Inside the audit: Part 5 - Trade Receivable

Objective:
The objective of trade receivables testing is to ensure that amounts due from customers for goods sold or services rendered are completely, accurately, validly recorded, recoverable, and appropriately classified and disclosed in the financial statements, in compliance with Accounting Standards (AS) / Ind AS and Schedule III requirements.

I. COMMON AUDIT PROCEDURES (APPLICABLE TO ALL TRADE PAYABLES)

A. Understanding of Process & Controls

- Understand the **order-to-cash** cycle from customer onboarding to collection.
- Review controls over **customer master creation, modification, and credit limit approvals**.
- Evaluate controls over **sales order processing, dispatch, invoicing, and revenue recognition.**
- Review controls over **pricing, discounts, sales returns, and credit notes.**
- Understand management review over **ageing, overdue balances, and recovery follow-up.**
- Review controls to prevent **duplicate, fictitious, or unauthorized invoicing.**
- Understand controls over **bad debts identification and provisioning/ECL.**

B. Substantive Procedures – Common Testing Across All Vendors

1) Existence / Occurrence

- Obtain customer-wise trade receivables ageing.
- Perform customer reconciliations for major balances.
- Trace selected receivable balances to:
  - Sales invoices
  - Delivery challans / Proof of delivery
  - Sales orders / service completion evidence (e.g., courier delivery status)
- Send external balance confirmations to significant customers.
- Verify subsequent receipts after the balance-sheet date to establish existence.

2) Completeness

- Reconcile sales ledger with general ledger.
- Review dispatch records / service completion reports to identify unbilled revenue (goods supplied or services rendered but not yet billed)
- Examine credit notes issued after year-end to assess whether they relate to pre year-end sales and identify any potential overstatement of revenue.
- Perform monthly and yearly sales trend analysis to identify unusual fluctuations.
- Analyse customer turnover (customers added / lost) to identify potential missing or unrecorded revenue

3) Accuracy / Valuation

- Verify invoice calculations including quantity, rate, discounts, and applicable GST.
- Check whether rates charged in invoices are as per the signed customer agreement / contract.
- Verify the validity, approval, and effective period of customer agreements used for pricing.
- Review amendments to agreements and ensure revised rates are correctly applied.
- Reconcile customer statements with ledger balances.
- Review long-outstanding balances and assess recoverability.
- Verify write-offs approved by appropriate authority.

4) Rights & Obligations

- Confirm that receivables represent valid enforceable claims of the entity.
- Review sales contracts for:
  - Right of return
  - Consignment sales
  - Bill-and-hold arrangements
- Verify receivables are not factored, assigned, or pledged, or ensure proper disclosure if so.

C. Cut-off

- Test sales transactions recorded around year-end with dispatch / service completion dates.
- Verify that revenue and receivables are recognized in the correct accounting period.
- Review goods dispatched before year-end but invoiced later to ensure proper accrual.

6) Classification & Presentation (Schedule III Review)

- Ensure trade receivables are classified under Current Assets.
- Verify separate disclosure of:
  - Trade receivables from related parties
  - Secured and unsecured receivables (if applicable)
  - Ageing schedule of trade receivables as per Schedule III
- Ensure allowance for doubtful debts is appropriately presented.

C. Analytical Review

- Perform month-on-month and year-on-year analysis of trade receivables.
- Compare revenue growth vs receivable movement.
- Analyse debtor days and changes therein.
- Review customer concentration and dependence on major customers.

II. ADDITIONAL PROCEDURES – IND AS BASED CLIENTS ONLY

(Not applicable to AS-based clients unless specifically adopted)

1) Expected Credit Loss (ECL) – Ind AS 109

- Evaluate management's ECL model and methodology.
- Verify use of simplified approach for trade receivables (lifetime ECL).
- Assess key assumptions such as:
  - Historical default rates
  - Forward-looking information
  - Customer credit risk profile
- Recompute ECL provision on sample basis.
- Verify segmentation of receivables (e.g., ageing buckets, customer type).

2) Significant Increase in Credit Risk (SICR)

- Review criteria used to identify significant increase in credit risk, if applicable.
- Check whether long-outstanding or disputed receivables are appropriately factored into ECL.

3) Contract Assets / Contract Liabilities (Ind AS 115)

- Review contracts to identify contract assets arising from unbilled revenue.
- Ensure appropriate classification and disclosure separate from trade receivables.
- Verify revenue recognition principles and linkage with receivable recognition.

4) Enhanced Disclosure Requirements

- Verify disclosures relating to:
  - Credit risk management
  - ECL movement reconciliation
  - Ageing of receivables used for ECL computation
- Ensure compliance with Ind AS 107 & Ind AS 109 disclosure requirements.

III. HIGH-RISK / ADDITIONAL AREAS

- Long-outstanding and disputed receivables.
- Significant balances with related parties.
- Revenue recognized near year-end.
- Post balance-sheet credit notes.
- Foreign currency receivables.
- Override of credit limits or unusual payment terms.