

Chapter 9: Auditing the Revenue Cycle

King, Hall, 4e

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Learning Objectives

- Understand the operational tasks associated with the revenue cycle under different levels of technology.
- Understand audit objectives related to the revenue cycle.
- Be familiar with revenue cycle control issues related to alternative technologies.
- Recognize the relationship between revenue cycle audit objective, controls, and tests of controls.
- Understand the nature of substantive tests in achieving revenue cycle audit objectives.
- Be familiar with common features and functions of ACL that are used to perform substantive tests.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Revenue Cycle Activities and Technologies

- Batch-Processing Sales Order System:
 - Order taking, credit checking, warehousing, and shipping are performed manually. Computer processes accounting records.
- Obtain and record customers' orders:
 - **Sales order** prepared with one copy placed in the **customer open order file**. **Credit authorization** copy to credit department for approval. Authorized copy triggers release of sales order into system. **Stock release (picking ticket)** copy to warehouse. Provides formal authorization to release inventory.
 - Shipping department receives **file copy, packing slip and shipping notice** copies. Packing slip stays with goods. Shipping notice informs billing department customer order has been filled and shipped.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Revenue Cycle Activities and Technologies

- Obtain and record customers' orders (cont'd):
 - Shipping clerk reconciles items with documents, packages goods, attaches packing slip, completes shipping notice, prepares a **bill of lading (BOL)** and transfers goods to carrier.
 - Clerk records shipment, sends shipping notice to billing and files one copy of the BOL and shipping documents.
- Computer programs (**runs**) process batches of sales orders and then pass the batch to the next run.
 - Data entry clerk converts hardcopy shipping notices to a file.
 - Edit run tests for errors and sort run reorders file by account.
 - AR update and billing run and inventory update run update files and triggers reorders. GL update run updates the GL accounts.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Batch Processing Cash Receipts System

- Cash receipts procedures are natural batch systems.
 - Mailroom separates checks and remittance advices and prepares a remittance list as a control document. Checks and copy of list sent to cash receipts. Remittance advices and copy of list go to AR.
 - Cash Receipts clerk reconciles checks with list, prepares deposit slips and creates a transaction file as input for the batch process.
 - AR clerk receives listing of all transactions processed, reconciles this list with other documents and files them.
 - Data processing runs a Master File update to update customer records in the AR Voucher file and a GL Update which is an end-of-day process.
 - Controller's office conducts periodic reviews of deposit slips returned from the bank and remittance lists prepared in the mailroom to reconcile final deposit with original receipt.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Integrated Real-Time Sales Order System

- Sales clerks receive and enter sales orders and initiate the following tasks:
 - Verify inventory availability and perform credit check. If approved, system adds record to the sales invoice file and transmits digital stock release to warehouse and digital packing slip to shipping.
 - Warehouse terminal generates hard-copy and clerk picks goods and send them to shipping with the stock release.
 - Shipping reconciles goods, prepares and ships them. After shipping a digital notice signals transaction is complete.
 - System automatically: updates customer credit history, reduces quantity on hand, determines and processes reorder if needed, inserts a ship date in sales invoice record, updates GL accounts and produces and distributes various management reports.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Integrated Real-Time Cash Receipts System

- Mailroom opens checks and remittance advices (RA), endorses checks "For Deposit Only" and prepares copies of remittance list. Copy of list and checks to Cash Receipts.
- Cash Receipts reconciles checks and RA with list, prepares deposit slips, creates a record in remittance file and files documents.
 - Security group deposits checks.
- Automatic data-processing procedures:
 - Closes sales invoices by placing customer check number and payment date in invoice record, posts to GL and prepares and distributes management reports.
- Controller's Office performs periodic reconciliations.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Relationship Between Management Assertions and Revenue Cycle Audit Objectives

| Management Assertions | Revenue Cycle Audit Objectives |
|-----------------------------|---|
| Existence or occurrence | Verify that the AR balance represents amounts actually owed to the organization at the balance sheet date Establish that revenue from sales transactions represent goods shipped and services rendered during the period covered by the financial statements. |
| Completeness | Determine that all amounts owed to the organization at the balance sheet date are reflected in AR Verify that all sales for shipped goods, all services rendered, and all returns and allowances for the period are reflected in the financial statements. |
| Accuracy | Verify that revenue transactions are accurately computed and based on current prices and correct quantities Ensure that the AR subsidiary ledger, the Sales Invoice file, and the Remittance file are mathematically correct and agree with general ledger accounts. |
| Rights and obligations | Determine that the organization has a legal right to recorded AR. Customer accounts that have been sold or factored have been removed from the AR balance. |
| Valuation or allocation | Determine that the AR balance states its net realizable value Establish that the allocation for uncollectible accounts is appropriate. |
| Presentation and disclosure | Verify AR and revenues reported for the period are properly described and disclosed in the financial statements. |

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Point-of-Sale Systems

- **POS systems** used extensively in retail companies.
 - Customers take inventory to cashier who scans **UPCs**.
 - POS system retrieves price and reduces inventory which is automatically reordered as needed. After all UPCs are scanned, taxes and totals automatically calculated.
 - Copy of receipt to customer with another stored internally.
 - After cash drawer reconciled to internal tape, cash receipts prepares cash reconciliation form, records to cash receipts journal, files credit card vouchers and secures cash.
 - Three-part deposit slip prepared and cash deposited. Batch program summarizes sales and cash receipts journal, prepares journal voucher and posts to GL. Cash over and short must be recorded.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Input Controls

- Ensure transactions are valid, accurate and complete.
- Credit authorization procedures ensure creditworthy customers.
 - Control techniques vary considerably between batch systems and real-time systems.
- Testing credit procedures:
 - Determine effective procedures exist to establish credit limits, information is communicated, credit policies are reviewed periodically and adherence to current policy is monitored.
 - Verify the correctness of programmed decision rules using either the *test data* or *integrated test facility* approach.
 - Verify proper authority for making line-of-credit changes.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Input Controls

- Data validation controls intended to detect transcription errors in data before they are processed. In batch systems, data validation occurs after goods have been shipped.
- Real time and POS systems can deal with errors as they occur.
- General validation tests include:
 - *Missing data checks* for the presence of blank fields.
 - *Numeric-Alphabetic data checks* for the correct form of data.
 - *Limit checks* to ensure value does not exceed max for the field.
 - *Range checks* ensures data is within upper and lower limits.
 - *Validity checks* compare actual values against acceptable values.
 - *Check digit* identify keystroke errors by testing internal validity.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Input Controls

- Testing Data Validation Controls:
 - Central audit issue is whether validation programs in data editing system are functioning correctly and have continued to function as intended through the period.
 - Validation of program logic can be difficult.
 - If controls over system development and maintenance are NOT weak, testing data editing/programming logic more efficient than substantive tests of details (test data, ITF).
 - Some assurance can be gained through the testing of error lists and error logs (detected errors only).
- Objective to reconcile output with original input. Controls continue through all computer processes.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Input Controls

- Important element is the batch transmittal sheet which captures relevant information about the batch.
 - Information entered as a separate control record system uses to verify the integrity of the batch.
 - Task of reconciling processing with control record provides assurance all sales invoices and cash receipts entered were processed (or rejected because of errors) only one time.
- Testing batch controls:
 - Involves reviewing transmittal records of batches processed and reconciling them to the batch control log (batch transmittal sheet).
 - Batch control totals are also a valuable tool.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Process Controls

- **File update controls:** Ensure each run in system processes the batch correctly and completely.
 - **Transaction code controls** – Tasks performed determined by transaction code assigned to records. Errors can cause incorrect processing resulting in materially misstated sales and AR.
 - **Sequence check controls** – When system uses sequential master files, order of records in batch critical to correct and complete processing.
- Testing file update controls:
 - Testing transaction codes and sequence checks can use ITF or test data that contains incorrect codes and records out of sequence.
 - Efficient use of logic-testing CAATs requires careful planning.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Access Controls

- Prevent and detect unauthorized and illegal access to firm's systems and/or assets. Techniques:
 - Warehouse security, depositing cash daily, using safe deposit or night box for cash, locking cash drawers and safes.
- Controlling access to accounting records also important. Risks:
 - Removal of an AR account from books, unauthorized shipments of goods, removal of cash, covered by adjustments to cash account, theft of products/inventory, covered by adjustments to inventory or cash accounts.
- Testing access controls (both system wide and application specific):
 - Passwords, data encryption, firewall and user views need to be tested as part of the review of general controls.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Physical Controls

- Proper segregation of duties ensures no single individual or department processes an entire transaction.
 - Rule 1: Transaction authorization separate from transaction processing.
 - Rule 2: Asset custody separate from record-keeping tasks.
 - Rule 3: Organization structured so that fraud requires collusion between two or more people.
- Supervision:
 - Compensates for inherent exposure when employees must perform incompatible functions.
 - Supplement when duties are properly segregated.
 - Can be an effective preventive control.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Physical Controls

- Independent verification reviews work performed by others at key points to identify and correct errors. Examples:
 - Shipping dept. verifies goods sent from warehouse dept. are correct in type and quantity. Billing dept. reconciles shipping notice with sales notice to ensure customers billed correctly.
- Testing physical controls:
 - Review organizational structure for incompatible tasks.
 - Tasks segregated in manual systems get consolidated in DP systems. Ensure design, maintenance, and operations for computers are separated and programmers not responsible for program changes.
 - Personal relationships between individuals in incompatible areas may require further investigation.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Output Controls

- Designed to ensure information is not lost, misdirected, or corrupted and system processes functions properly.
 - Reconciling GL to subsidiary ledgers.
 - Maintenance of an audit trail.
- Audit trail output controls include:
 - AR change report, transaction logs and transaction listings, log of automatic transactions, unique transaction identifiers and error listings.
- Testing output controls:
 - Review summary reports for accuracy, completeness, timeliness, and relevance for decisions. Trace sample transactions through audit trails reports. ACL is very helpful in this process.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Substantive Test of Revenue Cycle Account

- Strategy used in determining nature, timing, and extent of substantive tests.
 - Derives from auditor's assessment of inherent risk, unmitigated control risk, materiality and efficiency.
- Concern is potential overstatement of revenues and AR.
- Focus on large, unusual transactions near period-end.
- Issues that give rise to concern:
 - Recognizing revenues from sales that did not occur or before they are realized or failing to recognize cutoff points.
 - Underestimating allowance for doubtful accounts.
 - Shipping unsolicited products to customers, subsequently returned.
 - Billings customers for products held by seller.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Substantive Tests of Revenue Cycle Accounts

- To resolve concerns, auditor should perform a combination of tests of internal controls (general and application specific) and substantive tests.
- Auditor must understand systems and controls that produced the data, as well as physical characteristics of the files.
 - Customer, sales invoice, line item, inventory, and shipping log files.
- File preparation procedures:
 - In using ACL, each file needs to be defined in terms of its physical location and structure.
 - Important to validate contents before performing any substantive tests on a new file.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Testing the Accuracy and Completeness Assertions

- Often preceded substantive tests of details with an **analytical review** of account balances.
 - Provides auditor an overall perspective for trends in sales, cash receipts, sales returns, and AR.
 - May provides first-level assurance that amounts are reasonably stated and reasonably complete, allowing for a reduction in substantive testing.
- Review sales invoices for unusual trends, exceptions.
 - Use *Stratify* to look for anomalies such as credit balances in AR and the *filter capability* to identify specific records that appear to contain anomalies.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

As of: 05/10/2019 10:27:33

Command: STRATIFY ON amount MINIMUM -1000 MAXIMUM 5549.19 INTERVALS 10 TO SCREEN
Table: ar

Minimum encountered was -3,582.98
Maximum encountered was 5,549.19

| Trans Amount | Count | Percent of Count | Percent of Field | Trans Amount |
|---------------------|------------|------------------|------------------|-------------------|
| < -1,000.00 | 20 | 2.59% | -6.81% | -31,928.54 |
| -1,000.00 - -245.00 | 29 | 3.76% | -3.7% | -17,355.17 |
| -245.00 - 399.93 | 216 | 27.90% | 0.40% | 2,250.97 |
| 399.94 - 964.75 | 308 | 39.9% | 40.23% | 188,622.25 |
| 964.76 - 1,619.67 | 129 | 16.71% | 33.99% | 159,371.25 |
| 1,619.68 - 2,274.59 | 42 | 5.44% | 16.81% | 78,824.30 |
| 2,274.60 - 2,929.51 | 12 | 1.55% | 6.58% | 30,835.20 |
| 2,929.52 - 3,584.43 | 11 | 1.42% | 7.64% | 35,840.18 |
| 3,584.44 - 4,239.35 | 2 | 0.26% | 1.8% | 7,490.28 |
| 4,239.36 - 4,894.27 | 1 | 0.13% | 0.94% | 4,426.14 |
| 4,894.28 - 5,549.19 | 2 | 0.26% | 2.24% | 10,503.83 |
| Totals | 772 | 100% | 100% | 468,880.68 |

| Invoice Number | Customer Number | Invoice Sales Amount | Due Date | Closed Date | Remittance Date |
|----------------|-----------------|----------------------|----------|-------------|-----------------|
| 213309 | 376005 | -931.55 | 12/04/10 | 12/14/10 | |
| 213355 | 376005 | -374.71 | 12/04/10 | 12/14/10 | |
| 212297 | 784647 | -537.36 | 12/04/10 | 12/14/10 | |
| 214389 | 262001 | -300.39 | 12/10/10 | 12/20/10 | |
| 214390 | 641464 | -46.77 | 12/10/10 | 12/20/10 | |
| 214391 | 222006 | -62.15 | 12/10/10 | 12/20/10 | |
| 213699 | 878035 | -378.45 | 12/07/10 | 12/20/10 | |
| 213700 | 878035 | -742.75 | 12/07/10 | 12/20/10 | |

Testing the Accuracy and Completeness Assertions

- Review sales invoice and shipping log files for missing and duplicate transactions.
- Seek answers to these questions:
 - Are voided invoices documented and approved? How are gaps in sales invoice numbers communicated to management?
 - What physical controls exist over access to sales invoice source documents? Are batch totals used to control transactions during data processing?
 - Are transaction listings reconciled/reviewed by management?
 - Duplicate records in shipping log may indicate same item shipped twice. Missing invoices may mean items not shipped.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Duplicates and Gaps on Invoice Number

As of: 06/10/2004 10:59:15

Command: GAPS ON ref DUPLICATES TO SCREEN PRESORT

Table: ar

0 sequence errors detected
243 gaps and/or duplicates detected

Duplicates:

| Record Number | Ref No |
|---------------|--------|
| 5 | 13452X |
| 10 | 211286 |
| 12 | 212287 |
| 13 | 212297 |
| 17 | 212824 |
| 31 | 213227 |
| 34 | 213248 |
| 48 | 213389 |
| 55 | 213328 |
| 61 | 213355 |
| 73 | 213392 |
| 75 | 213398 |
| 81 | 213418 |
| 85 | 213423 |

Gaps Found Between:

| Ref No |
|-------------------|
| 10,000 - 12,284 |
| 12,284 - 13,065 |
| 13,065 - 13,452 |
| 13,452 - 205,605 |
| 205,605 - 206,300 |
| 206,300 - 207,137 |
| 207,137 - 211,206 |
| 211,206 - 212,297 |
| 212,297 - 212,334 |
| 212,334 - 212,592 |
| 212,592 - 212,824 |
| 212,824 - 213,052 |

| BOL Number | Invoice Number | Shipping Date | Carrier Code |
|------------|----------------|---------------|--------------|
| 50449 | 214088 | 11/29/10 | 538 |
| 50450 | 214090 | 11/29/10 | 530 |
| 50451 | 214089 | 11/30/10 | 531 |
| 50452 | 214087 | 11/30/10 | 532 |
| 50453 | 214092 | 12/14/10 | 533 |
| 50455 | 214093 | 12/10/10 | 523 |

Testing the Accuracy and Completeness Assertion

- Review line item and inventory files for price accuracy.
 - ACL allows auditor to compare prices on invoices (actual price charged) with inventory prices using *Join*.
 - Most relevant for this test is creating a third file that consists of matched records.
 - Create a *filter* for the new file that ignores all records in which sale and retail price are equal so that only price discrepancies remain. If material, issue needs to be pursued.
- Testing for unmatched records:
 - By selecting a different join option a file of only unmatched records can be created. This will identify errors and potential evidence of the need to write down the value of inventory.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

| Invoice Number | Item Number | Sales Price | Quantity | Extended Price |
|----------------|-------------|-------------|----------|----------------|
| 214297 | 030303413 | 4.69 | 20 | 93.88 |
| 214297 | 030303403 | 5.29 | 10 | 52.90 |
| 214297 | 030303343 | 12.98 | 2 | 25.96 |
| 214298 | 130305603 | 16.00 | 5 | 80.00 |
| 214298 | 030302303 | 44.95 | 12 | 539.40 |

INVENTORY FILE

| Item Number | Description | Ware-house Location | Quantity on Hand | Reorder Point | Order Quantity | PO Number | Unit Cost | Retail Price | Vendor Number |
|-------------|-------------------------|---------------------|------------------|---------------|----------------|-----------|-----------|--------------|---------------|
| 030303413 | 8 oz. Ball Peen Hammer | 03 | 1,248 | 510 | 1,500 | | 3.90 | 4.69 | 10879 |
| 030303403 | 12 oz. Ball Peen Hammer | 03 | 536 | 550 | 1,200 | 111104 | 4.12 | 5.29 | 12248 |
| 030303343 | Straight Claw Hammer | 03 | 735 | 550 | 1,600 | | 8.83 | 12.98 | 10951 |
| 130305603 | #4 Smooth Plane | 03 | 804 | 800 | 2,000 | 107427 | 14.12 | 22.98 | 10879 |
| 030309373 | Heavy Duty Brace | 03 | 842 | 900 | 1,200 | 108123 | 10.12 | 16.98 | 10951 |
| 030302903 | 4 pc. Chisel Set | 03 | 795 | 620 | 1,200 | | 10.12 | 16.98 | 13411 |
| 030302303 | Mitre Box 21" | 03 | 600 | 650 | 1,200 | 129124 | 41.23 | 54.95 | 11182 |

| Invoice Number | Item Number | Description | Sales Price | Retail Price |
|----------------|-------------|-------------------------|-------------|--------------|
| 214297 | 030303413 | 8 OZ. BALL PEEN HAMMER | 4.69 | 4.69 |
| 214297 | 030303403 | 12 OZ. BALL PEEN HAMMER | 5.29 | 5.29 |
| 214297 | 030303343 | STRAIGHT CLAW HAMMER | 12.98 | 12.98 |
| 214298 | 130305603 | #4 SMOOTH PLANE | 16.00 | 22.98 |
| 214298 | 030302303 | MITRE BOX 21" | 44.95 | 54.95 |

Testing the Existence Assertion

- Confirmation of Accounts Receivable:
 - SAS #67 states auditor should perform written confirm of account balances with client's customers except when: AR are immaterial; control risk is low; or confirmation process will be ineffective.
- Selecting accounts to confirm:
 - Consolidate open invoices for each customer using *Classify* which allows auditor to select only open sales invoices.
 - Use *Join* to link the new file to the customer file and select a sample of accounts to confirm using ACL's *Sample* feature.
 - Sample may be random or based on monetary value of accounts.
 - *Size* command helps calculate sample size.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

TABLE 9.3**Sales Invoice File**

| Invoice Number | Customer Number | Invoice Amount | Sales Date | Due Date | Closed Date | Remittance Number |
|----------------|-----------------|----------------|------------|----------|-------------|-------------------|
| 212209 | 376005 | 931.55 | 12/04/10 | 12/14/10 | | |
| 212255 | 376005 | 377.71 | 12/04/10 | 12/14/10 | | |
| 212297 | 784647 | 537.36 | 12/04/10 | 12/14/10 | | |
| 214088 | 065003 | 13.08 | 12/04/10 | 12/14/10 | 12/11/01 | 611243 |
| 214389 | 262001 | 300.39 | 12/10/10 | 12/20/10 | | |
| 214100 | 641464 | 46.77 | 12/10/10 | 12/20/10 | | |
| 214114 | 065003 | 9.76 | 12/04/10 | 12/14/10 | | |
| 214129 | 262001 | 116.72 | 12/04/10 | 12/14/10 | | |
| 214121 | 165006 | 29.40 | 12/04/10 | 12/14/10 | 12/12/01 | 613457 |
| 214185 | 165009 | 9.17 | 12/04/10 | 12/14/10 | 12/23/01 | 614476 |

Classified Invoices File

| Customer Number | Invoice Amount |
|-----------------|----------------|
| 376005 | 1,279.26 |
| 784647 | 537.36 |
| 262001 | 417.11 |
| 641464 | 46.77 |
| 065003 | 9.76 |

TABLE 9.5 Customer File Structure with Sample Data

| Customer Number | Customer Name | Street Address | City | State | Zip Code | Credit Limit |
|-----------------|--------------------|------------------|-------------|-------|----------|--------------|
| 065003 | Accel Enterprises | 1000 Strayer Rd. | Brookline | MA | 02167 | 72,000 |
| 262001 | Connecticut Corp. | 600 Paragon Dr. | Brooklyn | NY | 11201 | 80,000 |
| 376005 | Bully Industries | 8 West Street | Las Vegas | NV | 89109 | 53,000 |
| 641464 | First Healthcare | 88 State St. | Austin | TX | 78752 | 28,000 |
| 784647 | Salt Bank of Amer. | 401 N. Broadway | Bentonville | AR | 72712 | 27,000 |

TABLE 9.6 Accounts Receivable File Structure

| Customer Number | Customer Name | Street Address | City | State | Zip Code | Invoice Amount |
|-----------------|--------------------|------------------|-------------|-------|----------|----------------|
| 065003 | Accel Enterprises | 1000 Strayer Rd. | Brookline | MA | 02167 | 9.76 |
| 262001 | Connecticut Corp. | 600 Paragon Dr. | Brooklyn | NY | 11201 | 417.11 |
| 376005 | Bully Industries | 8 West Street | Las Vegas | NV | 89109 | 1,279.26 |
| 641464 | First Healthcare | 88 State St. | Austin | TX | 78752 | 46.77 |
| 784647 | Salt Bank of Amer. | 401 N. Broadway | Bentonville | AR | 72712 | 537.36 |

Testing the Existence Assertion

- Preparing confirmation requests.
 - Letters may be positive or negative confirmations.
 - ACL's *Export* feature can facilitate inserting relevant financial data for each customer into letter.
- Evaluating and controlling responses.
 - Maintaining auditor control is critical to integrity.
 - Auditor should retain custody of the confirmation letters until mailed.
 - Letters should be addressed to the auditor, not client.
 - The replies should be mailed to the auditor, not client.
 - Discrepancies in amounts owed should be investigated.
 - Non responses to positive confirmation should be investigated.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

CLIENT LETTERHEAD (CLIENT NAME AND ADDRESS)

(Name and Address of Client's Customer)

To whom it may concern:

In accordance with the request from our external auditors, we ask that you confirm your outstanding account balance with our organization. Our records indicate that your account balances as of **(end-of-period date)** amounted to **(\$ amount)**.

If your records agree with this balance, please indicate by signing in the space provided below and return this letter directly to our auditors using the enclosed envelope. Your prompt compliance with this request is greatly appreciated.

If the amount indicated is not in agreement with your records, inform the auditors directly using the enclosed envelope. In your response, please show the amount owed according to your records and include full details of the discrepancy.

Sincerely,
(Name of Entity)

The amount stated above is correct: (Customer Name)

Testing the Valuation/Allocation Assertion

- Corroborate or refute AR stated at reasonable net realizable value.
 - Objective rests on reasonableness of allowance for doubtful accounts derived from aged AR balances.
- Aging Accounts Receivable.
 - Is allowance for doubtful accounts reasonable compared to prior years and based on composition of AR portfolio?
 - ACL *Aging* feature will produce a report providing a clear feature of the AR composition.
 - Auditor should review past-due balances with credit manager to determine collectability.
 - Objective is to determine that methods used to estimate allowance is adequate and that overall allowance is reasonable.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Aging of Accounts Receivable Produced with ACL

As of: 06/10/2004 11:28:00

Command: AGE ON due CUTOFF 20031231 INTERVAL 0,30,60,90,120,10000 TO SCREEN
Table: ar

Minimum encountered was -124
Maximum encountered was 834

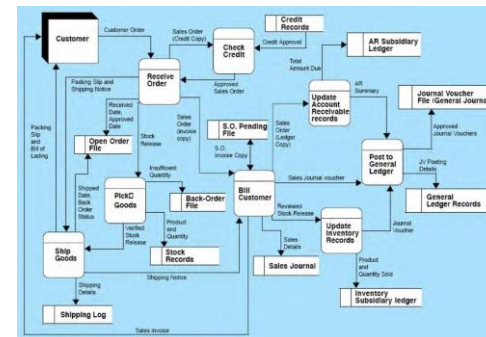
| Days | Count | Percent of Count | Percent of Field | Trans Amount |
|---------------|------------|------------------|------------------|-------------------|
| <0 | 255 | 33.03% | 46.3% | 217,113.27 |
| 0 - 29 | 259 | 33.55% | 38.86% | 181,252.50 |
| 30 - 59 | 170 | 22.02% | 11.66% | 54,676.94 |
| 60 - 89 | 58 | 7.51% | 1.81% | 8,496.10 |
| 90 - 119 | 17 | 2.2% | 1.52% | 7,137.88 |
| 120 - 10,000 | 13 | 1.68% | 0.04% | 204.00 |
| Totals | 772 | 100% | 100% | 458,880.69 |

Overview of Revenue Cycle Activities and Documents

APPENDIX

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

DFD of Sales Order Processing System



© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Sales Order Procedures

- **Customer order** is transcribed into a **sales order** with copy to **customer open order file**. **Credit copy** to check-credit task.
- **Approved sales order** triggers continuation of sales process releasing info to various tasks:
 - **Stock release document** (picking ticket) to the pick goods function. Goods and **verified stock release** to ship goods. **Back-order records** prepared when inventory insufficient.
 - Shipping receives **packing slip** and **shipping notice** from receive order function. Reconciles with goods received. Clerk packages goods, attaches packing slip, prepares **bill of lading**, transfers goods to carrier and updates shipping log. Shipping notice and stock release to bill-customer. Update to customer open order file.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Sales Order Processing

- Shipment marks completion of economic event and point at which customer should be billed.
 - Billing function awaits notification from shipping before it bills. Completed **sales invoice** is customer bill.
- Billing function:
 - Records sale in sales journal and forwards copy of sales order to "update AR" task. Sends stock release document to update inventory records task.
- **Sales journal** used for recording completed sales transactions which are summarized into **sales journal voucher** for updating GL.
 - Effective control against unauthorized GL entries.

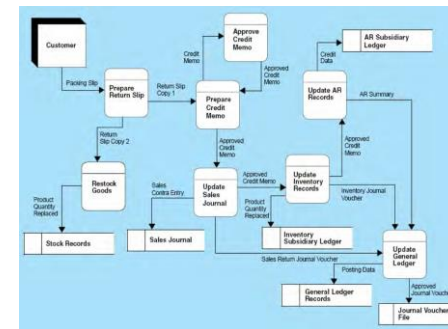
© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Sales Order Processing

- Inventory Control updates **inventory subsidiary ledger** accounts from information in the stock release document.
- Customer records in the **accounts receivable (AR) subsidiary ledger** updated from information in the sales order (**ledger copy**).
- By close of transaction processing, GL function has received journal vouchers from billing and inventory control and account summary from AR.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

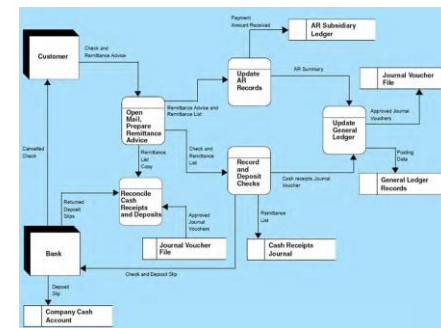
DFD of Sales Return Procedures



© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

- Some sales returned due to wrong shipments, defects, damage and buyer refusal.
- Receiving department prepares **return slip** with copies to warehouse and sales function.
- Goods & return slip to warehouse.
- Sales prepares **credit memo** which is approved by credit manager. **Approved credit memo** to sales.
- Transaction recorded in sales journal as contra entry with updates to inventory, AR and GL.

DFD of Cash Receipts Procedure



© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Cash Receipts Procedures

- Mail room receives payments and **remittance advices (RAs)** which help avoid errors and improve operational efficiency.
- Mail room routes check and RAs to clerks who endorse checks and reconcile RAs with checks.
- Administrative clerk records checks on cash prelist (**remittance list**) and sends list and checks to record and deposit checks.
- Prelist copies sent with RAs to update AR function and to a reconciliation task.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.

Cash Receipts Procedures

- Cash Receipts employee verifies checks, updates cash receipts journal, prepares bank **deposit slip** and forwards checks to bank.
- Remittance advices used to post to customer accounts in AR subsidiary ledger which are periodically summarized and forwarded to GL.
- GL reconciles journal voucher and account summaries and posts to cash and AR.
- Controller periodically reconciles cash receipts by comparing prelists, deposit slips and related journal vouchers.

© 2016 Cengage Learning®. May not be scanned, copied or duplicated or posted to a publicly accessible website, in whole or in part, except for use as permitted in a license distributed with a certain product or service or otherwise on a password-protected website or school-approved learning management system for classroom use.