AUDIT OF TRADE RECEIVABLES

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Abstract:*The present paper presents in the first part the trade receivables that arise from a company's relation with third parties and the main types of accounting records used in Romania. In the secont part of the paper, we present the auditor's point of view regarding the trade receivables, what he searches during his audit at a company, and what has to be verified and checked. In the last part of the paper, we present the audit evidences for trade receivables and we get to conclusions regarding the audit of trade receivables.*
Keywords: *accounting, trade receivables, accounting operations, suppliers, customers,account receivable, goods, incomes, expenses, credit control.*

I. INTRODUCTION

Trade receivables are a company's right to claim to third parties a value of moneyor equivalent consideration for the goods, works, services or amounts of money advanced to them. The natural and legal persons who have benefited from an advance and are obliged to give the corresponding equivalent back are generally called debtors. In accounting, trade receivables are part of patrimonial assets and can be grouped according to several criteria's:

- **Based on the nature of the operation made:**
  - ✓ Trade receivables (made on sale);
  - ✓ Financial receivables (made by granting loans);
  - ✓ Other receivables from other operations.
- **Based on the period of time needed to be solved:**
  - ✓ Long-term receivables;
  - ✓ Short-term receivables.
- **Based on the economic content of receivables:**
  - ✓ Customer receivables - for the products sold, the executed works or the services rendered;
  - ✓ Receivables on suppliers - as a result of payments and advances paid to suppliers in advance;
  - ✓ Receivables generated by having commercial effects (bills of exchange, promissory notes);
  - ✓ Debts to various borrowers.
- **Based on the way of liquidation:**
  - ✓ Receivables from sales on commercial credit when settlement is made with the usual settlement instruments;

  - ✓ Receivables from sales on cash, whose collection is based on bills of exchange (trades, promissory notes).
- **Based on maturity:**
  - ✓ Eligible debts, whose collection term is mentioned on the delivery documents;
  - ✓ Under settlement receivables, for sales arriving without invoice and whose collection period will be specified later on when the invoices arrive.
- **Based on the currency in which the sales are valued:**
  - ✓ Receivables from foreign clients - in foreign currency;
  - ✓ Receivables from domestic clients - in RON.

Trade receivables include clients, uncertain or disputed customers, customer receivables, customer-invoices, suppliers (debtors) for services and works executed.

The customers group include receivables from sold goods, executed works, services rendered, the consideration of which is definitely to be collected on a later date.

Uncertain or disputed customers are receivables from bad or doubtful customers. Their recording in accounting is generated by the non-payment of the related receivables due to the difficulties faced by the customers ona solvency line.

Customers – invoices to be made refer to receivables from deliveries to third parties for which no invoices have been made. However, the claims in question have a well-determined value.

Suppliers (debtors) for the provision of services and works represent the advances granted to these suppliers and the service or work has not yet been executed.

The effects that have to be received from customers are negotiable titles such as bill of exchange, promissory note, check which attest the existence of a receivable in commercial relations, which will be cashed in the short term, usually up to 90 days. The supplier company now has a claim on that customer. At the time of receiving this claim, the client does not have cash. With the consent of his supplier, the client issues a security paper (trade effect), under which he undertakes to pay off the counterfeit at a later date (maturity). The enterprise will receive the trade effect by maintaining its claim until maturity, when it will be presented to the customer for collection. Trade effects come in different forms (bill, promissory note, check).

The amounts receivable from affiliated companies are generated by settlement relationships between the parent (an enterprise with one or more subsidiaries) and its subsidiaries (parent-controlled enterprises): the amounts transferred to the subsidiaries, the value of the assets and stocks delivered to subsidiaries, dividends to be cashed, interest on short-term loans.

Other receivables represent the receivables from the settlement relations of the enterprise with the personnel, state budget, other public bodies, social insurance, social protection, various debtors, etc. The other receivable catergory include:

- ✓ Advances to staff and other claims related to it;
- ✓ The amounts to be received from the social security and unemployment bodies,
- ✓ Receivables represented by amounts paid in excess of those actually due to the corporate tax and VAT tax;
- ✓ Subsidies due from the state budget;
- ✓ Other claims arising from surplus transfers in addition to the state budget relating to other taxes and duties;
- ✓ Claims against debtors in claims, material damage;
- ✓ Claims arising from the sale of tangible and intangible fixed assets on credit;
- ✓ Interest receivable, related to current accounts with banks.

II. ACCOUNTING RECORDING OF TRADE RECEIVABLES IN A COMPANY FROM ROMANIA

The most significant types of records regarding customer settlements are as follows[1]:

1 Contabilitatea financiară a entităţilor din comerţ, turism si servicii – Marius Miculescu, editura Eurostampa, 2015.

A. The immediate sale of finished products, semi-finished goods, waste products and goods, as well as invoicing of executed works and services provided at take-over, plus VAT - collected:

4111 Customers	=	70 Turnover 4427 Output VAT

B. Acceptance of commercial effects to be paid:

413 Bills of exchange receivable	=	4111 Customers

C. Remittance to the bank, to collect the commercial effects:

5113 Bills of exchange held to maturity	=	413 Bills of exchange receivable

D. Receiving through the bank the commercially remitted effects:

627 Bank commissions and similar charges 4426 Input VAT 512 Cash at bank	=	5113 Bills of exchange held to maturity

E. The settlement of advances received from customers:

- ✓ advances received from customers:

512	=	419

Cash at bank		Customers – advance payments from customers
		4427
		Output VAT

Or:

512	=	419
Cash at bank		Customers – advance payments from customers

And:

419	=	4427
Customers – advance payments from customers		Output VAT

- ✓ Charge the customer with advance retention:

419	=	4111
Customers – advance payments from customers		Customers
4427		
Output VAT		
512		
Cash at bank		

F. <u>The registration of uncertain or disputed customers</u>:

4118	=	4111
Doubtful customers or customers involved in litigation		Customers

G. <u>Removal of insolvent clients from the patrimony</u>:

654	=	4118
Bad debts written off		Doubtful customers or customers involved in litigation
4427		

Output VAT

H. Reactivating customers out of the record:

4111 Customers	=	754 Bad debts written off and subsequently collected 4427 Output VAT

III.WHAT IS TRACKED IN AUDITING TRADE RECEIVABLES

In auditing accounts receivable and related revenue balances, several potential problems exist that could create material misstatements. Some of these would be errors whereas others would indicate fraud.

A set of basic internal control should be in place to prevent such erroneous or frauds from happening and a serial of substantive test to be conducted by auditors to make sure the accounts receivable's balances are free of misstatement. The most common errors and frauds in accounts receivable that potentially result in accounts receivable misstatement are the following:

- ✓ Reported receivables and sales could be false. Amounts were recorded to manipulate the reported amount of income. False sales are especially likely if: (1) the income to be reported is down for the period, (2) the employee compensation or bonuses are based on profits, or (3)the company plans to issue capital stock or borrow money in the near future.
- ✓ The incoming cash is stolen and theft is hidden. It is done by unethical custodians by writing off the receivable as a bad debt.
- ✓ Lapping is being carried out. Cash from one receivable is stolen and covered with cash received from a second customer during the following day or two.
- ✓ The year-end cut-off of transactions is incorrect. Transactions occurring before the end of year could be recorded in the subsequent period (thus, reporting for the initial year is not complete).
- ✓ Transactions after the end of year could be recorded prematurely in the initial year (reported transactions in initial year did not actually exist at the time of the financial statements).
- ✓ Customer is billed incorrectly (because of math errors, wrong quantity, wrong price, wrong items) or customer is just not billed at all for goods

that were actually shipped (inventory is gone but no collection is ever made).

- ✓ The transaction is with a related party so that disclosure is needed.

The company should have a system in place to record the sale, make proper shipment, control and collect the receivable balance to prevent such errors. The following basic internal controls set for accounts receivable and related revenues should be used by a company:

- ✓ Through e-mail, by phone or directly to an employee a customer order is received.
- ✓ On a pre-printed, pre-numbered sales order form, the sales department lists all relevant information: quantity, description, terms, buyer, address, method of payment, etc.
- ✓ The credit department reviews the credit file (which can hold credit report, references, financial statements, payment history of client, etc.). Approval or disapproval of the credit is then indicated on the sales order form.
- ✓ If approved, the sales order goes to the finished goods warehouse where goods are gathered and sent to the shipping department. Since the asset is being transferred, the shipping department should verify the description and the quantity against the sales order form. The condition of goods should also be checked. Shipping then signs and returns a copy of the sales order which is kept by the warehouse as a receipt to prove that transfer was made.
- ✓ The shipping department sends the goods to the customer and prepares a shipping document. One copy goes with merchandise and a second copy is sent directly to the customer.
- ✓ The copy of shipping document will be sent to the inventory accounting department which should maintain a perpetual listing of all inventory. An entry is made to remove the item from records.
- ✓ The entries are accumulated and forwarded to general accounting department for posting of the overall reduction of the inventory account.
- ✓ Copies of all documents go to the billings department. A comparison is made of quantity and description. If all information agrees, a sales invoice is prepared and sent to the client which is also recorded in the sales journal. The Summary of the sales journal is forwarded to the general accounting for recording.
- ✓ The copy of the sales invoice is sent to the accounts receivable department. The amount is recorded in the accounts receivable master file by the customer name.

- ✓ Periodically, an accounts receivable trial balance is prepared which lists each account by age. Old accounts are turned over to a collection department.
- ✓ If the balance still proves to be uncollectible, both collection and the accounts receivable departments file documentation to indicate the actions taken.
- ✓ Independent party reviews information before the final write-off of balance is approved.

An auditor creates the substantive test which is essential to achieve each of the 9 audit-related audit objectives. The nine general goals are the same for all accounts. When applied to trade receivables, they are called audit objectives related to the balance of customer receivables and consist of:

1) Customer receivables from the chronological check balance correspond to the sums in the relevant systematic files, and the total is correctly calculated and corresponds to the total in the ledger (detail concordance);
2) Recorded customer receivables exist (existence);
3) Existing client receivables are included (exhaustiveness);
4) Customer receivables are accurate (accurate);
5) Customer receivables are classified correctly (classification);
6) The receivables-client account is presented at the realizable value (realizable value);
7) Client is the right holder of client receivables (rights);
8) Presenting and disclosing information about client receivables is appropriate (disclosure).

The auditor uses the factors enrolled on the rows to estimate the planned detection risk of customer receivables on each objective. The auditor decides on the preliminary value of the materiality threshold for the financial statements as a whole and then assigns the preliminary value of the materiality threshold to each significant balance sheet, including customer receivables. This assignment is called tolerable error fixation. As a rule, the customer receivable account is one of the most significant accounts in the financial statements of companies that sell on credit. Even if the customer receivable account is not high, the sales-revenue operations that affect this balance will be very significant.

The confirmation of customer receivables is the most important test of client-debt details. Confirmation is broadly discussed in the study of the appropriate tests for each of the audit objectives on the balances, and then separately. The auditor draws up a planning worksheet and determines the planned detection risk of testing the details for each of the audit objectives related to the balances. The selected audit procedures and the size of their evidences will largely depend on the small, medium or large simple quantity planned for each objective.

Most of the tests applied to customer trade receivable accounts and doubtful debts provisions are based on the chronological check (seniority) balance. A chronological verification balance is a list of balances in the systematic debt-client file at the balance sheet date. It includes individual customer debt balances and a breakdown of each balance over time ranges between the sale date and the balance sheet date. Testing the consistency of the details of the information included in the chronological check balance is a necessary audit procedure. As a rule, this is done before any other tests, so that the auditor ensures that the population tested corresponds to the information in the ledger and in the systematic file of customer receivables.

The total column and the columns describing the length of the claims must be summed up for verification and the total of the verification balance must be compared to that in the ledger. In addition, an evidence of individual balances should be selected to be copied with supporting documents such as the copies of the sales invoices, verifying the customer's name, balance and the correct length of the claim. The depth of the details of the tests depends on the number of accounts involved, the extent to which the systematic file has been checked in the testing of the control mechanisms. Also the substantial tests of the operations and the extent to which the recapitulative statement of claims has been audited by an internal auditor or by another independent person before being assigned to the auditor influence the depth of the details. For the calculation of totals on the balance sheet lines and columns, as well as for the recalculation of the length of the receivables, audit software applications will be used in the process.

The recorded customer trade receivables exist. The most important test of balance details to determine the existence of customer receivables is the confirmation of customer debt balances. When customers do not respond to confirmation letters, the auditors examine the delivery documents for the purpose of verifying the dispatch of the goods, as well as the supporting documents of the subsequent receipt of the counter value of the deliveries, in order to determine whether those receivables have been received. Normally, auditors do not examine delivery documents or justifications of subsequent receipts for the accounts in the evidence that have been confirmed, but these documents are widely used as alternative evidence in the case of non-response to confirmation.

Existing customer receivables are recorded. It is difficult to test customer-omitted receivables from the verification balance by a method other than the one based on the self-balancing of the systematic debt-client file. For example, if the audit client has accidentally excluded a balance sheet debt, the only way this omission can be found is to calculate the total customer-balance verification balance and compare this table to the system account balance on the ledger. If sales to a particular customer are omitted from the sales log, sub evaluation of customer receivables is almost impossible to detect through account balance details tests. For example, auditors rarely send letters confirming commercial claims to customers who have 0 balance, partly because several studies have shown little likelihood of receiving a response to requests that show that the balance of a buyer's details is underestimated. Under evaluation of sales and customer receivables is most effectively discovered through substantial tests of operations when looking for deliveries but not registered and through analytical procedures.

The customer trade receivables are accurate. The confirmation for the selected balance accounts is the most commonly used balance detail test for the accuracy of customer receivables. When customers do not respond to confirmation requests, the auditors examine the supporting documents in the same way as in the purpose of existence. Testing debtor and creditor amounts in individual customer accounts is done by examining documents that justify deliveries and receipts.

The customer trade receivables are correctly classified. Normally, it is relatively easy to assess the classification of client receivables by examining the chronological check balance and by detecting significant claims on affiliated companies to senior executives, board members and other affiliated parties. If the effects receivable or other accounts that should not be classified as current assets are included in current trade receivables, they should also be separated. Finally, if the credit balances in the client-to-customer accounts are significant, they should be reclassified as current debts. There is a close link between the objective of classification and the objective of disclosure and disclosure. The classification refers to determining whether the customer has correctly separated the different categories of customer trade receivables. The presentation and disclosure refers to ensuring that these classifications are properly presented. For example, under the classification objective, the auditor determines whether all receivables on related parties have been included in a separate category of the chronological check balance. Within the presentation and disclosure objective, the auditor determines whether the related party transactions are properly presented in the financial statements.

Balance sheet items taken into account:[2]

1. Current assets
2. Receivables

When performing the audit, special consideration is given to verifying that the receivables are correctly summed up and that the analytical evidence is in line with the synthetic register of any receivables account. Most tests applied to customer trade receivable accounts and doubtful debts provision are based on the chronologically verified balance (seniority). A chronological verification balance is a list of balances in the systematic debt-to-file file at the balance sheet date. It comprises individual customer debt balances and a breakdown of each balance over short time intervals between the date of sale and the balance sheet date. One of the auditing procedures for trade receivables that apply in practice is requesting and confirming. The auditor selects a certain number of clients to whom he requests for confirmation from their balances, but can also be confirmed with the client's specific turnover for the entire period checked. Two types of confirmations are used to confirm customer receivables:

- **Positive confirmation** –this represents the statement addressed to the debtor asking him / her to confirm directly whether the balance is correct or incorrect. There is also *positive confirmation in white* - when the debtor is not given the amount to be confirmed (considered as more reliable); or invoice confirmation – a particular invoice is confirmed and not the whole balance.
- **Negative confirmation** - this represents the statement addressed to the debtor asking for an answer only when the debtor does not agree with the said amount.

2*Auditul situaţiilor financiare în entităţile economice* – Emil Ghizari, Alexandru Rusovici, Editura „Monitorul Oficial”, Bucureşti, 2006

It is also very important to determine the size of the evidence used to confirm the customers, the tolerable error, the inherent risk (the relative volume of the total customer receivables), the control risk, the confirmation type.

If there is a difference between the data that is recorded in accounting and the data that is sent by the customer, then the differences are analyzed and the reason this has appeared for example:

- Payment has already been done by the buyer, but it has not been booked by the audited customer;
- Goods have not been received (shipping period);
- The goods have been sent back;
- Accounting booking errors;
- Under settlement amounts.[3]

Also, in trade receivables, the auditor will verify the following:

1) The existing contracts with buyers (if any), the terms of delivery and payment;

2) The list of the debtors of the enterprise;

3) The appearance date of the claim (up to 30, 90, 180 etc. days);

4) If the customers or buyers with other debts to the economic agent still release other products, commodity or service parties;

5) Check other accounts receivable, namely the advances granted, the receivables of the company's personnel etc.

IV. AUDIT EVIDENCES IN TRADE RECEIVABLE AUDITING

3surse on-line

Section A: Participation at the stock inventory	When stock inventories are important and relevant for the financial statements, the auditor should obtain adequate and sufficient audit evidence of their existence and status by participating in the stocks inventory. If the auditor is unable to participate in stock inventories at the scheduled date due to unforeseen circumstances, he or she must take part or observe inventories at a later date and, if necessary, perform transaction tests that have taken place between time. Where the auditor's involvement in stocks inventory is not possible due to factors such as nature and location, the auditor should assess whether other alternative procedures provide adequate and sufficient audit evidence about the existence and condition of inventories to conclude that he does not need to do references to a limitation of the scope of applicability.

Section B: Confirmation of trade receivables	When the trade receivables are important and relevant for the financial statements and when it is reasonably expected that the debtors will respond to the confirmation request, the auditor should ordinarily plan to obtain direct confirmation of the receivables or accounting records in a particular account. When it is estimated that the debtorswill not respond to the confirmation request, the auditor should plan alternative procedures. If no positive confirmation response is received, alternative procedures should be applied or the case should be treated as an error. When the entity's management asks the auditor not to confirm certain balances of the receivables accounts, the auditor should consider whether there are serious reasons for such a claim. Before accepting a denial as justified, the auditor should examine any evidence available to support the management's explanations. In these cases, the auditor should apply alternative procedures to accounts receivable that are not subject to confirmation.

Section C: Investigation regarding litigations and claims for receivables	The auditor should perform the necessary procedures to become aware of any litigation or claim involving the entity that may have a material effect on the financial statements. When litigation and claims have been identified or when the auditor believes they can exist, they must establish a direct communication with the entity's lawyers. The letter to be drafted by the entity's management and sent by the auditor must ask the lawyer to communicate directly with the auditor. If the management refuses to allow the auditor permission to communicate with the entity's lawyers, this will be considered a limitation of activity and will ordinarily lead to a qualified opinion or the inability to express an opinion.
Section D: Evaluating and presenting long-term investigations	When long-term invitations are important and relevant to the financial statements, the auditor should obtain adequate and sufficient audit evidence regarding their valuation and presentation
Section E: Informations on key parts	When informations on key parts are important and relevant to the financial statements, the auditor should obtain adequate and sufficient audit evidence about their presentation in accordance with the applicable financial reporting framework.

IV. CONCLUSIONS

Keeping an eye on the trade receivables for a company should be a priority, and the management should give a great importance and keep a close watch on them. The manner in which the deadlines are met and the cash receivables are debited depends on the company's future evolution.

Thus, a responsible must be named in each company or a department should exist that tracks the collection, the payment deadlines, and the detection of potential bad customers. This department must be organized in such a way as to provide all the necessary information for taking measures to stop or eliminate uncollected claims.

The designated internal auditor should identify, through various methods and techniques, possible irregularities and present them to the management team in order to make decisions to improve the better recovery of trade receivables.

During his audit at a company, the auditor will investigate using special techniques and he will search for different evidences that can show what is happening at a company and how the trade receivables are being handled. After finishing his investigations, the auditor will present the management team his findings and also the proposed solutions that can help a company manage and track better the trade receivables.

Bibiografie

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