Tests of details

MODULE 3 | 3.3.2 | STUDENT COMPANION

Tests of details examine individual transactions and the items in a balance, and the **direction** of a test decides the assertion it supports. **Positive confirmations** are stronger than negative ones, non-responses need alternative procedures, and the auditor must control the whole confirmation process. **Stocktake attendance** tests existence and completeness by counting both ways, along with condition and cut-off. **Cut-off tests** check the period of transactions around year end, and the **search for unrecorded liabilities** looks beyond the payables list for what's missing.

Two kinds of tests of details

For a significant risk addressed only by substantive procedures, tests of details are required, because they give the most direct evidence about specific items.

Kind	What it examines	How
Tests of transactions	Individual transactions recorded during the period	**Vouching** from the records back to supporting evidence tests occurrence; **tracing** from source evidence forward into the records tests completeness
Tests of balances	The items making up a closing balance	Confirmation, inspection, physical counts, recalculation, and evidence from after the year end such as cash received or paid

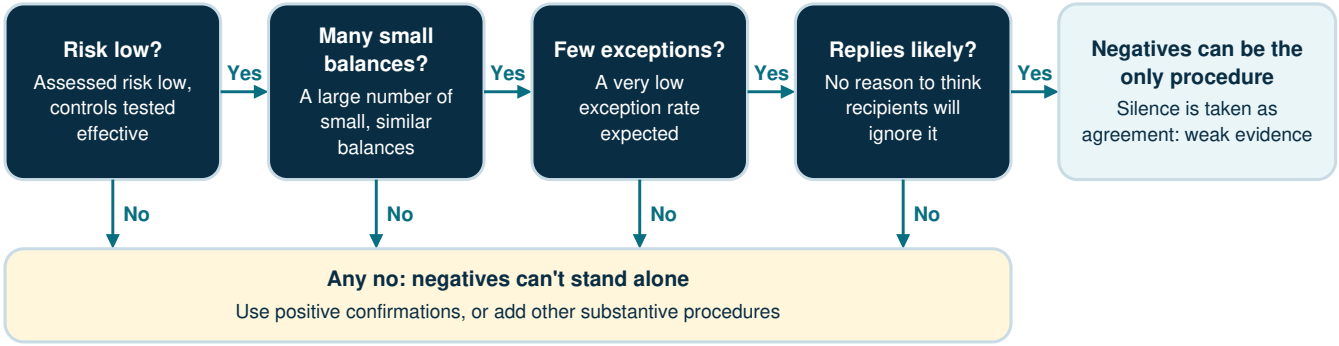
Tests of details and the assertions they support

Test of details at Voltana	Direction or source	Assertion it supports
Vouch recorded sales back to signed installation completion forms	From the records to the evidence	**Occurrence**
Trace completion forms forward into recorded sales	From the evidence to the records	**Completeness**
Positive confirmations of partner electricians' balances	Third party direct to the auditor	**Existence; rights**
Cash received after year end; the ageing of each balance	Later evidence	**Valuation (and existence)**
Credit notes issued after year end	Later evidence	**Occurrence of sales**
Test counts from the stock list to the shelf	From the records to the asset	**Existence**
Test counts from the shelf to the stock list	From the asset to the records	**Completeness**
Sales and goods received either side of 30 June	Around the year end date	**Cut-off**
Payments and supplier invoices after year end	Outside the payables list	**Completeness of payables**

External confirmations

A **positive** request asks the third party to reply in every case, either agreeing with the balance stated or giving the correct figure. A **negative** request asks for a reply only if the recipient disagrees, so silence is treated as agreement. Because silence may simply mean the letter was ignored, negative requests can be the **only** substantive procedure for an assertion only when all four conditions below hold; otherwise they can at most support other procedures.

Positive or negative confirmations?



Voltana's partner electricians: positive confirmations

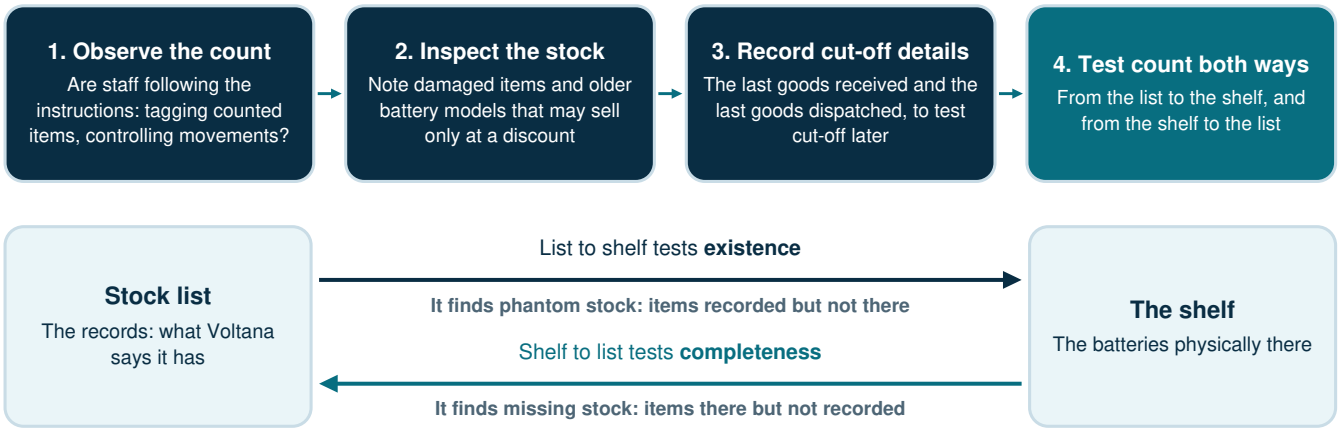
- **No reply:** alternative procedures, such as cash received after year end and the underlying installation records
- **A different figure:** every exception is investigated, because it may be a timing difference or a genuine misstatement

Case note: Parmalat's forged confirmation

Parmalat was a large Italian dairy and food group. Its accounts showed about 3.95 billion euros of cash and securities held by a subsidiary in the Cayman Islands, in an account at Bank of America. In December 2003 the bank said that no such account existed and that the document confirming it was a forgery. Within days Parmalat was insolvent, with a hole in its accounts that later reached around 14 billion euros, and its founder was eventually convicted. Reports later suggested the forged confirmation had been produced inside the company and had reached the auditors without the bank ever being involved. **The lesson:** a confirmation is independent evidence only if it travels directly between the auditor and the real third party. Once the client can touch it, it is just another document the client could have made.

Source: US SEC Litigation Release 18527 (December 2003); Italian court decisions (2008-2014).

Attending Voltana's stocktake on 30 June



Cut-off at Voltana

Area	What the team does
Sales	Selects sales recorded in the two weeks either side of 30 June and matches each to its installation completion form, checking the installation date
June manual revenue journals	Traces each one to signed completion forms; where no installation had happened by 30 June, the revenue belongs in the following year
Purchases	Compares the last goods received notes before year end with the purchase records
Cells at sea on 30 June	Uses the shipping terms to decide whether Voltana owned them yet, and so whether they belong in inventory and payables

The search for unrecorded liabilities. Examining the payables list can't find a liability that isn't on it, so the team looks outside: payments made in the weeks after year end, supplier invoices received after year end, and statements from major suppliers, asking of each whether it relates to goods or services received before 30 June. **For receivables,** valuation is tested through the ageing, cash received after year end, and credit notes issued after year end, which can also reveal sales that should never have been recorded.

Practice questions

MODULE 3 | 3.3.2 | TRY THESE BEFORE THE WORKED ANSWERS

Question 1 - Choose a test of details

Tarnwick Outdoor Distributors Pty Ltd (imagined) imports tents, sleeping bags, stoves and other camping gear and sells them to retailers. Its year ends on 30 June. Choose one test of details for each assertion.

Assertion	Test of details you would perform
(a) Existence of trade receivables	
(b) Valuation of trade receivables	
(c) Completeness of trade payables	
(d) Existence of inventory	
(e) Completeness of inventory	
(f) Valuation of inventory, including last season's camping stoves	
(g) Cut-off of sales	
(h) Rights to stock held at a third-party logistics warehouse	

Question 2 - Positive or negative confirmations?

Decide which form of confirmation would suit each group of Tarnwick's customers.

Group of customers	Positive or negative, and why
(1) Seven national outdoor and department store chains, each owing between $180,000 and $950,000; together 70% of receivables; two dispute recent deliveries	
(2) About 1,600 scout groups, schools and clubs on small trade accounts, mostly under $400 each; credit controls tested and effective; very few disputes in past years	
(3) About 45 independent camping stores owing $5,000 to $40,000 each; a new credit controller started in May, and several stores pay slowly	

Question 3 - Plan the stocktake attendance

Tarnwick counts its stock on 30 June at its main warehouse and at a smaller regional warehouse; more stock sits at a third-party logistics warehouse. A container of tents is due to arrive on 1 July, and the stock includes last season's stoves, which are selling slowly. Plan your attendance: what you would do before, during and after the count.

Worked answers

MODULE 3 | 3.3.2 | WORKED ANSWERS - ATTEMPT THE QUESTIONS FIRST

Question 1 - Tarnwick Outdoor Distributors (suggested)

Assertion	Test of details
(a) Existence of receivables	Positive confirmations of a sample of balances, with alternative procedures for non-replies
(b) Valuation of receivables	Review the ageing and cash received after year end; assess the allowance for slow payers and disputes
(c) Completeness of payables	Search for unrecorded liabilities: payments and invoices after year end, supplier statements
(d) Existence of inventory	Test counts from the stock list to the shelf
(e) Completeness of inventory	Test counts from the shelf to the stock list
(f) Valuation of inventory	Compare cost with selling prices achieved after year end, especially for the stoves; inspect condition at the count
(g) Cut-off of sales	Match sales either side of 30 June to dispatch records and their dates
(h) Rights to stock held by others	Confirm the quantities with the logistics provider and check the purchase invoices: is the stock Tarnwick's, not a customer's?

Question 2 - Tarnwick's customers (suggested)

Group	Form and reason
(1) National chains	**Positive.** Large balances, a high share of receivables and live disputes: the risk isn't low, and silence would prove nothing
(2) Small trade accounts	**Negative can suit, even on its own:** low risk with controls tested as effective, many small, similar balances and very few exceptions expected, provided there is no reason to think the groups will ignore the request
(3) Independent stores	**Positive.** Medium balances, a recent change in credit control and slow payers mean the risk isn't low

Question 3 - Stocktake attendance (sample answer)

- **Before:** read the count instructions, list the locations and the stock at each, and decide which counts to attend; plan to confirm the logistics warehouse's quantities directly, or attend there too; note the slow lines to inspect.
- **During:** observe that the instructions are followed, including tagging and no movements; inspect condition, especially the stoves; test count both ways; record the last goods received and dispatched, and confirm the tents arriving on 1 July are excluded unless Tarnwick already owns them under the shipping terms.
- **After:** agree the test counts to the final stock listing, follow up differences and cut-off, and use the stoves' prices after year end to judge whether they must be written down.