

Accounts Receivable, Notes Receivable, and Revenue

CHAPTER 11



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CHAPTER 11-1

TESTING ACCOUNTS RECEIVABLE

When testing accounts receivable, we are also testing?

INCOME STMT: SALES and bad debt expense

BALANCE SHEET: Allowance for doubtful accts

Therefore in MANY businesses, testing receivables is a critical test of the company's operating activities.

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Intro & Chapter 11-2

Management Assertions

When auditors test accounts receivable, what management assertion/s are they MOST interested in?

Valuation- did they record enough bad debt expense
Existence/ Cutoff- are these valid (NOW/ timing/ revenue recogn.)

What about the others:

Completeness

Not as concerned, but there might be some cut-off issues to consider.

Rights and Obligations

Are these related to sham transactions, sale lease-back, etc.

Presentation & Disclosure

Have the receivables been pledged? Do they secure something?

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Intro & Chapter 11-3

- Accounts or trade receivables
- Notes receivable
 - loans to officers, employees, subsidiaries
- Tax refunds
- Advances to suppliers

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Intro & Chapter 11-4

Internal Control Over the Revenue Cycle

- Controlling customers' orders
- Credit approval
- Issuing merchandise
- Shipping
- Billing
- Adjustments to sales and receivables

Revenue Cycle Documents

- Customer purchase order
- Sales order
- Bill of lading
- Invoice
- Control listing
- Credit memo

Balance Sheet

	2003
Assets:	
Accounts receivable	30,000
Allowance for D.A.	(1,000)

Liabilities:

Equity:

	Retained earnings	(29,000)
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Income Statement

	2003
Revenues:	
Sales	(30,000)

Expenses:

	Bad debts	1,000
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	Net (income) loss	(29,000)
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Made a sale for \$30,000 on account. Estimated \$1,000 would not be collectible.

A. Consider inherent risks, including fraud.

B. Consider internal control over receivables and revenue.

1. Obtain an understanding of internal control.
2. Assess control risk and design additional tests of controls and substantive tests.
3. Perform additional tests of controls.
 - a. Examine significant aspects of a sample of sales transactions.
 - b. Compare a sample of shipping documents to related sales invoices.
 - c. Review the use and authorization of credit memoranda.
 - d. Reconcile cash register tapes and sales tickets with sales journals.
 - e. Test computer application controls.
4. Reassess control risk and modify substantive tests.



C. Perform substantive tests of receivables and revenue.

1. Obtain an ARTB and reconcile to ledgers.
2. Confirm receivables with debtors.
3. Review the year-end cutoff of sales transactions.
4. Perform analytical procedures for A/R and revenue.
5. Review significant year-end sales contracts for unusual terms.
6. Evaluate the propriety of the accounting methods for receivables and revenue.
7. Evaluate accounting estimates related to revenue recognition.
8. Determine adequacy of allowance for uncollectible accounts- obtain the aging to assist in this.
9. Ascertain whether any receivables have been pledged.
10. Investigate any transactions with related parties.
11. Evaluate the business purpose of significant and unusual sales transactions.
12. Evaluate presentation / disclosure of receivables and revenue.



LINK SUBSTANTIVE TEST TO THE OBJECTIVE

EXISTENCE/ Cutoff

- Confirmations
- Sales cut-off
- Vouching from AR aging to sale invoices
- Vouching to subsequent receipts

COMPLETENESS/ Cutoff

- Sales cut-off
- Vouch from shipping documents to a/r

RIGHTS & OBLIGATIONS

- Confirmations- customer might tell you something
- Other testwork (debt for instance) may indicate pledges of receivables

VALUATION

- Analytics
 - Turnover computations and comparisons
 - Evaluation of aging
- Aging procedures (Inquire all balances > 90 days)

PRESENTATION & DISCLOSURE

- Factor what learned above into the financial statements.

