

Audit of the Sales and Collection Cycle

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Introduction

All organizations expect to maximize their profit while working to minimize their losses. One of the main ways that companies can achieve this is by performing internal audits to evaluate assertions. Moreover, firms should conduct regular audits to assess the understatement or overstatement of the company's assertions (Lidstone & MacLennan, 2017). On the other hand, an auditor must perform a substantive internal audit in order to recognize and control deficiencies in the company. The company should, therefore, follow all the recommendations issued by the auditors to achieve its goals.

Objective

The main goal of auditing the cycle of sales and collection is to assess if the accounts balances influenced by the cycle are moderately presented in line with the standards of accounting. However, the nature of the accounts can vary depending on the industry as well as the customer involved (Soykan & Ulucak, 2016). Moreover, there are differences in the account titles and nature of the service business, insurance company, and retail company. However, it is important to note that the key ideology remains the same.

Classes Of Transaction

Further, there is a way in which the accounting information should flow through several accounts in the cycle of sales and collection. The figure below shows the five classes of transformation that the information should flow in the cycle of sales and collection. It is significant to note that the cycle of sales and collection involves the decisions as well as procedures that are considered to be essential for the transfer of goods ownership and services to clients as soon as they are accessible for sale. This process starts with a demand by the clients and finishes with the change of service or material into the account that is receivable and eventually into cash (Awadallah, & El Said, 2017).

The eight business roles for the cycle of sales and collection happen in all the businesses within the recording of the classes of transactions within the cycle of sales and collection. Notably, in the business functions, the first four procedures, which are granting credit, shipping goods, billing customers, and recording sales, are used for sales recording, whereas all the other classes of transactions comprise just one business function. Therefore, before the auditors can evaluate the control risk and design the relevant test of control and tests of substantive of the transaction, they are required to completely understand documentation and the business function as well as records in

the business.

Customer Orders

The cycle is initiated by the clients who request services and goods. Further, in legal terms, it is a proffer to purchase goods or services under particular terms of the purchase. Therefore, the receipt of the client's order frequently results in the instant creation of the sale demand. In this sense, a customer order is a demand for services or goods by the clients (Young & Moyes, 2014). Besides, these orders may be received via letters or telephone that are sent to prospective and existing clients, through the Internet or salesperson, or through a working network connection between the customer and supplier. On the other hand, a sales order is a document that is used to communicate the description and quality of the goods ordered by the client. Moreover, it is usually used to indicate credit approval and automate the required shipment.

Granting Credit

Nevertheless, before the shipment of the goods, a properly authorized individual should approve the credit to the client for the sales on account. Therefore, a weak practice in credit approval constantly results in extreme debts and accounts receivable, which might be uncollectible. The indication of approval of credit on a sales order serves as an approval for the shipment of goods. In most organizations, the computer is formulated to automatically approve sales credit based on the pre-approved credit limits sustained in the customer file, which is known as the customer master file. Moreover, the computer permits sales to progress only at a time when the proposed total order of sales plus the existing client balance is less than the credit limit within the master file.

Shipping Goods

This is the critical role in the initial point in the cycle at which the organization gives up an asset. Several firms recognize sales at the point of shipment of goods. Further, a shipping document is always prepared during the period of shipment and is done automatically by the computer, depending on the information of the sales order (Young & Moyes, 2014). The shipping document is significant for the proper billing of the shipment to the clients. Organizations that sustain perpetual inventory records also update them in line with shipping records. In this case, the shipping document is a document prepared in order to start the shipment of the services and goods, which indicates the description of the goods, the quantity shipped, and any other relevant information. Therefore, it is the responsibility of the company to send the original shipping order to the client and keep one or even more copies of the shipping document. Moreover, the document of shipping serves as an indication to the bill the client and might be in paper or rather electronic form.

The main type of shipping document is the lading bills, which are the written contract between the

seller and carrier of the receipt as well as the shipment of goods. Usually, the lading bills comprise the number of pounds or boxes shipped instead of the complete detail of the description and quantity (Young & Moyes, 2014). Moreover, the lading bill is usually electronically transmitted once the goods have been shipped, and it automatically generates the invoice for the related sales and entries in the journal sales. Several organizations use handheld computers and bar codes to record the removal of inventory from the company warehouse. The data is then used to update the records of perpetual inventory.

Billing Customers And Recording Sales

Since billing clients is the means by which the client is informed of the amount required for the goods, it should be done correctly and on a timely basis. The most significant elements of billing are accuracy, competence and occurrence. Therefore, billing the correct amount is dependent on charging the client for quality shipping at an authorized price, which considers the charges of freight, terms of payment, and insurance (Gonzalez, Hoffman, & Ingram, 2014). In several systems, the billing of the client contains preparation of the electronic record or sales of the multi-copy invoices as well as the actual time updating of the files of the sales transaction, the account receivable master file, as well as the general ledger of the master file for account and sales receivable. Thus, the accounting system uses this data to generate the journal of sales along with the miscellaneous credit and cash receipts to prepare the account receivable trail balances.

Description Of Related Document

Sales invoice

A sales invoice is described as a document or electronic record showing the description as well as the quality of the goods and services sold, their prices, insurance, freight charges, terms of the sales and any other relevant information. Moreover, the sales invoice is a method of signalling the clients concerning the number of sales and the due date of payment. Normally, the company automatically generates the required sales invoice based on the client's quantity, number, sales terms, and destination of the goods shipped as entered. Moreover, the computer calculates the total sales invoice and extension amount using the data entered, with the prices within the inventory master file.

Sales transaction file

This is a file that is computer-generated and includes every sale transaction processed by an accounting system for a number of periods on a daily, weekly, or monthly basis. Moreover, the document comprises all the data entered into the company system as well as the data for every transaction, such as the name of the client, amount, date, salesperson, commission rate, and account

classification. Besides, the file might also include the allowances and returns, or the company can provide a different file for the transaction of the returns and allowances (Lidstone & MacLennan, 2017). Furthermore, the data within the sales transaction file can be used for different records, reports or listings based on the requirements of the company. These might comprise the sales journal, transactions for the particular account division or balance, and the accounts receivable master file.

Sales journal or listing

This is the document used for listing or generating reports from the sales transaction file, which generally includes the name of the client, amount, and account classification for every transaction, as well as the date. Also, it recognizes if the sale was for an account or even cash receivable. Moreover, the sales listing or journal is normally done on a monthly basis, but it can cover any period (Soykan & Ulucak, 2016). Usually, the sales listing or journal comprises the totals of each number of accounts for the required time. Moreover, a similar transaction which is included in the listing or journal is also recorded concurrently to the general ledger file and, if they are on the company account, to the account receivable master file. The listing or journal may include allowance and return, or the company can organize for a separate listing or journal of the transactions.

Account receivable master file

This is a file generated by a computer that is used to record individual sales, sales returns, cash receipts and allowances for every client and to sustain client account balances. It is important to note that the master file must be updated from the sales returns, sales as well, and cash receipts computer transaction files. Besides, the sum of the individual account balances within the master file is equivalent to the total balance of the receivable account within the general ledger (Gonzalez, Hoffman, & Ingram, 2014). The printout of the receivable account master file indicates, by the client, the starting balance in the receivable account, sales returns and allowances, every sale transaction, the ending balance as well as cash receipts.

Accounts Receivable Trial Balance

This report or list indicates that the total amount receivable for every client at a point of sale. It is directly generated from the account receivable master file and is normally an aged trail balance, which may include the outstanding total balance and the total days in which the receivable has been outstanding, which is usually categorized in the order of days.

Monthly Statement

A monthly statement is a document which is sent through mail or even electronically to every client showing the starting balance of the client's account receivable, the date and amount of every sale, the credit memos that have been issued, the total cash payable receivable as well as the ending balance which is due. It is, indeed, an important part of the client section of the account receivable master file.

Designing tests of controls and substantive tests

In this section, it is important to understand how the auditors attain an understanding of the internal control of the company. In applying a single usual approach for sales, the auditors study the flowchart of a customer, generate inquiries from the customer using the internal control questionnaire, and finally perform the walk-through tests of the relevant sales.

Moreover, the auditor will then use the data attained to understand how internal control operates to evaluate control risk. There are four important phases to this evaluation. The first step requires the auditor to obtain a framework for evaluating the control risk. This information or framework can be attained from the six transaction-related audit goals. It is significant to note that the objectives are similar to all the audits of the sales. The second phase is that the auditor is required to recognize the key internal control as well as the deficiencies for the sales (Gonzalez, Hoffman, & Ingram, 2014). However, these will not be the same for the entire audit since every customer has diverse internal controls. The third step is after the auditor recognizes the deficiencies and controls, the auditor links them with the goals of the auditing. Finally, the auditor evaluates the control risk for every objective by assessing the control as well as deficiencies for every objective. This phase is vital to auditing since it directly affects the auditor's decision concerning the control test as well as substantive tests. Moreover, their decisions should be subjective. Thus, the auditor should give their conclusion concerning the company's evaluated control risk.

Audit Program For Test Of Control And Substantive Test

Adequate Separation of Duties

The first audit program is the separation of duties. This helps in the prevention of several categories of misstatement due to fraud and errors. Therefore, in order to [prevent fraud](#), the management ought to deny access to cash to all the individuals who are responsible for entering the cash and sale receipts transaction data into the company computers (Lidstone & MacLennan, 2017). Moreover, the credit granting role must be separated from the other sales function since the credit checks are

supposed to offset the tendency of the salesperson in order to optimize the volume at the expense of extreme debt write-off. Moreover, the personnel responsible for making the internal comparison must be independent of the ones keying in the original information. For instance, the comparison of controlling the batch totals with the report's summary, as well as the comparison of the receivable account master file totals with the general ledger balance, must be conducted by an independent person of the ones entering the cash receipt and sales transactions.

Proper authorization

The auditor should also be concerned about the authorization at the three main points: the credit should be authorized properly prior to sales, the goods must be shipped only after ensuring proper authorization, and the prices, which include the discounts and basic terms, and the freight should also be properly authorized. The initial two controls are in place to prevent the loss of organization assets through shipping to the clients who are fictitious or even the ones who cannot pay for the goods and services. On the other hand, the price authorization is put in place to make sure that all the sales are billed at the formulated price according to the company policy. The authorization may be done for a particular transaction or as general authorization for a given particular class of transactions. The general authorizations are the ones done by the company computer automatically.

Adequate Documents and Records

Since every organization has a distinctive system of processing, recording, originating and transaction, the auditor might find it hard to assess if every customer's process is designed in order for maximum control. However, adequate keeping of records processes should exist prior to most of the transactions which are related to the audit objectives that can be met. Certain organizations, for instance, automatically generate a number of copies of pre-numbered sales invoices at the moment a client order is received. The copies of the document are used to approve credit, record the total number of shipped units, bill clients, and authorize shipment.

Pre-numbered Documents

Pre-numbering is meant for the prevention of both the failure to record and bill the sales as well as the occurrence of billings that are duplicated and recorded. However, it is not useful to have these documents without ensuring that they are accurately accounted for. To effectively use the documents, the billing clerk is supposed to file a single copy of every shipping document in the order of sequence after the shipment is billed.

Monthly Statements

It is vital to send the monthly statement since it encourages the clients to respond whether the balance stated is incorrect (Lidstone & MacLennan, 2017). However, the monthly statement must be controlled by individuals who do not have any responsibility for recording sales or even handling cash or accounts receivable in order to avoid the deliberate failure to send these statements. To maximize the effectiveness, every disagreement concerning account balances must be directed to the designated individuals who have no responsibility for accounts receivable, handling cash or even recording the company sales.

Conclusion

In summary, an efficient and appropriate internal audit ensures the propriety of the firm. The sources of the information used in the auditing may come from the amount in the balance report, financial report or other related documents in the company. The effective direction relies on the primary purpose of the audit.

References

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