CHAPTER 11

Accounts Receivable, Notes Receivable, and Revenue

Review Questions

11–1 The term "customer's order" refers to the purchase order received from a customer. The term "sales order" refers to the document created upon receipt of a customer's order. The sales order is a translation of the terms of the customer's order into a set of specific instructions for the guidance of various departments, including the credit department, finished goods, stores, shipping, billing, and accounts receivable.

11–2 The audit of revenue and receivables is of significant audit risk because (1) overstatement of revenue has been a factor in many instances of fraudulent financial reporting, (2) the overstatement of revenue results in a corresponding overstatement of net income, (3) the determination of the amount of revenue recognized may be determined by the application of complex accounting principles, and (4) significant accounting estimates may be involve in the determination of the financial statement presentation of receivables and revenue.

11–3 Good internal control in the billing process requires that someone other than the employee preparing the invoice shall review the accuracy of prices, credit terms, and other data on the invoice before this document is released.

11–4 The objective of the billing process is to notify the customer of the amount due for goods or services delivered. A most important document created by the billing department is the sales invoice. The original is sent to the customer, and copies are used to record accounts receivable and sales.

11–5 The statement is incorrect. Credit memoranda are used to credit (reduce) accounts receivable when goods sold on credit are being returned, or when a defect in the goods justifies a price reduction. Credit memoranda are not issued to remove uncollectible accounts receivable from the records. Such write-off of worthless receivables is handled by a general journal entry debiting the Allowance for Doubtful Accounts and crediting Accounts Receivable.

11–6 The sales invoices (and the shipping documents as well) should be serially numbered. When each day's invoices are transmitted from the billing department to the accounts receivable department, they should be accompanied by a transmittal list showing the serial numbers of all sales invoices. Every number in the series should be accounted for. If a computer is used to record sales invoices item counts and control totals should be used to ensure that all sales are recorded.
11–7 The statement is correct in suggesting that voided shipping documents should be cancelled. However, they should be retained, and not discarded so as to assure that the numerical sequence may be accounted for.

11–8 All sales invoices should be serially numbered. Each day the billing department should send copies of the invoices prepared that day to the accounts receivable department accompanied by a transmittal letter specifying the invoice numbers used and the total dollar amount billed. By comparing the individual invoices with the list of serial numbers and comparing the total debits to accounts receivable with the total figure for billings, the accounts receivable department can be sure that it has received and recorded all sales invoices.

11–9 Other specific procedures which contribute to good internal control over the business processes related to accounts receivable include (only three required):

(1) The separation of the duties of the accounts receivable accountant from all cash handling functions.

(2) Regular balancing of the subsidiary ledger of receivables with the general ledger control account by an employee other than the accounts receivable accountant.

(3) Regular aging of accounts receivable and review by management.

(4) Periodic review of delinquent accounts by an appropriate executive.

(5) Periodic confirmation of accounts receivable by internal auditors.

(6) Serial numbering of shipping documents, sales invoices, and credit memoranda, and regular accounting for all numbers in the series.

11–10 The auditors should confirm with the bank the loss contingency for notes receivable discounted. The auditors also should send separate confirmation requests to the makers of the notes receivable that were discounted to determine the genuineness and validity of the notes.

11–11 The write-off of small notes receivable from officers, directors, stockholders, or affiliated companies is obviously irregular and unacceptable practice. Such notes are almost always collectible by virtue of the positions held by the makers. The auditors should investigate these related party transactions fully; they will probably find that the charges to the allowance for uncollectible notes were made in error and were not authorized by management. If the amounts were large, there would be more reason to suspect an intention of self-serving activities or fraud on the part of the management.

11–12 Among the audit procedures commonly applied to notes receivable but not to accounts receivable are the following:

(1) Verification of interest earned and accrued interest receivable.

(2) Examination of the note.

11–13 The client company should request (on its letterhead) the customer to confirm the account receivable. The auditors have no authority to make such a request directly on their stationery. The return envelope should be addressed to the auditors' office to assure that the auditors have control over confirmation returns.
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11–14 The audit objective of determining the existence of receivables is most directly addressed by the audit procedure of confirming accounts receivable and notes receivable by direct communication with debtors. In addition, written confirmation also addresses the completeness and valuation assertions, but less effectively because it deals only with recorded accounts and provides limited information on whether the receivable is collectible. The procedure also provides evidence of occurrence and accuracy of revenue transactions.

11–15 If the auditors find post office box addresses for many individual customers whose accounts were selected for confirmation, the auditors should consider the possibility that the customers may be fictitious, and that dishonest employees of the client company plan to "answer" the confirmation requests.

11–16 Alternative auditing procedures to verify accounts receivable when confirmation is not practicable or possible include examination of customers' purchase orders or contracts; examination of client's duplicate shipping documents and invoices; and review of payments received from customers subsequent to the balance sheet date.

11–17 Alternate auditing procedures that may be used when customers have not replied to confirmation requests include:

(1) Send additional requests by registered or certified mail, with return receipt requested.

(2) The auditors might telephone to ascertain the balance or the reason for failure to respond to the written request.

(3) Under some circumstances, requests may be made by fax machine.

(4) The auditors may examine any payments to the account made subsequent to the balance sheet date. The auditors may also examine the duplicate invoices, shipping records, purchase orders, and so on, for transactions making up the unpaid balance.

11–18 To test the client's sales cutoff at June 30, the auditors should compare shipping records with entries in the sales journal, and receiving records with entries recording sales returns, for several days prior to and subsequent to June 30. The auditors will be alert for sales and sales returns recorded in the wrong accounting period.

11–19 An unusually large number of sales transactions just prior to the balance sheet date should be fully investigated by the auditors. This situation may result from a strenuous effort made during the closing days of the period to get out shipments and meet a sales quota. On the other hand, it may reflect an improper cutoff of sales transactions at year-end, or even the recording of fictitious sales. In any event, the auditors' investigation should include matching of sales invoices with shipping documents and customers' orders, and discussions with executives. Careful analysis of sales returns during the succeeding period may also shed light on the situation.

11–20 Excessive sales returns or allowances may indicate shipments made without customers' orders, shipments of defective merchandise, a misstatement of inventory or of sales and receivables, or weaknesses in internal control. One purpose of a review of sales returns and allowances subsequent to the balance sheet date is to uncover any facts that necessitate adjustment of inventories, receivables, or sales in the statements being audited. Another purpose is to test internal control effectiveness.
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11–21 The credit memoranda should bear the date and serial number of the receiving report on the return shipment. The credit memoranda selected by the auditors for testing can be compared with records of the receiving department to determine that goods were actually returned.

11–22 In testing the adequacy of the client company's allowance for doubtful accounts receivable, the auditors review the following:

(1) Large past-due accounts not paid subsequent to the audit date.

(2) An aged trial balance of accounts receivable and comparison with those of prior years.

(3) Accounts in dispute as evidenced by confirmation exceptions or by correspondence in the client's files.

(4) Unfavorable reports of collection prospects on accounts assigned to collection agencies or attorneys.

(5) Opinions of the client's credit manager as to the collectible portion of each large past-due account.

(6) Relationship of the valuation allowance to (a) accounts receivable, (b) net credit sales, and (c) accounts written off during the year. These ratios should be compared with those prevailing in past years and industry averages.

(7) Information from a retrospective review of prior year’s allowance that indicates whether management might bias its estimates.

11–23 Examples of types of receivables originating without arm's-length bargaining include loans to insiders (directors, officers, key employees) and loans to affiliated companies. These types of receivables should be shown separately with disclosure of the nature of the relationships and the amounts of the transactions.

11–24 A retrospective review is an analysis of the judgments and assumptions underlying a prior year accounting estimate. With hindsight the auditors can evaluate whether there appears to be any management bias in the prior year estimate. The purpose with respect to revenue is to provide information about possible management bias to assist in the audit of the current year revenue estimates.

Questions Requiring Analysis

11–25 a. According the SEC Staff Accounting Bulletin No. 104 the following criteria must be met for revenue to be recognized:

- Persuasive evidence of an arrangement (contract) exists,
- Delivery has occurred or services have been rendered,
- The seller’s price to the buyer is fixed or determinable, and
- Collectibility is reasonably assured.

b. To overstate revenue the following techniques might be used by Processing Solutions’ management (only two required):

1. Recording of fictitious contracts with customers.
2. Recording revenue before a contract is executed.
3. Recording revenue when the company has entered into side agreements with the customers that affect the realization of revenue (e.g., allowing liberal return privileges).

4. Allocating excessive amounts of revenue to the delivery and set-up of the system to recognize revenue early.

c.  

<table>
<thead>
<tr>
<th>Overstatement Technique</th>
<th>Audit Procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Recording of fictitious contracts with customers.</td>
<td>- Confirmation of contracts with customers. Inquiries of salespeople about contracts.</td>
</tr>
<tr>
<td>2. Recording revenue before a contract is executed.</td>
<td>- Inquiries of salespeople about contract execution dates.</td>
</tr>
<tr>
<td>3. Recording revenue when the company has entered into side agreements with the customers that affect the recognition of revenue (e.g., allowing liberal return privileges).</td>
<td>- Confirmation of contract terms with customers, including the existence of any side agreements.</td>
</tr>
<tr>
<td>4. Allocating excessive amounts of revenue to the delivery and set-up of the system to recognize revenue early.</td>
<td>- Inquiries of salespeople about oral modification of contract terms and side agreements.</td>
</tr>
</tbody>
</table>

11–26 a. When a company engages in bill and hold transactions there is a possibility that the company is inappropriately recognizing revenue. The auditors must ascertain that any transactions recognized as sales meet the criteria for revenue recognition as set forth in SEC Accounting and Auditing Enforcement Release No. 108. In these circumstances, the auditors will review the provisions of sales contracts and consider confirming the terms with customers.

b. When a company sells using a multiple element arrangement, the revenue must be allocated to the elements in relation to their fair values. Therefore, there is a possibility that management may attempt to misstate revenue by inappropriate allocation. In these situations, the auditors will review the sales contracts and evaluate the reasonableness of management’s allocation of the revenue to the various elements.

c. When a company uses the percentage-of-completion method, there is a risk that management may misestimate the amount of revenue earned on uncompleted contracts. The auditors must carefully evaluate the costs allocated to the contracts and the estimates of the percentage-of-completion. In some cases, the auditors may decide to engage a specialist, such as an engineer.

d. When a company’s sales agreements allow for returns, there is a risk that management may
misstate the estimate of sales returns and, therefore, misstate revenue and receivables. In these situations, the auditors should carefully review the contracts to determine that revenue should be recognized at the time of sale. If revenue recognition is appropriate, they should next evaluate the adequacy of management’s estimate of sales returns.

e. When salespeople modify the terms of sales through various side agreements and issue may arise as to whether any particular sale meets accounting criteria to be recorded as such, and whether the allowance for returns needs to be adjusted.

11–27 a. An audit confirmation request is a written communication received by the auditors directly from a party outside the client organization. The written communication usually affirms the existence of, and rights to, an amount recorded in the client’s accounting records.

b. To be valid evidence, an audit confirmation response must be received directly by the CPA firm from the outside party who has replied to the confirmation request.

c. A positive confirmation request requires a reply from the client’s customer in every case. A negative confirmation request requires a reply only if the balance for which confirmation has been requested is incorrect.

d. Negative confirmation requests may be used for situations in which (1) the combined assessed level of inherent and control risk is low; (2) a large number of small balances are involved; and (3) the auditors have no reason to believe that the recipients of the requests are not likely to give them consideration.

11–28 The confirmation requests should go to the makers of the notes regardless of whether the notes have been discounted. The act of discounting a note receivable does not reduce the importance of the note being genuine and collectible. A company that discounts its notes receivable remains in a position of sustaining a loss if the makers of the notes fail to make payment at the maturity dates.

11–29 Confirmation of accounts receivable by direct communication with debtors is usually essential to the issuance of an unqualified audit report. Confirmation of receivables is a presumed procedure, and failure to perform such a procedure when issuing an unqualified report requires justification in the working papers. The auditors must generally disclaim an opinion on the client’s financial statements when they have been forbidden by the client to confirm receivables.

11–30 a. When confirmation requests are mailed to debtors whose accounts were written off as uncollectible, the auditors’ purposes are to determine that the receivables were genuine when they were first recorded in the accounts and to determine that the accounts were not collected and the proceeds stolen. In some fraud cases, fictitious accounts receivable have been created to cover up a shortage. Eventually these fictitious receivables must be disposed of; one method is to write off the fictitious accounts as uncollectible. In other cases, valid accounts receivable have been collected, but written off as uncollectible by the employee who has procured the funds.

b. The Solar executive appears to believe the auditors are solely concerned with the valuation or collectibility of accounts and notes receivable. In fact, the confirmation process is primarily intended to establish that the receivables are valid and that the customers (or makers of notes) exist. Other audit procedures are followed to determine proper valuation.
11–31 Conn should consider applying the following additional substantive audit procedures:

1. Test the accuracy of the aged accounts receivable schedule.
2. Confirm receivables.
3. Review the year-end cutoff of sales transactions.
4. Perform analytical procedures.
5. Review significant year-end sales contracts for unusual terms.
6. Evaluate the propriety of the client’s accounting methods for receivables.
7. Determine the adequacy of the client’s allowance for uncollectible accounts.
8. Ascertain whether any receivables have been pledged.
9. Investigate any transactions with or receivables from related parties.
10. Evaluate the business purpose of significant and unusual sales transactions.
11. Evaluate financial statement presentation and disclosure.

11–32 In testing the aging of accounts indicated as past due, the assistant indeed verified the aging of those accounts. However, the assistant completely neglected the accounts indicated as current on the client-prepared trial balance. Any number of "current" accounts might in reality be past due. By ignoring a significant number of individual accounts, the assistant was deficient in the test and had no basis whatsoever for reporting to the senior auditor that the client's aging work was satisfactory.

11–33 The answer to this question will vary with the nature of the company that the students select. However, almost universally these companies use the percentage-of-completion method for at least a portion of their revenues. This obviously presents the auditors with the risk that management’s estimates of cost to complete a project will not be reasonable, and revenue will be prematurely recognized.

11–34 a. When the auditors identify a risk as being significant and requiring special audit consideration, they must:

1. Evaluate the design of the related controls and determine that they have been implemented;
2. Not rely solely on analytical procedures to address the risk; and
3. Not rely on evidence obtained from prior audits regarding the operating effectiveness of the related internal controls.

b. Examples of ways that Nelson may react to this particular risk include (only one):

1. Confirm the terms of sales contracts with selected customers.
2. Examine a larger sample of sales contracts.
3. Make expanded inquiries of sales personnel regarding the terms of contracts.
Objective Questions

11–35 Multiple Choice Questions

a. (4) Over-recorded sales due to a lack of control over the sales entry function relates to control risk not inherent risk. The other three replies all relate to inherent risk.

b. (4) Answer (4) is correct because receivables are valued at net realizable value, and assessing the allowance for uncollectible accounts for reasonableness will help the auditor determine the proper amount. Answer (1) is incorrect because the limited information in the accounts receivable ledger will not make possible tracing details to the shipping documents—also, the shipping documents may not even capture the total sales price that is included in the accounts receivable ledger. Answer (2) is incorrect because while comparing turnover ratios may provide some information on the collectibility of receivables, it is very imprecise. Answer (3) is incorrect because it relates to presentation and disclosure more directly than valuation.

c. (4) A sale either shouldn’t be recorded, or a proper allowance for returns should be established when a customer is likely to return the goods. Thus, simply recording the sale is an example of fraudulent financial reporting when the customer is likely to record the goods. Answers (1) and (3) are examples of errors, while answer (2) is an example of misappropriation of assets.

d. (4) Theft of cash register sales is an example of misappropriation of assets. Answer (1) is an example of an error while answers (2) and (3) are examples of fraudulent financial reporting.

e. (1) A presumption that receivables will be confirmed requires a combined assessment of inherent risk and controls risk at the low level, immaterial receivables, or circumstances in which the use of confirmations would be ineffective.

f. (2) Answer (2) is not among the criteria because of the portion of the answer that states “scheduled to occur in the near future.” Ordinarily delivery must have occurred. Answers (2), (3) and (4) all describe circumstances required to recognize revenue.

g. (1) The goal is to determine the population to be sampled from to determine that all sales have been recorded; therefore, the sample should be taken from a population of source documents, here the shipping documents file. None of the other three answers represent source documents that may be sampled from to determine that all sales have been recorded.

h. (4) Detecting overstated sales is a primary reason the auditors' review of a client's sales cutoff. For example, shipments made in the first part of January may be improperly included in the December sales total.

i. (3) The objective is to determine the population the auditors would sample from to test the existence assertion for recorded receivables. The direction of testing should be from the accounts receivable subsidiary ledger to the available support, such as sales invoices, bills of lading, sales orders, and customers' orders.

j. (2) Comparing shipping documents to related sales invoices addresses the completeness assertion relating to sales. More specifically, it addresses whether all items that have been shipped have been recorded as sales.
k. (1) The auditor would send positive confirmations rather than negative confirmations because the fact that the balances are delinquent may indicate that amounts are in dispute. Examining subsequent cash receipts, answer (3), is unlikely to be effective since many of the accounts will not have been collected. Inspection of internal records, answer (4), is likely to result in less credibility evidential matter than confirming the accounts.

k. (1) Write-offs of receivables should be approved by a responsible officer after a review of the account by the credit department. Answer (2) is incorrect because accounts receivable, a recordkeeping function, should not authorize such entries. Answer (3) is incorrect because other procedures (e.g., a review of shipping documents) may be used to determine that the goods were received and because the shipping department would have no other information on whether the receivable is likely to be collectible. Answer (4) is incorrect because the account need not be overdue by several months as a "current" receivable may become worthless due to, for example, a bankruptcy.

11–36 Adapted AICPA Task Based Simulation

<table>
<thead>
<tr>
<th>Procedure</th>
<th>Audit Procedure</th>
<th>Classification of Audit Procedure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Requested responses directly from customers as to amounts due.</td>
<td>(2)</td>
<td>(9)</td>
</tr>
<tr>
<td>Compared total bad debts this year with the totals for the previous two years.</td>
<td>(1)</td>
<td>(9)</td>
</tr>
<tr>
<td>Questioned management about likely total uncollectible accounts.</td>
<td>(3)</td>
<td>(9)</td>
</tr>
<tr>
<td>Watched the accounting clerk record the daily deposit of cash receipts.</td>
<td>(6)</td>
<td>(10)</td>
</tr>
<tr>
<td>Examined invoice to obtain evidence in support of the ending recorded balance of a customer.</td>
<td>(4)</td>
<td>(9)</td>
</tr>
<tr>
<td>Compared a sample of sales invoices to credit files to determine whether the customers were on the approved customer list.</td>
<td>(8)</td>
<td>(10)</td>
</tr>
<tr>
<td>Examined a sample of sales invoices to see if they were initialized by the credit manager indicating credit approval.</td>
<td>(4)</td>
<td>(10)</td>
</tr>
</tbody>
</table>
11–37 Adapted AICPA Task-Based Simulation

<table>
<thead>
<tr>
<th>Customer Reply (and any audit action already taken)</th>
<th>Proper Action</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. “We mailed the check for this on December 31.”</td>
<td>(3)</td>
</tr>
<tr>
<td>b. “We returned those goods on December 2.” You have been able to determine that the goods were received by the client on December 29, but not recorded until January 2.</td>
<td>(1)</td>
</tr>
<tr>
<td>c. “We also owe for two more invoices for purchases we made around year-end, I’m not sure of the exact date.”</td>
<td>(4)</td>
</tr>
<tr>
<td>d. “We are very satisfied with Jelco and plan to purchase from them in the future.”</td>
<td>(5)</td>
</tr>
<tr>
<td>e. “While that’s what we owe, we didn’t owe it on December 31 since we didn’t receive the goods until January 2 of year 2.”</td>
<td>(3)</td>
</tr>
<tr>
<td>f. You received no reply to a negative confirmation request to Adams Co.</td>
<td>(5)</td>
</tr>
<tr>
<td>g. You received no reply to a positive confirmation request to Blake Co. Subsequently you recalled that Blake Co. has a policy of not responding to confirmations—in writing or orally.</td>
<td>(3)</td>
</tr>
</tbody>
</table>

11–38 Adapted AICPA Task-Based Simulation

a. Neither
b. Strength
c. Strength
d. Deficiency
e. Neither
f. Deficiency
g. Deficiency
h. Deficiency
i. Deficiency
j. Strength
k. Strength
l. Strength
m. Strength
n. Strength

11–39 Adapted AICPA Task-Based Simulation

a. **C.** Invoices posted to incorrect customer accounts will be detected by analyzing customer responses to monthly statements that include errors, particularly statements with errors not in favor of the customer.

b. **G.** The comparison of shipping documents with sales invoices will detect goods that have been shipped but not billed when no sales invoice is located for a particular shipping document.
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c. F. To provide assurance that all invoiced goods that have been shipped are recorded as sales, daily sales summaries should be compared with invoices. For example, a sale that has not been recorded will result in a sales summary that does not include certain sales invoices.

d. K. A comparison of the amounts posted to the accounts receivable ledger with the control total for invoices will provide assurance that all invoices have been posted to a customer account.

e. I. Comparing customer orders with an approved customer list will provide assurance that credit sales are made only to customers that have been granted credit.

f. B. Requiring an approved sales order before goods are released from the warehouse will provide assurance that goods are not removed for unauthorized orders.

g. D. A comparison by shipping clerks of goods received from the warehouse with the approved sales orders will provide assurance that goods shipped to customers agree with goods ordered by customers.

h. L. A comparison of sales invoices with shipping documents and approved sales orders will detect invoices that do not have the proper support. Accordingly, it will help prevent the recording of fictitious transactions.

i. P. Comparing amounts posted to the accounts receivable ledger with the validated bank deposit will detect improper postings to accounts receivable since any differences in amounts will be investigated.

j. C. Misappropriations of customers’ checks will be detected when customers indicate that they have made payments for items shown as payable on their monthly statement. Note that replies O and P will only detect this misappropriation in the unlikely event that the perpetrator does not dispose of the remittance advice.

k. C. Mispostings of payments made will be detected when customers indicate that they have made payments for items shown as payable on their monthly statement.

l. P. Crediting more than one account for a cash receipt will be detected when the total of amounts posted to the accounts receivable ledger is compared with the validated bank deposit slip.

m. S. An independent reconciliation of the bank account will reveal improper total recording of receipts in the cash receipts journal because unallocated differences between bank and book balances will occur and be investigated.

n. P. Comparing total amounts posted to the accounts receivable ledger with the validated bank deposit slip will detect a difference between total cash receipts and the amount credited to the accounts receivable ledger.

o. N. Requiring the approval of the supervisor of the sales department for goods received will provide assurance that invalid transactions granting credit for sales returns are not recorded. Note that using prenumbered credit memos (reply M) will only be effective if the sequence is accounted for and if credit memos may be compared in some form to actual returns.

11–40
a. Correct.
b. Incorrect.
c. Correct.
d. Correct.
e. Incorrect.
f. Correct.
g. Incorrect.
h. Correct.
i. Incorrect.
j. Incorrect.

11–41 Simulation
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a. (2) Answer (2) is correct because vouching sales recorded in January 20X9 will provide evidence on whether sales made prior to year-end are properly included in 20X8.

b. (4) Answer (4) is correct because a review of the aged trial balance for significant past due accounts will provide evidence on how much is expected to be realized on receivables.

c. (2) Answer (2) is correct because vouching sales recorded in January will reveal whether December sales were improperly recorded in January.

d. (3) Answer (3) is correct because vouching sales recorded in November will reveal whether those sales are properly recorded.

e. (7) Answer (7) is correct because a review of drafts of financial statements will help assure that presentation and disclosure of receivables is adequate.

f. (3) Answer (3) is correct because vouching a sample of sales supporting receivables from the year will best address the accuracy of receivables. Of the options listed, vouching November sales is best.

Problems

11–42 SOLUTION: Halston Toy Manufacturing Co. (Estimated time: 15 minutes)

a. Due to the fact that Halston has a number of new products and a liberal return policy, it may be very difficult to estimate the allowance for sales returns. With new products it may be difficult to use prior return history to estimate the amount of returns.

b. The auditors might consider performing the following procedures:

(1) Review any trade journals and industry data that might have information relevant to sales of the new products.
(2) Review trends in sales returns in prior periods, especially when new products were introduced.
(3) Make inquiries of sales personnel about customer feedback on sales of the new toys.
(4) Review sales returns given in the subsequent period and compare the amounts to prior periods.

11–43 SOLUTION: Internal Control, Tests of Controls, Substantive Procedures (Estimated time: 20 minutes)

a. (1) Checking the clerical accuracy of invoices is a procedure that is designed to improve the accuracy of customer billings and, therefore, the accuracy of sales and accounts receivable.
(2) Accounting for prenumbered shipping documents is a procedure that is designed to reduce the risk of unbilled shipments to customers. Thus, the procedure serves to insure that all sales and accounts receivable are recorded.
(3) Approval of credit prior to shipment reduces the risk of sales to customers in amounts in excess of their credit limits. The procedure helps to prevent excessive credit losses.
b. (1) Clerical checking of invoices could be tested by examining a sample of sales invoices processed throughout the year for indication (e.g., the checker's initials) of performance of the procedure. Of course, the auditors should verify the clerical accuracy of the sample invoices themselves to obtain evidence that the checker effectively performed the procedure.

(2) Accounting for prenumbered shipping documents might be tested by reviewing the numerical file of shipping documents (typically maintained in the billing department) for missing items.

(3) Adherence to credit approval procedures could be tested by examining the documentation of a sample of transactions processed throughout the year, noting that the credit approval date is before the date of shipment.

c. (1) Failing to check the clerical accuracy of sales invoices results in an increased probability of errors in sales and accounts receivable. The auditors might compensate by increasing the number of accounts receivable selected for confirmation, or by shifting the confirmation date from an interim date to year-end. Also, analytical procedures applied to the client's sales or gross margin might provide evidence that sales are not materially misstated. For example, monthly sales for the year under audit could be compared to forecasted amounts or similar amounts from prior years.

(2) Lack of control over shipping documents may result in an understatement of sales and accounts receivable. To test for this understatement the auditors could select a sample of shipping documents processed during the year and trace the details to a recorded sales transaction. Again, analytical procedures for sales or gross margin percentages might provide an indication of whether sales are understated by a material amount.

(3) When credit approval is not obtained prior to shipment of goods, the amount of uncollectible account expense as a percentage of sales is not likely to be as stable. Thus, loss percentages of prior years are less useful in testing the adequacy of the current year's allowance for doubtful accounts. To compensate, the auditors might examine more credit information for specific accounts, especially for those that are larger in amount or past due.

11–44 SOLUTION: Martin Mfg. Co. (Estimated time: 30 minutes)

The journal entry recording Martin's sale of land to Ardmore is not acceptable, for it fails to recognize the discount implicit in the transaction. The fair value of the note receivable from Ardmore is not $550,000; because Ardmore refused to pay more than $770,000 principal and interest. By acquiescing to an 8 percent interest rate, Martin's management tacitly acknowledged that the fair value of the land was less than the $550,000 face amount of the note. The auditors should propose the following adjusting entry as of March 31, 20X0:

- Gain on Sale of Land 50,000
- Loss on Sale of Land ($500,000 – $436,590) 63,410
- Discount on Note Receivable ($550,000 – $436,590) 113,410

To correct entry recording sale of land to Ardmore Corp. Note receivable from Ardmore ($550,000) has a present value of $436,590 when its $770,000 maturity value is discounted at 12 percent; as a result a loss of $63,410 ($500,000 cost less $436,590 fair value of note) was realized on the sale.

11–45 SOLUTION: Granite Corporation (Estimated time: 15 minutes)
(1) A contingent liability of $50,000 exists with respect to the discounted 60-day note from the customer of unquestioned financial standing and this contingency should be disclosed by a note to the balance sheet.

(2) The contingent liability to the bank for the $60,000 note receivable discounted should be disclosed by a note to the financial statements. This disclosure should include a statement of the intention to make an advance of $80,000 to the affiliate from which the affiliate will make payment of the present note to the bank. The disclosure should also describe the relationship between the two companies.

(3) The $20,000 note from the former executive appears to be worthless and the loss should be recognized and reflected in the financial statements. In this case, the liability to the bank is not really of a contingent nature since all available information indicates that Granite Corporation will have to make the payment. Consequently, a current liability should be included in the balance sheet to show the anticipated payment to the bank.

11–46 SOLUTION: Aerospace Contractors, Inc. (Estimated time: 20 minutes)

a. AEROSPACE CONTRACTORS, INC.
Partial Balance Sheet
July 31, 20X0

Current Assets:
Accounts receivable:
  Commercial, less allowance
    for uncollectible accounts $75,000 $  542,000
  U.S. government, including $320,000
    claims under terminated contracts 3,502,000

Other Assets:
Due from Harwood Co., investee 480,000

b. The claims receivable from public carriers and the trade notes receivable are immaterial, and may be included with commercial accounts receivable. The allowance for doubtful accounts and notes relates to the commercial accounts and trade notes, since receivables from the U.S. government are collectible. Receivables from the U.S. government are of sufficient materiality to warrant presentation. Since the termination claims are different from the regular receivables and are themselves material, they should be disclosed.

   The amount due from the investee should be shown separately because it is a related party receivable. It also may need to be classified as a noncurrent asset, since it may be collected at the convenience of the borrower.

In-Class Team Case

11–47 SOLUTION: Wellington Sales, Inc. (Estimated time: 30 minutes)

# 5 Zimber should determine that the check was deposited on December 28 by examining the supporting documentation (e.g., entry in cash receipts journal, deposit ticket, bank statement). He should also determine (1) that the error has been corrected, (2) why the account was recorded improperly, and (3) whether it is indicative of broader problem. This account should have had a balance of zero as of year-end.

#22 Zimber should determine whether these goods were ever shipped, and if so, whether they have been returned. The existence (or nonexistence) of a shipping document will in this case
provide a starting point for the analysis. It seems likely that the balance of the account should be zero, but, prior to performing the above procedures, this is uncertain.

#47 Zimber should send a second request to The Big Edge. This second request should include individual invoice numbers and amounts. It might also be helpful to send copies of the invoices themselves. Another option here is to examine shipping documents and subsequent cash receipts. At this point, no evidence on the proper balance has been collected.

#51 Zimber should determine whether (and when) the check was received and recorded in the cash receipts journal. If it was received after year-end, the account is a valid receivable as of December 31.

#62 Zimber should determine Pibson Gonker Corporation's address. This may be available, for example, from the purchase order Pibson sent initiating the order. Zimber might wish to further examine the propriety of this address through various databases on the Internet. While the return of a confirmation request such as this might simply be due to misprocessing the address, it might also have resulted from the company going out of existence or never having existed in the first place. The proper balance is very much in question, although it may well be found to be proper.

#68 Zimber should simply determine that the check was received early in January. The balance of $66,000 has been confirmed without exception.

#72 While this receivable would seem to be confirmed without exception, the note might lead the auditors to an investigation of whether the right of return on these and other goods is typical for the industry and whether any sort of allowance for returns is necessary.

#77 Zimber should examine the terms of the documents supporting the transaction to determine whether this is a sale or a consignment. If it is a sale, it represents a receivable, although the customer's misunderstanding may cause the auditor to question whether an allowance for returns is necessary. If it is a consignment, the transaction should be recorded at cost with a debit to Consigned Inventory and a credit to Inventory—in such case the receivable is misstated.

#79 Zimber should consider the terms of shipment to determine whether a valid sale has occurred. For example, if goods were shipped "FOB shipping point" on December 31, or before, the receivable is properly recorded as of year-end. If shipped "FOB destination" no sale should be recorded until the customer receives the goods. Students will probably have learned about shipping terms in prior classes; the information is subsequently presented in this text in Chapter 13. The only real knowledge necessary is that for transactions such as this title ordinarily passes as follows:

   FOB shipping points—title ordinarily passes when the goods are shipped.
   FOB destination—title ordinarily passes when the goods are received by customer.
Ethics Case

11–48 SOLUTION: Universal Air (Estimated time: 20 minutes)

a. Issues related to each of the justifications include:

- This explanation may be acceptable if the auditor has reasonable assurance that no material misstatement is likely to exist. Any unrecorded liability relating to these flights at year-end must be immaterial in order to justify the treatment.

- While booking the sale may be critical, the service provided by this company is transportation. Conceptually, the revenue should not be recognized before the flight.

- The difficulty of obtaining the information does not justify a departure from GAAP that materially distorts results.

b. While under circumstances of relatively small changes in sales one might expect an “averaging out” to occur, there seems to be no reason to expect this to be so when sales are up 30 percent as compared to the previous year. How significant the 30 percent change is depends upon the dollar amount of advance sales.

c. To determine whether this averages out, one approach is to randomly select a sample of sales late in each year (depending upon how far in advance passengers typically book tickets) and attempt to determine whether they approximate one another. Also, an estimate might be based on number of reservations booked in the new year if it is possible to efficiently capture that information from the preceding year (which seems doubtful). Using that approach one still needs to make an estimate of revenues related to the bookings. Another approach, that might or might not be possible, is to obtain assistance from the sales department (reservation department). For example, the sales department could have helpful reports that could help the accountant to make an estimate of sales for next year’s flight.

11–49 SOLUTION: Universal Air II (Estimated time: 20 minutes)

a. A significant deficiency is a deficiency that adversely affects the company’s ability to initiate, authorize, record, process, or report external data reliably in accordance with generally accepted accounting principles, such that there is more than a remote likelihood that a misstatement of the company’s financial statements, which is more than inconsequential will not be prevented or detected. This does not appear to be a significant deficiency. If the auditor considers it a significant accounting policy it should be communicated to the audit committee.

b. There is no requirement to report it elsewhere. It is doubtful that this policy is illegal. If material refunds are expected an allowance for sales returns type entry might be necessary.

c. The policy might cause one to question the integrity of the firm’s management. It also seems shortsighted as the airline’s success must in part be due to repeat customers. Future customer or press awareness of this policy is not likely to have a positive impact on sales.

Other issues that might be addressed include:

(1) Discuss the somewhat incomplete nature of auditor responsibilities in a case such as this. The client’s policy does not seem ethical, and one might question what other similar policies
(2) What response is appropriate if the accountant’s assistant, Jane McClain, believes that someone should be informed or, at a minimum, the financial statements should include a note regarding the policy. Arguments for such a note would be that it is a significant accounting policy or that a possible contingent liability exists. Both of these seem doubtful.

(3) In recent years, auditors have increasingly attempted to provide value-added services to clients in addition to the audit itself. The problem described in this case is a flaw in the client’s business process and should be brought to the attention of management.

Chapter 11 Appendices

Audit Case Exercises

11A–1 KCN Revenue Cycle Controls (Estimated time: 20 minutes)

a. Sales controls:

<table>
<thead>
<tr>
<th>Control</th>
<th>Error or Fraud Controlled</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Application controls are applied when customer orders are entered by the sales order clerk.</td>
<td>Controls errors in the delivery and billing of sales transactions.</td>
</tr>
<tr>
<td>2. The computer assigns numbers to sales invoices when they are prepared.</td>
<td>Controls the recording of sales to ensure completeness.</td>
</tr>
<tr>
<td>3. Monthly statements are mailed to customers.</td>
<td>Controls the recording of fictitious sales and inaccurate sales to customer accounts.</td>
</tr>
</tbody>
</table>

b. Cash receipts controls

<table>
<thead>
<tr>
<th>Internal Control Procedure</th>
<th>Error or Fraud Controlled</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Cash receipts are prelisted by the receptionist.</td>
<td>Controls errors in the recording of cash and controls the abstraction of cash.</td>
</tr>
<tr>
<td>2. The accounting manager reconciles control totals generated by the accounts receivable computer program.</td>
<td>Controls the embezzlement of cash receipts and errors in and incomplete postings to accounts receivables records.</td>
</tr>
<tr>
<td>3. The computer summaries of cash collections and cash sales are reconciled to prelistings of cash receipts and cash deposits by the accounting manager.</td>
<td>Controls the abstraction of cash and the incorrect recording of cash receipts and cash sales.</td>
</tr>
</tbody>
</table>

11A–2 KCN Internal Control Weaknesses (Estimated time: 15 minutes)
The first weakness is that sales invoices are prepared and mailed prior to delivery of goods. Errors may occur in that different quantities of goods may ultimately be delivered than have been ordered, or goods may not be delivered at all. A related problem, at year-end, is that sales may be recorded for goods not delivered until subsequent to year-end, thus overstating sales and accounts receivable for the year.

The second weakness is that accounts receivable are not written-off on a regular basis. This may result in an inadequate Allowance for Doubtful Accounts, with an associated understatement of Bad Debt Expense. Also, if management is not monitoring receivables collections, the company may currently be selling goods on credit to uncreditworthy customers.

11A–3 KCN Attributes Sampling (Estimated time: 35 minutes)

a. Audit sampling for tests of controls can be used when performance of the internal control procedure leaves some evidence of performance, such as a completed document or the initials of the person performing the procedure. This evidence of performance allows the auditors to determine whether the control procedure was applied to each item included in the sample. In addition, sampling will only be used in circumstances in which (1) the auditors wish to assess control risk for an assertion below the maximum, and (2) the likely rate of deviation from the control is less than the tolerable deviation rate.

b. The appropriate table for determining the required sample size is illustrated in Figure 9.4. Using the row for a 1 percent expected deviation rate, and the column for a tolerable deviation rate of 15 percent, we find a required sample size of 30 items, with 1 allowable deviation.

Attributes Sampling Summary—Revenue Cycle
December 31, 20X5

<table>
<thead>
<tr>
<th>Objectives of test:</th>
<th>To test the operating effectiveness of the procedures for matching sales invoices with deliver receipts.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Test</strong></td>
<td><strong>Population</strong></td>
</tr>
<tr>
<td>(1)</td>
<td>Sales invoices</td>
</tr>
</tbody>
</table>

**Sampling unit:** Individual reports

**Random selection procedure:** Random number table

**Risk of assessing control risk too low:** 5%
Tolerable Deviation Rate | Expected Deviation Rate | Sample Size | Number of Deviations | Achieved Maximum Rate
--- | --- | --- | --- | ---
1. Matching of sales invoices with delivery receipts | 15% | 1% | 30 |  |

Conclusion:

11B–1 SOLUTION: KCN Substantive Procedures Audit Program (Estimated time: 20 minutes)

a. “KCN has engaged in a strategy to sell to customers with higher credit risk.” The implication of this risk is that the company may experience significant additional amounts of bad debt expense. The audit team addressed this risk primarily with the following steps:

10. Review the adequacy of the allowance for uncollectible accounts by performing the following procedures:
   a. Review the aged trial balance of accounts receivable with the president.
   b. Review confirmation exceptions for indications of disputed amounts.
   c. Analyze and review trends in the following relationships:
      (1) Accounts receivable to net sales.
      (2) Allowance for bad debts to accounts receivable.
      (3) Bad debt expense to net sales.

11. Review credit memoranda for sales returns and allowances through the last day of fieldwork to determine if an adjustment is needed to record the items as of year-end.

12. c. Compute the accounts receivable turnover.

b. “The officers of the company receive significant bonuses based on quarterly results.” The implication of this risk is that management may be inclined to misstate quarterly results to maximize bonuses. The audit team addressed this risk primarily with the following steps:

- The confirmation procedures for accounts receivable, which include steps 2, 4, 5, 6, and 7.
- Review credit files and investigate any indications of fictitious accounts, step 8.
- The cutoff procedures for sales, steps 11, 12, and 13.
- The analytical procedures in step 14, especially the sales by month by salesperson.

11B–2 a. Examining the sales by month schedule provides an indication that management may be overstating revenue to meet quarterly and annual sales budgets. From the schedule, we see a pattern of increases in sales in the months of March, June, September, and December, with respect to computer sales. Also, note that the amount of sales tends to fall off in the month following the end of the quarter. This pattern is even more pronounced with respect to consulting revenue. The pattern is illustrated more dramatically with the following two
tables. Schedule I presents monthly sales amounts as a percentage of total sales for the year, and Schedule II presents changes in monthly sales from the same quarter in the previous year.

### Schedule I

Keystone Computers & Networks

Monthly Sales (Percentages)

For the Year Ended 12/31/20X5

<table>
<thead>
<tr>
<th></th>
<th>Sales of Computers 20X5</th>
<th>Consulting Revenue 20X5</th>
<th>Service Revenue 20X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>7.72%</td>
<td>6.96%</td>
<td>7.11%</td>
</tr>
<tr>
<td>February</td>
<td>8.49%</td>
<td>7.29%</td>
<td>8.06%</td>
</tr>
<tr>
<td>March</td>
<td>8.93%</td>
<td>8.26%</td>
<td>8.75%</td>
</tr>
<tr>
<td>April</td>
<td>7.50%</td>
<td>7.45%</td>
<td>8.31%</td>
</tr>
<tr>
<td>May</td>
<td>7.94%</td>
<td>7.69%</td>
<td>8.06%</td>
</tr>
<tr>
<td>June</td>
<td>8.80%</td>
<td>8.99%</td>
<td>9.00%</td>
</tr>
<tr>
<td>July</td>
<td>7.84%</td>
<td>7.77%</td>
<td>8.06%</td>
</tr>
<tr>
<td>August</td>
<td>8.43%</td>
<td>8.26%</td>
<td>8.06%</td>
</tr>
<tr>
<td>September</td>
<td>9.18%</td>
<td>9.39%</td>
<td>9.47%</td>
</tr>
<tr>
<td>October</td>
<td>7.46%</td>
<td>8.50%</td>
<td>8.54%</td>
</tr>
<tr>
<td>November</td>
<td>8.36%</td>
<td>9.15%</td>
<td>8.06%</td>
</tr>
<tr>
<td>December</td>
<td>9.36%</td>
<td>10.28%</td>
<td>8.53%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>100.00%</strong></td>
<td><strong>100.00%</strong></td>
<td><strong>100.00%</strong></td>
</tr>
</tbody>
</table>

### Schedule II

Keystone Computers & Networks

Changes in Sales from the Same Month in the Prior Year

<table>
<thead>
<tr>
<th></th>
<th>Sales of Computers 20X4</th>
<th>Sales of Computers 20X5</th>
<th>Consulting Revenue 20X4</th>
<th>Consulting Revenue 20X5</th>
<th>Service Revenue 20X4</th>
<th>Service Revenue 20X5</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
<td>3.92%</td>
<td>-6.06%</td>
<td>-2.90%</td>
<td>-9.68%</td>
<td>-0.13%</td>
<td>-10.08%</td>
</tr>
<tr>
<td>February</td>
<td>9.73%</td>
<td>-2.68%</td>
<td>-15.10%</td>
<td>-5.41%</td>
<td>5.83%</td>
<td>-10.83%</td>
</tr>
<tr>
<td>March</td>
<td>3.12%</td>
<td>-0.02%</td>
<td>-0.21%</td>
<td>-1.99%</td>
<td>-0.84%</td>
<td>3.36%</td>
</tr>
<tr>
<td>April</td>
<td>-2.77%</td>
<td>-12.68%</td>
<td>0.07%</td>
<td>-10.50%</td>
<td>4.94%</td>
<td>-8.01%</td>
</tr>
<tr>
<td>May</td>
<td>-4.78%</td>
<td>-7.39%</td>
<td>-5.27%</td>
<td>-5.25%</td>
<td>-2.54%</td>
<td>-4.93%</td>
</tr>
<tr>
<td>June</td>
<td>1.32%</td>
<td>-1.84%</td>
<td>3.77%</td>
<td>4.12%</td>
<td>3.92%</td>
<td>-6.28%</td>
</tr>
<tr>
<td>July</td>
<td>-10.30%</td>
<td>-4.76%</td>
<td>-11.76%</td>
<td>-4.25%</td>
<td>-1.35%</td>
<td>-10.74%</td>
</tr>
<tr>
<td>August</td>
<td>-3.37%</td>
<td>-4.64%</td>
<td>2.81%</td>
<td>-7.62%</td>
<td>-0.65%</td>
<td>-4.88%</td>
</tr>
<tr>
<td>September</td>
<td>3.39%</td>
<td>-2.39%</td>
<td>0.72%</td>
<td>8.81%</td>
<td>0.26%</td>
<td>4.86%</td>
</tr>
<tr>
<td>October</td>
<td>-5.16%</td>
<td>-16.67%</td>
<td>-5.42%</td>
<td>-4.90%</td>
<td>-7.21%</td>
<td>-5.64%</td>
</tr>
<tr>
<td>November</td>
<td>-8.24%</td>
<td>-7.87%</td>
<td>1.64%</td>
<td>-2.16%</td>
<td>1.26%</td>
<td>-10.69%</td>
</tr>
<tr>
<td>December</td>
<td>-4.13%</td>
<td>-1.63%</td>
<td>4.18%</td>
<td>8.77%</td>
<td>-2.70%</td>
<td>0.69%</td>
</tr>
</tbody>
</table>

**b.** The procedures that would address the risk of management overstatement of revenue in the existing audit program include:

1. Confirm a sample of customer’s accounts at 12/31/X5.
2. Review the aged trial balance of accounts receivable with the president.
3. For all sales recorded in the last week of the year inspect the related delivery receipt to determine the sale occurred before 12/31/X5.

4. Review credit memoranda for sales returns and allowances through the last day of fieldwork to determine if an adjustment is needed to record the items as of year-end.

c. Other procedures that might address the risk of management overstatement of revenue include (only two required):

   (1) Review contracts for consulting jobs performed during the period and examine time records or other records that serve as a basis for billings. Ascertain that actual billings agree to these records.
   (2) Consider confirming consulting contract terms with customers and progress on existing contracts.
   (3) Make inquiries of salesmen regarding modifications to typical sales terms, e.g., right to return goods for an extended period of time.
   (4) Review sales recorded near the end of each quarter and inspect the related delivery receipts.

11B–3 SOLUTION: KCN Sampling Results (Estimated time: 35 minutes)

   a. Analysis of exceptions

<table>
<thead>
<tr>
<th>Book Value</th>
<th>Audited Value</th>
<th>Mistatement</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. $120,000</td>
<td>$120,000</td>
<td>—</td>
<td>The book value is correct because the cash receipt was not received by KCN prior to year-end.</td>
</tr>
<tr>
<td>2. $30,000</td>
<td>$29,670</td>
<td>$330</td>
<td>The return should have been dated as of December 31.</td>
</tr>
<tr>
<td>3. $214,000</td>
<td>$214,000</td>
<td>—</td>
<td>The balance is correct because the payment was made and received after year-end.</td>
</tr>
<tr>
<td>4. $130,000</td>
<td>$120,000</td>
<td>$10,000</td>
<td>Because a portion of the delivery was subsequent to year-end, it should not be recorded until 20X6.</td>
</tr>
<tr>
<td>5. $18,000</td>
<td>$17,460</td>
<td>$540</td>
<td>Because only $1,746 will be received, the adjustment should be made in the period the sale is recorded.</td>
</tr>
</tbody>
</table>

   b. Projected misstatement

<table>
<thead>
<tr>
<th>Book Value</th>
<th>Audited Value</th>
<th>Misstatement</th>
<th>Tainting %</th>
<th>Sampling Interval</th>
<th>Projected Misstatement</th>
</tr>
</thead>
<tbody>
<tr>
<td>$30,000</td>
<td>$29,670</td>
<td>$330</td>
<td>1.1%</td>
<td>39,400</td>
<td>$433.40</td>
</tr>
<tr>
<td>130,000</td>
<td>120,000</td>
<td>10,000</td>
<td>NA</td>
<td>NA</td>
<td>10,000.00</td>
</tr>
<tr>
<td>18,000</td>
<td>17,460</td>
<td>540</td>
<td>3.0%</td>
<td>39,400</td>
<td>1,182.00</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>$11,615.40</td>
</tr>
</tbody>
</table>

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(2) **Basic precision** = Reliability factor × Sampling interval

\[
3.00 \times 39,400 = 118,200
\]

(3) **Incremental allowance**

<table>
<thead>
<tr>
<th>Reliability Factor</th>
<th>Increment</th>
<th>(Increment-1)</th>
<th>Projected Misstatement</th>
<th>Incremental Allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.00</td>
<td>1.75</td>
<td>.75</td>
<td>1,182.00</td>
<td>886.50</td>
</tr>
<tr>
<td>4.75</td>
<td>1.55</td>
<td>.55</td>
<td>433.40</td>
<td>238.37</td>
</tr>
<tr>
<td>6.30</td>
<td></td>
<td></td>
<td></td>
<td>$1,124.87</td>
</tr>
</tbody>
</table>

(4) Upper limit on misstatement = $11,615.40 + $118,200 + $1,124.87 = $130,940.27

Since the upper limit on misstatement is less than the tolerable misstatement ($150,000), the results indicate that the auditors would accept the population as being materially correct.