact that it has to verify the conformity of the financial situations with the reality, on one hand, and on the other, to verify the respectability of principles, rules and criteria established for the registration and presentation of accounting information. (Todea, Stanciu, 2009, p. 218)

This scientific approach seeks to present information linked to the influence of an inadequate evaluation on cash reserves regarding an opinion issued by the financial auditor, theoretically and practically.

2. Methodology

The objective of this paper is to present the influence which an improper evaluation on cash

reserves exerts on the opinion issued by the financial auditor.

The methodology used is based on theoretical scientific research regarding the concepts and regulations from within the domain, accompanied, as well, by empirical research. For the accomplishment of this study we researched the Evaluation International Standards, Audit International Standards, the works from the financial accounting domain, the analysis of regulations from the domain, being an exploratory qualitative research as well as the practical aspects of how the auditor formulates his or her opinion according to the errors identified in the financial statements and what is the professional reasoning which it is based upon.

3. Aspects regarding the evaluation of available funds

The evaluation represents the process which determines the value to which financial situation elements are recognized in accounting and presented in the balance sheet, respectively the abridged balance sheet and in the profit and loss account. (OMFP 1802/2014, 47)

Within the patrimony elements, a significant share is held by the available funds. The available funds include the economical values which take the form or function of money. This category includes: cash (in lei and foreign currency) found in the cashier of the entity, money held in the current accounts and bank deposits (in lei and foreign currency), letters of credit other treasury stock etc. With the help of cash reserves operations of receipts and payments are effectuated which may be in cash and through bank statement (without cash). (Matiș, 2010, p. 74)

Monetary items denominated in foreign currency (reserves and other assimilated elements like letters of credit and bank deposits, receivables and payables in foreign currency) must be evaluated and presented in the annual financial situations using the exchange rate published by the National Bank of Romania and valid at the date of financial year closing. The exchange differences, favorable or unfavorable, between the exchange currency market, communicated by the National Bank of Romania, from the date of receivables registration or foreign currency debts, or the rate at which they are registered into accounting and the exchange rate of the financial year closing date, are registered as income or expenses from foreign exchange differences, where appropriate. (OMFP 1802/2014, 94)

Reassessment of available funds has imposed an increased attention regarding the way in which it is carried out, due to the fact that existing differences between the carrying amount and fair value of these elements are in a position to significantly change the content and values presented in the financial statements.

4. Aspects regarding the issuance of the audit opinion

Economic instability has had the consequence of the increasing importance of certification of financial statements, through audit, thus ensuring an increase in the reliability of the information issued to diverse user categories, through the opinion issued by the financial auditor in the audit report.

The aim of the financial audit is achieved by expressing an opinion based on the image of the situation offered by the financial statements, namely the extent to which this is true, in all significant aspects, according to the accounting general accepted principles. (Dănescu, 2007, p.106)

According to the International Audit Regulations, respectively ISA 700, the opinion of the auditor is presented in a standardized format. The terms used for expressing the opinion of the auditor are: "offer a faithful image" or "accurately present in all significant aspects. We deduce from this that the auditor has taken into consideration only the significant elements of the financial statements. The way of expression is not random, since it covers in a necessary and extremely intelligent way the responsibility of the auditor. Based on this, any evidence or information which were not included in the professional reasoning of the auditor can be justified by the argument that they are not part of the significant elements regarding the financial statements. (Horomnea, 2010, p. 234)

In order to issue the audit opinion, the auditor resorts to specific techniques to provide a reasonable degree of assurance. Thus, determining the materiality threshold, taking into account its relationship with the audit risk.

If the practitioner reaches the conclusion that the distortions can be significant, have reached or passed the threshold, in the first phase, reducing the audit risk is taken into consideration through extended verification or requesting from the management to adjust the financial statements. (Domnişoru, 2011, p. 220)

5. Case study regarding the influence of cash reserves evaluation on the opinion issued by the financial auditor.

Audit entity SC ALFA SRL, is responsible for audit engagement carried out on the financial situations of entity SC BETA SRL, whose main activity is the production of chocolate.

Being an older audit customer, the auditor is familiar with the behavior of the accounting department personnel and that of the manager, which do not comply with the deadlines for sending the documents to the auditor.

Following the documentation process of internal control, the financial auditor identified the following situation:

- The cashier of the entity performs the following operations: collects the cash, keeps the cash register, records transactions which affect the account “CASA” in the day book.
- There are situations when the cashier takes the cash home and takes it to the bank for deposit the following day.
- The family relationship between the cashier and the person empowered to manage the available funds in the bank account is of the second degree.
- The person empowered to manage the cash in the bank accounts performs the following operations: signs the payment orders, records entries in the day book, for the account “Available in the bank”.
- Due to various divergences which the internal auditor had with the persons in the family relationship, he had no longer effectuated the internal audit procedures regarding the confirmations from the bank balances, inventory of cash and evaluation of the available cash.

Table number 1 Extract from the entity SC BETA SRL balance sheet:

Indicators	2015	2014
Fixed assets	879300	832400
Current assets	312500	429000
Current debts	105700	499000
Long-term debts	978200	612000
Company Funds	98670	134580

Source: personal creation

Table number 2 Extract from the profit and loss account of the entity

Indicators	2015	2014
Turn-over	1572000	1182000
Gross Profit	153400	1200

Source: personal creation

Following the audit procedures, the auditor found that in the bank accounts there is a sum of 48000 euro. For the audited year the average exchange rate was of 4,5 lei/euro, on the 31st of December it decreased to 4,1 lei/euro, but in the first days of the following year, the exchange rate recovered. Due to these variations the management decided not to reassess the existing currency, according to the rate of the 31st of December 2015.

In order to issue an opinion, the financial auditor will go through the following steps:

The deficiencies met by the financial auditor when inventorying the available funds of the audited entity which led to the assessment of an inherent general risk of a high degree.

Following the verifications performed by the financial auditor, the main deficiencies identified when performing the activity of inventorying the entity’s bank accounts and hard cash, which led to the assessment of an inherent general risk of a high degree, was the behavior of the personnel from the accountancy department as well as the manager’s, who do not comply with the deadlines for handing over the documents to the auditor, thus encountering difficulties in obtaining audit evidence, as well as the pressures on the internal auditor, which had no longer conducted internal audit procedures regarding the bank balances confirmations, inventory and evaluation of the

available cash.

The deficiencies met by the financial auditor when inventorying the available funds of the audited entity which led to the assessment of a high risk level of control.

The main deficiencies of the internal control regarding the available cash and bank accounts, identified by the auditor and which determined the assessment of a high risk level of general control were:

- The auditor has identified a lack of segregation of the cashier's function, due to the fact that he is also the one that collects the cash, keeps the cash register, but also records in the day book the cash register operations.
- It is forbidden for the cashier to take the cash home in order to deposit it at the bank the following day.
- The auditor identified a lack of segregation of the function for the person responsible with the bank due to the fact that he signs the payment orders and records in the day book, for the "Available in the bank" account.
- Due to the fact that between the cashier and the empowered person to manage the bank accounts' available funds, exists a family relationship of the second degree, there is an increased risk of fraud.
- Due to various divergences which the internal auditor had with the persons in the family relationship, he had no longer performed internal audit procedures regarding the bank balances confirmations, inventory of cash and evaluation of the available cash reserve.

In order to verify the available cash and bank accounts, the auditor applied substantive procedures, as:

- He obtained a confirmation from the bank regarding the entity's available funds, afterwards he verified the correspondence with the balances registered in the accountancy.
- Starting from the family relationship between the cashier and the empowered person to manage the bank accounts' available funds, the auditor analyzed the possibility of existence of customized operations linked to the hard cash and bank fund availability. This way, he could have the assurance that all payments were registered into accounting before the closing of the financial statement, he reviewed the significant operations related to the cash book and the bank statements, from the financial year end, as well as analyzed the returns and cancellations from the following period of time.
- The auditor verified the overdrafts to ensure that they are presented within the financial statements.

Assessment of the materiality threshold

Due to the fact that the auditor assessed an inherent risk and of a high degree control, the risk of the accepted undetected is decreased, thus decreasing the risk of audit to an accepted degree.

In the assessment of the global materiality threshold, after applying the proportionate percentages, the auditor calculated the variation (the trend), for each percentage separately.

Following the preliminary evaluation of the audit risk, the auditor evaluated a low degree risk of audit, the professional rationality applied for the determination of the global materiality threshold being: if the audit risk is low, then the auditor will assess a high global materiality threshold, where the variation (trend) is high. Thus, within the table, the auditor identified the materiality threshold, the indicator with the highest variation, namely 15220, equal to 10% of the indicator *Profit before tax*, the value of this percentage being assessed as global materiality threshold, 15340 lei.

Table number 3 Establishing the materiality threshold

Indicators	2015	2014	Trend
Total assets	1191800	1261400	
1,00%	11918	12614	-696
2,00%	23836	25288	-1452
Turnover	1572000	1182000	
1,00%	15720	11820	3900
2,00%	31440	23640	7800
Profit before tax	153400	1200	
5,00%	7670	60	7610
10,00%	15340	120	15220

Global materiality threshold	15340		
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Source: personal adaptation

Written declarations of management

According to ISA 580 “Written declarations”, concerning the cash held and available funds in the bank the management has stated the following:

- The management has granted access to the auditor regarding all information deemed relevant for elaborating of financial statements that offers it’s faithful image to the user .
- The management has granted the auditor access to the entity’s personnel so that he/she may obtain audit evidence deemed necessary.
- The management has granted the auditor access to the internal auditor.
- The management has submitted all operations carried out by the entity.
- The management has submitted the results of the evaluation and of the inventory.
- The management has submitted any suspicion of fraud.
- The management states the fact that the re-evaluation of the cash reserves in the bank accounts of 48000 € at the currency exchange of 31.12.2015 was not accomplished, since the variation of the exchange rate was fortuitous, as it returned to normal prior to the authorizing of the financial statement, although for the audited year, the average exchange rate was 4.5 lei/€, on 31.12.2015 it declined to 4.1 lei/€, and in the first days of the following year it recovered.

The professional reasoning applied to establishing the audit opinion

Over the course of the financial audit activity, the auditor had analysed the extent to which the entity applied proper conduct regarding the operations concerning cash and cash reserves.

Beginning with the observation according to which the entity had decided not to re-evaluate the existing currency, according to the exchange rate of 31 December 2015, the auditor has determined that a proper conduct was implemented, because Order 1802/2014, requires the compulsoriness of evaluating cash reserves at the exchange rate emitted by the National Bank of Romania on the last day of the financial exercise.

The cash reserves held by the entity with the amount of 48000 € is a monetary element whose evaluation at the exchange rate valid on December 31 is obligatory. As a result, the entity must admit the discrepancies in the exchange rate, in the present case an expenditure of 19200 lei (4800 x 4.5 – 4800 x 4.1). It is regarded as a significant amount in light of the materiality threshold, established at 15340 lei.

The auditor informs the audited entity concerning the identified deficiencies, presenting the effects of their decision to not asses the cash reserves in currency at the exchange rate of the final day of the financial exercise on the information offered by the financial statements. The approach that the auditor suggests is recording the dissimilarity in the exchange rate into the accountancy:

$$\begin{array}{rclcl}
 19200 & & 665 & = & 5124 & & 19200 \\
 & & \text{„Expenses with the differences} & & \text{„Bank accounts in currency”} & & \\
 & & \text{of the exchange rate”} & & & &
 \end{array}$$

Depending on the decision of the entity to perform the suggested alterations or not, the financial auditor will issue a qualified opinion or an unqualified opinion, like it’s shown further:

Situation I. Management does not perform the adjustments suggested by the auditor

The impact of improper conduct led to an overvaluation of assets and of profit, contrary to the principle of prudence according to which assets and debts must not be over-/under-evaluated. Also, it had a fiscal impact establishing income tax.

In the event that the entity S.C. BETA S.R.L. does not record adjustments concerning available currency for the audited year so that it faithfully illustrate the situation, the auditor will issue a qualified opinion, since the misrepresentation is a significant one (it exceeds 10% of the profit), but it is quantifiable, it may be isolated and it does not affect the credibility or the integrity of the financial statements of the entity.

The formulation of the opinion as shown below is performed in accordance with that of the ISA Standard 705 “Modifications of the independent auditor’s report”. (CAFR, 2013, p. 728-729)

Excerpt from the audit report performed on the entity S.C. BETA S.R.L.

The basis for the qualified opinion is that the entity did not re-evaluate the available currency at the closing of the financial year at the exchange rate conveyed by the BNR, considering that it is a

transient variation. This influenced the profit, current assets, but also the income tax, thus in accordance with the requirements of the applicable reporting framework expenses worth 19200 lei from the discrepancies in exchange rates would have been recorded and the profit would have been smaller with that same amount.

The qualified opinion

In the auditor's opinion, excepting the effects of the presented aspect at the basis of the issuing of a qualified opinion, the financial situations faithfully display in all major respects, the financial position of the entity S.C. BETA S.R.L. on the 31st of December 2015, its financial performance and cash flow corresponding to the fiscal year that came to an end on that date, in accordance with the International Financial Reporting Standards.

Situation II. Management performs the adjustments suggested by the auditor

In the event that the audited entity performs the adjustments suggested by the auditor, he/she will issue an unqualified opinion. The formulation of the opinion displayed below is done in conformity with that of the ISA Standard 700 "Forming an opinion and reporting on financial statements". (CAFR, 2013, p.707)

Excerpt from the audit report performed on the entity S.C. BETA S.R.L.

Opinion

In our opinion, the financial statements faithfully portray, regarding all of the significant aspects the financial position of the entity S.C. BETA S.R.L. on 31 December 2015, and its financial performance and its cash flow corresponding to the fiscal year that came to an end on that date, in accordance with the International Financial Reporting Standards.

Other aspects

Without expressing other reservations we draw attention to the fact that the audited entity has made adjustments concerning the evaluation of available funds in currency at the exchange rate determined by the National Bank of Romania at the end of the fiscal year, which is 31.12.2015.

6. Conclusions

In a global market economy, in a perpetual change and harmonization, the offering of assurance on the information presented by the financial statements, represents one of the principal preoccupations of all parts involved in the commercial act.

The offering of an opinion by the financial auditor on the information shown by the financial statements, brings assurance regarding their veracity and a high level of trust to the final user. The evaluation represents one of the preliminary stages of elaborating the financial statements which establishes the fair value of patrimonial elements. Omitting the evaluation of these elements may lead to the significant distortion of the information offered by the financial statements and may have consequences on the decisions taken by the final user on the basis of these statements.

Thus, we may deduce the importance of respecting the general framework of financial reporting in drawing up financial statements, the importance of the auditor's activity progressing with professional skepticism and professionalism to increase the level of trust of the final users regarding the information offered by the financial statements.

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