

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

Lindsay M. Andiola
Virginia Commonwealth University

Tamara A. Lambert
Lehigh University

Edward J. Lynch
California State University, Fullerton

ABSTRACT: Workpaper review is an important quality control mechanism in the audit environment. However, appropriately responding to review notes is not commonly taught. The Sprandel, Inc. case provides a hands-on learning experience for students to connect textbook audit knowledge through use of an activity regularly performed in audit practice: closing review notes. Through the process of closing review notes, students practice auditing accounts receivable, including performing audit procedures related to internal controls and substantive audit work. The case also provides students with an opportunity to use Excel to complete electronic workpapers and to document their audit procedures. Further, the case requires students to use critical-thinking skills and apply professional skepticism when performing audit procedures, evaluating audit evidence, and making decisions. Finally, this case helps students 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; electronic workpapers; audit documentation; accounts receivable; substantive tests; internal control tests.

CASE

Introduction and Background

Sprandel, Inc. is a publicly held, mid-sized manufacturer of plastic bottles, and is classified as an accelerated filer by the U.S. Securities and Exchange Commission. In 1987, the company was founded by a young entrepreneur who was interested in creating plastic bottles in shapes and sizes that were unique and affordable to customers who needed packaging for an assortment of products such as food, drinks, automotive oil, and personal care products. Sprandel's claim to fame is that the company is the first bottle manufacturer to produce a line of "honey bear" bottles. The company started as one facility in Tulsa, Oklahoma, but Sprandel has since expanded to six facilities in Oklahoma, Wisconsin, and Maryland. These facilities collectively house 35 production lines. Sprandel produces 74 different stock bottles in various shapes and sizes and can produce custom bottles based on customer specifications. Over the past 30 years, Sprandel's 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

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financial statements for the last four 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 informed you that you have three primary 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 explained that the signatures of both the accounts receivable supervisor (Meg Black) and the account manager responsible for the customer account (Kate Burke or John Sawyer, depending on the customer) are necessary for the write-off of an account receivable and crediting 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. Two PCAOB assertions pose the highest inherent risk for these account balances: existence and valuation. Also, when evaluating the design and effectiveness of controls, the most significant risks arise from ensuring that transactions are recorded in the appropriate period and that write-offs and credits are appropriately authorized. During the team planning meeting, the risk of material misstatement for accounts receivable was assessed as moderate based on prior year audit work and the audit team noted no significant changes in Sprandel's operations in the current year. Based on this level of risk, the team assessed tolerable misstatement for accounts receivable to be \$750,000, meaning any misstatements greater than \$750,000 require the client to book an adjusting entry.

In order to complete the audit of the abovementioned accounts for Sprandel, your team obtained a number of prepared-by-client (PBC) documents from your client contacts. These include: (1) the Accounts Receivable detailed listing (AR Detail); (2) the roll forward of the Allowance account from the prior period balance to the current period balance; (3) the write-off detail; (4) the early and late cutoff details; and (5) 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 have already diligently worked to complete the relevant workpapers to support conclusions for both the Gross Accounts Receivable balance and the Allowance balance. The procedures you were assigned include: (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 and emailed the Excel file containing those workpapers to your audit manager, Bill Davis, for his review.¹ This morning, Bill electronically returned the workpapers to you with several review notes that you must address to finalize the audit work.

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. The 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 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 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* (fully addressed) before submitting them to a higher-level team member for review, at which time the process begins again. When a supervisor is satisfied with the workpaper, he or she will sign off on the audit work.

The ultimate goals of the workpaper review process are to ensure that 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

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).

of identification) of exceptions and issues that may lead to misstatements or internal control deficiencies. Therefore, staff auditors must highlight items that are of concern and may be exceptions, using tickmarks, and communicate these concerns to their audit supervisors.² Raising an 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, para. 5) during their review. However, supervisors cannot properly perform this evaluation if issues and exceptions are not clearly pointed out to them.

While the review process is designed to improve the quality of the workpapers and help maintain consistency, some factors can limit a supervisor’s ability to perform a quality review—often the biggest factor is time. The completion phase of the audit is a particularly busy time, and as a result, audit supervisors may feel rushed to review workpapers and spend limited time in 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 documenting the additional work you performed, is particularly important. A 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://lindsay.fildred.com/teaching-cases/sprandel-inc/> and click on the “Download Workpapers” button, then save this Excel file to your computer.

At this point, you may wish to familiarize yourself with the workpapers and the review notes your audit manager left. The Excel file has five tabs: (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. You will find descriptions of each of these workpapers in the Case Glossary in Appendix A, in the “Electronic Workpaper Descriptions” section. In Appendix A, the “Key Case Terms” section includes other audit terms that may be helpful to know: audit program, credit memos, exceptions, tickmark, tracing, vouching, workpapers, and write-off memos. You will find the review notes in comment boxes within the Excel file and close to the audit documentation related to the comment. For example, Review Note 1 of 6 is on the tab “AR-100 AR Leadsheet” in the cell next to the text that needs editing. You may find that you can close some review notes (address within the workpapers and respond within the review note) now without further guidance or audit evidence. Other review notes will require you to review your audit firm guidance and previously obtained evidence, and/or follow-up with the client contacts to request new or additional information or evidence. For these review notes, you must click on the “Begin Case” button, which will take you to the Main Menu to perform these activities.

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

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 your work provide sufficient and appropriate audit evidence regarding the financial statement assertions being audited (PCAOB 2016a, AS 1215, para. 9). If you find other issues or exceptions that you believe may change your conclusion, be sure to note your concern in your memo to your audit manager.

² Audit supervisors rarely re-perform the staff auditors’ work. Therefore, staff auditors must thoroughly inspect underlying supporting audit documentation and bring any concerns to the attention of their supervisors to make a final determination of whether an issue is an actual exception.

³ You can ask about audit issues by speaking with the appropriate client contact (click on the “Ask about Audit Issues” button provided on each client contact web page) and identifying the item to which the issue relates. To obtain additional information, you must ensure that you ask the correct client contact, and specifically reference the item using the sales invoice number, write-off memo number, or credit memo number identified in your audit documentation.

Deliverables

Your deliverables will consist of two parts:

- Part (1) **Completed Workpaper Excel File** (available at: <http://lindsay.fildred.com/teaching-cases/sprandel-inc/>): Each review note should be clearly addressed or closed in the Excel file. In some instances, the review note may be a relatively easy documentation fix, such as Review Note 1 of 6, for which you can make the requested edit and note that you have closed the review note. For example, you may write, “RN CLOSED—We changed the date” in the comment box. In other instances, such as Review Note 3 of 6, the review note may require you to perform other procedures. In these circumstances, as mentioned above, you may need to add columns or tickmarks to document procedures and issues or exceptions you find. It is up to you to decide how to document these items in the workpapers, just be clear and consistent in the formatting you choose. In these instances, in the comment box, you should briefly note changes you made to the workpaper to point your audit manager to the items to review. For example, 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 needs to be modified in light of any issues or exceptions you find.
- Part (2) **Completed Memo:** Write a memo to the audit manager (your instructor) in the format provided in Appendix B, and include discussion of the following:
- how you addressed each review note;
 - all issues/exceptions you found when performing the added audit work that should be brought to the attention of your audit manager;
 - further audit steps that you believe may be necessary;
 - whether you believe the conclusion of the workpaper should be modified; and
 - responses to the Critical-Thinking Questions.

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. 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. . .”).

- 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 procedures.
- For Review Note 3, you were asked to perform alternative procedures to verify existence. Refer to PCAOB AS 2310, paragraphs 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?
- Review Note 5 required you to test the operating effectiveness of an internal control (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 that 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)?
- Review Note 6 related to an exception found during cutoff testing and the required additional procedures to be performed. Based on this exception and the additional procedures you performed, discuss the implications. Consider the following in your discussion:
 - which financial statement assertion this audit work most closely relates to,
 - the total dollar amount of the exception(s) based on the testing performed,
 - 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
 - the appropriate auditor response to the exception(s).

⁴ If submitting this workpaper in a hardcopy format to the manager (instructor), be sure to format each Excel tab to print on one page for ease of review.

- (5) Using PCAOB AS 1215, paragraphs 8 and 12, describe the auditor's responsibilities for documenting information related to significant findings or issues inconsistent with the auditor's conclusions and *three* 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 to be significant?

REFERENCES

- American Institute of Certified Public Accountants (AICPA). 2011. *AU-C Section 220, Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards. Statement on Auditing Standards No. 122*. New York, NY: AICPA.
- Public Company Accounting Oversight Board (PCAOB). 2016a. *Audit Documentation. Auditing Standard No. 1215*. Washington, DC: PCAOB.
- Public Company Accounting Oversight Board (PCAOB). 2016b. *Supervision of the Audit Engagement. Auditing Standard No. 1201*. Washington, DC: PCAOB.

APPENDIX A Glossary of Case Terminology

Electronic Workpaper Descriptions

- AR-100 AR Leadsheet:** 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-101 AR Testwork:** 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, auditors often select a sample from the total population. 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, then verifying subsequent cash receipt, as well as examining other audit evidence is often necessary.
- AR-102 Allowance Roll Forward:** 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 (e.g., an estimate of future uncollectible receivables) and a subtractions row or column (e.g., receivables deemed uncollectible); and (3) an ending balance row or column.
- AR-103 Write-Offs:** uses a dual-purpose test to verify that 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 such a determination is made, a write-off memo is issued. In the case of Sprandel, the accounts receivable supervisor, as well as the account manager assigned to the customer's account, must authorize the write-off memo.
- AR-104 Cutoff:** 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 20X4. Late cutoff testing is designed to ensure that credit memos issued after 12/31/20X3 relate to 20X4, rather than 20X3.

Key Case Terms

- Audit Program:** a list of procedures and tasks performed by the auditor to complete a portion of the audit. The audit team creates the audit program, often using the audit firm's guidance and recommended procedures, as well as generating additional procedures that may be specific to an industry or client. Audit programs are grouped by related accounts or audit cycles.
- Credit Memos:** issued when a customer returns goods, resulting in the customer receiving a credit on the goods for which they previously paid.
- Exceptions:** 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, it would be considered an exception. Often when auditors describe a procedure they performed, they write, "Procedure X was performed without exception," which means no misstatements or control deficiencies were noted.

Tickmark: 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, number, or 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; it 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 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, such as invoices and 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).

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.

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

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)