

Redpack beer company – allowance for bad debts essay sample

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Based on my analysis of the transcript, I believe that RedPack Beer Company should increase its reserve, specifically the reserve related to Golden Holdings. Per the discussion with Katie Henson, RedPack Beer does not currently maintain a reserve for the outstanding balance of \$2, 706. 54. Clint Maddox mentioned that RedPack would not let this receivable go uncollected and that a collection agency would be used to collect the balance. Based on the normal arrangements with the collection agency, RedPack would receive 50% of the collection they receive from the customer. Therefore, to remain consistent with RedPack's conservative approach, I believe that Golden Holdings reserve should be increased by \$1, 353. 47 (half of their current outstanding balance).

In regards to the reserves for Distinct Beer and Eagle Beverage, I believe that these two reserves are properly valued and should remain at their current amount. These two reserves should remain the same because RedPack has already accounted for the entire outstanding balance for Eagle Beverage in which they will be issuing a credit memo for that remaining balance. RedPack has already taken conservative steps to account for Distinct Beer's outstanding balance by including 50% of that balance in the reserve. Based on this, Distinct Beer's reserve should remain unchanged until new circumstances arise that force the reserve to be recalculated.

There is one concern that I have in regards to the reporting of revenues and accounts receivable. My sole concern is the approach that management takes in reporting the company's revenue. It was mentioned that management maintains a conservative approach in its accounting for

accounts receivable, therefore it would be ideal to assume that they utilize the same approach for revenue recognition. However, auditors should thoroughly inspect RedPack's revenue recognition approach to ensure that they are not overly aggressive in their recognition method.

Based on the information I have gathered, the adjusted reserve amount I have calculated is \$6, 902. 47. The increase in the reserve amount of \$1, 353. 47 is due to the added reserve associated with Golden Holdings. The difference in my reserve estimate and the client's estimate is not material due to the \$2, 500 threshold established by the audit plan.

Due to the fact that the new reserve estimate is under the materiality threshold, there is not adjusting journal entry required to adjust management's estimate of the reserve. Additional procedures that could be performed to verify the accuracy of the allowance for bad debts are found in AU-C 540. AU-C 540 addresses the auditors responsibility related to accounting estimates including fair value estimates and related disclosures. Based on the inherent risk being set at a high level in conjunction with the moderate control risk, there is a high likelihood for a potential material misstatement to occur. Based on this, additional procedures that could be implemented include: Evaluating alternative assumptions or outcomes based on potential judgment bias in the estimation process. Testing the operating effectiveness of the controls over how management made the accounting estimate Test how management made the estimate and the data that the estimate was based on. Review the outcome of accounting estimates include in the prior period financial statements.