

# Auditing Revenue

The ultimate cheat sheet for external auditors testing revenue in small and medium-sized organizations.

- Engagement Type: External Audit
- Client Industry: General Commercial
- Standards: US GAAS/ISA
- Area: Risk Assessment/Response to Risk

## Risk Assessment



### Typical Risks

Risk	Risk Level	Assertions
Risk of fraud in revenue recognition	Significant	O
All transactions have not been recorded	Normal	C
Transactions recorded in the incorrect period	Normal	CO
Transactions have not been recorded appropriately	Normal	A
Transactions recorded in inappropriate accounts	Normal	CL
Transactions may not have occurred	Normal	O

### Other Potential Risks

**Legend:** CO = Cutoff, C = Completeness, O = Occurrence, A = Accuracy, CL = Classification

Risk	Assertions
Significant credit notes received after period end	O, A
Bill and hold arrangements exist which may impact revenue recognized during the accounting period	O, A, CO, CL
Consignment arrangements exist which may impact revenue recognized during the accounting period	O, A, CO, CL
Long-term sales contracts may impact revenue recognized during the accounting period	O, A, CO, CL
Management fee transactions may impact revenue recognized during the accounting period	O, A, CO, CL
Returns, discounts or other incentives exist and have not been recorded appropriately	O, C, A
Unfulfilled commitments exist which may require recognizing during the accounting period	A, CL

## Response to Risk

### Example Controls to Consider Testing



Control
Orders received compared to customer credit limits
Management reviews daily/weekly/monthly sales reports
Invoices generated upon appropriate sales event
Invoices reviewed and approved prior to system processing
Invoices sequentially numbered
System populates invoice prices based on approved pricing
System performs mathematical calculations for invoices
Cash receipts matched to customer accounts / invoices
Management reviews and approves bad debt provision
Credit notes are appropriately authorized
Discounts and allowances are approved
Management reviews and approves sales returns provision
Review and approval of ledger reconciliations
System applies foreign exchange to transactions correctly

### Common Substantive Tests of Detail



Test	Assertions
Obtain and reconcile revenue detailed listing	C, A
Test revenue: ledger to order, invoice, cash	O, A, CL
Test revenue: order to ledger	C, CL
Test revenue cutoff	CO
Test revenue returns	O, C

## Ratio Analysis



### Typical Ratios

Ratio	Calculation
Receivables Turnover	Revenue / Average Accounts Receivable
Average Sales Value	Revenue / # Revenue Transactions
Credit Period	Average Accounts Receivable x Period Days / Revenue
Growth in Revenue	(CY Revenue - PY Revenue) / PY Revenue
Revenue Reversals: Volume	#Debit Transactions / #Credit Transactions
Income per Tangible Assets	Revenue / Tangible Assets
Working Capital to Revenue	Net Current Assets / Revenue

### Additional Substantive Tests of Details



Test	Assertions
Evaluate revenue accounting policies	ALL
Review revenue disclosures	CL
Test credit notes after the period end	A, CO, CL
Test bill and hold arrangement sales	ALL
Test consignment sales	ALL
Test long-term contracts	ALL
Test management fee transactions	O, A, CO, CL
Test sales returns, discounts, and incentives	O, C, A
Test unfulfilled commitments	A, CL
Test accounting estimates in revenue	CL
Test accrued revenue	O, A, CO, CL
Test deferred revenue	C, A, CO, CL

## Regulator's Radar

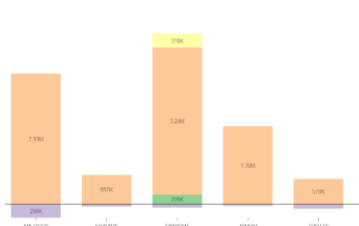


- Split fraud risk from normal risks
- Assess risk and design responses for each revenue stream
- Focus on occurrence & accuracy assertions over completeness
- Target judgemental areas
- Substantive analytical procedures are rarely suitable
- Sample sizes should not be capped
- Use Audit Data Analytics to help stratify and test revenue

## Substantive Audit Data Analytics



Visualize revenue transactions by period, user, source document, etc. to investigate and test notable items.



Analyze revenue transaction double entry combinations to trace revenue transactions to cash.



If you found this helpful, follow me for more



Mark Edmondson

