Audit of Accounts Receivable

The tests of transactions for the sales and collection cycle include compliance tests to enable the auditors to evaluate the effectiveness of the controls and substantive tests to enable them evaluate the correctness of the dollar amounts in the records.

Extent of substantive testing procedures depends upon the outcome of the auditors' evaluation of internal control and the results of the compliance tests. If the compliance procedures indicate that the controls are inadequate, the substantive tests may need to be expanded.

The audit procedures include decisions about:

- The sample size
- Items to select
- Timing of tests

Audit Objectives

Accounts receivable yearend balance is audited to ensure:

- Accounts receivable balance is mechanically accurate
- Accounts receivable are valid
- Existing accounts receivable are included
- Accounts receivable are owned
- Accounts receivable are properly valued
- Accounts receivable are properly classified
- Transactions are recorded in the proper period
- Accounts receivable disclosures are proper

Audit approach

The general audit approach in connection with trade debtors:

Completeness	to ensure that all trade debtors are owned by the client at the end of the accounting period have been recorded
Existence	to ensure that the recoded trade debtors were in existence at the end of the accounting period and

	that they represent amounts due from the specified debtors
Ownership	to ensure that the recorded trade debtors were properly owned by the entity at the end of the accounting period
Valuation	to ensure that recorded trade debtors were accurately valued
Disclosure	to ensure that the disclosure of trade debtors is properly made

Confirmation of accounts receivable or receivables circularization is the most important direct test. The purpose of this test is to obtain direct third party confirmation as to existence and valuation of receivables. Confirmation is more effective in uncovering overstatements than understatements. It is also effective in discovering invalid accounts.

Advantages

- Independent evidence
- External evidence
- Relatively efficient (if successful)

Method

- Select sample of receivables to be circularized
- Inform client of intended list of those to be circularized
- Consider implications if client object to any of the accounts selected being circularized
- Record names and amounts circularized
- Record replies received and consider implications of any accounts not agreed
- For non replies perform alternative procedures

Types of Confirmation

The letter of confirmation is sent by the client to the debtors requesting them to send their reply directly to the auditors. There are two common types of confirmation: positive and negative.

Positive confirmation: communication addressed to the debtor requesting him to confirm directly whether the balance as stated in the confirmation request is correct or incorrect.

- This type of confirmation is more reliable as the auditor can perform procedures where response is not received

Negative confirmation: communication addressed to the debtor but it requests a response when he disagrees with the stated amount.

- Failure to reply must be regarded as a correct response even though the debtor has ignored the confirmation request

For any positive confirmation not returned, the following documents can be examined to verify the validity and valuation of individual sales transactions making up the ending balance in accounts receivable, as alternative procedures to confirmation:

- Subsequent cash receipts
- Duplicate sales invoices
- Shipping documents
- Correspondence with the client

The other audit procedures performed in the receivables area are:

- Carry out analytical review procedures with reference to prior periods with reference to budgets, prior periods and the volume of business
- Carry out appropriate tests to ensure that debtors' cutoff procedures have been properly observed. The following tests may be conducted in this respect:
    - Check dispatch notes and sales invoices towards the end of the current period and beginning of the subsequent period to ensure that the dates agree

- Compare signed delivery notes and sales invoices to ensure that dates agree
- Check goods receiving notes, relevant correspondence and sales invoices together with credit notes to ensure that the dates agree
- Examine credits towards the beginning of the subsequent periods so as to determine whether adjustments are necessary
- Ensure that all sales invoices and credit notes are recorded in the financial year they relate to

- Make sure that sufficient provisions have been made for uncollectible accounts, discounts and returns