Chapter 6

Audit Responsibilities and Objectives

■ Concept Checks

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1. It is management's responsibility to adopt sound accounting policies, maintain adequate internal control, and make fair representations in the financial statements. The auditor's responsibility is to conduct an audit of the financial statements in accordance with auditing standards and report the findings of the audit in the auditor's report.

2. Auditing standards require that the audit be planned and performed with an attitude of professional skepticism in all aspects of the engagement, recognizing the possibility that a material misstatement could exist regardless of the auditor's prior experience with the integrity and honesty of client management and those charged with governance. Professional skepticism consists of two primary components: a questioning mind and a critical assessment of audit evidence. A questioning mind means the auditor approaches the audit with a "trust but verify" mental outlook. A critical assessment of audit evidence includes asking probing questions and paying attention to inconsistencies.

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1. The cycle approach is a method of dividing the audit such that closely related types of transactions and account balances are included in the same cycle. For example, sales, sales returns, and cash receipts transactions and the accounts receivable balance are all a part of the sales and collection cycle. The advantages of dividing the audit into different cycles are to divide the audit into more manageable parts, to assign tasks to different members of the audit team, and to keep closely related parts of the audit together.

2. Management assertions are implied or expressed representations by management about classes of transactions and the related accounts and disclosures in the financial statements. These assertions are part of the criteria management uses to record and disclose accounting information in financial statements.

   The PCAOB describes five categories of management assertions:
   1. Existence or occurrence−Assets or liabilities of the public company exist at a given date, and recorded transactions have occurred during the period.
   2. Completeness−All transactions and accounts that should be presented in the financial statements are so included.

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3. Valuation or allocation−Assets, liability, equity, revenue, and expense components have been included in the financial statements at appropriate amounts.
4. Rights and obligations−The public company holds or controls rights to the assets, and liabilities are obligations of the company at a given date.
5. Presentation and disclosure−The components of the financial statements are properly classified, described, and disclosed.

The PCAOB provides for one set of assertions that apply to all financial statement information. These assertions are similar to the assertions in international and AICPA auditing standards, except that international and AICPA standards further divide management assertions into three categories:

1. Assertions about classes of transactions and events for the period under audit
2. Assertions about account balances at period end
3. Assertions about presentation and disclosure

■ Review Questions

6-1 The objective of the audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which the financial statements present financial position, results of operations, and cash flows in conformity with applicable accounting standards.

The auditor meets that objective by accumulating sufficient appropriate evidence to determine whether management's assertions regarding the financial statements are fairly stated.

6-2 An error is an unintentional misstatement of the financial statements. Fraud represents an intentional misstatement. The auditor is responsible for obtaining reasonable assurance that material misstatements in the financial statements are detected, whether those misstatements are due to fraud or error.

An audit must be designed to provide reasonable assurance of detecting material misstatements in the financial statements. Further, the audit must be planned and performed with an *attitude of professional skepticism* in all aspects of the engagement. Because there is an attempt at concealment of fraud, material misstatements due to fraud are usually more difficult to uncover than errors. The auditor's best defense when material misstatements (either errors or fraud) are not uncovered in the audit is that the audit was conducted in accordance with auditing standards.

6-3 Misappropriation of assets represents the theft of assets by employees. Fraudulent financial reporting is the intentional misstatement of financial information by management or a theft of assets by management, which is covered up by misstating financial statements.

Misappropriation of assets ordinarily occurs either because of inadequate internal controls or a violation of existing controls. The best way to prevent theft of assets is through adequate internal controls that function effectively. Many times theft of assets is relatively small in dollar amounts and will have no effect on the fair presentation of financial statements, although there are some cases of material theft of assets. Fraudulent financial reporting is inherently difficult to uncover because it is possible for one or more members of management to override internal controls. In many cases the amounts are extremely large and may affect the fair presentation of financial statements.

6-4

CHARACTERISTIC	AUDIT STEPS
1. Management's characteristics and influence over the control environment.	■ Investigate the past history of the firm and its management. ■ Discuss the possibility of fraudulent financial reporting with previous auditor and company legal counsel after obtaining permission to do so from management.
2. Industry conditions.	■ Research current status of industry and compare industry financial ratios to the company's ratios. Investigate any unusual differences. ■ Read the AICPA *Industry Audit Risk Alert* for the company's industry, if available. Consider the impact of specific risks that are identified on the conduct of the audit.
3. Operating characteristics and financial stability.	■ Perform analytical procedures to evaluate the possibility of business failure. ■ Investigate whether material transactions occur close to year-end.

6-5 The auditor should obtain sufficient appropriate evidence regarding material amounts and disclosures that are directly affected by laws and regulations. For example, the auditor should perform tests to identify if there have been any material violations of federal or state tax laws. The auditor should inquire of management and inspect correspondence with relevant licensing and regulatory agencies to identify instances of noncompliance with other laws and regulations that may have a material effect on the financial statements. During the audit,

6-5 (continued)

other audit procedures may bring instances of suspected noncompliance to the auditor's attention. However, in the absence of identified or suspected noncompliance, the auditor is not required to perform additional audit procedures.

6-6 If the auditor becomes aware of information concerning an instance of noncompliance or suspected noncompliance with laws and regulations, the auditor should obtain an understanding of the nature and circumstances of the act. Additional information should be obtained to evaluate the possible effects on the financial statements. The auditor should also discuss the matter with management at a level above those involved with the suspected noncompliance and, when appropriate, those charged with governance. If management or those charged with governance are unable to provide sufficient information that supports that the entity is in compliance with the laws and regulations, and the auditor believes the effect of the noncompliance may be material to the financial statements, the auditor should consider the need to obtain legal advice. The auditor should also evaluate the effects of the noncompliance on other aspects of the audit, including the auditor's risk assessment and the reliability of other representations from management.

6-7 Academic research on the topic of professional skepticism suggests there are six characteristics of skepticism:

1. Questioning mindset—a disposition to inquiry with some sense of doubt
2. Suspension of judgment—withholding judgment until appropriate evidence is obtained
3. Search for knowledge—a desire to investigate beyond the obvious, with a desire to corroborate
4. Interpersonal understanding—recognition that people's motivations and perceptions can lead them to provide biased or misleading information
5. Autonomy—the self-direction, moral independence, and conviction to decide for oneself, rather than accepting the claims of others
6. Self-esteem—the self-confidence to resist persuasion and to challenge assumptions or conclusions

Awareness of these six elements throughout the engagement can help auditors fulfill their responsibility to maintain an appropriate level of professional skepticism.

6-8 The Center for Audit Quality's ***Professional Judgment Resource*** outlines five key elements of a professional judgment process:

1. **Identify and Define the Issue:** The starting point to an effective professional judgment begins with identifying and defining the issue by carefully analyzing the situation and its potential effect on the audit.
2. **Gather the Facts and Information and Identify the Relevant Literature:** With the problem defined, the auditor seeks to understand the relevant facts and available information concerning the issue. This might include obtaining facts and information about key inputs and assumptions to a transaction, event, or situation through discussions with client personnel who are knowledgeable of the situation.
3. **Perform the Analysis and Identify Potential Alternatives:** The next element of the professional judgment process involves analyzing the issue based on the facts and information gathered and the relevant authoritative literature identified. As part of that analysis, the auditor considers a number of factors such as whether he or she understands the form and substance of the transaction or event, whether the relevant authoritative literature has been applied consistently by the client to similar situations, whether the auditor has been able to corroborate the facts and assumptions that are important to the analysis, and whether the auditor has identified any discrepancies or inconsistencies in the facts and information obtained.
4. **Make the Decision:** Once the analysis of the facts and information has been completed, the auditor applies judgment to make a decision. The analysis may identify only one appropriate response to the issue or it may conclude that there are multiple responses that could reasonably be made in the circumstances, requiring the auditor to identify which alternative best addresses the issue.
5. **Review and Complete the Documentation and Rationale for the Conclusion:** As the auditor articulates in written form the rationale of his or her judgment, the auditor may find that the reasoning appears faulty or incomplete and therefore is not persuasive. This should direct the auditor to evaluate which aspects of the analysis and judgment process may warrant further consideration. The process of documenting helps the auditor to be more objective and complete in assessing the reasoning used in reaching a judgment decision.

6-9 Auditors should be alert for potential judgment tendencies, traps, and biases that may impact the decision-making process. The table below summarizes four common judgment tendencies:

Judgment Tendency	**Description**
Confirmation	The tendency to put more weight on information that is consistent with initial beliefs or preferences
Overconfidence	The tendency to overestimate one's own abilities to perform tasks or to make accurate assessments of risks or other judgments and decisions

6-9 (continued)

Judgment Tendency	Description
Anchoring	The tendency to make assessments by starting from an initial value and then adjusting insufficiently away from that initial value
Availability	The tendency to consider information that is easily retrievable or what's easily accessible as being more likely or more relevant

6-10

GENERAL LEDGER ACCOUNT	CYCLE
Sales	Sales & Collection
Accounts Payable	Acquisition & Payment
Retained Earnings	Capital Acquisition & Repayment
Accounts Receivable	Sales & Collection
Inventory	Inventory & Warehousing
Repairs & Maintenance	Acquisition & Payment

6-11 There is a close relationship between each of these accounts. Sales, sales returns and allowances, and cash discounts all affect accounts receivable. Allowance for uncollectible accounts is closely tied to accounts receivable and should not be separated. Bad debt expense is closely related to the allowance for uncollectible accounts. To separate these accounts from each other implies that they are not closely related. Including them in the same cycle helps the auditor keep their relationships in mind.

6-12 AICPA auditing standards classify assertions into three categories:

1. Assertions about classes of transactions and events for the period under audit
2. Assertions about account balances at period end
3. Assertions about presentation and disclosure

6-13 General audit objectives follow from and are closely related to management assertions. General audit objectives, however, are intended to provide a framework to help the auditor accumulate sufficient appropriate audit evidence. Audit objectives are more useful to auditors than assertions because they are more detailed and more closely related to helping the auditor accumulate sufficient appropriate evidence.

6-14

RECORDING MISSTATEMENT	TRANSACTION-RELATED AUDIT OBJECTIVE VIOLATED
Fixed asset repair is recorded on the wrong date.	Timing
Repair is capitalized as a fixed asset instead of an expense.	Classification

6-15 The existence objective deals with whether amounts included in the financial statements should actually be included. Completeness is the opposite of existence. The completeness objective deals with whether all amounts that should be included have actually been included.

In the audit of accounts receivable, a nonexistent account receivable will lead to overstatement of the accounts receivable balance. Failure to include a customer's account receivable balance, which is a violation of completeness, will lead to understatement of the accounts receivable balance.

6-16 Specific audit objectives are the application of the general audit objectives to a given class of transactions, account balance, or presentation and disclosure. There must be at least one specific audit objective for each general audit objective and in many cases there should be more. Specific audit objectives for a class of transactions, account balance, or presentation and disclosure should be designed such that, once they have been satisfied, the related general audit objective should also have been satisfied for that class of transactions, account, or presentation and disclosure.

6-17 For the specific balance-related audit objective, all recorded fixed assets exist at the balance sheet date, the management assertion and the general balance-related audit objective are both "existence."

6-18 For the specific presentation and disclosure-related audit objective: "read the fixed asset footnote disclosure to determine that the types of fixed assets, depreciation methods, and useful lives are clearly disclosed," the management assertion and the general presentation and disclosure-related audit objective are both "classification and understandability."

6-19 The four phases of the audit are:

1. Plan and design an audit approach based on risk assessment procedures.
2. Perform tests of controls and substantive tests of transactions.
3. Perform substantive analytical procedures and tests of details of balances.
4. Complete the audit and issue an audit report.

6-19 (continued)

The auditor uses these four phases to meet the overall objective of the audit, which is to express an opinion on whether the financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows in conformity with applicable accounting standards. By accumulating sufficient appropriate evidence for each audit objective throughout the four phases of the audit, the overall objective is met.

■ Multiple Choice Questions From CPA Examinations

6-20 a. (2) b. (3) c. (1)

6-21 a. (1) b. (2) c. (1)

6-22 a. (3) b. (2) c. (2)

■ Multiple Choice Questions From Becker CPA Exam Review

6-23 a. (3) b. (4) c. (3)

■ Discussion Questions And Problems

6-24

a. Paragraph .11 of AU-C 200 states that "[T]he overall objectives of the auditor, in conducting an audit of financial statements, are to

a. obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with an applicable accounting framework; and

b. report on the financial statements, and communicate as required by GAAS, in accordance with the auditor's findings."

As a results of the clarity project, Paragraph .11 of ISA 200 has identical wording, except GAAS is replaced by the ISAs in paragraph b.

b. Paragraph .03 of PCAOB Auditing Standard 5 states that "The auditor's objective in an audit of internal control over financial reporting is to express an opinion on the effectiveness of the company's internal control over financial reporting." That standard notes that to form a basis for an opinion, the auditor must plan and

6-24 (continued)

perform the audit to obtain competent evidence that is sufficient to obtain reasonable assurance about whether material weaknesses exist as of the date specified in management's assessment.

c. Both U.S. GAAS and international auditing standards define financial statements as being fairly stated when they are free of material misstatements. PCAOB Auditing Standard 5 defines internal control as effective when no material weaknesses exist. These definitions are related. The presence of a material misstatement generally suggests the presence of a material weakness, since management's internal controls over financial reporting failed to detect the material misstatement. While the presence of a material weakness in internal control does not automatically mean the financial statements contain a material misstatement, there is a high likelihood that a material misstatement could occur.

6-25 a. The purpose of the first part of the report of management is for management to state its responsibilities for internal control over financial reporting. The second part of the report states management's responsibility for the fair presentation of the financial statements.

b. The auditor's responsibility is to express an opinion on the fairness of the presentation of the financial statements and an opinion on the effectiveness of internal control over financial reporting.

6-26 a. Auditing standards indicate that reasonable assurance is a high level of assurance. Accordingly, financial statement users should have a high degree of confidence in the financial statements. However, reasonable assurance is not an absolute level of assurance, and there is at least some risk that the audited financial statements may include material misstatements.

b. The responsibility of the independent auditor is to express an opinion on the financial statements he or she has audited. Inasmuch as the financial statements are the representation of management, responsibility rests with management for the proper recording of transactions in books of account, for the safeguarding of assets, and for the substantial accuracy and adequacy of the financial statements.

In developing the basis for his or her opinion, the auditor is responsible for conducting an audit that conforms to auditing standards. These standards constitute the measure of the adequacy of the audit. Those standards require the auditor to obtain sufficient appropriate evidence about material management assertions in the financial statements.

6-26 (continued)

The informed judgment of a qualified professional accountant is required of an independent auditor. The auditor must exercise this judgment in selecting the procedures he or she uses in the audit and in arriving at an opinion.

In presenting himself or herself to the public as an independent auditor, the auditor is responsible for having the abilities expected of a qualified person in that profession. Such qualifications do not include those of an appraiser, expert in valuation, expert in materials, expert in styles, insurer, or lawyer. The auditor is entitled to rely upon the judgment of experts in these other areas of knowledge and skill.

c. Auditors are responsible for obtaining reasonable assurance that material misstatements of the financial statements are detected, whether those misstatements are due to fraud or error. Professional standards acknowledge that it is often more difficult to detect fraud than errors because management or employees perpetrating the fraud attempt to conceal the fraud. That difficulty, however, does not change the auditor's responsibility to properly plan and perform the audit. Auditors are required to specifically assess the risk of material misstatement due to fraud and should consider that assessment in designing the audit procedures to be performed.

There has been increased emphasis on auditors' responsibility to evaluate factors that may indicate an increased likelihood that fraud may be occurring. For example, assume that management is dominated by a president who makes most of the major operating and business decisions himself. He has a reputation in the business community for making optimistic projections about future earnings and then putting considerable pressure on operating and accounting staff to make sure those projections are met. He has also been associated with other companies in the past that have gone bankrupt. These factors, considered together, may cause the auditor to conclude that the likelihood of fraud is fairly high. In such a circumstance, the auditor should put increased emphasis on searching for material misstatements due to fraud.

The auditor may also uncover circumstances during the audit that may cause suspicions of fraudulent financial reporting. For example, the auditor may find that management has misled the auditor about the age of certain inventory items. When such circumstances are uncovered, the auditor must evaluate their implications and consider the need to modify audit evidence.

Adequate internal control should be the principal means of thwarting and detecting misappropriation of assets. To rely entirely on an independent audit for the detection of misappropriation of assets would require expanding the auditor's work to the extent that the cost might be prohibitive.

6-26 (continued)

The auditor normally assesses the likelihood of material misappropriation of assets as a part of understanding the entity's internal control and assessing control risk. Audit evidence should be expanded when the auditor finds an absence of adequate controls or failure to follow prescribed procedures, if he or she believes a material fraud could result.

Because the auditor's responsibility is limited to material misstatements, we believe that the auditor's responsibility is appropriate. However, some students may take the position that the auditor's responsibility to detect fraud is too great because of the potential for collusion and deception by management.

The independent auditor is not an insurer or guarantor. The auditor's implicit obligation is that the audit be performed with due professional skill and care in accordance with auditing standards. A subsequent discovery of fraud that existed during the period covered by the independent audit does not of itself indicate negligence on the auditor's part.

6-27 a. Professional skepticism primarily consists of two components: a questioning mind and a critical assessment of the audit evidence. A questioning mindset means the auditor approaches the audit with a "trust but verify" mental outlook, as well as a critical assessment of the evidence that includes asking probing questions and attention to inconsistencies.

b. Because the vendor allowance agreements were unwritten, this should have increased the auditor's professional skepticism. In addition, increases in the size of the allowances and the close relationship between Just for Feet and the vendors should have increased professional skepticism.

c. Auditors may be inclined to accept client representations because of a natural bias to want to trust the client. In addition, if these allowances had been used in the past, the auditor may have been more inclined to accept them as a regular business practice.

d. The following are example of three probing questions related to the vendor allowances:

- Are there written agreements or other corroborating evidence that would support the amount of these allowances?
- Can specific payments or credits be matched to specific vendor allowances?
- Why are the allowances greater this year compared to the prior year?

6-28 1. When Chen Li saw that the recorded balance for the allowance followed the client's allowance policy and the fact that AHA's policy of recording an allowance for patient receivables equal to the amount of receivables over 180 days old had historically approximated subsequent write-offs, Chen Li likely had difficulty considering an amount different from what was already recorded, despite the effect of recent regulatory changes on patients' ability to pay. This is an example of the anchoring judgment trap.

2. Sherry Zipersky's judgment was likely impacted by the complexity of the impairment testing and the time and complexity that would be involved if she reached out to colleagues in her firm to assist in making an independent assessment. The availability of the client's extensive information and detailed schedules likely convinced her that the impairment assessments were reliable. This is an example of the availability judgment trap.

3. Jason Jackson's judgment was likely impacted by the confirmation judgment trap. The contracts and other documentation, including the purchase order, shipping documents, and invoices, that Jason examined all supported the occurrence of the sales transactions. Because that information confirmed his initial belief about the proper recording of the sales transactions, he placed less emphasis on the emails that suggested potential concerns about side agreements that might impact their recording as sales. In this case he placed more confidence on information that confirmed his initial belief and less confidence on information that was potentially disconfirming.

4. Allison Garrett's judgment about the inventory obsolescence reserve was likely negatively impacted by the overconfidence judgment trap. Allison's experience in auditing clients in the technology equipment manufacturing industry segment led her to believe she could effectively evaluate the obsolescence of inventory by quickly performing substantive analytical procedures. Her overconfidence caused her to rush the judgment about the reserve.

6-29 a.

CYCLE	BALANCE SHEET ACCOUNTS	INCOME STATEMENT ACCOUNTS
SALES AND COLLECTION	Accounts receivable Allowance for doubtful accounts Cash Notes receivable—trade	Bad debt expense Sales

6-29 (continued)

CYCLE	BALANCE SHEET ACCOUNTS	INCOME STATEMENT ACCOUNTS
ACQUISITION AND PAYMENT	Accounts payable Accumulated depreciation—furniture and equipment Cash Furniture and equipment Income tax payable Inventory Prepaid insurance Property tax payable	Advertising expense Depreciation expense—furniture and equipment Income tax expense Insurance expense Property tax expense Purchases Rent expense Telecommunications expense
PAYROLL AND PERSONNEL	Cash Accrued sales salaries	Salaries, office and general Sales salaries expense
INVENTORY AND WAREHOUSING	Inventory	Purchases
CAPITAL ACQUISITION AND REPAYMENT	Accrued interest expense Cash Common stock Loans payable Notes payable Retained earnings	Interest expense

b. The general ledger accounts are not likely to differ much between a retail and a wholesale company unless there are departments for which there are various categories. There would be large differences for a hospital or governmental unit. A governmental unit would use the fund accounting system and would have entirely different titles. Hospitals are likely to have several different kinds of revenue accounts, rather than sales. They are also likely to have such things as drug expense, laboratory supplies, etc. At the same time, even a governmental unit or a hospital will have certain accounts such as cash, insurance expense, interest income, rent expense, and so forth.

6-30 a. Management assertions about transactions relate to transactions and other events that are reflected in the accounting records. In contrast, assertions about account balances relate to the ending account balances that are included in the financial statements, and assertions about presentation and disclosure relate to how those balances are reflected and disclosed in the financial statements.

6-30 (continued)

MANAGEMENT ASSERTION	b. CATEGORY OF MANAGEMENT ASSERTION	c. NAME OF ASSERTION
a. Receivables are appropriately classified as to trade and other receivables in the financial statements and are clearly described.	Presentation and disclosure	Classification and understandability
b. Sales transactions have been recorded in the proper period.	Classes of transactions	Cutoff
c. Accounts receivable are recorded at the correct amounts.	Account balances	Valuation and allocation
d. Sales transactions have been recorded in the appropriate accounts.	Classes of transactions	Classification
e. All required disclosures about sales and receivables have been made.	Presentation and disclosure	Completeness
f. All accounts receivable have been recorded.	Account balances	Completeness
g. Disclosures related to accounts receivable are at the correct amounts.	Presentation and disclosure	Accuracy and valuation
h. Sales transactions have been recorded at the correct amounts.	Classes of transactions	Accuracy
i. Recorded accounts receivable exist.	Account balances	Existence
j. Disclosures related to sales and receivables relate to the entity.	Presentation and disclosure	Occurrence and rights and obligations
k. Recorded sales transactions have occurred.	Classes of transactions	Occurrence
l. There are no liens or other restrictions on accounts receivable.	Account balances	Rights and obligations
m. All sales transactions have been recorded.	Classes of transactions	Completeness

6-31

SPECIFIC BALANCE-RELATED AUDIT OBJECTIVE	MANAGEMENT ASSERTION	COMMENTS
a. There are no unrecorded receivables.	2. Completeness	Unrecorded transactions or amounts deal with the completeness objective.
b. Uncollectible accounts have been provided for.	3. Valuation or allocation	Providing for uncollectible accounts concerns whether the allowance for uncollectible accounts is adequate. It is part of the realizable value objective and the valuation or allocation assertion.
c. Receivables that have become uncollectible have been written off.	3. Valuation or allocation	This is part of the realizable value objective and the valuation or allocation assertion. There may also be some argument that this is part of the existence objective and assertion. Accounts that are uncollectible are no longer valid assets.
d. All accounts on the list are expected to be collected within one year.	3. Valuation or allocation	Accounts that are not expected to be collected within a year should be classified as long-term receivables. It is therefore included as part of the classification objective and consequently under the valuation or allocation assertion.
e. The total of the amounts on the accounts receivable listing agrees with the general ledger balance for accounts receivable.	3. Valuation or allocation	This is part of the detail tie-in objective and is part of the valuation or allocation assertion.
f. All accounts on the list arose from the normal course of business and are not due from related parties.	3. Valuation or allocation	Concerns the classification of accounts receivable and is therefore a part of the classification objective and the valuation or allocation assertion.

6-31 (continued)

SPECIFIC BALANCE-RELATED AUDIT OBJECTIVE	MANAGEMENT ASSERTION	COMMENTS
g. Sales cutoff at year-end is proper.	3. Valuation or allocation	Cutoff is a part of the cutoff objective and therefore part of the valuation or allocation assertion.
h. Receivables have not been sold or discounted.	4. Rights and obligations	Receivables not being sold or discounted concerns the rights and obligations objective and assertion.

6-32 a. Management assertions are implied or expressed representations by management about the classes of transactions and related accounts in the financial statements. AICPA auditing standards identify five assertions about classes of transactions that are stated in the problem. These assertions are the same for every transaction cycle and account. General transaction-related audit objectives are essentially the same as management assertions, but they are expanded somewhat to help the auditor decide which audit evidence is necessary to satisfy the management assertions. Accuracy and posting and summarization are a subset of the accuracy assertion. Specific transaction-related audit objectives are determined by the auditor for each general transaction-related audit objective. These are done for each transaction cycle to help the auditor determine the specific amount of evidence needed for that cycle to satisfy the general transaction-related audit objectives.

b. and c.

The easiest way to do this problem is to first identify the general and transaction-related audit objectives for each specific transaction. It is then easy to determine the management assertion using Table 6-4 (p. 162 in text) as a guide.

6-32 (continued)

SPECIFIC TRANSACTION-RELATED AUDIT OBJECTIVE	b. MANAGEMENT ASSERTION	c. GENERAL TRANSACTION-RELATED AUDIT OBJECTIVE
a. Existing cash disbursement transactions are recorded.	2. Completeness	7. Completeness
b. Recorded cash disbursement transactions are for the amount of goods or services received and are correctly recorded.	3. Accuracy	8. Accuracy
c. Cash disbursement transactions are properly included in the accounts payable master file and are correctly summarized.	3. Accuracy	9. Posting and summarization
d. Recorded cash disbursements are for goods and services actually received.	1. Occurrence	6. Occurrence
e. Cash disbursement transactions are properly classified.	4. Classification	10. Classification
f. Cash disbursement transactions are recorded on the correct dates.	5. Cutoff	11. Timing

6-33

AUDIT PROCEDURE	BALANCE-RELATED AUDIT OBJECTIVE	TRANSACTION RELATED AUDIT OBJECTIVE	PRESENTATION AND DISCLOSURE AUDIT OBJECTIVE
a. Examine a sample of duplicate sales invoices to determine whether each one has a shipping document attached.		(9) Occurrence	
b. Add all customer balances in the accounts receivable trial balance and agree the amount to the general ledger.	(6) Detail Tie-In		
c. For a sample of sales transactions selected from the sales journal, verify that the amount of the transaction has been recorded in the correct customer account in the accounts receivable subledger.		(14) Posting and summarization	
d. Inquire of the client whether any accounts receivable balances have been pledged as collateral on long-term debt and determine whether all required information is included in the footnote description for long-term debt.			(15) Occurrence and rights
e. For a sample of shipping documents selected from shipping records, trace each shipping document to a transaction recorded in the sales journal.		(10) Completeness	
f. Discuss with credit department personnel the likelihood of collection of all accounts as of December 31, 2016, with a balance greater than $100,000 and greater than 90 days old as of year-end.	(7) Realizable value		
g. Examine sales invoices for the last five sales transactions recorded in the sales journal in 2016 and examine shipping documents to determine they are recorded in the correct period.	(5) Cutoff		

6-33 (continued)

AUDIT PROCEDURE	BALANCE-RELATED AUDIT OBJECTIVE	TRANSACTION RELATED AUDIT OBJECTIVE	PRESENTATION AND DISCLOSURE AUDIT OBJECTIVE
h. For a sample of customer accounts receivable balances for December 31, 2016, examine subsequent cash receipts in January 2017 to determine whether the customer paid the balance due.	(1) Existence (7) Realizable value		
i. Determine whether all risks related to accounts receivable are adequately disclosed.			(16) Completeness
j. Foot the sales journal for the month of July and trace postings to the general ledger.		(14) Posting and summarization	
k. Send letters to a sample of accounts receivable customers to verify whether they have an outstanding balance at December 31, 2016.	(1) Existence		
l. Determine whether long-term receivables and related party receivables are reported separately in the financial statements.			(18) Classification and understandability

6-34

AUDIT ACTIVITIES	AUDIT PHASE
a. Examine invoices supporting fixed asset additions.	3. Perform substantive analytical procedures and tests of details of balances (Phase III)
b. Review industry databases to assess the risk of material misstatements in the financial statements.	1. Plan and design an audit approach based on risk assessment procedures (Phase I)
c. Summarize misstatements identified during testing to assess whether the overall financial statements are fairly stated.	4. Complete the audit and issue an audit report (Phase IV)
d. Test computerized controls over credit approval for sales transactions.	2. Perform tests of controls and substantive tests of transactions (Phase II)
e. Send letters to customers confirming outstanding accounts receivable balances.	3. Perform substantive analytical procedures and tests of details of balances (Phase III)
f. Perform analytical procedures comparing the client with similar companies in the industry to gain an understanding of the client's business and strategies.	1. Plan and design an audit approach based on risk assessment procedures (Phase I)
g. Compare information on purchase invoices recorded in the acquisitions journal with information on receiving reports.	2. Perform tests of controls and substantive tests of transactions (Phase II)