

Sprandel, Inc.: Electronic Workpapers, Audit Documentation, and Closing Review Notes in the Audit of Accounts Receivable

ABSTRACT: Workpaper review is an important quality control mechanism in the audit environment. However, appropriately responding to review notes is not a commonly taught skill. The Sprandel, Inc. case provides a hands-on learning experience for students to connect textbook audit knowledge with an activity regularly performed in audit practice, “closing review notes.” In requiring students to address review notes left by an audit manager, this case offers students an opportunity to use Excel to complete electronic workpapers and appropriately document audit procedures. The case also allows students to practice auditing accounts receivable, including performing audit procedures related to internal controls and substantive audit work. Further, the case requires students to use critical thinking skills and to apply professional skepticism when performing audit procedures, evaluating audit evidence, and making decisions. Finally, this case helps students to understand how auditing standards apply to the procedures performed during an audit of accounts receivable. The case is designed for auditing courses at the undergraduate or graduate level.

Keywords: workpaper review notes; electronic workpapers; audit documentation; accounts receivable; substantive tests of details; internal controls

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CASE

Introduction and Background

Sprandel, Inc. is a publicly-held, mid-sized manufacturer of plastic bottles, classified as an accelerated filer by the U.S. Securities and Exchange Commission. The company was founded in 1989 by a young entrepreneur interested in creating plastic bottles in shapes and sizes that were unique and affordable to customers in need of packaging a wide assortment of products such as food, drinks, automotive oil, and personal care products. Sprandel's "claim to fame" is being the first bottle manufacturer to produce a line of honey bear bottles. The company started as one facility in Tulsa, Oklahoma, but has since expanded into six facilities located in Oklahoma, Wisconsin, and Maryland. These facilities house 35 different production lines. Sprandel produces 74 different stock bottles in various shapes and sizes, but also has the capability to produce custom bottles based on customer specifications. Over the past 25 years, Sprandel management has strived to take a long-term view with respect to investment in equipment, employees, and customers. Carty and Plews LLP has audited Sprandel's financial statements for the last three years. Over those years, Sprandel has consistently reported positive earnings and has had a small but steady increase in revenues, consistent with the industry trend.

As a staff auditor with Carty and Plews LLP, you have been assigned to the 12/31/20X3 fiscal year-end audit. One of the areas you are assigned to work on is accounts receivable. To complete the required audit work, your audit manager, Bill Davis, has advised you that you have three main client contacts: (1) Meg Black, Accounts Receivable Supervisor, (2) Kate Burke, Account Manager, and (3) John Sawyer, Account Manager. Meg Black oversees the accounting for accounts receivable and the account managers are responsible for providing customer service and correspondence related to specific accounts. Bill explains to you that the signatures of both the accounts receivable supervisor (Meg Black) and the account manager specifically responsible for the customer account (either Kate Burke or John Sawyer, depending on the customer) are necessary for the write-off of an account receivable, as well as for the crediting of a customer for returned merchandise. In addition, your audit team has determined that the internal audit function of Sprandel is independent of the accounting function and the work of this group can be relied on when necessary. Therefore, you can treat evidence obtained from or verified by internal audit as acceptable audit evidence.

The Audit of Accounts Receivable

The audit of accounts receivable for Sprandel primarily involves two accounts: (1) the Gross Accounts Receivable account and (2) the Allowance for Doubtful Accounts (hereafter, "the Allowance"), which together make up the Net Accounts Receivable balance reported on the balance sheet at 12/31/20X3. The PCAOB assertions that pose the highest inherent risk for these account balances are existence and valuation. In addition, when evaluating the design and effectiveness of controls the most significant risks arise from ensuring transactions are recorded in the appropriate period and write-offs and returns are appropriately authorized.

In order to complete the audit of the above-mentioned accounts for Sprandel, your team previously obtained a number of prepared by client (PBC) documents from your client contacts. These include: (1) the General Ledger (GL); (2) the accounts receivable detailed listing (AR Detail); (3) the roll forward of the Allowance account from the prior period balance to the current period balance; (4) the write-off detail; (5) the early and late cutoff details; and (6) a list of each

account manager's customer accounts. With some guidance from your audit manager and by following the procedures in your firm's Accounts Receivable Audit Program, you diligently worked to complete the relevant workpapers to support conclusions for both the Gross Accounts Receivable balance and the Allowance balance. These procedures included: (1) agreeing a sample of accounts receivable balances to confirmations received or performing alternative procedures when responses were not received; (2) recalculating the Allowance Roll Forward schedule; (3) verifying uncollectable balances and ensuring they were properly written off; and (4) performing procedures to ensure proper cutoff of the issuance of credit memos. At the end of last week, you signed-off on all completed workpapers related to accounts receivable and emailed the Excel file containing the workpapers to your audit manager, Bill Davis, for his review.¹ This morning Bill electronically returned the workpapers to you. Bill has left several review notes that you must address in order to finalize the workpapers.

The Workpaper Review Process

Staff auditors commonly receive a number of comments, or review notes, from audit supervisors as their work is reviewed by each level in the hierarchy of the audit team. This process is referred to as a "workpaper review." Supervisory review is required by auditing standards (AICPA 2011; PCAOB 2016b) and is viewed as an important quality control mechanism for the audit firms. Throughout the phases of the audit, senior associates, managers, and partners review audit workpapers to ensure that documentation is clear and sufficient, that all procedures are performed, and that conclusions are appropriately supported by the audit work. The review process is both hierarchical and sequential in that additional reviews may occur as the work passes through the team hierarchy to partners. This process often results in several rounds of review notes as the workpapers are prepared, submitted, revised, and then resubmitted to ensure the notes are properly "closed" (i.e., fully addressed) before submitting them to a higher level team member for review where the process begins again. When a supervisor is satisfied with the workpaper, they too will "sign-off" on the audit work.

The ultimate goals of this review process are to ensure the documentation is sufficient and that the conclusions drawn in the underlying audit work support the overall audit opinion. These conclusions are driven by the identification (or lack of identification) of exceptions and issues that may lead to possible misstatements or internal control deficiencies. Therefore, staff auditors must highlight items that are concerning and may be exceptions, using tickmarks, and clearly communicate these concerns to their audit supervisors.² Raising the issue and being wrong is better than missing an exception that is important to the audit opinion. Auditing standards specifically require supervisors to "evaluate issues and determine the appropriate actions are taken in accordance with PCAOB standards" (PCAOB 2016b, AS 1201 Par 5) during their review. However, supervisors cannot properly perform this evaluation if issues and exceptions are not clearly highlighted to them.

While the review process is designed to improve the quality of the workpapers and help maintain consistency, some factors can limit the ability of a supervisor to perform a quality review; the biggest factor often being time. The completion phase of the audit is a particularly busy time,

¹ Staff auditors commonly signify completion of their work by either signing their initials in the upper right-hand corner of each workpaper under the workpaper reference number (more common in smaller firms) or signing-off within the electronic workpaper review system (more common in larger firms).

² Audit supervisors rarely re-perform the work of staff auditors due to time constraints in the audit environment. Therefore, staff auditors must thoroughly inspect underlying supporting audit documentation and bring any concerns to the attention of their supervisors so that they can make a final determination of whether an issue is an actual exception or not.

and as a result, audit supervisors may feel rushed to review workpapers and may spend limited time when performing a second review of a workpaper after the review notes are “closed.” Therefore, properly addressing the review notes, including fully performing appropriate follow-up procedures and clearly documenting the additional work you performed is particularly important. One common mantra in public accounting firms is “If you didn’t document it, you didn’t do it;” keep this in mind as you work through the task of “closing the review notes.”

Case Requirements

Your audit manager, Bill Davis, has left six review notes in the accounts receivable workpapers that need to be addressed. To begin the task of closing the review notes, proceed to <http://sprandel.fildred.com> and click on the button “Download Workpapers,” then save this Excel file to your computer.

At this point, you may wish to familiarize yourself with the workpapers and the review notes left by your audit manager. The Excel file has five tabs, including (1) AR-100 AR Leadsheet; (2) AR-101 AR Testwork; (3) AR-102 Allowance Roll Forward; (4) AR-103 Write-Offs; and (5) AR-104 Cutoff. Descriptions of each of these workpapers are provided in the Case Glossary located in Appendix A Panel A. Appendix A Panel B includes other audit terms that you need to be familiar with, including audit program, credit memos, exceptions, tickmark, tracing, vouching, write-off memos, and workpapers. You will find the review notes in comment boxes within the Excel file and close to the audit documentation that the comment relates to (e.g., Review Note 1 of 6 is on the tab “AR-100 AR Leadsheet” in the cell directly next to the text that requires editing). You may find that some review notes you can “close” (i.e., address within the workpapers and respond within the review note) now without needing any further guidance or audit evidence. Other review notes will require you to review your audit firm guidance, review previously obtained audit evidence, and/or follow-up with the client contacts to request new or additional information or audit evidence. For these review notes, you must click on the button “Begin Case,” which will take you to the Main Menu where you can perform these activities.

Should you find additional issues or exceptions while closing the review notes, you should explicitly highlight these issues or exceptions using a tickmark on the appropriate workpaper tab. In the tickmark legend next to your chosen tickmark, you should clearly and concisely document the issue or exception. You should also try to follow-up with your client contacts on any issues in order to resolve the issue and/or get further details on why the exception occurred. Any further information obtained should be included in the workpapers and highlighted to your audit manager in your memo.³ In addition, because your audit manager has already reviewed the bulk of your work, it is important that you highlight these items to him in your memo when resubmitting your workpapers after completing your revisions. Finally, you should document any additional procedures you performed on the appropriate workpaper tab. In these instances, you may create an additional tickmark or add to a previously created one. Either way, you should ensure that it is clear on which items you performed the new procedure. The procedures and tickmarks already noted in the workpapers provide examples for you to use as a guide.

Ultimately, your goal is to appropriately close the review notes to complete the accounts receivable audit work for this fiscal year. In completing this task, you need to evaluate whether the results of this work provide sufficient appropriate audit evidence regarding the financial statement

³ You can “ask about audit issues” by “speaking” with the appropriate client contact and identifying the item in which the issue relates. In order to obtain additional information you must ensure that you are asking the right client contact, and specifically referencing the sample item using the sales invoice number, the write-off memo number, or the credit memo number identified in your workpaper documentation.

assertions being audited (PCAOB 2016a, AS 1215 Par 9). In this regard, if you find additional issues or exceptions that you believe would change your conclusion, be sure to modify the conclusion in the workpapers and note this change to your audit manager. Your deliverables will consist of two parts:

Deliverables:

Part 1) Completed Workpaper Excel File (Available at <http://sprandel.fildred.com>): Each review note should be clearly addressed/“closed” in the Excel file. In some instances, the review note may be a relatively easy documentation fix, like Review Note 1 of 6, where you can make the requested edit and note that you have “closed” the review note (e.g., you may write “RN CLOSED – We fixed the noted spelling error” in the comment box). In other instances, the review note may require you to perform additional or new procedures, like Review Note 3 of 6. In these circumstances, as mentioned above, you may need to add additional columns or tickmarks to document procedures, as well as any issues or exceptions that you find. It is up to you to decide how you wish to document these items in the workpapers; just be clear and consistent in the formatting you choose to use. In these circumstances, in the comment box you should briefly note the changes you made to the workpaper to point your audit manager to the items they need to review (e.g., you may write “RN CLOSED – see new tickmarks X and Y for additional procedures performed and noted issues we uncovered”).⁴ Finally, you should consider whether the conclusion on each workpaper is still accurate or if it requires some modification in light of any issues or exceptions that you find.

Part 2) Completed Memo: A memo, in the format provided in Appendix B, should be written to your instructor, as the audit manager, and should include discussion of the following:

- a. how you addressed each review note.
- b. all issues/exceptions that you found when performing the additional audit work that should be brought to the attention of your audit manager, any further audit steps that you believe may be necessary, and whether you believe the conclusion of the workpaper should be modified.
- c. responses to the Critical Thinking Questions provided below.

Critical-Thinking Questions

The following questions are designed to help you make connections between the work you performed in the audit of Sprandel, Inc., the applicable auditing standards, and the concepts learned in your audit class. You should be sure to answer all components of each question. When needed, the PCAOB standards are available at: <https://pcaobus.org/Standards/Auditing/Pages/default.aspx> and should be appropriately referenced in your responses (e.g., “According to AS 1215 paragraph 5, audit documentation is...”).

- 1) Review Note 3 required you to perform procedures on accounts receivable items selected for testing the existence assertion. Refer to PCAOB AS 2310 paragraph 34. What is the recommended procedure for verifying the existence assertion of accounts receivable? Explain why this procedure provides more reliable audit evidence than other possible procedures.

⁴ When submitting this workpaper to the manager (instructor), students should be sure to format each Excel tab to print on one page for ease of reviewing.

- 2) To respond to Review Note 3 you were asked to perform alternative procedures to verify existence. Refer to PCAOB AS 2310 paragraph 31-32. Discuss the reliability of the evidence you examined compared to that of the recommended PCAOB procedure (refer to Question 1 above). Each sample item you tested had varying evidence to corroborate existence. Were you more skeptical of evidence you were able to obtain for some of the sample items versus others? Why?
- 3) Review Note 5 required you to test the operating effectiveness of an internal control (i.e., ensuring appropriate approval of write-offs). To which financial statement assertion does this internal control relate most closely? Based on the evidence you gathered, and considering the Audit Risk Model, would you recommend your audit team revise the audit plan? If so, which risks in the Audit Risk Model would change and how (increase/decrease)? How might you respond to the changes in these risk(s)?
- 4) Review Note 6 related to an exception found during cutoff testing and requires additional procedures to be performed. Based on this exception and the additional procedures you performed discuss the possible implications. Consider the following in your discussion:
 - a. which financial statement assertion this audit work most closely relates to,
 - b. the total dollar amount of the exception(s) based on the testing performed,
 - c. the effect of the exception(s) on the accounts receivable balance (understatement or overstatement) in the current year (12/31/20X3) and next year (i.e., 12/31/20X4) if not adjusted, and
 - d. the appropriate auditor response to the exception(s).
- 5) Using PCAOB AS 1215 paragraphs 8 and 12 describe the auditor's responsibilities for documenting information that relates to significant findings or issues inconsistent with the auditor's conclusions and three of the factors that would indicate a finding or issue is "significant". Would you deem any of the issues/exceptions that you noted during your audit work "significant"?

APPENDIX A

Glossary of Case Terminology

Panel A: Electronic Workpaper Descriptions

Allowance Roll Forward (AR-102): presents a schedule that shows how the Allowance for Doubtful Accounts (the Allowance) balance changed over the year. Roll forward schedules are often categorized into (1) a beginning balance row or column, which should equal the ending balance from the previous year; (2) an additions row or column (i.e., an estimate of future uncollectible receivables) and a subtractions row or column (i.e., receivables deemed uncollectible); and (3) an ending balance row or column.

AR Leadsheet (AR-100): summarizes the current year and prior year balances that are relevant to the audit of accounts receivable. A leadsheet is typically created from a trial balance or general ledger provided by the client. The prior year balances are agreed to the audit workpapers from last year. The current year balances are agreed to the draft financial statements for this year to ensure the balances agree to the amounts that will be presented in the financial statements.

AR Testwork (AR-101): uses a substantive test of details to verify the existence of accounts receivable. Depending on the balance and the number of items that make up the balance, it is often necessary to select a sample from the total population, as is the case with Sprandel, Inc. The standard procedure for verifying a sample of accounts receivable items is to send confirmations and compare the amounts reported by the audit client to the amounts provided by the customer on the confirmation. If a confirmation is not returned, verifying subsequent cash receipt, as well as examining other audit evidence is often necessary.

Cutoff (AR-104): uses a substantive test of details to verify the presentation and cutoff of accounts receivable. The test of credit balances is designed to verify that these balances are appropriately classified. Early cutoff testing is designed to ensure that credit memos issued before 12/31/20X3 relate to this period, rather than the 20X4. Late cutoff testing is designed to ensure that credit memos issued after 12/31/20X3 relate to 20X4, rather than the 20X3.

Write-Offs (AR-103): uses a substantive test of details to verify the customer accounts receivable balances were properly written off at the appropriate amounts. A “write-off” is performed when a customer balance is deemed uncollectible. When this determination is made, a write-off memo is issued. In the case of Sprandel, the accounts receivable supervisor, as well as the account manager that is assigned to the customer’s account, must authorize the write-off memo.

Panel B: Key Case Terms

Audit Program: a list of procedures and tasks to be performed by the auditor to complete a portion of the audit. The audit team creates the audit program, often using guidance and recommended procedures of the audit firm, as well as generating additional procedures that may be specific to an industry or client. Audit programs are grouped by related accounts or by audit cycles.

Credit Memos: issued when a customer returns goods to Sprandel Inc., resulting in the customer receiving a credit on the goods for which they had previously paid.

Exceptions: are misstatements or control deficiencies found when performing audit procedures. For example, if a staff auditor notes an approval signature is missing on a check that was issued this would be considered an exception. Often when auditors describe a procedure that they

performed they will write, “Procedure X was performed without exception,” which means no misstatements or control deficiency was noted when performing this procedure.

Tickmark: is a symbol used in workpapers to indicate that a certain task was performed or to highlight a comment about a specific item. After completing a procedure, an auditor will place a tickmark (often a letter, a number, or a symbol) next to each item on which the procedure was performed. The auditor then describes in a legend the meaning for each tickmark. For example, “Z: Recalculated the depreciation expense for the fixed asset item without exception.” or “@: This item did not have the required approval signature, this item is an exception.” The legend typically appears at the bottom of the related workpaper. Audit firms often have standard tickmarks for commonly performed tasks such as “PY,” which means that an amount was agreed to the prior year balance. These tickmarks are typically denoted in a primary legend, and may not be included in a specific workpaper legend.

Tracing: To verify that an amount, or other information, obtained from supporting documents (e.g., invoices, shipping documents) agrees to the client’s journals or ledgers (i.e., “trace forward”).

Vouching: To verify that an amount, or other information, contained in the client’s journals or ledgers agrees to supporting source documents (i.e., “vouch back”).

Write-off Memos: issued when a customer balance is determined to be uncollectable, and therefore is written off.

Workpapers: used to describe the audit documentation produced during an audit. Audit documentation is required by auditing standards to ensure there is a written record of the audit work and to provide evidence that the audit was conducted in accordance with auditing standards.

APPENDIX B

Memo—Student Deliverable

To: [Instructor's Name] – Audit Manager

From: [Student Name(s)] – Audit Staff

Date: [Current Date]

Re: Sprandel, Inc. Accounts Receivable Revised Audit Work

Explanation of how each review note was closed:

RN1:

RN2:

RN3:

RN4:

RN5:

RN6:

Identification of issues noted in revising and completing the workpapers, any suggested next audit step(s), and whether the conclusion related to the workpaper requires modification:

Responses to critical thinking questions:

1)

2)

3)

4)

5)

REFERENCES

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