Chapter 14—Auditing the Revenue Cycle

Ics in sales are designed to achieve these seven objectives:

1—recorded transactions are valid
2—transactions are properly authorized
3—existing transactions are recorded (completeness)
4—transactions are properly valued
5—transactions are properly classified
6—transactions are recorded at the proper time
7—transactions are properly included in master files and correctly summarized

Tests of Controls

Several of the tests of controls can be done using the computer. The auditor must first evaluate the effectiveness of general controls related to program changes and file security. The auditor should make inquiries and inspect documentation about changes made to the programs and master files used

for sales orders, shipping, billing, and recording.

For testing sales orders, the auditor can enter test data to evaluate program results for:

--a missing or invalid customer number
--an invalid product code
--an order that exceeds the customer's credit limit

The use of independent persons for checking the processing and recording of sales is critical.

e.g.,

IC Objective	Verification Procedure
Sales are recorded on a timely basis	Examine unbilled shipping documents in the possession of the billing clerk to determine whether shipments that should have already been billed are not included

Substantive Tests of Sales Transactions

Recorded sales are valid

e.g., to test for recorded sales for which there wre no shipments, the auditor can trace from selected entries in the sales journal to make sure a related copy of the bill of lading exists

Sales are properly authorized

An example here would be:

Compare actual prices charged with the authorized price list

Cash Receipts Functions

1. **receiving cash receipts**

   entails two risks:

   1. **theft**
   2. **possibility of errors occurring in receipt processing**

Control procedures are aimed at reducing these risks. Many firms use a lockbox to minimize these two risks. Companies that process their own mail receipts shold mark all checks "for deposit only."

Control Activities—Sales Adjustment Transactions

Several useful control activities include:

--proper authorization of all sales adjustment transactions
--the use of appropriate documents and records
--segregation of duties for authorizing sales adjustment transactions and handling and recording cash receipts

Revenue Recognition

Example audit procedures

--perform a thorough review of original source documents including: invoices, shipping documents, customer purchase orders, cash receipts, and written correspondence between the client and customer

--analyze and review credit memos and other A/R adjustments for the period subsequent to the balance sheet date

--as part of the A/R confirmation effort, confirm with customers the terms of sales agreements, including the absence of right of return and terms that might preclude immediate revenue recognition

--analyze all large or unusual sales made in the last month prior to the end of the period. Vouch to original source documents. Confirm terms of the transaction directly with the customer.

--scan the G/L, A/R subledger, and sales journal for unusual activity

--compare operating cash flow to sales. Analyze by sales person, location, or product.

Accounts Receivable

What to look for

Be alert for the following, which may be present when the frauds described already are occurring or have occurred:

--unexplained differences noted by customers ontheir A/R confirmations

--significant delays between the date the customer states a payment was made and the date payment was recorded as received by the firm

--a significant number of credit entries and other adjustments made to the A/R records

--unexplained or inadequately explained differences between the A/R subsidiary ledger and the G/L

--discrepancies between customer names and amounts on deposit slips and subledger accounts and amounts credited

Example audit procedures

Consider expanding the extent of testing perhaps by selecting more items. Also consider:

--confirm account activity with customers directly. Confirm credit memo and sales return activity, as well as the dates on which payments were made

--perform analytical reviews of credit memo and writeoff activity by comparing to prior periods. Look for unusual trends or patterns such as large numbers of credit memos pertaining to one customer or sales person

or those processed shortly after the close of an accounting period.

--vouch credit memos and other writeoffs to receiving records for returned goods, correspondence with customers, and other documentation supporting the transactions

--investigate all differences between the payment date reported by the customer and the payment date recorded by the company. Do not rely on company-generated activity summaries—review both sides of the original checks or check copies

--analyze recoveries of written-off accounts

--obtain an understanding of how the accounts receivable agins is prepared and who has access to the data used to prepare the aging

--review collections of A/R in subsequent periods to determine validity of sales in prior periods