Chapter 16

Completing the Tests in the Sales and Collection Cycle: Accounts Receivable

■ **Concept Checks**

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1. Auditors perform substantive analytical procedures for the entire sales and collection cycle, including accounts receivable. This is necessary because of the close relationship between income statement and balance sheet accounts. Table 16-1 presents examples of several substantive analytical procedures that may be performed related to the sales and collection cycle. Several of the examples of substantive analytical procedures relate to the comparison of current year sales, gross margins, and sales returns and allowances to prior year amounts and at disaggregated levels, such as by product, by month, or by geography. These substantive analytical procedures may indicate a heightened risk of material understatement or overstatement in those income statement accounts that also may affect accounts receivable.

   Other substantive analytical procedures in the sales and collection cycle relate to the comparison of customer accounts receivable balances to prior years, which might indicate risks of misstatements in accounts receivable. Other substantive analytical procedures focus on misstatements related to the realizable value balance-related audit objective. Those procedures might include comparison of bad debt expense as a percentage of sales, the number of days in accounts receivable, or aging categories as a percentage of accounts receivable with those of prior years.

2. The most important objectives satisfied by confirmations are existence, rights, and accuracy. In extreme cases, confirmations are also useful tests for cutoff. Sometimes confirmations may also help the auditor satisfy the completeness objective.

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1. There are two common types of confirmations used for confirming accounts receivable: "positive" confirmations and "negative" confirmations. A positive confirmation is a letter, addressed to the debtor, requesting that the recipient indicate directly on the letter whether the stated account balance is correct or incorrect and, if incorrect, by what amount. A negative confirmation is also a letter, addressed to the debtor, but it requests a response only if the recipient disagrees with the amount of the stated account balance. A positive confirmation is more reliable evidence because

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the auditor can perform follow-up procedures if a response is not received from the debtor. With a negative confirmation, failure to reply must be regarded as a correct response, even though the debtor may have ignored the confirmation request.

Offsetting the reliability disadvantage, negative confirmations are less expensive to send than positive confirmations, and thus more of them can be distributed for the same total cost. The determination of which type of confirmation to be sent is an auditor's decision, and it should be based on the facts in the audit. Auditing standards indicate that it is acceptable to use negative confirmations only when all of the following circumstances are present:

1. The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate evidence regarding the design and operating effectiveness of controls relevant to the assertion being tested by the confirmation procedure.
2. The population of items subject to negative confirmation procedures is made up of a large number of small, homogenous account balances, transactions, or other items.
3. The auditor expects a low exception rate.
4. The auditor reasonably believes that recipients of negative confirmation requests will give the requests adequate consideration.

Typically, when negative confirmations are used, the auditor is using a reduced control risk assessment in the audit of accounts receivable. It is also common to use negative confirmations for audits of hospitals, retail stores, and other industries where the receivables are due from the general public. In these cases, far more assurance is obtained from tests of controls and substantive tests of transactions than from confirmations.

2. Alternative procedures are procedures performed on a positive confirmation not returned by the debtor using documentation evidence to determine whether the recorded receivable exists and is collectible. It is common to send second requests for confirmations and sometimes even third requests. Even with these efforts, some customers do not return the confirmations, so it is necessary to follow up with alternative procedures. The objective of the alternative procedures is to determine, by a means other than confirmation, whether the unconfirmed account existed and was properly stated at the confirmation date. For any confirmation not returned, the following documentation can be examined to verify the existence and accuracy of amounts making up the ending balance in accounts receivable:

   1. *Subsequent cash receipts* Evidence of the receipt of cash subsequent to the confirmation date includes examining remittance advice,

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entries in the cash receipts records, or perhaps even subsequent credits in the accounts receivable master file. The examination of evidence of subsequent cash receipts is usually the most useful alternative procedure because it is reasonable to assume that a customer would not make a payment unless it was a valid receivable. On the other hand, the fact of payment does not establish whether there was an obligation on the date of the confirmation. In addition, care should be used to match each unpaid sales transaction with evidence of its payment as a test for disputes or disagreements over individual outstanding invoices.

2. *Duplicate sales invoices* These are useful to verify the actual issuance of a sales invoice and the actual date of the billing
3. *Shipping documents* These are important to establish whether the shipment was actually made and as a test of cutoff.
4. *Correspondence with the client* Usually it is unnecessary to review correspondence as a part of alternative procedures, but it can be used to disclose disputed and questionable receivables not uncovered by other means.

The extent and nature of the alternative procedures depends primarily upon the materiality of the unconfirmed accounts, the nature and extent of the misstatements discovered in the confirmed responses, the subsequent cash receipts of the unconfirmed accounts, and the auditor’s evaluation of the effectiveness of internal controls. It is normally desirable to account for all unconfirmed balances with alternative procedures, even if the amounts are small, as a means of properly generalizing from the sample to the population.

■ Review Questions

16-1 Tests of details of balances are designed to determine the reasonableness of the balances in sales, accounts receivable, and other account balances that are affected by the sales and collection cycle. Such tests include confirmation of accounts receivable and examining documents supporting the balance in these accounts.

Tests of controls and substantive tests of transactions for the sales and collection cycle are intended to determine the effectiveness of internal controls and to test the substance of the transactions that are produced by this cycle. Such tests consist of activities such as examining sales invoices in support of entries in the sales journal, reconciling cash receipts, or reviewing the approval of credit.

The results of the tests of controls and substantive tests of transactions affect the procedures, sample size, timing, and items selected for the tests

16-1 (continued)

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of details of balances (i.e., effective internal controls will result in reduced testing when compared to the tests of details required with inadequate internal controls).

16-2 The negative form requests the recipient to respond only if he or she disagrees with the information stated on the request. Negative confirmation requests may be used to reduce audit risk to an acceptable level when:

1. The auditor has assessed the risk of material misstatement as low and has obtained sufficient appropriate evidence regarding the design and operating effectiveness of controls relevant to the assertion being tested by the confirmation procedure.
2. The population of items subject to negative confirmation procedures is made up of a large number of small, homogenous account balances, transactions, or other items.
3. The auditor expects a low exception rate.
4. The auditor reasonably believes that recipients of negative confirmation requests will give the requests adequate consideration.

For example, in the examination of demand deposit accounts in a financial institution, it may be appropriate for an auditor to include negative confirmation requests with the customers' regular statements when the combined assessed level of inherent and control risk is low and the auditor has no reason to believe that the recipients will not consider the requests.

The preceding requirement that negative confirmations are considered appropriate where the internal controls of the sales and collection cycle are effective is violated by Cynthia Roberts' approach. Not only is her approach questionable from the standpoint that nonresponses have not necessarily proved the existence of the receivable, but her confirmation at an interim date requires her to assume an assessed control risk less than maximum, but she has not tested the related internal controls to justify this assumption.

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16-3 The following are analytical procedures for the sales and collection cycle, and potential misstatements uncovered by each test. Each ratio should be compared to previous years.

ANALYTICAL PROCEDURE	POTENTIAL MISSTATEMENT
1. Gross margin by product line	Sales cutoff errors or other misstatements involving sales; purchase cutoff errors or other misstatements involving inventory or purchases.
2. Sales returns and allowances as a percentage of gross sales by product line or segment	All returns were not recorded, or shipments to customers were not in accordance with specifications and were returned (this could result in significant operating problems).
3. Trade discounts taken as a percentage of net sales	Discounts that were taken by customers and allowed by the company were not recorded.
4. Bad debts as a percentage of gross sales	Misstatement in determining the allowance for uncollectible accounts.
5. Days sales in receivables outstanding	A problem with collections, potentially causing an understatement of bad debts and allowance for uncollectible accounts.
6. Aging categories as a percentage of accounts receivables	Collection problems and understatement of allowance for uncollectible accounts.
7. Allowance for uncollectible accounts as a percentage of accounts receivable	Misstatement in determining the allowance for uncollectible accounts.
8. Comparison of the balances in individual customers' accounts over a stated amount with their balances in the previous year	A problem with collections and therefore a misstatement of the allowance for uncollectible accounts, or cutoff errors or other misstatements in customer accounts.

16-4 In most audits it is more important to carefully test the cutoff for sales than for cash receipts because sales cutoff misstatements are more likely to affect net earnings than are cash receipt cutoff misstatements. Cash receipt cutoff misstatements generally lead to a misclassification of accounts receivable and cash and, therefore, do not affect income.

To perform a cutoff test for sales, the auditor should obtain the number of the last shipping document issued before year-end and examine shipping documents representing shipments before and after year-end and the related sales invoices to determine that the shipments were recorded as sales in the appropriate period.

The propriety of the cash receipts cutoff is determined through tests of the year-end bank reconciliation. Deposits in transit at year-end should be **16-1**
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traced to the subsequent bank statement. Any delays in crediting deposits by the bank should be investigated to determine whether the cash receipts books were held open.

16-5 The following are balance-related audit objectives and related audit procedures for the audit of accounts receivable.

BALANCE-RELATED AUDIT OBJECTIVE	AUDIT PROCEDURE
Accounts receivable in the aged trial balance agree with related master file amounts; the total is correctly added and agrees with the general ledger (detail tie-in).	■ Trace twenty accounts from the trial balance to the related accounts in the master file. ■ Use audit software to foot the aged trial balance, and trace the total to the general ledger.
The accounts receivable in the aged trial balance exist (existence).	Confirm accounts receivable using positive confirmations. Confirm all amounts over $15,000 and a statistical sample of the remainder.
Existing accounts receivable are included in the aged trial balance (completeness).	Trace ten accounts from the accounts receivable master file to the aged trial balance.
Accounts receivable in the trial balance are accurately recorded (accuracy).	Confirm accounts receivable using positive confirmations. Confirm all amounts over $15,000 and a statistical sample of the remainder.
Accounts receivable in the aged trial balance are properly classified (classification).	Review the receivables listed on the aged trial balance for notes and related party receivables.
Transactions in the sales and collection cycle are recorded in the proper period (cutoff).	Select the last 10 sales transactions from the current year's sales journal and the first 10 from the subsequent year's and trace each one to the related shipping documents, checking for the date of actual shipment and the correct recording.
Accounts receivable in the trial balance are owned (rights).	Review the minutes of the board of directors for any indication of pledged or factored accounts receivable.
Accounts receivable in the trial balance are stated at realizable value (realizable value).	Discuss with the credit manager the likelihood of collecting older accounts. Examine subsequent cash receipts and the credit file on older accounts to evaluate whether receivables are collectible.

16-6 Accounting standards require that sales returns and allowances be *matched with related sales* if the amounts are material. For most companies, however, sales returns and allowances are recorded in the *accounting period in*

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which they occur, under the assumption of approximately equal, offsetting amounts at the beginning and end of each accounting period. This approach is acceptable as long as the amounts are not material.

When the auditor is confident that the client records all sales returns and allowances promptly, the cutoff tests are simple and straightforward. The auditor can examine supporting documentation for a sample of sales returns and allowances recorded during several weeks subsequent to the closing date to determine the date of the original sale. If auditors discover that the amounts recorded in the subsequent period are significantly different from unrecorded returns and allowances at the beginning of the period under audit, they must consider an adjustment.

16-7 A necessary audit procedure is to test the information on the client's trial balance for detail tie-in. The footing in the total column and the columns depicting the aging must be checked and the total on the trial balance reconciled to the general ledger to determine that all accounts are included in the listing.

The master file records are the tie-in between tests of controls, substantive tests of transactions, and tests of details of balances. The aged trial balance is the listing of the master file. Since the auditor uses the aged trial balance in tests of details, he or she must be sure that information is the same as that tested in tests of controls and substantive tests of transactions. In addition to tests of computerized controls over the master file and aged trial balance, the auditor usually traces a sample of individual balances to the master file to determine that the trial balance has been properly summarized from the master file. In most cases, it will not be necessary to trace each amount to the master file unless a significant number of misstatements is noted and it is determined that reliance cannot be place upon the trial balance with less than 100% testing.

16-8 The purpose of the accuracy tests of gross accounts receivable is to determine the correctness of the total amounts receivable from customers. These tests normally consist of confirmation of accounts receivable or examination of shipping documents in support of the shipment of goods to customers.

The purpose of the test of the realizable value of receivables is to estimate the amount of the accounts receivable balance that will not be collected. To estimate this amount, the auditor normally reviews the aging of the accounts receivable, analyzes subsequent cash payments by customers, discusses the collectibility of individual accounts with client personnel, and examines correspondence and financial statements of significant customers.

16-9 The value of accounts receivable confirmation as evidence can be visualized more clearly by relating it to tests of controls and substantive tests of transactions. If the beginning balance in accounts receivable can be assumed to be correct and careful tests of the controls have been performed, the auditor

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should be in an excellent position to evaluate the fairness of the ending balance in accounts receivable.

Confirmations are typically more effective than tests of controls and substantive tests of transactions for discovering certain types of misstatements. These include invalid accounts, disputed amounts, and uncollectible accounts resulting from the inability to locate the customer. Although confirmations cannot guarantee the discovery of any of these types of misstatements, they are more reliable than tests of controls and substantive tests of transactions, because tests of controls and substantive tests of transactions rely upon internally created documents, whereas confirmations are obtained from independent sources.

There are two instances in which confirmations are less likely to uncover omitted transactions and amounts than tests of controls and substantive tests of transactions. First, in order to send a confirmation, it is necessary to have a list of accounts receivable from which to select. Naturally, an omitted account will not be included in the population from which the auditor is selecting the sample. Second, if an account with an omitted transaction is confirmed, customers are less likely to respond to the confirmation, or, alternatively, will state that it is correct. Tracing shipping documents or sales orders to the related duplicate sales invoice and the accounts receivable master file is an effective method of discovering omitted transactions.

Clerical errors in billing customers and recording the amounts in the accounts can be effectively discovered by confirmation, tests of controls, or substantive tests of transactions. Confirmations are typically more effective in uncovering overstatement of accounts receivable than understatements, whereas tests of controls and substantive tests of transactions are effective for discovering both types. The important concept in this discussion is the existence of both a complementary and a substitute relationship between tests of controls and substantive tests of transactions, and confirmations. They are complementary in that both types of evidence, when combined, provide a higher level of overall assurance of the fair presentation of sales, sales returns and allowances, and accounts receivable than can result from either type considered separately. The strengths of tests of controls and substantive tests of transactions combined with the strengths of confirmation result in a highly useful combination. The two types of evidence are substitutes in the sense that the auditor can obtain a given level of assurance by decreasing the tests of controls and substantive tests of transactions if there is an offsetting increase in the confirmation of accounts receivable.

The extent to which the auditor should rely upon the tests of controls and substantive tests of transactions is dependent upon his or her evaluation of the effectiveness of internal controls. If the auditor has carefully evaluated internal control, tested internal controls for effectiveness, and concluded that the internal controls are likely to provide correct results, it is appropriate to

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reduce the confirmation of accounts receivable. On the other hand, it would be inappropriate to bypass confirmation altogether.

In the situation being addressed in this problem, the auditor will want to

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put more emphasis on tests of controls and substantive tests of transactions than confirmations because of the nature of the customers and the effectiveness of internal control. Nevertheless, both types of tests should be used.

16-10 It is common to use a combination of negative and positive confirmations by sending the positives to accounts with large balances and negatives to those with small balances. This allows the auditor to focus the confirmation testing on large account balances, while still testing a representative sample from the rest of the population at minimal cost.

16-11 It is acceptable to confirm accounts receivable prior to the balance sheet date if the internal controls are adequate and can provide reasonable assurance that sales, cash receipts, and other credits are properly recorded between the date of the confirmation and the end of the accounting period.

Other factors the auditor is likely to consider in making the decision are the materiality of accounts receivable and the auditor's exposure to lawsuits because of the possibility of client bankruptcy and similar risks. If the decision is made to confirm accounts receivable prior to year-end, it is necessary to test the transactions occurring between the confirmation date and the balance sheet date by examining internal documents and performing analytical procedures at year-end.

16-12 The most important factors affecting the sample size in confirmations of accounts receivable are:

- Performance materiality
- Inherent risk (relative size of total accounts receivable, number of accounts, prior year results, and expected misstatements)
- Control risk
- Achieved detection risk from other substantive tests (extent and results of substantive tests of transactions, substantive analytical procedures, and other tests of details)
- Type of confirmation (negatives normally require a larger sample size)

16-13 Auditing standards indicate oral responses, including responses received over the telephone, are not considered confirmations, but constitute other evidence in support of a receivable balance. Email responses are considered to be valid confirmation responses if the auditor can be confident in the identity of the confirmation respondent. Auditors can verify mailing addresses to phone directories, or to information in the client's accounts receivable master file if the client has adequate controls over the master file. Email **16-1**
16-13 (continued)

responses can be verified by third-party intermediaries, or by verifying the domain of the email address.

16-14 An auditor might choose to confirm information such as the right of return or sales terms when they suspect aggressive revenue recognition

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techniques like channel-stuffing or bill-and-hold sales. The auditor may have identified such risks when performing substantive analytical procedures, particularly if sales in the fourth quarter of the year are unexpectedly high. Alternatively, if the auditor notes sales returns are particularly high following year-end, they might suspect channel-stuffing and change the audit approach for confirmations.

16-15 Confirmation of accounts receivable is normally performed on only a sample of the total population. The purpose of the confirmation is to obtain outside verification of the balance of the account and to obtain an indication of the rate of occurrence of misstatements in the accounts. Most misstatements indicated by differences on the confirmation replies will not be material; however, differences must be analyzed individually and in total to determine their effect on the total accounts receivable balance. Though the individual differences may not be material, they may indicate a material problem when extended to the entire population, and with regard to the internal controls over the accounts receivable.

16-16 Three differences that may be observed in the confirmation of accounts receivable that do not constitute misstatements, and an audit procedure that would verify each difference are as follows:

1. Payment has been made by the customer, but not received by the client at the confirmation date. The subsequent payment should be examined as to the date deposited.
2. Merchandise shipped by the client has not been received by the customer at the confirmation date. The shipping documents should be examined to verify that the goods were shipped prior to the confirmation date.
3. Merchandise has been returned, but has not been received by the client at the confirmation date. Receiving documents and the credit memo should be examined.

16-17 With regard to the sales and collection cycle, the auditor uses flowcharts, assessing control risk for the accounting cycle, tests of controls, and tests of details of balances in the determination of the likelihood of a material misstatement in the accounts affected by the sales and collection cycle. The flowcharts provide a means for the auditor to document and analyze the accounting systems as represented by the client. The auditor would then make an initial assessment of control risk based on the controls which are present in the accounting cycle as documented in the flowcharts, and would plan the tests
16-17 (continued)

of controls based upon the selection of the significant controls. The auditor would then perform the tests of the significant controls to determine the effectiveness ofthe controls and to plan the substantive tests that are necessary based upon the revised assessment of control risk for this accounting cycle. Finally, after considering the results of tests of controls and substantive tests

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of transactions, the auditor would perform tests of details of balances to determine whether material misstatements exist in the account balances.

16-18 The determination of test of details procedures is directly affected by results from tests of controls and substantive test of transactions. When results of tests of controls and substantive tests of transactions do not support the auditor's initial assessment of control risk, the auditor will increase control risk, which then increases the need to perform additional substantive tests, particularly tests of details.

■ Multiple Choice Questions From CPA Examinations

16-19 a. (4) b. (2) c. (4)

16-20 a. (3) b. (4) c. (4)

16-21 a. (1) b. (1) c. (1)

■ Multiple Choice Questions From Becker CPA Exam Review

16-22 a. (4) b. (1) c. (3)

■ Discussion Questions and Problems

16-23 a. The SEC states that revenue generally is realized or realizable and earned when all of the following criteria are met:

- Persuasive evidence of an arrangement exists,
- Delivery has occurred or services have been rendered,
- The seller's price to the buyer is fixed or determinable, and
- Collectibility is reasonably assured.

b. In a "bill and hold transaction," a customer agrees to purchase the goods, but the seller retains physical possession until the customer requests shipment to designated locations.

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16-23 (continued)

c. Normally, such an arrangement does not qualify as a sale because delivery has not occurred. Under certain conditions, however, when a buyer has made a firm purchase commitment and has assumed the risks and rewards of the purchased product, but is unable to accept delivery because of a compelling business reason, bill and hold sales may qualify for revenue recognition.

d. The SEC states that the following are important criteria:

- The risks of ownership must have passed to the buyer;
- The customer must have made a fixed commitment to purchase the goods, preferably in written documentation;
- The buyer, not the seller, must request that the transaction be on a bill and hold basis. The buyer must have a substantial business purpose for ordering the goods on a bill and hold basis;
- There must be a fixed schedule for delivery of the goods. The date for delivery must be reasonable and must be consistent with the buyer's business purpose (e.g., storage periods are customary in the industry);
- The seller must not have retained any specific performance obligations such that the earnings process is not complete;
- The ordered goods must have been segregated from the seller's inventory and not be subject to being used to fill other orders; and
- The goods must be complete and ready for shipment.

16-24 a. One of the risks of material misstatement related to notes receivable generally relates to the existence balance-related audit objective, given that there is some risk that notes receivable may be recorded that do not represent valid receivables. Similar to other types of receivables, collectibility of the balance would generally represent a risk of material misstatement, which relates to the realizable value balance-related audit objective. The classification balance-related audit objective may represent a risk of material misstatement, particularly related to whether the receivable is properly classified as a short-term or long-term receivable.

b. Risk of material misstatement related to the realizable value balance-related audit objective would most likely represent a significant risk. This is particularly a concern because many of the stores are located in cities that have recently experienced higher rates of unemployment. Depending on how the economy is impacting sales at the stores, it is possible that the risk of material misstatement related to the existence balance-related audit objective might also be considered a significant risk.

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16-24 (continued)

c. Given the concerns related to higher unemployment in markets where the stores are located, collectibility of the notes receivable may be more challenging, resulting in slower note payments received. That would result in an increase in the number of days receivable outstanding in the current year relative to prior years.

d. Assuming the notes receivable balances are material, the auditor would send notes receivable confirmations in the current year to obtain evidence related to the existence and accuracy balance-related audit objectives. For this entity, the notes receivable are similar to trade accounts receivable for other retailers. Auditing standards require that confirmations be sent for accounts receivable.

e. The confirmation of notes receivable will provide little, if any, evidence related to the realizable value balance-related audit objective. While the confirmation would confirm the existence of the receivable and may provide evidence about discrepancies in the accuracy of the receivable, it would not provide the auditor information about the customer's likelihood to pay.

16-25 a.
1. Completeness
2. a. Detail tie-in
   b. Realizable value
3. Detail tie-in
4. a. Existence
   b. Realizable value
5. a. Existence
   b. Accuracy
   c. Realizable value (if cash receipts relate to older accounts)
6. a. Existence
   b. Accuracy

b. The auditor would likely perform the steps in the following order: 4, 3, 2, 1, 6, and 5. The auditor would perform analytical procedures as part of the planning process to identify potential misstatements. The auditor would next perform the detail tie-in procedure of footing and cross-footing the listing of aged accounts receivable and trace the total to the general ledger before performing any tests to ensure they are using the correct aging list for testing. The auditor would then trace a sample of accounts from the aged listing to the master file for detail tie-in, and then trace a sample of accounts from the master file to the aged listing to ensure

16-25 (continued)

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completeness. Next, the auditor would select a sample of accounts to confirm, mail the confirmations, receive confirmations and perform testing, or follow up on any nonresponses by examining subsequent cash receipts or supporting documents.

16-26

a. BALANCE-RELATED AUDIT OBJECTIVE	b. PREVENTIVE INTERNAL CONTROL	c. TESTS OF DETAILS OF BALANCES AUDIT PROCEDURES
1. Customer balances stated at the correct amount (accuracy).	The client should scan the remittance advice returned with the customer payment electronically rather than manually entering the customer number.	The auditor should note any replies to the confirmation of accounts receivable which indicate disputes between a customer and client.
2. Transactions are recorded in the proper period (cutoff).	The client should establish cutoff procedures so that only shipments made before year-end are recorded as current period sales.	Examine shipping documents for sales recorded immediately before and after year-end to test whether sales are recorded in the proper period.
3. Accounts receivable are stated at realizable value (realizable value)	The client should perform an analysis of the collectibility of accounts receivable at the end of the year and should communicate with its customers to determine the likelihood of the collectibility of individual accounts.	The auditor should keep informed of current economic conditions and consider their effect on collectibility of accounts receivable for the client. The auditor may compare cash receipts after year-end to the cash receipts of the similar period of the previous year and consider any changes as to their effect on the collectibility of the accounts receivable.

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a. BALANCE-RELATED AUDIT OBJECTIVE	b. PREVENTIVE INTERNAL CONTROL	c. TESTS OF DETAILS OF BALANCES AUDIT PROCEDURES
4. Accounts receivable are stated at the correct amounts (accuracy).	The client should record claims for defective merchandise as soon as possible after the claim is received to keep accounts receivable balances as accurate as possible.	The auditor should note any replies to the confirmation of accounts receivable which indicate disputes between a customer and client. The auditor should review the client's correspondence files from customers.
5. The company has rights to accounts receivable (rights and obligations) (also presentation and disclosure).	The controller should maintain a schedule containing all required disclosure information, including pledging or other restrictions on accounts receivable.	The auditor's standard bank confirmation should contain an inquiry as to assets pledged for loans from that institution. When loan confirmations are sent by the auditor, they should contain an inquiry as to any assets pledged for the indebtedness.
6. Transactions are recorded in the proper period (cutoff).	The client should establish cutoff procedures so that sales returns received in the current period are recorded as current period sales returns.	Examine receiving reports for sales returns recorded immediately before and after year-end to test whether sales returns are recorded in the proper period. The auditor should perform an analytical test to determine whether or not returns in the first month of the next year are similar in magnitude to those experienced in the same period of previous years.
7. Existing accounts receivable are included in the aged trial balance (completeness).	The accounts receivable master file should be reconciled to the control account periodically by an independent person.	Foot the aged trial balance and compare the total to the general ledger. Trace a sample of accounts from the master file to the aged trial balance to determine if all are included.

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16-26 (continued)

a. BALANCE-RELATED AUDIT OBJECTIVE	b. PREVENTIVE INTERNAL CONTROL	c. TESTS OF DETAILS OF BALANCES AUDIT PROCEDURES
8. Accounts receivable exist (existence).	The accounts receivable master file should be reconciled to the control account periodically by an independent person.	Foot the aged trial balance and compare the total to the general ledger. Trace from the aged trial balance to the master file, looking for duplicates.
9. Accounts receivable are properly classified (classification).	The client should maintain separate accounts for the recording of receivables due from affiliated companies.	The auditor should review the trial balance of accounts receivable to determine whether or not accounts from affiliated companies are included in the customer accounts. The auditor should be aware of affiliated companies and the transactions between them and the client, and should inquire and follow up to determine that accounts receivable from affiliates are not included in the accounts receivable from customers.

16-27

PROCEDURE	a. TYPE OF TEST	b. BALANCE-RELATED AUDIT OBJECTIVE
1	Test of details	Existence and accuracy
2	Test of details	Cutoff
3	S T of T	Cutoff
4	Test of details	Accuracy and existence (may also include realizable value if cash receipts examined are for older accounts)
5	S T of T	Classification
6	S T of T	Rights
7	Test of details	Completeness
8	ST of T	Existence

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16-27 (continued)

PROCEDURE	a. TYPE OF TEST	b. BALANCE-RELATED AUDIT OBJECTIVE
9	Test of control	Accuracy
10	S T of T	Completeness
11	Test of details	Detail tie-in
12	S T of T	Detail tie-in
13	Test of details	Classification

16-28 a. A shipment should be recorded as a sale when the risks of ownership transfer to the buyer and collectibility is reasonably assured. Ordinarily, a shipment is considered a sale when it is shipped from the seller, or delivered to the buyer, depending on the shipping terms. Typically, title and risks of ownership would not transfer to the buyer before shipment (with the exception of bill-and-hold sales).

b. See the table below. The sales invoice number can be ignored, except to determine the shipping document number. In this solution, it is assumed that title transfers to the buyer when the goods are shipped.

INVOICE NO.	SHIPPING DOCUMENT NO.	MISSTATEMENT IN SALES CUTOFF	OVERSTATEMENT OR UNDERSTATEMENT OF AUG. 31 SALES
August sales			
5431	2164	none	
5434	2169	4,214.30	overstatement
5432	2165	none	
5433	2168	1,620.22	overstatement
5435	2166	none	
		5,834.52	
September sales			
5437	2163	2,541.31	understatement
5436	2167	106.39	understatement
5438	2170	none	
5440	2171	none	
5439	2172	none	
		2,647.70	
Net overstatement		3,186.82	
Adjusting entry			
Sales		3,186.82	
Accounts receivable			3,186.82

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16-28 (continued)

c. After making the type of cutoff adjustments shown in part b., current year sales would be overstated by:

	Amount of sale
2168	1,620.22
2169	4,214.30
2170	852.06
2171	1,250.50
2172	646.58
	8,583.66

The best way to discover the misstatement is to be on hand on the balance sheet date and record in the audit working papers the last shipping document issued in the current period. Later, the auditors can examine shipping documents before and after the balance sheet date to determine if they were correctly dated.

An alternative, if there are perpetual records, is to follow up on differences between physical inventory counts and perpetual record balances to determine if the cause was end of the period cutoff misstatements. Assume, for example, that there were 626 units of part X263 on hand August 31, but the perpetual records showed a total of 526, and a shipment of 100 units included on the perpetual August 31. This is a likely indication of a September shipment that had been dated August 31.

d. The following procedures are usually desirable to test for sales cutoff.

1. Be present during the physical count on the last day of the accounting period to determine the shipping document number for the last shipment made in the current year. Record that number in the working papers.
2. During year-end field work, select a sample of shipping documents preceding and succeeding those selected in procedure 1. Generally, shipping documents with the same or with a smaller number than the one determined in procedure 1 should be included in current sales; however, this depends on the shipping terms. Generally, those with document numbers larger than that number should have been excluded from current sales.
3. During year-end field work, select a sample of sales from the sales journal recorded in the last few days of the current period, and a sample of those recorded for the first few days in the subsequent period. Trace recorded sales to related shipping documents to make sure that each is recorded in the proper period.

16-28 (continued)

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e. The following are effective controls and related tests of controls to help prevent cutoff misstatements.

CONTROL	TEST OF CONTROL
(1) Policy requiring the use of prenumbered shipping documents.	Examine several documents for prenumbering.
(2) Policy requiring the issuance of shipping documents sequentially.	Observe recording of documents, examine document numbers and inquiry.
(3) Policy requiring recording sales invoices in the same sequence as shipping documents are issued.	Observe recording of documents, examine document numbers and inquiry.
(4) Policy requiring dating of shipping documents, immediate recording of sales, and dating sales on the same date as the shipment (depending on shipping terms).	Observe dating of shipping documents and sales invoices, and timing of recording.
(5) Use of perpetual inventory records and reconciliation of differences between physical and perpetual records.	Examine worksheets reconciling physical counts and perpetual records.

16-29

a. TYPE OF EVIDENCE	b. TYPE OF TEST	c. and d. OBJECTIVE(S)
1. Reperformance	(4) Test of details of balances	Detail tie-in
2. Inspection	(1) Test of control	Completeness
3. Inquiry	(4) Test of details of balances	Cutoff
4. Observation	(1) Test of control	Posting and summarization
5. Inspection	(2) Substantive test of transactions	Timing
6. Inspection	(1) Test of control	Occurrence
7. Inspection	(4) Test of details of balances	Cutoff
8. Analytical procedure	(3) Substantive analytical procedure	N/A

16-30 a. The two types of confirmations used for confirming accounts receivable are "positive" and "negative" confirmations. A positive

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confirmation is a letter, addressed to the debtor, requesting that the recipient indicate directly on the letter whether the stated account balance is correct or incorrect and, if incorrect, by what amount. A negative confirmation requests a response from the debtor only when the debtor disagrees with the stated amount.

When deciding which type of confirmation to use, the auditor should consider the assessed control risk in the sales and collection cycle, the make-up of the population, cost/benefit relationship, and any information about the existence of the accounts. Positive confirmations are more reliable but more expensive than negative confirmations. Positive confirmations should be used when the population is comprised of a small number of large accounts, and when there are suspected conditions of dispute or inaccuracy. When negative confirmations are used, the auditor has normally assessed control risk below maximum and tested the internal controls for effectiveness. Negative confirmations are often used when accounts receivable are comprised of a large number of small accounts receivable from the general public.

b. When evaluating the collectibility of accounts receivable, the auditor may review the aging of accounts receivable, analyze subsequent cash receipts from customers, discuss the collectibility of individual accounts with client personnel, and examine correspondence and financial statements of significant customers. Changes in the aging of receivables should be analyzed in view of any changes in the client's credit policy and in the current economic conditions.

c. When customers fail to respond to positive confirmation requests, the CPA may not assume with confidence that these customers checked the request, found no disagreement, and therefore did not reply. Some busy customers will not take the time to check confirmation requests and will not respond, hence obvious exceptions may exist without being reported to the CPA. In the case of fraud or embezzlement, the perpetrators could perhaps prevent exceptions from being reported and prevent letters addressed to nonexistent customers from being returned from the post office as undeliverable. Confirmations returned as undeliverable by the post office will require appropriate action to obtain better addresses.

Follow-up is necessary when customers do not reply because the CPA has selected the positive confirmation route for certain receivables, and the most logical step to follow first is to mail second requests.

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16-30 (continued)

d. When no response is received to the second request for positive confirmation, the auditor should use alternative procedures. These normally include examination of the customer's remittance advice and related cash receipt. This is often a simple and effective check where cash receipts were received subsequent to the balance sheet date. Correspondence in the client's files will also sometimes offer satisfactory evidence. The auditor should also examine shipping documents, sales invoices, contracts, or other documents to substantiate that the charges were proper.

In unusual cases, the CPA should mail a third request and possibly make telephone calls in an effort to get a reply directly from the customer. The CPA may find it necessary, where significant amounts are involved and circumstances are not clear, to investigate the existence and/or financial status of a customer.

16-31 a. Tim needs to consider the likelihood of receiving responses, the efficiency of the confirmation process, and the reliability of audit evidence obtained from the different approaches. If a low response rate to written confirmations is expected, then Tim may decide to use email confirmations or direct access in order to increase the likelihood of receiving a response. Email confirmations and direct access are also more efficient than written confirmations. However, Tim needs to ensure that email addresses or direct access information is reliable, just as he would need to ensure the addresses used to mail confirmations are reliable. Electronic methods may be more susceptible to someone intercepting and altering the response.

b. The audit firm needs to perform procedures to verify the email addresses or Web site links for direct access are correct. Typically, the client will provide the addresses for written confirmations, or email addresses for email confirmations, and the auditor will perform procedures to verify. For example, the auditor would verify that the email address is consistent with the customer's Web site domain address. For direct access to electronic records, the audit firm should obtain the login information directly from the third party providing the access. The extent of procedures the auditor performs to verify that addresses are accurate and that responses have not been altered will depend on the assessed risk of fraud.

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16-32 a. Tests of controls and substantive tests of transactions related to the allowance for doubtful accounts include the following:

1. Test of controls for customer authorization and credit approval.
2. Substantive tests of transactions for posting and summarization and aging of accounts receivable.
3. Substantive tests of transactions for bad debt charge-offs.
4. Tests of controls over follow-up on past due accounts.

b. An analysis of the allowance for doubtful accounts as a percentage of accounts receivable and the percentage of receivables in each aging category follows.

	12/31/2016	**12/31/2015**
Allowance as a % of accounts receivable	6.25%	7.27%
Charge-offs as a % of sales	0.94%	0.99%
Percentage of receivables in each aging category		
0-30 days	62.28%	67.42%
30-60 days	17.65%	15.62%
60-90 days	11.93%	10.28%
Over 90 days	8.14%	6.68%
Total	100.00%	100.00%

Despite the increase in the allowance account from $75,000 in 2015 to $90,000 in 2016, the analysis suggests the account is understated. Whether the allowance is misstated by more than $15,000 is a matter of judgment. Although the allowance increased from $75,000 to $90,000, it decreased as a percentage of accounts receivable from 7.27% in 2015 to 6.25% in 2016. An increase in the allowance of almost $15,000 would be necessary to maintain the allowance at the same percentage of accounts receivable as the prior year.

In addition, current accounts receivable decreased from 67.42% to 62.28% of accounts receivable. The amount of past due receivables increased from $335,892 to $543,346. The allowance is 16.56% of past due receivables for 2016 and 22.33% for 2015. To maintain the allowance as the same percentage of past due receivables would require an increase in the allowance of more than $30,000.

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16-33 a. Confirmation responses that represent timing differences are due to such items as payments and shipments in transit. Responses that represent likely timing differences are:

#2 – represents a likely payment in transit

Item #3 refers to a payment after year-end. This is not a timing difference, but an apparent misunderstanding by the customer as to the required response.

#4 could represent a payment in transit, and #10 could represent a credit in transit. However, this is unlikely given the date of the transactions.

b. It is difficult to determine whether a confirmation difference is a misstatement without further investigation.

#6 appears to represent a misstatement as the client does not appear to have properly accounted for the advance payment.

For response #8, the customer is contesting the charge. The auditor will need to investigate whether the customer's balance is likely to be adjusted.

#9 indicates that goods were shipped on consignment, and appears to represent a misstatement.

c. For all of the exceptions, the auditor is concerned about four principal things:

(1) Whether there is a client error. Many times the confirmation response differences are due to timing differences for deposits in the mail and inventory in transit to the customer. Sometimes customers misunderstand the confirmation or the information requested. The auditor must distinguish between those and client errors.
(2) The amount of the client error if any.
(3) The cause of the exception. It could be intentional, a misunderstanding of the proper way to record a transaction, or a breakdown of internal control.
(4) Potential misstatements in the sample not tested. The auditor must estimate the misstatement in the untested population, based on the results of the tests of the sample.

Suggested steps to clear each of the comments satisfactorily are:

1. (a) Examine supporting documents, including the sales invoices and applicable sales and shipping orders, for propriety and accuracy of the sales.
(b) Review the cash receipts books for the period after December 31, 2015, and note any cash receipts from the PDQ Company. The degree of internal control over cash

16-33 (continued)

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receipts should be an important consideration in determining the reliance that can be placed on the cash receipts entries. In addition, because there is no assurance that cash receipts after December 31 represent the payment of invoices supporting the December 31 trial balance, consideration should be given to requesting a confirmation from the PDQ Company of the invoices paid by their checks.

2. This is an apparent timing difference. The auditor should examine the date of receipt of payment on the client's book to see if this was in fact a payment in transit at December 31.

3. This is a confirmation of the balance with an additional comment about a subsequent payment. Since the customer has given us the data, it is preferable to check to see that the information agrees with the company's records.

4. (a) The cause should be investigated thoroughly. If the cash receipt was posted to the wrong account, it may indicate merely a clerical error. On the other hand, posting to the wrong account may indicate lapping.
   (b) Such a comment may also indicate a delay in posting and depositing of receipts. If this is the case, the company should be informed immediately so that it can take corrective steps.

5. This appears to represent a shipment in transit. The auditor should evaluate the shipping document and evaluate whether it is reasonable that the customer received the goods on January 5th.

6. (a) Determine if such advance payment has been received and that it has been properly recorded. A review should be made of other advance payments to ascertain that charges against such advances have been properly handled.
   (b) If the advance payment was to cover these invoices, the auditor should propose a reclassification of the $1,350, debiting the advance payment account and crediting accounts receivable – trade.

7. (a) The auditor should be alert to the possibility of a fictitious sale or receivable. The auditor should verify the address of the company to determine if the confirmation was sent to the correct address. It is possible the company has moved, or is no longer in business. If the address used was incorrect, a revised confirmation should be sent.
   (b) Examine the shipping order for indications that the goods were shipped and, if available, carrier's invoice and/or bill of lading for receipt of the goods.

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8. This should be discussed with the appropriate officials and correspondence with the customer should be reviewed to allow determination whether an adjustment should be made in the amount of the receivable or if an allowance for uncollectible accounts should be set up.
9. As title on any goods shipped on consignment does not pass until those goods are sold, the sales entry should be reversed, the inventory reduction reversed, and cost of sales credited if it is actually a consignment sale. Other so-called sales should be reviewed and company officials queried to determine if other sales actually represent consignment shipments; if so, a similar adjustment should be made for all consignment shipments.
10. This may indicate a misposting of the credit or a delay in posting the credit. Comments under 4 above would also apply to credits.

16-34

CHANGE IN CIRCUMSTANCE	LIKELY TEST OF DETAILS OF BALANCES RESPONSE
1. Substantive analytical procedures indicated a significant slowing in accounts receivable turnover.	d. Expand the review of cash receipts after year-end to evaluate the collectibility of accounts receivable.
2. The client entered into sales contracts with new customers that differ from the client's standard sales contracts.	b. Send positive confirmations that include requests for information on side agreements and special terms.
3. The client had a significant increase in sales near year-end.	e. Increase the sample size for sales cutoff testing for sales recorded before year-end.
4. Accounts receivable confirmations were ineffective due to a very low response rate in the prior year audit.	i. Perform alternative procedures to test the existence and accuracy of accounts receivable instead of sending positive confirmations.
5. The client began experiencing an increase in returns due to product changes that resulted in increased defects.	a. Expand testing of sales returns after year-end and compare the level of returns with the prior year.

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CHANGE IN CIRCUMSTANCE	LIKELY TEST OF DETAILS OF BALANCES RESPONSE
6. You found several pricing errors in your substantive tests of transactions for sales.	g. Increase the sample size for positive confirmations of accounts receivable.
7. In performing substantive test of transactions for cash receipts, you found that receipts were promptly recorded in customer accounts, but there were delays in depositing the receipts at the bank.	h. While at the client's premises at year-end, obtain information on the last few cash receipts at year-end for cash receipts cutoff testing.
8. The client entered into a new loan agreement with the bank. Accounts receivable are pledged as collateral for the loan.	f. Send a confirmation to the bank confirming amounts pledged as collateral under loan agreements.
9. The client did not reconcile the accounts receivable subledger with the accounts receivable balance in the general ledger on a regular basis.	c. Increase the number of accounts traced from the accounts receivable trial balance to the accounts receivable subledger.

16-35 a. If called upon to evaluate the adequacy of the sample size, the type of confirmation used, and the percentage of accounts confirmed, the following additional information would be required:

- The number of accounts that had positive balances at 12/31/16
- The performance materiality of total accounts receivable
- The distribution and size of the accounts receivable
- The assessment of control risk based on the understanding obtained of internal control and tests of controls
- The results of the confirmation tests in previous years
- The risk of exposure to bankruptcy and similar risks (audit risk)
- Expected misstatements

b. If the amounts are material, it is necessary to perform follow-up procedures for positive confirmations not returned by the debtor. It is common to send second requests for confirmations and sometimes even third requests. Even with these efforts, some customers do not return the confirmation, so it is necessary to follow up on all nonresponses with a method referred to as "alternative procedures."

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16-35 (continued)

c. The alternative procedures used for verifying the two nonresponses do not appear to be adequate. In scheduling the subsequent cash receipts for confirmation request no. 9, the auditor should have indicated which invoices the payments applied to and whether or not the invoices were included in the balance at 12/31/16. In addition, the auditor should have examined copies of checks or remittance advices if they were available or traced the amounts to the bank deposit slip and into the bank statement. The cash receipts listed for confirmation request no. 9 total in excess of the balance due at 12/31/16; the auditor should have indicated what portion of this balance applies to the balance at 12/31/16.

The alternative procedures for confirmation request no. 26 show a small payment for which no indication of the invoice to which it applies is given. The auditor examined a duplicate sales invoice, which may or may not support the balance at 12/31/16. The auditor must determine which sales invoices are represented by the $2,500 balance at 12/31/16 and then examine a shipping document to support the shipment of goods to the customer. The even amount of the balance and periodic payments also raise a question about the possibility of a note outstanding rather than an account receivable.

■ **Case**

16-36 a. There are four major factors affecting business risk and acceptable audit risk for the audit of Smalltown Regional Hospital.

1. There are several large loans from two local banks, both which have said they are reluctant to extend more credit.
2. A modern hospital is being built in a nearby city, which affects the competitive environment, and therefore the likelihood of financial failure.
3. The hospital has incurred significant deficits in the past.
4. County taxes may not be able to make up the deficits, as they have in the past.

Considering the combined effect of these factors, the auditor should set a low acceptable audit risk.

b. The following are major inherent risks:

1. In the audit of accounts receivable and property, plant, and equipment, the amounts are highly material.
2. Misstatements are common in billings, cash receipts, accounts receivable balances, and bad debts.
3. Due to the high unemployment rate, there is a significant risk of increased bad debts.

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c. The auditor would likely deem that the risks of material misstatement related to all of the transaction-related audit objective for sales and cash receipts transactions as significant risks due to the deficiencies in internal control and the concerns about unintentional errors in billing, recording sales, and cash receipts. Relatedly, the auditor would most likely deem the risks of material misstatement related to the balance-related audit objectives of existence, accuracy, and realizable value for accounts receivable would be considered a significant risks due to the deficiencies and the auditor's concern about unintentional errors in accounts receivable and bad debts.

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d. The following emphasis is appropriate for each type of test:

TYPE OF TEST	EMPHASIS	REASON
1. Test of controls	None, except control of cash receipts. Test internal controls over cash receipts using tests of controls to make sure that the controls are effective to prevent fraud.	Controls are deficient in all areas except cash receipts.
2. Substantive test of transactions	Extensive. Do substantive tests of transactions for revenues, with emphasis on tests for unrecorded revenues, billing misstatements, and recording misstatements. The sample for sales should be traced to subsequent cash receipts to test whether each receipt has been correctly recorded. One important test is to select a sample of patient charts and trace transactions through to the revenue journal. The patient chart is a reliable indicator of services provided to patients	Tests of details of balances evidence (confirmation) is not reliable, therefore substantive tests of transactions are the most important evidence. Substantive tests of transactions are even more important because of potential for misstatement for the completeness objective. Tests of details of balances are unlikely to uncover any existing misstatements for this objective.
3. Substantive analytical procedures	Extensive. A careful evaluation of all older, outstanding accounts is essential due to the likelihood of bad debts. The high unemployment rate in the community increases the likelihood of a material misstatement of the allowance for uncollectible accounts. A number of substantive analytical procedures would be performed to analyze trends related to collectibility.	An indication of misstatements may result from these tests.
4. Tests of details of balances	Reasonably extensive, except confirmations which should be minimal. The accounts receivable aged trial balance should be tested for detail tie-in. Minimal confirmations should be sent, with emphasis on large or unusual balances. The emphasis should be on subsequent cash receipts.	Confirmations are not emphasized because of the lack of reliability in the situation. Tests of details of balances are used most extensively for bad debts and the allowance for uncollectible accounts.

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■ **Integrated Case Application**

16-37

PINNACLE MANUFACTURING - PART VII

a. Relationships, ratios, and trends:

1. Comparison of current listing of accounts payable with that of the previous audit date, noting significant changes in amounts and makeup, e.g., changes in major suppliers.

2. Ratios:
   - Accounts payable / purchases
   - Gross profit ratio
   - Overhead / materials cost
   - Material / total product cost: total dollar basis and unit cost basis
   - Overhead / direct labor
   - Units purchased / units sold
   - Specific expense items / sales

3. Trends:
   - Purchases by month
   - Gross profit by month
   - Other recurring expenses by month

b. 1. Re-add or use the computer to total the accounts payable list and trace the total to the general ledger.

Ending balance tests

2. Select a sample of 51 vendors and request that they send a copy of their year-end statement directly to you. Examine the vendors' statements and reconcile these to the accounts payable list. (Note: student sample sizes will vary.)

3. Trace from the accounts payable list to vendors' invoices and statements for any non-responses.

Cutoff tests

4. Obtain number of last receiving report issued as part of physical observation of inventory.

5. Examine subsequent cash disbursements greater than $50,000 and examine related documentation to determine if such disbursements were properly recorded as liabilities as of the balance sheet date. (Note: student sample sizes or selection criteria will vary.)

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6. Trace a sample of receiving reports issued just before and after year-end to the appropriate journal and vendor invoice.
7. Examine vendor invoices for merchandise received shortly after year-end to determine whether they were on an FOB origin basis.

Disclosure and classification tests

8. Review the list and master file for related parties, notes or other interest-bearing liabilities, long-term payables, and debit balances.
9. Review financial statements to make sure that material related parties, long-term, and interest-bearing liabilities are segregated.

c. Audit procedures would be conducted more extensively and sample sizes would increase in a situation where assessed control risk and inherent risk were high and analytical procedures indicated a high potential for misstatements. It is likely that there would be confirmation of accounts payable whereas in part b. that may not have been necessary. There would also be more extensive out-of-period liability tests.

d,
e,
and f. *See pages 16-32 and 16-33*.

g. Students' conclusion about whether accounts payable is materially misstated will depend on their estimate of the allowance for sampling risk in part e. The projected error in accounts payable affecting the income statement is an overstatement of $124,915 compared to performance materiality of $250,000. The total projected error in accounts payable is an understatement of $171,607. Students should also recognize that some of the errors in accounts payable do not affect net income, and performance materiality for the balance sheet and accounts payable is likely to be larger than performance materiality for accounts payable as it relates to the income statement.

The presence of potentially material misstatements in accounts payable suggests that control risk may need to be increased for one or more objectives and substantive tests of balances increased. Most of the errors in year-end accounts payable relate to cutoff. In this case, the auditor may decide that year-end cutoff tests should be expanded.

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Requirements d., e., and f.

Vendor Key Accounts (>$250,000)	Balance Per Books	Amount Confirmed by Vendor	Difference: Books Over (Under) Amount Confirmed	Timing Difference: No Misstatement	Misstatement in Accounts Payable o/s (u/s)	Misstatement in Related Accounts: Other Balance Sheet Misstatement o/s (u/s)	Misstatement in Related Accounts: Income Stmt mis-statement o/s (u/s)	Brief Explanation
FiberChem	793,050	825,550	(32,500)		(32,500)	(32,500)		FOB Origin (Inventory and A/P)
Total	**793,050**	**825,550**	**(32,500)**	--	**(32,500)**	**(32,500)**	--	
Accounts in Stratum $50,001 - $250,000								
Mobil	93,210	131,022	(37,812)	(37,812)				Timing difference – shipment in transit
Norris	88,315	205,611	(117,296)		(117,296)		117,296	Unrecorded A/P (Purchases and A/P)
Remington	123,411	123,411	--		53,529		(53,529)	Pinnacle recorded FOB shipment before received (Purchases and A/P)
Advent	51,750	59,250	(7,500)		(7,500)	(7,500)		B/S fixed asset error
Total	**356,686**	**431,137**	**(162,608)**	**(37,812)**	**(71,267)**	**(7,500)**	**63,767**	
Accts in Stratum less than or equal to $50000								
Fuller	32,470	39,570	(7,100)	(7,100)				Timing difference – payment in transit
Total	**32,470**	**39,570**	**(7,100)**	**(7,100)**	**--**	--	**--**	

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16-37 (continued)

Estimate of m/s in the income statement				
Misstatements in sample-Stratum $50,000-$250,000		63,767		
Dollars sampled-Stratum $50,001-$250,000		2,660,879		
Dollars in Pop-Stratum $50,001-$250,000		5,212,467		
Income statement m/s - Point estimate			124,915	(63,767/2,660,879*5,212,467)
Estimate of sampling error			100,000	Highly judgmental
Total Estimate			**224,915**	

Estimate of m/s in accounts payable			
Misstatements in key items		**(32,500)**	
Misstatements in stratum $50,001-$250,000:			
Misstatements in sample	(71,267)		
Dollars sampled	2,660,879		
Dollars in Pop-Stratum $50,001-$250,000	5,212,467		
Point estimate		**(139,607)**	(-71,267/2,660,879*5,212,467)
Accounts payable m/s-Point estimate		**(171,607)**	
Estimate of sampling error		(150,000)	Highly judgmental
Total Estimate		**(321,607)**	

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16-38 ACL Problem

a. There are 91 invoices in the file that are still outstanding, totaling $893,619.03. *(Use the Filter command to retain all invoices with "Outstanding" in the payment_status field and use "Save As to save the file as Accounts_Receivable. The total number of records is shown at the bottom of the screen. Use the Total command under Analyze to determine the total amount outstanding.)*

b. When using the Summarize command under Analyze to determine the amount of accounts receivable outstanding from each customer, the total amount due is $893,619.03, which equals the amount determined in part a. There are 90 customers with balances outstanding, while there are 91 invoices outstanding as noted in part a. This is due to the fact that there are two invoices outstanding from Customer Number 0252620. Customer Number 0249158 has the largest balance due of $28,821.31. *(Use the Summarize Command under Analyze and then use Quick Sort to arrange the Invoice Amount column in descending order.)*

c. The largest balance due is $28,821.31 from Customer Number 0249158 and the smallest balance due is $804.55 from Customer Number 0263849. *(Use Quick Sort to arrange the Invoice Amount column in descending order.)*

d. There are 26 invoices that are more than 90 days outstanding, comprising 27.62% of the total outstanding invoices. The auditor would use this information to assess the collectibility of accounts receivable as part of the examination of the realizable value balance-related audit objective for accounts receivable. *(Use the Age command under Analyze)*.

Days	Count	Percent of Count	Percent of Field	Invoice Amount
0 - 29	32	35.16%	42.22%	377,291.82
30 - 59	18	19.78%	13.06%	116,703.48
60 - 90	15	16.48%	17.1%	152,771.32
>90	26	28.57%	27.62%	246,852.41
Totals	91	100%	100%	893,619.03

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