

Two Assertions For Which Confirmation Of Accounts Receivable Balances Provides Primary Evidence Are Completeness;

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In the realm of financial auditing, the confirmation of accounts receivable balances is a fundamental procedure used to obtain audit evidence regarding the accuracy and existence of receivables reported on the financial statements. This process involves direct communication with the company's customers to verify the amounts owed. Among the various assertions that auditors seek to substantiate, two stand out as primarily supported through confirmation procedures: completeness and existence.

This article delves into the specific assertion of completeness, exploring how confirmation of accounts receivable balances acts as primary evidence to substantiate that all receivables that should have been recorded are indeed reflected in the financial statements. We will also discuss the context of these assertions in the overall audit process, outline the procedures involved, and highlight their importance in ensuring accurate and reliable financial reporting.

Understanding the Role of Assertions in Financial Statement Audits

What Are Financial Assertions?

Financial assertions are implicit or explicit representations made by management regarding the accuracy, completeness, and validity of the financial information presented. Auditors assess these assertions to determine whether the financial statements are free of material misstatement. The primary assertions related to accounts receivable include:

- Existence: The receivables recorded actually exist at the reporting date.
- Completeness: All receivables that should have been recorded are included.
- Rights and Obligations: The company has the rights to the receivables.
- Valuation and Allocation: The receivables are recorded at appropriate amounts.
- Presentation and Disclosure: The receivables are properly presented and disclosed.

Among these, confirmation primarily provides evidence for existence and completeness, with the latter being the focus of this article.

The Significance of Confirmation in Auditing Accounts Receivable

What Is Accounts Receivable Confirmation?

Accounts receivable confirmation is a procedure where auditors send requests to the company's customers to verify the amounts owed by them as of the balance sheet date. These confirmations can be:

- Positive confirmations: Requesting the customer to reply whether they agree or disagree with the amount.
- Negative confirmations: Asking the customer to reply only if they disagree with the stated amount.

The primary purpose of confirmation is to validate the existence of receivables. However, depending on the context, it can also provide evidence about the completeness of receivables.

Why Is Confirmation a Critical Audit Procedure?

Confirmation procedures are considered highly reliable because they involve direct communication with third parties. When properly performed, they provide compelling evidence regarding the accuracy and validity of receivables. They also help identify issues such as unrecorded receivables, misstatements, or disputes.

How Confirmation Provides Evidence for the Completeness Assertion

Understanding the Completeness Assertion

The completeness assertion states that all accounts receivable that should be recorded are included in the financial statements. In essence, the company has not omitted any receivables that it is entitled to report.

Ensuring completeness is vital because omissions can lead to understated assets and income, which misrepresent the company's financial position and performance.

Role of Confirmation in Supporting Completeness

While confirmation is traditionally associated with verifying existence, it also significantly supports the completeness assertion in the following ways:

1. Detection of Unrecorded Receivables:

When customers confirm their balances, discrepancies or unpaid invoices can highlight receivables that have not been recorded by the company. For instance, if a customer confirms a balance that is higher than what the company has recorded, it suggests incomplete recording of receivables.

2. Identification of Unbilled or Uninvoiced Items:

Confirmations can reveal receivables arising from goods or services delivered but not yet billed or recorded in the books. This is especially relevant in cases where the company might have overlooked certain transactions.

3. Verification of Cut-off Procedures:

Confirmations help ensure that receivables are recorded in the correct accounting period. If a customer confirms a balance that does not align with the company's cutoff date, it may indicate unrecorded receivables or misstatements.

4. Corroborating Internal Records:

The confirmation process acts as an external check that complements internal records, thereby providing evidence that the company's accounts receivable ledger is complete.

Audit Procedures Supporting Completeness Through Confirmation

Designing an Effective Confirmation Process

To leverage confirmation as primary evidence for completeness, auditors should adopt a systematic approach:

- Select appropriate sample sizes:

Based on risk assessments, auditors determine which balances to confirm, focusing on high-value or aged receivables.

- Use positive confirmations when necessary:

These require customers to reply regardless of agreement, thus providing more reliable evidence.

- Follow-up procedures:

Non-responses or discrepancies should be investigated to identify potential omissions.

- Complement with other audit procedures:

Such as reviewing subsequent cash receipts, examining shipping documents, and analyzing aged receivables to identify unrecorded balances.

Additional Supporting Procedures

While confirmation is critical, auditors also perform other procedures to support the completeness assertion:

- Analytical procedures:

Comparing receivables to sales trends, aging reports, and industry benchmarks.

- Review of subsequent collections:

Examining cash receipts after the reporting date to identify receivables that may have been omitted.

- Reconciliation of subsidiary records to general ledger:

Ensuring all subsidiary receivable accounts are reflected in the main financial statements.

Limitations of Confirmation in Supporting Completeness

Despite its usefulness, confirmation has limitations regarding the completeness assertion:

- Non-responses:

Customers may not respond, making it difficult to confirm the absence of unrecorded receivables.

- Dispute or disagreements:

Customers might dispute balances, which could obscure the true completeness of receivables.

- Timing issues:

Confirmations are only effective if performed close to the reporting date, as receivables can change rapidly.

- Risk of collusion or fraud:

Customers or management might manipulate confirmations, underscoring the need for supplementary procedures.

Conclusion: The Critical Role of Confirmation in Establishing Completeness

In the audit of accounts receivable, confirmation is a vital procedure that provides primary evidence supporting various assertions. While its most well-known role is confirming the existence of receivables, it also plays a crucial part in substantiating the completeness assertion. By verifying that all receivables are recorded and identifying unrecorded balances, confirmation enhances the auditor's confidence in the accuracy and integrity of the financial statements.

Achieving reliable evidence for completeness requires careful planning, execution, and integration with other audit procedures. When performed diligently, confirmation helps auditors detect omissions, verify cutoff procedures, and ensure that the accounts receivable balances presented in the financial statements accurately reflect the company's financial position.

Key takeaways:

- Confirmation of accounts receivable provides primary evidence for completeness and existence.
- It aids in identifying unrecorded receivables and verifying that all owed amounts are included.
- Complementary procedures strengthen the audit evidence concerning completeness.
- Awareness of limitations ensures auditors interpret confirmation results appropriately.

Ensuring the completeness of accounts receivable balances through confirmation enhances the overall reliability and credibility of financial reporting, which is fundamental for stakeholders relying on audited financial statements.

Keywords: Accounts Receivable Confirmation, Completeness Assertion, Audit Evidence, Financial Statements, External Confirmation, Unrecorded Receivables, Audit Procedures, Financial Reporting Accuracy

Frequently Asked Questions

What is the significance of confirming accounts receivable balances in relation to completeness assertions?

Confirming accounts receivable balances helps verify that all receivables are recorded, thereby providing primary evidence for the completeness assertion.

How does confirmation of accounts receivable support the assertion of completeness?

It ensures that all receivables existing at year-end are included in the financial statements, confirming that no receivables have been omitted.

Why is confirmation of accounts receivable considered a primary evidence for completeness?

Because external confirmations directly verify the existence and accuracy of receivables, helping auditors determine that the recorded balances are complete and no receivables are missing.

Can confirmation of accounts receivable also provide evidence for valuation assertions?

While primarily used for existence and accuracy, confirmations can indirectly support valuation by verifying receivable amounts, but they are mainly focused on existence and completeness.

What are the limitations of using accounts receivable confirmations to verify completeness?

Limitations include potential non-responses from customers, the possibility of collusion, or unreturned confirmations which may affect the completeness assessment.

In what scenarios is confirmation of accounts receivable most effective in

providing evidence for completeness?

It is most effective when the receivables are significant, diverse, or when internal controls are weak, and external confirmation can directly verify that all receivables are recorded.

How do auditors differentiate between confirmation responses that support completeness versus existence?

Responses indicating all receivables are recorded support completeness, while positive confirmations that show specific balances support existence; auditors analyze responses accordingly.

What steps should auditors take if confirmation of accounts receivable indicates potential omissions?

Auditors should investigate further, review additional supporting documentation, and consider adjusting the financial statements if omissions are confirmed.

Are there alternative procedures to confirm accounts receivable for testing completeness?

Yes, alternative procedures include reviewing subsequent cash receipts, analyzing aged receivables, and performing cutoff tests to ensure completeness of recorded receivables.

How does the confirmation process integrate with overall audit procedures for accounts receivable?

Confirmation complements other audit procedures by providing external, independent evidence, helping auditors assess the completeness and accuracy of receivables in conjunction with internal controls and substantive tests.

Additional Resources

Two Assertions For Which Confirmation Of Accounts Receivable Balances Provides Primary Evidence Are Completeness;

When conducting an audit of a company's financial statements, auditors rely heavily on substantive procedures to obtain sufficient appropriate audit evidence. One of the most common and effective procedures involves confirming accounts receivable balances directly with the company's customers. The phrase confirmation of accounts receivable balances provides primary evidence are completeness underscores the vital role that this audit procedure plays in validating specific financial statement

assertions—primarily, the assertion of completeness. In this article, we will explore what this assertion entails, why confirmation is so critical for it, and the broader implications for audit work and financial statement reliability.

Understanding the Assertion of Completeness in Accounts Receivable

What is the Completeness Assertion?

In the context of financial statement audits, the completeness assertion pertains to whether all transactions and accounts that should have been recorded have, in fact, been included in the company's financial records. Specifically, for accounts receivable, this means ensuring that:

- All amounts due from customers at the balance sheet date are properly recorded.
- No receivable balances have been omitted, either intentionally or unintentionally.
- The receivables presented on the financial statements genuinely reflect all outstanding customer debts.

Completeness is critical because an understatement of receivables can lead to an understated asset base and overstatement of income, thereby misleading stakeholders.

How Does Confirmation Support Completeness?

Confirmation of accounts receivable involves sending requests to customers to verify the balances owed. When done thoroughly, this process provides strong evidence that:

- The receivable balances recorded by the company are supported by actual customer records.
- All significant receivable balances are reflected in the company's books, reducing the risk of omissions.

By confirming balances directly with customers, auditors obtain evidence that the receivable accounts are complete, i.e., there are no unrecorded receivables lurking in the company's books.

The Role of Confirmation in Auditing Accounts Receivable

What is a Confirmation?

A confirmation is a direct correspondence sent by the auditor to third parties (usually customers) to verify the accuracy of account balances. Confirmations can be positive, requesting the customer to confirm whether the balance is correct, or negative, asking the customer to respond only if the balance is incorrect.

Why is Confirmation Considered Primary Evidence?

Confirmation is regarded as primary evidence because it originates outside the company, providing an independent verification. Compared to internal documents, confirmations reduce the risk of management bias or misstatement. They are especially valuable when verifying existence and accuracy, but as we will see, they also have implications for completeness.

Two Assertions for Which Confirmation of Accounts Receivable Balances Provides Primary Evidence Are Completeness

Although confirmations are often associated with verifying existence and accuracy, they are also instrumental in confirming the completeness of accounts receivable balances. Here are the two key assertions:

1. Completeness of Accounts Receivable Balances

Confirmation procedures help auditors determine whether all receivable balances that should be recorded have been included in the financial statements.

- How confirmation supports this assertion:
- When an auditor sends out confirmation requests to a sample of customers, they expect responses from those who owe balances.
- If responses are received from all customers with outstanding balances, it supports the idea that the company has recorded all receivables owed by customers—i.e., completeness.
- Conversely, if some customers with known balances do not respond, or if responses indicate outstanding balances not recorded by the company, it may suggest unrecorded receivables.

Key points:

- Confirmation can reveal unrecorded receivables if customers acknowledge balances that are not reflected in the company's books.
- Lack of response from certain customers, especially those with significant balances, can be a red flag for potential omissions.

2. Existence (and its relation to completeness)

While existence is the primary assertion confirmed through positive confirmations, the process also indirectly supports completeness because:

- Confirmations that do not respond or show discrepancies may prompt auditors to investigate whether other receivables exist but are unrecorded.
- The process encourages auditors to perform additional procedures, such as reviewing subsequent cash receipts or analyzing aging reports, to ensure all receivables are accounted for.

Note: While confirmation primarily provides evidence about existence, the absence of expected responses or discrepancies can alert auditors to potential incompleteness, prompting further investigation.

Practical Application: How Auditors Use Confirmation to Assess Completeness

Step-by-step Approach

1. Planning and Risk Assessment:

- Auditors identify the population of receivables to confirm based on materiality and risk.
- They consider factors such as prior periods' issues, unusual transactions, or known unrecorded receivables.

2. Selection and Sending of Confirmations:

- Auditors select a representative sample of customer balances, focusing on large or risky accounts.
- They send positive or negative confirmation requests.

3. Interpreting Responses:

- Positive confirmations: Require a response whether the balance is correct or not, providing strong evidence for both existence and completeness.
- Negative confirmations: Request a response only if the balance is incorrect, less effective for completeness but useful in low-risk situations.

4. Follow-up Procedures:

- For non-responses, auditors perform alternative procedures:
- Review subsequent cash receipts.
- Examine shipping and sales records.
- Review aging schedules and credit policies.

5. Assessing Evidence for Completeness:

- If confirmations reveal balances not recorded in the books, the auditor may conclude receivables are incomplete.
- Conversely, if all confirmed balances align with the company's records, the evidence supports the completeness assertion.

Limitations of Confirmation for Completeness

While confirmation is a powerful tool, it has limitations in establishing completeness:

- Non-responses: Customers may not respond, even if all receivables are recorded, leading to gaps in evidence.

- Unreturned confirmations: The absence of responses does not necessarily imply unrecorded receivables.
- Timing issues: Some receivables may have been settled after the confirmation date but before the audit, affecting completeness assessments.
- Fraud or collusion: Customers and management might collude to hide unrecorded receivables.

Therefore, confirmations are used in conjunction with other substantive procedures to obtain a comprehensive view of completeness.

Broader Implications for Auditors and Financial Statement Users

For Auditors:

- Confirmations are a crucial part of audit evidence for accounts receivable, particularly when assessing the completeness assertion.
- They help reduce detection risk related to omitted receivables.
- Auditors must design their procedures carefully, selecting appropriate samples and follow-up procedures.

For Financial Statement Users:

- The reliability of accounts receivable balances hinges on robust audit procedures, including confirmations.
- Properly verified receivables support accurate asset valuation and revenue recognition.
- Confidence in the completeness of receivables enhances stakeholders' trust in the financial statements.

Conclusion

Confirmation of accounts receivable balances provides primary evidence on completeness because it directly tests whether all receivables owed by customers are properly recorded and reflected in the financial statements. While traditionally associated with verifying existence and accuracy, confirmation procedures also play a vital role in establishing the completeness assertion. This ensures that the company's assets are neither understated nor misstated due to unrecorded receivables. Combining confirmation with other substantive procedures allows auditors to form a well-rounded opinion on the accuracy and completeness of accounts receivable, ultimately underpinning the credibility of the financial statements and fostering stakeholder confidence.

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