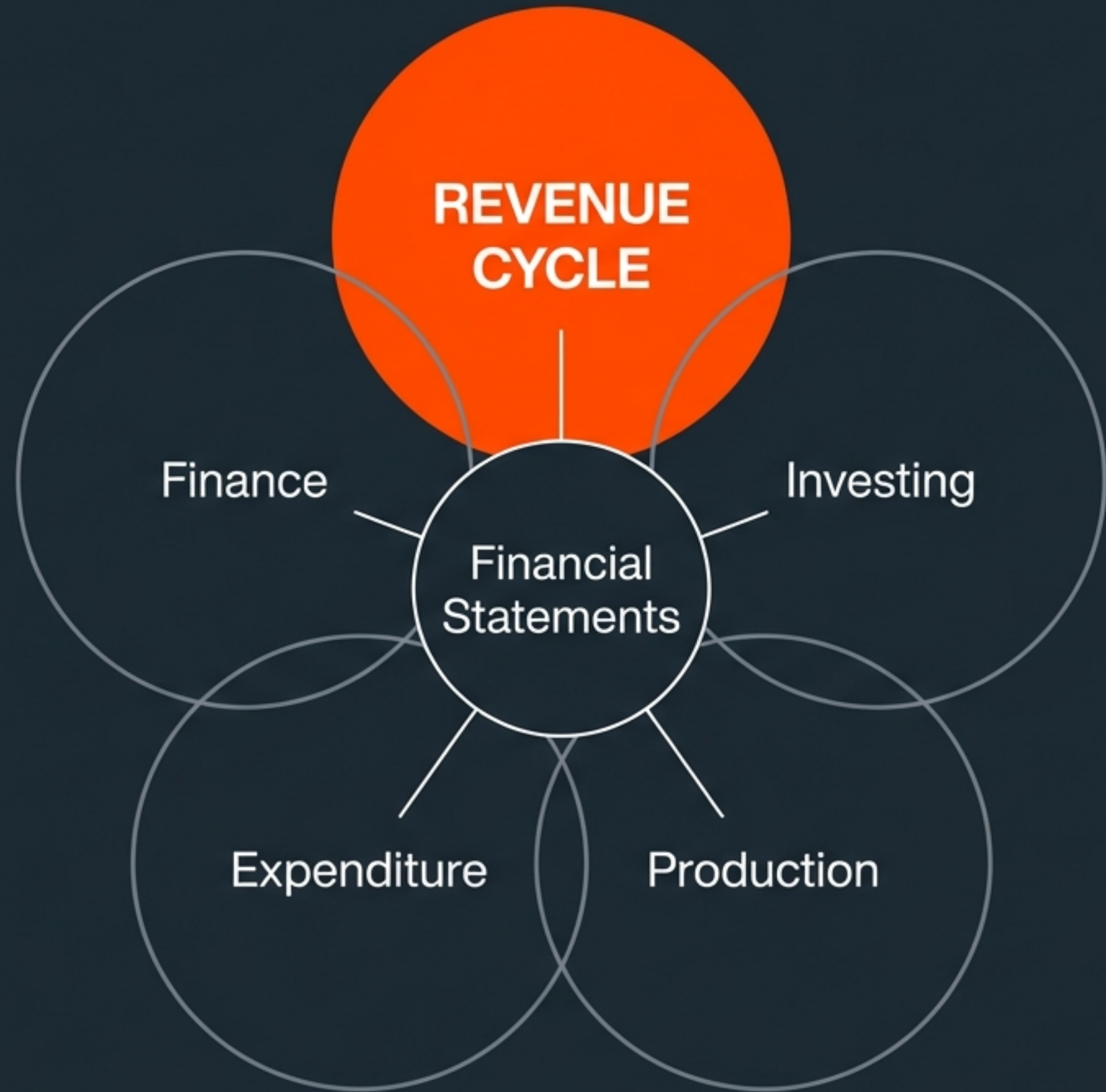


# AUDITING THE **REVENUE** CYCLE

Risks, Internal Controls,  
and Substantive Procedures

# The Financial Ecosystem



# The Flow of Value



Sales Activity



Cash Collection



Adjustments



## Key Accounts

Accounts Receivable  
Allowance for Doubtful Accounts  
Sales Revenue  
Cash / Bank

# The Motivation to Manipulate

## OVERSTATEMENT RISK



Goal: Inflate Net Income

## UNDERSTATEMENT RISK



Goal: Deflate Net Income

# How Risks Materialize

## FICTITIOUS REPORTING

---

Recording sales from future periods.

Creating fake orders to boost quotas.

## LIQUIDITY & VALUATION

---

Overstating cash flow.

Under-estimating the Allowance for Doubtful Accounts.

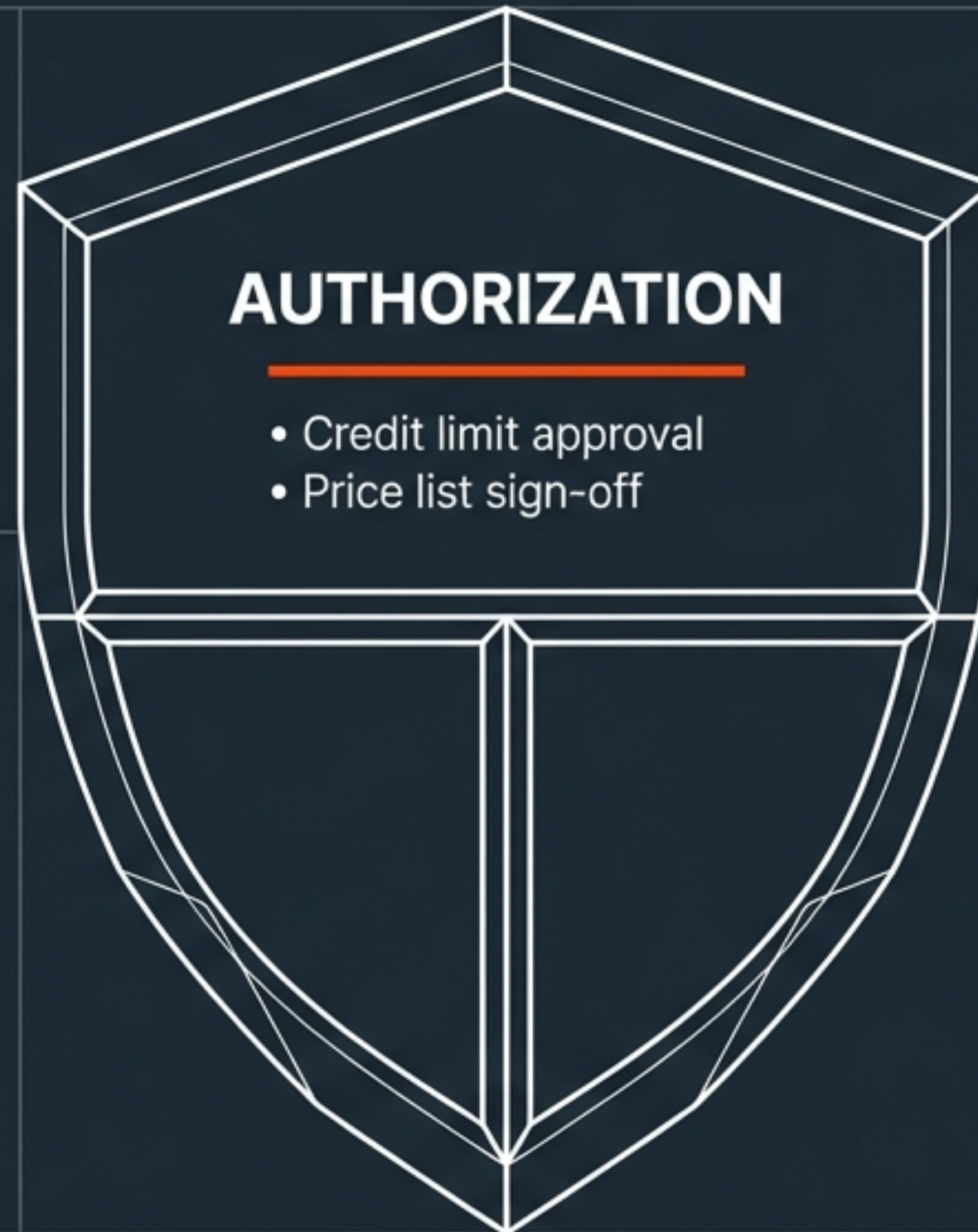
## THEFT & CONCEALMENT

---

Lapping (covering one payment with another).

Unauthorized write-offs to hide stolen cash.

# Internal Controls: The Shield



## **AUTHORIZATION**

- Credit limit approval
- Price list sign-off

## **CUSTODY**

- Restricted warehouse access
- Cash safes & deposits

## **RECORDING**

- Separation of duties
- Sequential document numbering

# Verifying the Controls



Risk: Theft of Cash

Test: Observe cashier & Reconcile bank deposits.



Risk: Unauthorized Sales

Test: Inspect sales orders for approval signatures.



Risk: Missing Recordings

Test: Check sequential numbering of shipping docs.

# Substantive Procedures: Analytics

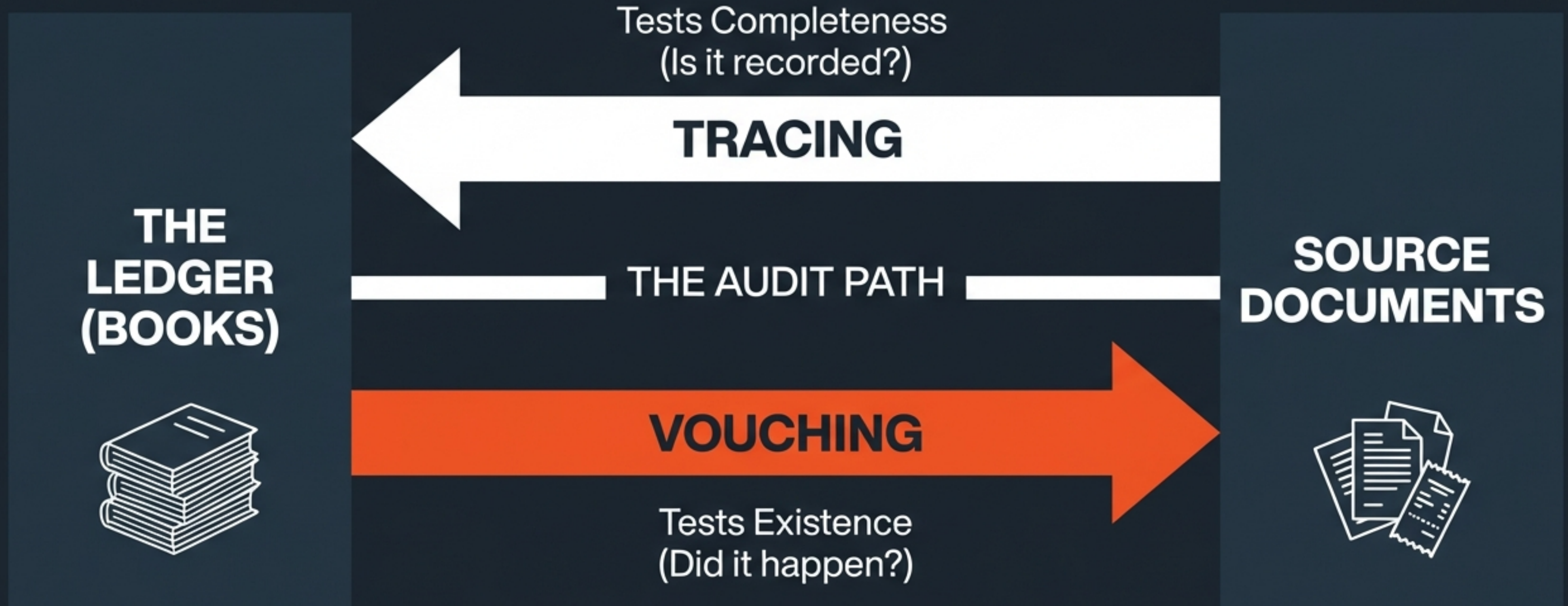


Analyze:  
Accounts  
Receivable Turnover

Analyze:  
Allowance %  
of Assets

Compare Against:  
Budgets, Forecasts,  
Market Share Data


# Vouching vs. Tracing




# The Cut-Off Test

Rule: Revenue Recognized  
at **FOB Shipping Point**


**Invoice 1**  
Rec: Dec 26  
Ship: Dec 29



**Invoice 2**  
Rec: Dec 29  
Ship: Jan 02



**Invoice 3**  
Rec: Jan 02  
Ship: Dec 31

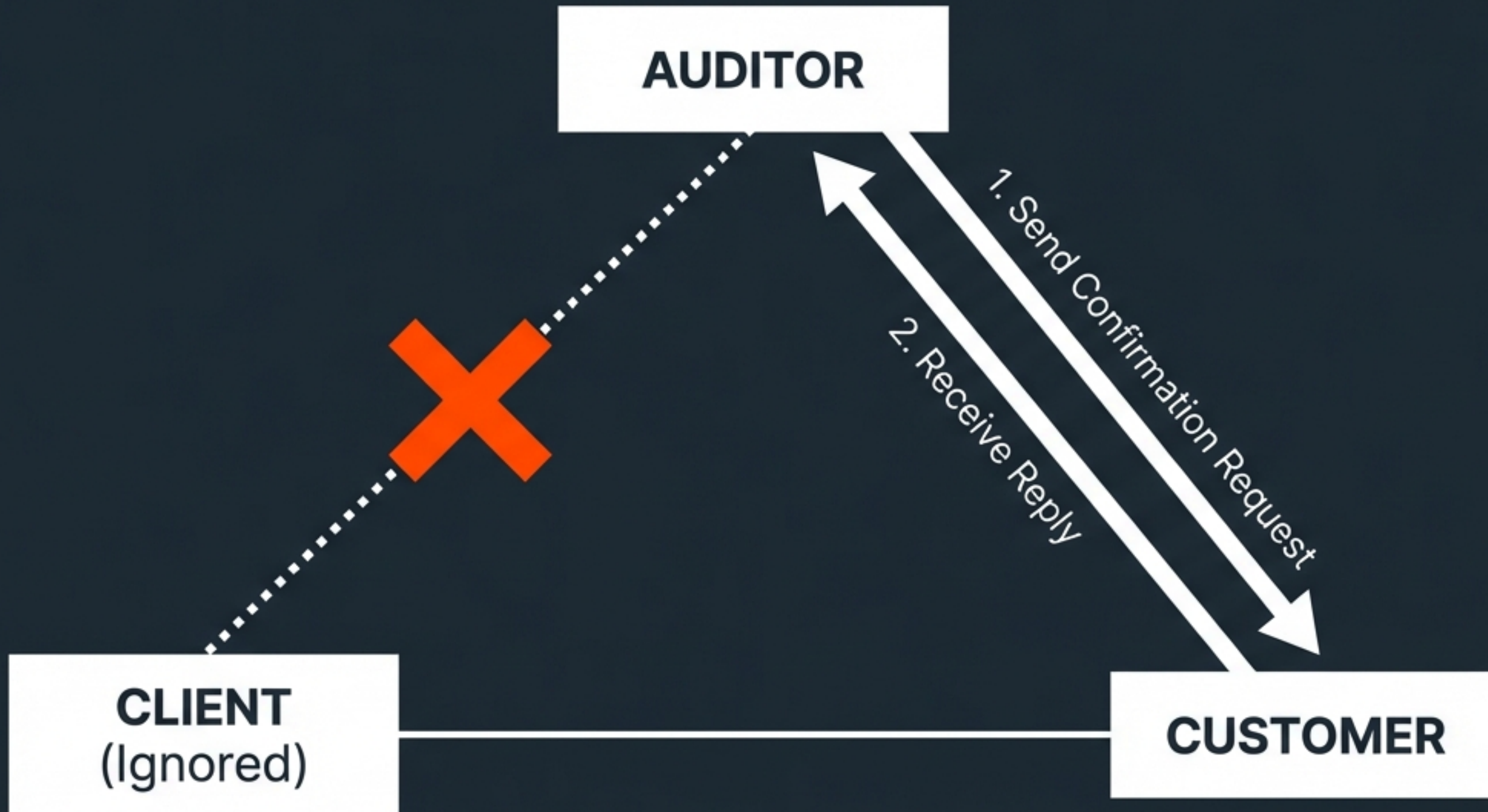


**ERROR: Overstatement**

**ERROR: Understatement**

**DEC 31**  
(Year End)

# Confirmation of Balances



## If No Reply, Alternative Procedures:

- Examine Subsequent Cash Receipts
- Verify Shipping Docs

# Valuation & The Allowance

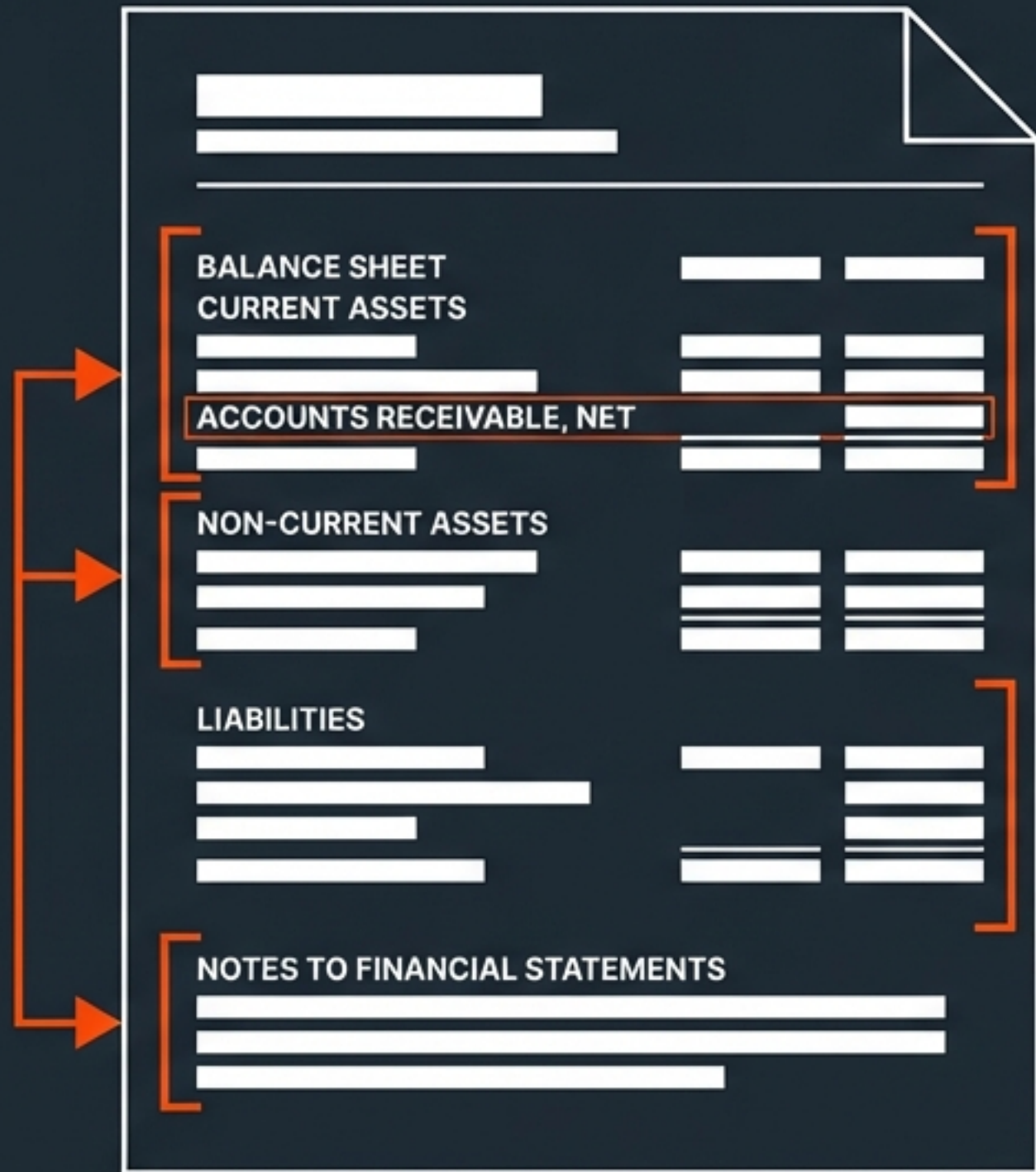


Analyze Aging Schedule

Review Disputes & Bankruptcy

Ensure Net Realizable Value

# Presentation & Disclosure



- **Classification:** Separate Trade vs. Non-Trade Receivables
- **Time Horizon:** Verify Current vs. Non-Current
- **Pledging:** Disclose assets used as collateral
- **Credit Balances:** Reclassify negative AR as Liabilities

# Key Takeaways

**01. RISK:** Incentives exist for both overstatement and understatement.

**02. SHIELD:** Verify Authorization, Custody, and Recording controls.

**03. TEST:** Vouch for Existence. Trace for Completeness.

**04. PRECISION:** Cut-off tests define the boundary of financial **Truth.**