

CHAPTER THREE

RECEIVABLE AND SALES AUDIT

3.1 INTRODUCTION

- Receivable is a general term that may refer to many types of receivables whose origin and nature may be different.
- Receivables include amounts **due from customers**, employees, and affiliates on open accounts, notes, and loans and accrued interest on such balances.

3.2 SOURCES AND NATURE OF RECEIVABLE

- The sales and collection cycle including the receiving of orders from customers are delivery and billing of merchandise to customers, and the recording and collection of receivables.
- Receivables from customers include both accounts receivable and various types of notes receivable.
- It is important to differentiate the origin and nature of receivables to

3.3 FINANCIAL REPORTING STANDARDS

- Financial reporting standards for receivables require:
 - separation of trade from non - trade receivables.
 - assurance of ownership disclosure.
 - assurance of collectability of receivables.
 - assurance of consideration for returns and allowances.
 - appropriate classification of current and non - current.

3.4 AUDIT OBJECTIVES

- The audit objectives for the receivables and sales relate to obtain to sufficient competent evidence about each significant financial statement assertion that pertains receivables and sales transactions and balances.
- To achieve each of these specific audit objectives, the auditors employ various parts of the audit planning and audit testing methodology.

The auditors' objectives in the examination of receivables and sales are:

- 1.To consider internal control over receivables and sales transactions.
- 2.To determine the **existence of receivables**, the clients ownership of these assets, and the occurrence of sales transactions.
- 3.To establish the **completeness of receivables** and sales transactions.
- 4.To establish the **clerical accuracy** of records and supporting schedules of receivables and sales.
- 5.To determine that the valuation of receivables is at appropriate **net realizable values**.
- 6.To determine that the statement presentation of receivables and sales is adequate.

Assertion Category	Transaction class Audit objective	Account balance Audit objective
Category Existence or Occurrence	Recorded sales transactions represent goods shipped during the period. Recorded cash receipts transactions represent cash received during the period.	Accounts receivable include all amounts owed by the customers exists at the balance sheet date.
Completeness	All sales, cash receipts sales adjustments that occurred during the period have been recorded.	Accounts receivable include all claims on customers at the balance sheet date.
Rights and Obligations	The entity has rights to the receivables and cash resulting from sales transactions.	Accounts receivable at the balance sheet date represents legal claims of the entity.
Valuation	All sales, cash receipts and sales adjustments transactions are correctly journalized, summarized and posted	Accounts receivable represent gross claims, On customers at the balance sheet date. The

3.5 INTERNAL CONTROL OF SALES AND RECEIVABLES

- The objectives of internal controls over receivables are to ensure:
 - a. All goods dispatched/Shipped are invoiced.
 - b. Invoicing is at correct price and discount.
 - c. Goods are only dispatched on credit to approved customers.
 - d. Invoices are recorded and related to subsequent cash receipts.
 - e. Receivables are controlled and bad debts pursued.
 - f. Credit notes approved.

- In addition the internal control over receivables should be such that the possibility of any falsification of the receivables accounts is eliminated.
- An important part of the controls would be to ensure that the cashier does not have access to the sales ledger, and the sales ledger clerk does not have access to cash received.

- Control procedures, over sales and receivables include the following.

a.Orders.

- The orders should be checked against the customer's account.
- All orders received should be recorded on pre-numbered sales order documents.

b. Dispatch.

- Dispatch notes should be **pre-numbered** and a register kept of them to relate to sales invoices and orders.
- Goods dispatch notes should be **authorized** as **goods leave**.

c. Invoicing

- Sales invoices should be authorized by a **responsible official**.
- Sales invoices should be **checked for prices** and **calculations** by a person other than the one preparing the invoice.
- All invoices should be pre-numbered consecutively.
- Copies of cancelled invoices should be retained/booked.

c.Receivables.

- A receivable ledger control account should be prepared and checked to individual sales ledger balances.
- Receivables ledger **personnel** should be independent of dispatch and cash receipt functions.
- Statements should be sent regularly to customers.

e. Bad debts.

- The authority to **write off a bad debt** should be given in writing and adjustments made to the accounts receivable ledger.
- The use of **court action or write-off of a bad debt** should be authorized by an official independent of the cash

3.6 AUDIT PROGRAM FOR RECEIVABLES AND SALES TRANSACTIONS

- The following audit procedures are typical of the work done in the verification of notes, accounts receivable, and sales transaction.

A.Consider internal control for receivables and sales.

- Obtain an understanding of internal control for receivables and sales.
- The auditors' consideration of **internal controls** over receivables and sales may begin with the preparation of a written narrative or flow chart and the completion of an internal control questionnaire.

■ As the auditors' confirm their understanding of the sales and collection cycle, they will observe whether there is appropriate segregation of duties, and enquire as to who performed various functions throughout the year.

■ Assess control risk and design additional tests of controls for receivables and sales. After obtaining an understanding of the client's internal control for receivables and sales transactions, the auditors perform their **initial assessment of control risk for the variant financial statement assertions.**

■ Perform additional tests and controls: Tests directed towards the effectiveness of control help to evaluate the client's internal control, and determine the extent to which the auditors are justified in reducing their assessed levels of control risk for the assertion about the receivables and sales accounts.

The following are examples of **additional tests:**

1. Examine significant aspects of a sample of sales transactions.
2. Compare a sample of shipping documents to related sales invoices.
3. Review the use and authorization of **credit memoranda.**
4. Reconcile selected cash register tapes and sales invoices with sales

■ Reassess control risk and design substantial tests. When auditors have completed the procedures described in the preceding sections, they should assess the extent of control risk for each financial statement assertions regarding receivables and sales transactions. The assessment will determine the nature, extent, and

B. Substantive tests

1. Obtain an **aged trail balance** of trade accounts receivable and analyses of other accounts receivable and reconcile to ledgers. When **trial balances or analyses of accounts receivable** are furnished to the auditors by the client's employees, some independent verification of the listings is essential.
2. **Obtain analyses of notes receivable** and related interest.
3. Inspect notes on hand and confirm those not on hand with holders.
4. Confirm receivables with debtors.
5. Receive the year-end cutoff/limit of sales transactions.

6. **Perform analytical procedures** for accounts receivable, sales, notes receivable, and interest revenue.
7. Verify **interest earned** on notes and accrued interest receivable.
8. **Evaluate the propriety/correctness** of the client's accounting for receivables and sales.
9. Determine **adequacy of allowance for uncollectible accounts**.
10. **Ascertain** whether any receivables have been pledged.
11. **Investigate fully any** notes or accounts receivable from related parties.
12. **Evaluate financial statement presentation** and disclosure.

END OF
CHAPTER 3
THANK YOU!