

Advanced auditing case 2.3

Finance



Advanced Auditing Case Assignment 2.3 1. (a) When confirming year-end accounts receivable, auditors hope to accomplish the objective of obtaining evidence from third parties to evaluate the client's assertions of year-end accounts receivable amounts. The client's assertions that accounts receivable confirmation can effectively address are existence, rights, and valuation. b) When performing year-end sales cutoff tests, auditors hope to accomplish the objective of obtaining evidence from third parties to evaluate the client's assertions of sales recorded for the period under audit. The client's assertions that sales cutoff tests can effectively address are completeness and presentation. 2. Coopers & Lybrand made several significant errors of judgment in its effort to confirm the Wow Wee receivable at the end of 1995.

These errors of judgment include ignoring or overlooking red flags including: the 69% change in the percentage of factored accounts receivable from 1994 to 1995, the \$2.4 million in sales to Wow Wee booked in the final day of fiscal 1995, the fact that Wow Wee is a manufacturing company, the fact that Wow Wee was left out of the top 25 customers list when it was among the top 5 based on recorded sales, and the clearly falsified bill of lading.

Coopers & Lybrand failed to make the appropriate modifications to their planned audit procedures to examine these irregularities. Coopers & Lybrand also failed to follow up on the confirmation of the Wow Wee receivable that they accepted from Goldberg. These errors of judgment involve extreme negligence on the part of the auditors. I would classify these errors as reckless as there is no evidence to support that Coopers & Lybrand were involved in the fraud.

I think that the auditors did not suspect that fraud would occur at Happiness Express in 1995 as they had previously audited Happiness Express in 1994 and rightfully issued an unqualified opinion. I think that the auditors believed that these were simple mistakes that did not need to be further examined. The company's revenue grew so significantly from 1994 to 1995 and because of this, I think that it was easy for the auditors to believe that the employees were simply overwhelmed by the company's alarming growth and made mistakes as a result. . Yes Coopers & Lybrand should have confirmed the receivable from West Coast Liquidators at the end of fiscal 1995 because it represented 13%, a clearly material amount, of the total accounts receivable. They also should have included one or more of the sales to West Coast Liquidators in their year-end sales cutoff tests for 1995 as many of these transactions were booked in the final month of the fiscal year.

Sales transactions occurring close to the end of the fiscal year are much more likely to be suspicious in nature or fraudulent than transactions occurring earlier in the year. 4. The alternative procedures that can be applied to a large receivable of an audit client when a confirmation cannot be obtained include examination of subsequent cash receipts, the matching of such receipts with the actual items paid for, and examination of shipping, or other client documentation.

The evidence provided by these methods may differ from the evidence provided by confirmation of a receivable depending on the client's documentation of the transaction. Typically, in a company with proper internal controls and documentation, alternative procedures should be able

to effectively address the same assertions that the confirmation of a receivable address. At very least, alternative procedures provide evidence for the existence assertion. 5. According to AU Section 317. 7, auditors should be aware of the possibility that illegal acts, such as insider trading, may have occurred however, an audit made in accordance with GAAS provides no assurance that illegal acts will be detected or that any contingent liabilities that may result will be disclosed. In the event that an auditor discovers evidence concerning the existence of possible illegal acts that could have a material indirect effect on the financial statements, they should apply audit procedures directed to ascertain whether an illegal act has occurred.