

## Audit and Attestation—Sample Simulation

**Tab Title:** Situation (Facts)

**Interaction Type:** None

**Text of screen/directions:**

Peters & Michael CPA (P&M) is the incumbent auditor for the financial statements of Lakeland Supermarkets, Inc. (Lakeland) for the year ended December 31, Year 2. Lakeland is a relatively small and new company that is nevertheless publicly traded on a major U.S. stock exchange. P&M has previously obtained and documented its understanding of Lakeland's internal controls for cash receipts, cash disbursements, and cash balances. No significant weaknesses were found.

It is now January 31, Year 3, and the audit field work for Year 2 is just beginning to commence. You are an auditor with P&M and have been assigned specifically to audit Lakeland's cash accounts as part of your duties. Materiality for the overall financial statements is set at \$20,000.

The lead schedule for cash has been prepared and is shown below.

| Account Number | Account             | Description      | Unaudited Year 2 | Audited Year 1 | Change from Prior Year |
|----------------|---------------------|------------------|------------------|----------------|------------------------|
| 100            | First National Bank | General Checking | \$573,250        | \$599,623      | (\$26,373)             |
| 101            | Second Federal Bank | Payroll          | \$42,401         | \$36,888       | \$5,513                |
| 102            | Cash at Store 1     | Cash at store    | \$4,250          | \$6,698        | (\$2,448)              |
| 103            | Cash at Store 2     | Cash at store    | \$4,977          | \$5,454        | (\$477)                |
| 104            | Cash at Store 3     | Cash at store    | \$4,338          | \$8,239        | (\$3,901)              |
| 105            | Cash on Hand        | Petty -          | \$2,000          | \$2,000        | \$0                    |
|                | Total Cash          |                  | \$631,216        | \$658,902      | (\$27,686)             |

**Tab Title:** -Bank Reconciliation

**Interaction Type:** Matching

**Text of screen/directions:**

The controller of Lakeland has provided you with reconciliations for all of its bank accounts. The reconciliation for the First National Bank account is shown below.

For each section of the bank reconciliation (numbered 1 to 5 in the right column below), select the appropriate procedures from the left column that would most likely be performed during an audit of cash. Click on the letter beside the appropriate Audit Procedure and drag it to the answer space in the right column. One or more Audit Procedures may be selected for each item.

Lakeland Supermarkets, Inc.  
Account 100 – General Checking – First National Bank  
Bank Reconciliation  
12/31/Y2

|   |  |               |              |                  |
|---|--|---------------|--------------|------------------|
| 1 | Balance per Bank at 12/31/Y2                                       |               |              | \$545,979        |
| 2 | Add – Deposits in Transit:   |               |              |                  |
|   | 12/29/Y2   | 31,000        |              |                  |
|   | 12/30/Y2   | 29,445        |              |                  |
|   | 12/31/Y2   | <u>42,505</u> | 102,950      |                  |
| 3 | Subtract – Outstanding Checks                                      |               |              |                  |
|   | #1211  | 3/15/Y2       | 1,112        |                  |
|   | #1511  | 12/16/Y2      | 47           |                  |
|   | #1515  | 12/30/Y2      | 10,000       |                  |
|   | #1516  | 12/30/Y2      | 12,115       |                  |
|   | #1517  | 12/30/Y2      | 1,189        |                  |
|   | #1518  | 12/30/Y2      | <u>6,216</u> | -30,679          |
| 4 | Other reconciling items:   |               |              |                  |
|   | Another bank customer's deposit<br>erroneously credited to account |               |              | -45,000          |
| 5 | Balance per General Ledger at 12/31/Y2                             |               |              | <u>\$648,929</u> |

| <b>Audit Procedures</b> |   |
|-------------------------|---|
| A.                      | Trace and agree the amount to the bank confirmation.                  |
| B.                      | Trace and agree the amount to the general ledger.                     |
| C.                      | Test the clerical accuracy of the figures on the bank reconciliation. |
| D.                      | Trace the amount to the January, Year 3 cash receipt records.         |
| E.                      | Trace the amount to the December, Year 2 cash receipt records.        |
| F.                      | Trace the amount to the January, Year 3 cash disbursement records.    |

|    |   |
|----|---|
| G. | Trace the amount to the December, Year 2 cash disbursement records.                         |
| H. | Trace the amount to the cash activity listed in the January, Year 3 cut-off bank statement. |
| I. | Trace the amounts to the supporting vendor invoices to verify the disbursement              |

**Correct Answer/Explanation Text:**

|    |       |  |
|----|-------|--|
| 1. | A     | The amount stated on the bank statement should be traced and agreed to the balance provided on the bank confirmation (the bank confirmation should be received directly from the financial institution).   |
| 2. | C-E-H | Deposits in transit that are listed on the bank reconciliation should be re-totaled by P&M to confirm Lakeland's calculation. The deposits in transit should be traced and agreed to the cash receipt records for the year being audited (Year 2) since the amounts are already included in calculating the December 31, Year 2 cash balance but are not included on the December 31, Year 2 bank statement balance. The deposits in transit should also be traced to the cut-off bank statement (presumably received sometime in January, Year 3) from the bank to confirm that the amounts were subsequently received. |
| 3. | C-G-H | The outstanding checks listed on the bank reconciliation should be re-totaled by P&M to confirm Lakeland's calculation. The outstanding checks should be traced and agreed to the cash disbursement records for the year being audited (Year 2) since the amounts are not included (thus, have been deducted) in calculating the December 31, Year 2 cash balance but are included (thus, have not been deducted) in the December 31, Year 2 bank statement balance. Finally, the outstanding checks should be traced to the cut-off bank statement to confirm that the amounts were subsequently disbursed.             |
| 4. | H     | The erroneous bank deposit should be traced and agreed to the bank cut-off statement to ensure that the amount was subsequently corrected by the bank.   |
| 5. | B-C   | The balance of \$573,250 should be traced and agreed to Lakeland's trial balance or general ledger. Additionally, the balance should be recomputed by P&M to confirm the accuracy of Lakeland's total.   |

**Tab Title:** Confirmation

**Interaction Type:** Pull-down menu

**Text of screen/directions:**

A bank confirmation request was sent to every bank with which Lakeland does business. A standard bank confirmation form was used. First National Bank (National) promptly completed the form and returned it directly to P&M. Second Federal Bank (Federal) had not returned the confirmation as of January 31, Year 3, when the audit testing commenced.

The following is a list of statements regarding the bank confirmations. For each of the following statements, indicate whether the statement is True or False by clicking on the appropriate selection in the box next to each statement.

|    |  |
|----|--|
| 1. | Confirmations do not need to be sent to the banks where Lakeland's accounts have been closed.  |
| 2. | Materiality is not considered when determining which of Lakeland's bank accounts need to be confirmed.                                   |
| 3. | Sending bank confirmation requests to the Lakeland's banks is useful in corroborating deposit and loan balances.                         |
| 4. | It is optional to send a second bank confirmation request to Federal.  |
| 5. | Bank confirmations are a useful procedure in detecting kiting schemes.   |
| 6. | Bank confirmations are designed to provide significant evidence to substantiate the completeness assertion.                              |
| 7. | Sending a standard confirmation to Lakeland's banks will provide evidence of any secured transactions.                                   |
| 8. | Banks are required to search their records for bank balances or loans beyond those listed by P&M on the standard bank confirmation form. |

**Correct answer/explanation text:**

|    |       |  |
|----|-------|--|
| 1. | False | Confirmations should be sent to the banks where Lakeland's accounts have been closed to ensure that negative cash balances (i.e., overdrafts) have not been hidden.  |
| 2. | True  | Materiality is not considered because although the ending cash balance may often be immaterial in terms of quantitative financial statement impact, the cash transactions that collectively determine the ending balance are usually not immaterial. |
| 3. | True  | P&M would usually provide the account information on the standard bank confirmation request form and ask for balance corroboration (i.e., bank fills in the appropriate amount(s) in the space(s) provided).   |

|    |       |   |
|----|-------|---|
| 4. | False | When a bank confirmation has not been received, it is necessary for P&M to send a second request to the financial institution to document the attempt at performing the primary procedures prior to performing alternate procedures.  |
| 5. | False | Bank confirmations are not useful in detecting a kiting scheme since they do not show the subsequent cash activity necessary to ensure that the bank transfers were recorded correctly.   |
| 6. | False | Bank confirmations are designed to substantiate evidence primarily for the existence assertion. Bank confirmations are not designed to discover or provide assurance about the accounts not listed on the form and, therefore, do not provide evidence to support the completeness assertion. It is important to note that it might not be possible for P&M to send confirmations to all of the possible banks if Lakeland manages not to disclose them. Therefore, there is the possibility that not all cash balances nor bank indebtedness are being reported. |
| 7. | False | Sending a standard confirmation to Lakeland's banks will not provide evidence of any secured transactions since a standard bank confirmation does not specifically request this information.  |
| 8. | False | For privacy and confidentiality reasons, banks are not required to search their records for bank balances or loans beyond those listed by P&M on the standard bank confirmation form.   |

**Tab Title:** Confirmation

**Interaction Type:** Pull-down menu

**Text of screen/directions:**

The bank confirmation received from First National Bank is shown below. The following is a list of statements regarding auditing the bank confirmation. For each statement, indicate whether it is true or false by clicking the appropriate selection in the box next to each statement.

**Standard Form to Confirm Account  
Balance Information with Financial Institutions**

Dec 31, Year 2  
Confirmation Date

Lakeland Supermarkets, Inc.  
Customer Name

Financial  
Institution's  
Name and  
Address

|  |
|--|
| <p><i>First National Bank</i><br/><i>9211 Front Street</i><br/><i>Lakeland, FL 32084</i></p> |
|--|

1. At the close of business on the date list above, our records indicate the following deposit balance(s):

| Account Name     | Acct. No. | Interest Rate | Balance   |
|------------------|-----------|---------------|-----------|
| General Checking | 2345-0099 | 0%            | \$545,979 |

1. We were directly liable to the financial institution for loans at the close of business on the date listed above:

| Acct No.              | Balance   | Due Date     | Interest Rate | Date through which interest is paid | Description of collateral   |
|-----------------------|-----------|--------------|---------------|-------------------------------------|-----------------------------|
| line of credit        | \$150,000 | Dec 31, Yr 5 | 8.80%         | Dec 31, Yr 4                        | general security agreement  |
| construction mortgage | \$300,000 | Jun 30, Yr 6 | 5.60%         | Dec 31, Yr 4                        | property at 1111 Elm Street |

Lewis Johnston, CFO  
Customer's Authorized Signature

Jan 7, Year 3  
Date

Sharon Likens, Vice President  
Financial Institution Authorized Signature

Jan 15, Year 3  
Date

| Exceptions and/or comments  |
|---|
| <p>Our records show that \$20,000 of general checking balance is restricted for taxes on the property under construction.</p> |

|    |  |
|----|--|
| 1. | The \$545,979 balance per the bank confirmation should be cross-referenced and agreed to the year-end balance in the general ledger.   |
| 2. | The mortgage balance confirmed by the bank is \$25,000 lower than the balance recorded in Lakeland's records. Since P&M should only be concerned with the understatement of liabilities and this particular liability seems to be overstated by the client, no further work is required. |
| 3. | The balances confirmed are fundamental to performing a proof of cash.  |
| 4. | The line of credit balance of \$150,000 confirmed by the bank differs from Lakeland's records by \$10,000. Therefore, P&M should immediately request a reconfirmation of the balance by the bank.  |
| 5. | Even if deemed material, the restricted cash is not required to be disclosed separately in the notes to the financial statements.  |

**Correct answer/explanation text:**

|    |       |  |
|----|-------|--|
| 1. | False | The confirmed bank balance (cash basis) should be traced and agreed to the balance per bank on the reconciliation, NOT the general ledger (accrual basis).   |
| 2. | False | The difference of \$25,000, if left unresolved, could result in a material overstatement of liabilities (recall that the overall financial statement materiality is only \$20,000). Such a material overstatement of liabilities would result in the overall financial statements being materially misstated, which would not allow for a clean audit opinion. Therefore, further work is required by P&M to resolve the apparent balance discrepancy. |
| 3. | False | Bank confirmations are generally not required to be used when performing a proof of cash. Note, P&M would only perform a proof of cash if there is a material internal control weakness for cash at Lakeland.  |
| 4. | True  | A reconfirmation of the line of credit balance of \$150,000 is necessary to ensure that there was no error on the part of the bank in the original confirmation process.   |
| 5. | False | The restricted cash relating to real estate taxes on the property under construction must be disclosed separately in the notes to the financial statements.  |

**Tab Title:** Obtaining Evidence-

**Interaction Type:** Pull-down menu

**Text of screen/directions:**

You prepared the following bank transfer schedule as shown below. Review the items on the schedule.

For each statement below, determine whether it is True or False by clicking the appropriate selection in the boxes next to each statement.

**Bank Transfer Schedule**

**Lakeland Supermarkets**

**12/31/Y2**

| <b>Disbursements</b> |                |               |                      |                  | <b>Receipts</b>      |                      |                      |
|----------------------|----------------|---------------|----------------------|------------------|----------------------|----------------------|----------------------|
| <u>Check No.</u>     | <u>Bank</u>    | <u>Amount</u> | <u>Date Recorded</u> | <u>Date Paid</u> | <u>Bank</u>          | <u>Date Recorded</u> | <u>Date Received</u> |
|                      |                |               | <u>in books</u>      | <u>by Bank</u>   |                      | <u>in books</u>      | <u>by Bank</u>       |
| #112                 | First National | \$55,000      | 12/22/Y2             | 12/29/Y2         | Charter Money Market | 12/23/Y2             | 12/30/Y2             |
| #115                 | First National | \$63,000      | 1/2/Y3               | 1/3/Y3           | Charter Money Market | 12/30/Y2             | 1/4/Y3               |
| #122                 | First National | \$98,650      | 1/2/Y3               | 1/7/Y3           | Charter Money Market | 1/4/Y3               | 1/8/Y3               |
|                      |                | (1)           | (2)                  | (3)              |                      | (4)                  | (5)                  |

|    |   |
|----|---|
| 1. | The amounts listed in column (1) should be traced to Lakeland's cash disbursement records.  |
| 2. | Disbursements on the bank transfer schedule should be correctly included in - the year end bank statement as outstanding checks.  |
| 3. | The bank transfer schedule is prepared using bank statements for the periods before and after year-end and by using Lakeland's cash receipts and disbursements records. |
| 4. | Check #122 is a deposit in transit at December 31, Year 2.  |
| 5. | Tracing the bank transfers to the bank statements and general ledger will help to detect whether Lakeland's cash balances are overstated.                               |

**Correct Answer/Explanation Text:**

|    |       |  |
|----|-------|--|
| 1. | True  | Disbursement amounts included on a bank transfer schedule should be traced to the client's cash disbursement records to determine if the amount was appropriately included or excluded from the records. |
| 2. | False | Disbursements on the bank transfer schedule should be correctly included or excluded depending on the date when the particular item cleared the bank.  |
| 3. | True  | All of the information is required to prepare a complete bank transfer schedule.   |
| 4. | False | Check #122 is a not a deposit in transit at December 31, Year 2 since it was not disbursed until the following year, Year 3.   |
| 5. | True  | The procedure helps to detect the overstatement of cash due to kiting.   |