

The importance of stocks audit for the quality Increase of the operational fluxes

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Abstract.

In a company specialized in trade, operating flows consist mainly in the marketing of goods and in producing operational flows are the flows of production. In both types of companies operational quality streams depends on good management of stocks. The overall objective of the stocks audit is to determine whether raw materials, products in the process of manufacture, stocks of finished goods and cost of sold goods are accurately presented in the financial statements. Research methodology chosen is based on general issues relating to inventory and audit stages reached with particular aspects of the audit procedures to be used with entities in the woodworking industry. The results show exposure requirements for higher quality operational streams: the reduction of the costs of storage and the need for restraint of a smaller value of money in stocks.

Key words: reality; honesty; completeness; procedures.

1. Introduction

Stocks audit is an important component of the audit works and the research thereto may be developed on several directions, considering the array of practical situations that may occur in different fields of the economic activity. Given the role of stocks in an economic entity, the stocks audit should be emphasized to improve the quality of operational flows.

A company's performance improvement implies the optimum and as accurate as possible measurement of efforts and effects, the efficient use of the company's resources, as well as the identification of the consumption reduction ways, where stocks hold a significant position. Stocks audit organization are ever more based on the structure and dynamics elements research, but especially on decoding the future evolution trends of the phenomena occurred inside and outside the company.

2. Concept and Terms

The quality of the operational fluxes can be appreciated through the analysis of the ratio between costs implicated in the operational flux and the incomes it generates. The increase of quality in operational flows may be viewed by observing positive changes in the volume of sales and cash flow from one financial year to another.

Authors as Christian Bernard Esnault and Hoarau conceive that "in accountancy, flows can be defined as a translation of the book trade relationships that the company has with its environment" (Esnault & Hoarau, 1994). The two authors mentioned indicate that the concept of flow is a concept of economical nature that corresponds to the transfer of a quantity of goods and services during a certain period.

To highlight the importance of auditing in higher quality of information flows, it is appropriate to present different approaches of audit, found in literature. Thus, the audit involves "issuing a reasoned opinion on the correspondence between the existing benchmarks." (Grand & Verdalle, 1999) In another approach, the audit "is a mission of opinion, given to an independent professional

(internal/external auditor), which uses a specific methodology and justifies a level of acceptable divergences against the rules." (Obert, 1998)

In the audit of stocks, the stock accounts control aim the following issues (Florea & Macovei, 2005): the existence of stocks and their correct boundaries and employment groups, assessment of stocks at the proper cost, respecting the principle of separation of the year; adjustment of the stocks value with slow moving, damaged or rusty, the mathematical accuracy of calculations; the principle of consistent methods, identifying the movements of stocks (purchases, sales, consumption); analysis of a very high volume stocks.

In achieving these objectives the auditor may rely to some extent on the internal control system, but should not neglect the necessity of numerous direct controls.

3. Solution Approach

A research on the importance of stocks audit to increase quality of the operational flows is required by the necessity to create security and certainty in the processes of production and sales. The overall objective of the audit of stocks is to determine whether raw materials, products in the process of manufacture, stocks of finished goods and cost of goods sold are accurately presented in the financial statements.

Research methodology is the starting point for audit criteria: the criteria of reality, exhaustiveness criteria and the criteria of correctness. Given the complexity of productive woodworking industry, the research methodology focuses on the analysis of audit stocks phases. In an audit of industrial stocks may be divided into five phases (Arens & Loebbecke, 2000): registration and purchase of raw materials transfer of the stock, the delivery of products, observing physical inventory and assessment of stocks. For management knowledge of the storage process is a problem because of the formation, location and management of stocks is carried out in close correlation with the strategic indicators and in interdependence with the permanent economical and financial results of the activity.

Specifying the audit procedures that could be used for entities in the woodworking industry contributes to the knowledge of storage. This process must be conducted on the basis of concepts and strategies designed to protect the entity's business of the conjectural elements on the international market and at the same time to use effectively the favourable conditions from the relationship between supply and demand in certain periods.

4. Analysis and Results

The first component of the stock audit relates to *the purchase and registration of the raw materials*. It comprises essentially three main functions: processing purchase orders, receiving raw materials and their storage. At this stage, the audit procedures to be used for an entity in the wood processing industry are:

- analyzing the management relations between the departments of supply - production - sales on the one hand and sales departments - Treasury - supply, on the other;
- a document verifying the entry of stock;
- an identification of the procedures used for registration of entries in stock;
- performing control tests regarding:
 - minimum standing stock (opportunity, necessity);
 - regular supply quantities;
 - number of failures, unannounced stops due to size differences between the orders received for finished goods and purchase orders for raw materials undelivered on time (comparisons between two consecutive financial years);
 - speed of rotation of stocks;

- storage costs;
- supply procedures;
- share of accepted orders, total orders received;
- check the necessary conditions to storage the materials and products.

For the auditor it is very important to understand the internal control mechanisms and to estimate the planned control risk. These objectives will be achieved through analysis of the mechanisms - the internal control key in a firm of wood processing industry, refer to: authorizing purchases, separation of goods received from other functions, management, record on time and independent verification of transactions and authorization payments to suppliers.

Appropriate authorization for purchases is important because it ensures that goods purchased will be stored according to the objectives of the firm authorized and prevent the acquisition of or excessive amounts of stock items that are not necessary.

The separation of property management from other functions is that the receiving department personnel should be independent of store personnel and accounting department. In the receiving department to prepare a slip of entry - as justification for receiving and verifying receipt of goods purchased. Analysis of how they draw up this slip may provide the auditor conclusive audit evidence.

Recording on time and independent verification of the operations of the acquisition of goods stored for audit is important because evidence relating to a debt purchase can be done at the time of receipt of goods or receipt of supplier invoice.

Analysis of how the payments are approved for suppliers completes the purchase - payments cycle, but is not of major importance for the stock accounts.

The internal transfer of stocks, the second component of the stock's audit has in sight modifying the raw materials and stocking the finished goods. Analyzing the stock's issue on more firms in the woodworking industry (Tulvinschi, 2008), we have come to the conclusion that in the transformation of the raw materials process (wood) into semi-manufactured (timber) and then into finished goods (furniture), of a great importance is to establish the over size's that must be taken into consideration because of the wood's reduction due to drying, at the fixated width and thickness for the highly humid timbers, so that at the reference humidity the pieces resulted to have the nominal sizes required. The correct establishment of these sizes influences the movements' of the stocks accounts and therefore the control of the stocks accounts as a component of the audit.

In figure 1 are presented the over size's necessary for the resinous timber depending on it's humidity.

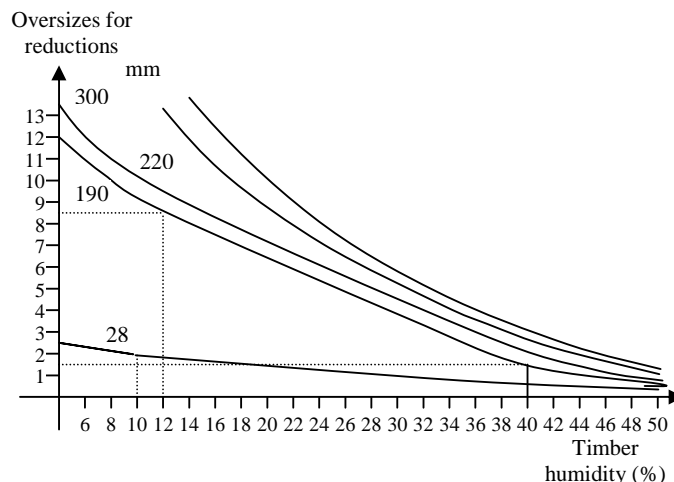


Figure 1 The oversize for reduction of the resinous timber

The use of the diagram in figure 1 is highlighted in the following examples:

We propose ourselves to determine the oversize for reduction in width of a pine board of 190 mm debited from logs with 40% humidity and of which moisture content should be 12%.

Following the perpendicular diagram high on the abscissa axis, which corresponds to 40% humidity and the horizontal line drawn from the point where it crosses the curve for the nominal size of 190 mm, we determine on the ordinates axis the oversize of 1,3 mm. Similar to the 12% humidity, is determined the oversize of 8,5 mm. The difference between these two values ($8,5 - 1,3 = 7,2$ mm) is the oversize we were looking for the given reduction. So the initial width of the pine board must be $190 + 7,2 = 197,2$ mm

Quantitatively determining the oversize will influence the value of leaving the administration of the timber to be processed. The same observation can be made for the stock of resinous logs. Therefore the raw materials and semi-manufactured goods will be credited to amounts less than originally foreseen.

Analytical procedures applied to the phase transfer of the stocks are very different. Analysis of trends shown at the branch or sector of activity may be essential for the development of analytical procedures to be applied for the evaluation of the entity's analytical information. For example, if the auditors noted a significant decrease of turnover at the branch, they can expect a similar evolution speed of rotation of the stocks in question. If the speed of rotation calculated at the company indicates the expected trend, the auditor may suspect the existence of errors on either the stock or the turnover used to calculate indicator. The more accelerated the speed of rotation of stocks is, the more the economic entity will be able to solve economic tasks proposed with a less volume of stocks. The speed of rotation of stock is an indicator expressing the effectiveness of their use. It is expressed through two indicators: the speed of rotation in days and the rate of rotation speed. The speed of rotation in days is determined as a report which where at the numerator will be entered the average stock and the number of days in the year or semester, and the denominator will be the volume of annually or quarterly turnover. The coefficient of speed of movement is calculated either as the ratio between turnover and stock environment, or as a ratio between time and speed of rotation in days.

The speed of rotation of stocks must be compared over time to draw conclusions and to act on the level of stocks according to its economic interests. Accelerating the speed of rotation has positive influence on profit rates and profitability. Accelerating the speed of rotation of stocks can be ensured through the technical, organizational and financial actions to be applied at each stage of the operation: the supply, production and marketing.

The main audit procedures applied to the phase transfer of the stock in an entity of the woodworking industry can, in summary, the following:

- tracking the performance indicators;
- examination the documents of internal control and the central situations on:
 - production process and results;
 - direct and indirect costs;
 - the contracts, sales to date and in the short term;
 - compliance with quality indicators;
- developing verification, certification and approval of production projects;
- the implementation of production projects in phases;
- examining the measures on the protection of pre-manufacturing processes, models and original recipes, and information about competitive actions;

- establish the existence or absence of partial or total records on machinery and facilities in use for:
 - conducting periodic repairs,
 - finding the causes and prevention of unwarranted interruptions;
 - ensure the maintenance of production capacity;
 - determining the need for equipment or facilities replacement;
 - specify the cost;
- periodic determination of the cost / benefit on places of production;
- verification of documents for entry and exit stocks;
- establishment and analysis of indicators of quality for the production process.

Delivery of products is the third component of the stocks audit in which are considered the following issues:

- if recorded sales meet actual deliveries to customers (existence);
- if existing sales are recorded (completeness);
- if sales recorded correspond to the quantity of goods delivered and invoiced correctly and recorded (accurately);
- if sales are made correctly (chronological criterion).

To check the first appearance, auditor will check the log sales, big book and the claims of systematic customers to identify large or unusual amounts. Later entries in the log will be confronted with copies of sales invoices for delivery. Completeness of transactions will be verified by comparing data from the delivery records of the log sales.

The accuracy of recording the supply of information products involves recalculation of the sales invoices and dealing with price lists approved and orders to customers.

To see if the supply of products were recorded in the correct data we will appeal to comparisons between data on operations reported sales of records and data delivery.

Observing physical inventory, the fourth component of the stock audit, is governed by ISA 501 "Audit Evidence - Additional considerations for specific items". Typically, the management entity establishes procedures under which stocks are inventoried at least once a year to serve as a basis for preparing financial statements or to evaluate the credibility of the ongoing inventory.

Applying physical observation technique where inventory, the auditor will ensure that (Mikol, 1999):

- all items are properly inventoried (no stocks forgotten, no counting errors);
- all items inventoried are appropriate qualitatively (no material unusable).

When stocks are significant for the financial statements, the auditor should obtain appropriate audit evidence sufficient to verify the existence and condition by their participation in the inventory, unless this is not possible. Auditor's participation to stock inventory allows them to inspect inventory, to observe compliance with the established procedures, management operations on the registration and control of inventory results, and provide evidence on the credibility of management procedures. When the presence of the auditor to stocks inventory is not possible, due to factors such as the nature and location, the auditor should consider whether alternative procedures provide adequate audit evidence sufficient to verify the existence and status of stocks to conclude that there are no needs to make reference to a limitation of application of the audit. An alternative procedure would be one in which

the auditor is based on the work of internal auditors or the auditors of the participating secondary stock inventory at different locations.

Participation in planning or inventory to use alternative procedures, the auditor should consider the following:

- risk of distortion in the stocks;
- the nature of the internal control systems used in relation to stocks;
- if expected to be established and issued proper instructions for inventory;
- when the inventory is held;
- where stocks are kept;
- if the participation of an expert is necessary.

In stock inventory observation, the auditor shall not bear any responsibility with regard to inventory. He is not participating in the inventory conduction, but he only observes and records the memorandum of all actions undertaken by the company during the inventory. In doing so, the auditor obtains knowledge about the quality of the policies and procedures developed and implemented inventory management and, thereby, assess the credibility of the allegations concerning the quantity and physical condition of stock.

Assisting in inventory stocks provides the auditor the possibility of applying both tests of control over the procedures used by the economic entity and the fund procedures. The auditor should examine and evaluate the procedures of the entity in sufficient time before their own inventory - because he actually does not have alternative strategies for a situation where the inventory is inadequate. Thus, the economic entity has time to respond favourably to suggestions made by the auditor on the procedures for changing inventory before actual termination.

In an entity in the woodworking industry, the area stretching for the fund procedures applied by the auditor for stocks inventory may vary, depending on the nature and composition of stocks. In such an entity, the auditor should identify stocks that have a particularly high value to be tested separately from the representative sample set for normal stocks. In the memorandum, the auditor shall provide a complete description of the items tested (serial identification unit of measure, value, location, etc.). Such information shall enable the auditor to compare the tests applied by him to those applied by the audited entity.

Stock assessment is the fifth component of the stock audit. At this stage, the auditor must determine whether the firm being audited properly applied a method of evaluating stocks, in conformity with the generally accepted accounting principles and consistent with the method used in previous years.

The cost of inventories of raw materials and materials, which is determined by applying one of the FIFO or CMP methods, involves the examination of invoices received from suppliers on the invoiced amount. "In the case of stocks currently on production, and semi-finished products, the cost must be verified through the computer records of the costs. The calculations used by the entity are valued in principle during the interim audit tests at the application of the methods of calculation of production cost." (Dobroțeanu, 2002) If the stocks of production are valued at standard cost, changes made to it must be analyzed. Applying standard costs to firms in the wood processing industry is not indicated in view of ongoing oscillations prices.

According to International Accounting Standard IAS 2 "Stocks", the cost of stocks is not recoverable if those stocks that have suffered damages, were used morally, totally or in part, or if their selling prices have decreased. The cost of inventories is also irredeemable and in conditions under which they've increased the estimated costs to completion or the estimated costs necessary to make the sale. The practice of reducing the stock below cost to net achievable value is consistent with the principle that assets should not be reflected in the balance sheet at an amount greater than the amount which

cannot be obtained by using or selling them. Consequently, stocks are reflected in the balance sheet at the achievable value if it is lower to cost.

Average net realizable value involves the use of accounting estimates, which means that auditors should consider the International Auditing Standard ISA 540 "Audit of accounting estimates. Accounting estimates are an approximation of the value of an item in the absence of accurate means of evaluation. Basically, this standard requires auditors to examine and verify the estimation methods applied by management, to use independent estimates, analyze and review events subsequent permanent. In essence, the achievable net selling price is estimated that could be obtained during the normal conduct of business, less estimated costs to complete the asset sale and costs.

As regards to the inherent risk assessment in the light of under-evaluation elements, accounting adjustment value of stock, the auditor must apply substantive procedures to enable the identification of needs adjustment of the accounting value of stocks. The background can be applied by auditors in a separate woodworking industry concerns: finding stocks damaged during assist in inventory, analyze sales by date for the balance sheet analysis in inventories held by reference to turnover scheduled to result in excess inventory.

If the allegations presented in the financial statements of the amount of stocks are related to complicated technical issues, the auditors may use the assistance of technical experts under the International Standard on Auditing ISA 620 "Using the services of an expert."

Through the stages of stocks audit, the auditor should ensure that the main categories of stocks have been identified and grouped correctly in the financial statements. Based on evidence obtained by comparing the financial requirements established by the standards of presentation and publication, the auditor can determine the fairness of presentation of stocks in the financial summary.

5. Conclusions

A research on the issue of operational stocks and flows can not cover issues related to audit inventory and its importance to increase operational quality streams. Reduction of the costs of storage and the need for restraint of a smaller value of money in stocks is the basic requirements for higher quality operational streams.

We can say that there is a standard audit of stocks, because this program depends exclusively on the previous stages of the audit mission and characteristics of each economic entity.

Since in the article the inventories audit steps have been customized for the woodworking industry, it should be emphasized that the strategic development of this sector of activity may be increasing the quality of the operational flows. This would consist in applying a strategy based on quality management in which the auditor's opinion on the presentation of financial stocks should occupy a privileged place. Thus, it could create centres for advice and guidance to the geographic areas with development potential for the wood industry. Specialists of these centres together with the economic agents in the area can define, manage and support individual and collective projects that will have positive consequences on growth and operational quality streams implicitly on developing the regional economy.

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