

Goodfoot is a small company which manufactures high quality shoes and sells them to small retailers. This is your first year as auditor. Goodfoot has a debtors ledger with approximately 750 accounts. A number of the debtor accounts are old, some have nil or credit balances and some should probably be written off. The company's client base is mixed. Bad debts have generally represented about 2% of the total debtors figure and a general provision of 1.5% has been made in the past in addition to any specific provisions. Most of the bad debts relate to smaller customers but there are some very slow moving larger accounts in the current year. The total value of debtors is £750,000, 60% of which comprises some thirty large accounts, and 40% of which comprises a large number of small accounts.

You have tested the system of internal controls over debtors and it appears to be working adequately. In your experience debtors circularisations in this sector generally have a response rate of just over 50%.

Required:

Describe the audit work you will perform on debtors and bad debts at Goodfoot. (10 marks)

Note: You are not required to perform numerical calculations in this question.

Audit work on debtors and bad debts

- (i) Comfort can be taken from the proper operation of internal controls over debtors and it is therefore possible to reduce the level of substantive testing.
- (ii) The primary focus of substantive testing will be the circularisation. A 50% response rate is quite adequate. All of the thirty largest accounts can be circularised together with a representative sample of the remainder, paying particular attention to old accounts, nil balances and credit balances.
- (iii) For those accounts circularised where there is no reply, and for any other accounts selected for testing it will be necessary to gain comfort on the amount receivable by reviewing cash received after the period end. Where cash has not been received, it will be necessary to review signed delivery notes, contracts, the pattern of payments, etc.
- (iv) For accounts circularised, any differences should be thoroughly investigated and followed up, with the help of the client if necessary. It should be remembered that where a debtor agrees that an amount is owed, it does not automatically follow that the amount will be paid.
- (v) The bad debt provision should be reviewed in the light of past experience and current period conditions. Generally, specific provisions are permissible for tax purposes but not general provisions and the tax computation should be checked.
- (vi) The arithmetical accuracy of the ledger should be checked as should the correct presentation of the amounts in the financial statements.
- (vii) A review of invoices and credit notes around the period-end may highlight the need for additional provisions.
- (viii) Analytical procedures on the ageing of debtors by comparison with prior periods will give comfort on bad debt provisions.
- (ix) Sales cut-off testing should be performed to ensure that amounts have been correctly recorded in the correct period.