TOPIC 4

REVENUE AND RECEIPTS CYCLE

TOPIC OVERVIEW

In business, **revenue** is income that arises in the course of ordinary activities of an entity, usually from the sale of goods and services to customers. Depending on the type of business activities, some companies receive revenue from fees, interest, dividends or royalties (see International Accounting Standard, IAS 18).

The revenue and receipts cycle includes the following transactions and balances:

Statement of financial position	**Statement of comprehensive income**
Accounts receivable	Credit sales (turnover) Sales returns Discount allowed Credit losses (bad debts) Interest received
Cash and cash equivalents	Cash sales (turnover) All receipts (revenue and other)

The focus in this topic is on a trading concern where revenue is earned through the buying and selling of goods and services, which can consist of credit sales and/or cash sales.

The aim of this topic is to explain and apply the actions, functions and documents in the revenue and receipts accounting cycle. The risks in this cycle will also be explained and internal controls applied to mitigate those risks, as well as internal control over revenue transactions in a computerised environment.

This topic is divided into the following learning units:

	4.2	**Cash sales**	
	4.2.1	Stages of a cash sale	
	4.2.2	Risks and internal control over a cash sale	

Learning outcomes

Learning unit	**In this topic we focus on the following learning outcomes:**	**Level**
4.1 Credit sales	• Describe credit sales transactions by referring to the activities, functions and documents associated with these transactions.	2
	• Identify and explain the risks associated with credit sales transactions and explain and apply the internal controls that could be implemented to mitigate the risks.	2
	• Describe and apply internal control in a computerised environment to credit sales transactions.	2
4.2 Cash sales	• Describe cash sales transactions by referring to the activities, functions and documents associated with these transactions.	2
	• Identify and explain the risks associated with cash sales transactions.	2
	• Describe and apply the internal controls that could be implemented to mitigate the risks.	2

LEARNING UNIT 4.1

CREDIT SALES

INTRODUCTION

Your prescribed textbook, Jackson & Stent (2014:10/2), explains revenue transactions and indicates that this cycle deals with the accounting system and related internal controls which are put in place to control the sale of the company's goods or services, and the collection of amounts owed in respect of those sales.

4.1.1 ACTIVITIES AND FUNCTIONS IN THE CYCLE

Although revenue and receipts systems can vary considerably, your textbook, Jackson & Stent (2014: 10/2–10/5), describes a system for a business which has conventional revenue and receipt functions. Note that the functions in the credit sales cycle also include the collection of payments from accounts receivable (trade debtors).

STUDY

Jackson & Stent (2014:10/2–10/7)

ACTIVITY 1

Rearrange the following functions in a credit sales transaction in the correct order and provide a brief explanation of each:

1 Invoicing
2 Credit management
3 Warehouse/despatch
4 Receiving and recording payment from debtors
5 Order department
6 Recording sales and raising the debtor

FEEDBACK ON ACTIVITY 1

Reference: Jackson & Stent (2014:10/3-10/4; 10/8-10/9)

Note the logical flow of documents through the different functions for credit sale transactions in the flow charts on pages 10/8 to 10/9 of your prescribed textbook. The normal order of the functions in a credit sales transaction is:

1. Order department
2. Warehouse/despatch
3. Invoicing
4. Recording sales and raising the debtor
5. Receiving and recording payment from debtors
6. Credit management

4.1.2 DOCUMENTS USED IN THE CYCLE

STUDY

Jackson & Stent (2014:10/7–10/8)

ACTIVITY 2

Match the documents explained in your textbook to the different functions in the revenue/receipts cycle mentioned in 2.1 above.

FEEDBACK ON ACTIVITY 2

Function	Document
Order department	Price lists Customer order Internal sales order Back-order note
Warehouse/despatch	Picking slip Delivery note
Invoicing	Invoice
Recording of sales and raising debtors	Statement Goods returned voucher Credit note
Receiving and recording payments from debtors	Remittance advice Remittance register Receipt Deposit slip
Credit management	Credit application form

ACTIVITY 3

The **Consumer Protection Act, 68 of 2008,** which came into effect on 1 April 2011, lays down in section 26(3) the following minimum requirements that should be stated on sales documentation:

1. the supplier's full name, or registered business name, and VAT registration number, if any
2. the address of the premises at which, or from which, the goods or services were supplied
3. the date on which the transaction occurred
4. a name or description of any goods or services supplied or to be supplied
5. the unit price of any particular goods or services supplied or to be supplied
6. the quantity of any particular goods or services supplied or to be supplied
7. the total price of the transaction, before any applicable taxes
8. the amount of any applicable taxes
9. the total price of the transaction, including any applicable taxes

REQUIRED

Indicate in which respects the following tax sales invoice does not meet the minimum requirements as stipulated in the Consumer Protection Act.

TAX INVOICE INV 772

COPRO LIMITED Date: 31 August 20xx

To: Customer A
PO Box A
Durban
4001

Description	**Total**
No XL001 Stapler	2 430.00
No 1185 Paper	49 200.00
No 2.1 pencils	2 100.00
Subtotal	53 730.00
VAT	522.22
Total	**61 252.20**

FEEDBACK ON ACTIVITY 3

The following information required by the Consumer Protection Act, 68 of 2008, is not indicated on the invoice:

1. the VAT registration number of Copro Ltd
2. the address of the premises of Copro Ltd

3. the unit price of the particular goods supplied
4. the quantity of the particular goods supplied
5. the amount of any applicable taxes
6. the total price of the transaction, including any applicable taxes

ACTIVITY 4

The following are examples of an order form, delivery note and tax invoice issued by company XY Ltd for commodities sold by the company:

SALES ORDER OD 1028

XY LIMITED
PO Box X
Pretoria
0001

Date: 30 May 20xx

To: Customer Y
PO Box Y
Durban
4001
Account number: Y4458

Description	Quantity	Unit price	Total
No XL001 Stapler	85	28.60	2 430.00
No 1185 Paper	400	123.00	49 200.00
No 2.1 Pencil	1000	2.10	2 100.00
		Subtotal VAT **Total**	53 730.00 7 522.20 **61 252.20**
		Authorised:	OrderClerk

DELIVERY NOTE DN 532

XY LIMITED
PO Box X
Pretoria
0001

Date: 3 June 20xx

To: Customer Y

Deliver to: Customer Y: Warehouse C

PO Box Y
Durban
4001
Account number: Y4458

55 1st Street
Durban North
4001

Description	Quantity
No XL001 Stapler	85
No 1185 Paper	400
No 2.1 Pencil	1000
Goods received in good order by customer: Date:	CustomerY 3/06/20XX

TAX INVOICE INV 772

(Vat no 123456789)

XY LIMITED
PO Box X
Pretoria
0001

Date: 3 June 20xx

To: Customer Y
PO Box Y
Durban
4001
Account number: Y4458

Description	Quantity	Unit price	Total
No XL001 Stapler	85	28.60	2 430.00
No 1185 Paper	400	123.00	49 200.00
No 2.1 Pencil	1000	2.10	2 100.00
		Subtotal VAT **Total**	53 730.00 7 522.20 **61 252.20**

REQUIRED

Indicate which of the information shown on the above documents demonstrates that the objective of control for financial reporting have been addressed.

FEEDBACK ON ACTIVITY 4

The following information on the order form, delivery note and tax invoice illustrates that the accounting system produces information which **occurred, is accurate** and **complete.**

Occurred:

1. The name and address of XY Ltd on the order form, delivery note and tax invoice.
2. A valid customer account number on the order form, delivery note and tax invoice.
3. The signature on the order form indicating that it was approved.
4. The customer signature on the delivery note indicating that the goods were received and accepted.
5. The existence of a corresponding order form and delivery note for the invoice.

Accurate:

1. The total amount (including VAT) of the credit sale on the invoice, which accurately corresponds with the sales order (to be recorded against the customer's account).
2. The credit sales amount and the VAT amount on the invoice which accurately correspond with the sales order (to be recorded against the sales revenue and VAT accounts).
3. The order form and delivery note items, quantities and amounts that correspond with the invoice.
4. The customer name and account number on the order form, delivery note and tax invoice.

Complete:

1. The date of the invoice to be recorded in the accurate period in the accounting records of XY Ltd.
2. The invoice number to be sequentially recorded in the accounting records of XY Ltd.

4.1.3 RISKS AND INTERNAL CONTROL IN THE CYCLE

The functions that can be distinguished for credit sale transactions were explained in learning unit 4.1.1.

Risks associated with each of these functions are mentioned in your prescribed textbook; internal controls (control activities) that could be implemented to mitigate the risks are described as well.

STUDY

Jackson & Stent (2014:10/10–10/19)

ACTIVITY 5

Answer the following questions regarding the order department of a trading concern that sells goods on credit (credit sales):

1. Give a system description of the activities in the order department.
2. Name the documents usually encountered in an order department.
3. Explain the control risks that can exist in an order department.
4. Describe the internal controls (control activities) that can be implemented to mitigate the risks in an order department.

FEEDBACK ON ACTIVITY 5

1. System description of the activities in the order department

   Refer to Jackson & Stent (2014:10/3–10/4) where the activities of the order department are presented.

2. Documents usually encountered in an order department

   Refer to Jackson & Stent (2014:10/10) where the documents used in the order department are presented.

3. Explain the control risks that can exist in an order department.

   Refer to Jackson & Stent (2014:10/10–10/11) where the control risks in an order department are described.

4. Internal controls (control activities) that can be implemented to mitigate the risks in an order department.

   Refer to Jackson & Stent (2014:10/10–10/11) where the control activities for an order department are mentioned.

Note that you should limit your answer to the order department, which includes receiving customer orders and sales authorisation.

ACTIVITY 6

1. Describe the internal controls that can be implemented to minimise the following risks associated with credit sales transactions:

   - Goods may be removed from the inventory warehouse for fictitious/unauthorised sales.
   - Incorrect goods or quantities could be despatched.
   - Goods despatched may not be invoiced.
   - Invoices could be duplicated in the sales journal.
   - Payments received from customers may not be deposited in the bank due to theft or carelessness.

2. Name the internal control objective(s) for financial reporting affected by each of the risks mentioned in 1 above.

Present your answer in a tabular format.

FEEDBACK ON ACTIVITY 6

Reference: Jackson & Stent (2014:10/10-10/19)

Risk	**1. Internal control**	**2. Assertion**
Goods may be removed from the inventory warehouse for fictitious/ unauthorised sales.	1. Supervisory checks should be carried out by the warehouse foreman to ensure that all goods picked are supported by signed picking slips.	Occurrence
Incorrect goods or quantities could be despatched.	1. On receipt of the goods, picking slip and delivery notes from the warehouse, the despatch clerk should check quantities and description of goods against the authorised picking slip and delivery note.	Occurrence for the incorrect goods Accuracy for the incorrect quantities
Goods despatched may not be invoiced.	1. The invoice clerk should prepare a numerically sequenced invoice and cross-reference it to the delivery note/customer order. 2. The file of delivery notes matched against sales invoices should be sequence-tested and gaps in sequence investigated.	Completeness

Invoices could be duplicated in the sales journal.	1. Prior to entry in the sales journal, invoices should be added to obtain a control total. This control total should then be compared to the total in the sales journal after entry of individual invoices.	Accuracy and occurrence
Payments received from customers may not be banked due to theft or carelessness.	1. Post must be opened by two people. 2. All payments received in the post should be recorded in a remittance register and a prenumbered receipt should be made out for each payment received. 3. All amounts received should be banked daily. 4. The remittance register and receipts issued should be reconciled to bank deposits by an independent supervisory employee. 5. Bank deposits should be reviewed regularly and gaps in daily banking investigated by management.	Completeness

4.1.4 COMPUTERISATION OF THE CYCLE

Your textbook, Jackson & Stent, describes an integrated manual and computerised credit sales system of telesales transactions that are entered and processed in real time.

STUDY

Jackson & Stent (2014:10/23–10/43)

ACTIVITY 7

1. Describe the application controls that should be present in a computerised environment to ensure that only **authorised** amendments are made to the debtors masterfile in a credit sales accounting system.

2. Mention things that could go wrong (risks) if no application controls exist over amendments to the debtors masterfile, for each of the objectives of control.

FEEDBACK ON ACTIVITY 7

1. The application controls that should be present in a computerised environment to ensure that only authorised amendments are made to the debtors masterfile are described in Jackson & Stent (2014:10:23–10/25) and are not repeated here.

2. Things that could go wrong (risks) if no application controls exist over amendments to the debtors masterfile:

   Reference: Jackson & Stent (2014:10/23–10/25)

   Occurrence: Unauthorised and fraudulent amendments could be made to the detriment of the company, for example a debtor's credit limit could be increased, allowing the debtor credit facilities which he/she cannot pay within the allowed payment terms.

   Accuracy: Incorrect amendments could be made to the debtors masterfile, for example a change in a debtor's postal address could be recorded incorrectly, resulting in a debtor not receiving monthly statements and not paying his/her account (accuracy) or an incorrect change to a debtor's account number could result in incorrect postings (classification).

   Completeness: Amendments to the debtors masterfile could be incomplete, for example a new debtor is not loaded onto the debtors masterfile and his/her purchase order would not be accepted and processed (completeness) or amendments could be made in the incorrect period (cut-off).

ACTIVITY 8

1. Explain what the term "real time" means and what the effect on the application control of "batching" will be.
2. Describe the application controls that should be present to ensure that orders received from customers are **accurately** entered into the computerised credit sales system.

   Use the framework described in learning units 2.3.1 and 2.3.2 in topic 2 to answer the question.

FEEDBACK ON ACTIVITY 8

1. "Real time"
   Reference: Jackson & Stent (2014:8/35) section 3.1.3

This term means that transaction data are entered immediately online as each transaction occurs and relevant program checks take place as information is keyed in. This means that transactions are not batched before entering.

2. Application controls to ensure that orders received from customers are accurately entered into the computerised credit sales system.

Reference: Jackson & Stent (2014:10/30)

Internal control objective	**Input**	**Processing**	**Output**	**Master file**
Occurrence				
Accuracy	1. **Screen formatting:** the screen will be formatted to look like a sales order document. 2. **Minimum entry:** for example entering the inventory item code, will bring up the description of the item being ordered and the price. 3. **Mandatory fields:** for example, to proceed with the order, a number must be entered in the quantity field and a customer order reference must be entered. 4. **Alphanumeric check:** for example, on the quantity field to check that no alphanumeric characters were entered. 5. **Limit or reasonableness check:** to ensure that reasonable quantities are entered, for example not 1 billion items, which is more than realistic production targets. 6. **Screen prompts** will require the order clerk to confirm details of order			

	and important details. 7. **Fields on the "on screen sales order"** which cannot be changed by the order clerk. 8. The system will allocate a **customer reference number** to every sales order which is given to the customer at the time of placing the order in order for the customer to follow up on inaccurate information on the sales order.			
Completeness				

Note that only application controls relevant to **input** and **accuracy** are included in the solution, as required. Remember to use this table to limit your answer to only the information required.

ACTIVITY 9

Answer the following questions regarding application controls over the bank account:

1. Why is it important to restrict access to the bank account in a computerised system?
2. Describe the access controls that should be implemented to ensure sound control over the bank account.
3. Provide a list of sound controls over passwords as part of access controls over the bank account.

FEEDBACK ON ACTIVITY 9

1. Restriction of access to the bank account

   Reference: Jackson & Stent (2014: 8/30–8/31) Section 2.6

   Violations of access to the bank account in a computerised system can have extremely serious consequences for the business. These include:

   - Destruction of data: The internet bank account itself or account details could be deleted.
   - "Theft" of data: Bank account details could be stolen and abused.
   - Improper changes to data: Payment beneficiaries' details could be changed in order to channel payments to unauthorised accounts.

- Recording of unauthorised or nonexistent transactions: Unauthorised transfers of money could be done.

2. Access controls over the bank account

Reference: Jackson & Stent (2014:10/33) point 1

The access controls that should be implemented to ensure sound control over the bank account are:
- The terminal, onto which the bank's software is loaded, should be in the debtors section, and will usually be the terminal of the senior debtors clerk.
- Access to the bank's site should be gained in the normal manner, but to access the company's bank account, the senior debtors clerk should need to enter a PIN and password.
- If this identification and authentication procedure is successful, a menu of the functions available should be displayed, one of which will be "download bank statement".
- This function should be linked to the senior debtors clerk's user profile to enable him/her to initiate the download.

3. Sound controls over passwords

Reference: Jackson & Stent (2014:8/20)

The strict control of passwords as part of access controls over the bank account is fundamental to successful, logical access controls. Sound controls over passwords are:
- Passwords to access the bank account should be unique to the senior debtors clerk (group passwords should not be used).
- Passwords to access the bank account should consist of at least six characters, be random, not obvious, and be a mix of letters, numbers, upper/lower case and symbols.
- Passwords and user IDs for terminated or transferred senior debtors clerks should be removed or disabled at the time of termination or transfer.
- Passwords to access the bank account should be changed regularly and the senior debtors clerk should be forced by the system to change the password (system sends the senior debtors clerk a screen message to change the password and allows a limited number of attempts to enter the existing password. After this, access will not be granted until a new password has been registered.)
- The first time a new senior debtors clerk accesses the bank account, he/she should be prompted to change the initial password.
- Passwords to access the bank account should not be displayed on PCs at any time, be printed on any bank statements or logged in bank transaction logs.

- Password files should be subject to strict access controls to protect them from unauthorised read and write access. Encryption of password files is essential.
- Passwords should be changed if confidentiality has been violated, or violation is expected.
- Passwords should not be obvious, for example birthdays, names, name backwards, or common words, and should not be the same as the user ID.
- The senior debtors clerk should be prohibited from disclosing his/her passwords to others and subjected to disciplinary measures should he/she do so.
- Passwords to access the bank account should be changed if confidentiality has been violated, or violation is expected.
- Passwords to access the bank account should not be obvious, for example birthdays, names, name backwards, common words, and should not be the same as the senior debtors clerk's user ID.

Note: Refer to chapter 8 of your prescribed textbook again if you need to remind yourself of the theory of the control of passwords.

SUMMARY

In this learning unit we explained and applied the actions, functions and documents of credit sales transactions. The risks and internal control in credit sales were also explained and applied, as well as internal control over credit sales transactions in a computerised environment.

LEARNING UNIT 4.2

CASH SALES

INTRODUCTION

Cash sales transactions occur daily in many business entities. Cash transactions carry a high risk of fraud and theft, over which management should implement a strict system of internal control (Jackson & Stent 2014:10/2 & 10/40).

4.2.1 STAGES OF A CASH SALE

In a cash sales transaction, payment is received from the customer when the goods are supplied to the customer. In broad terms, a cash sale transaction follows the same process as a credit sales transaction.

STUDY

Jackson & Stent (2014: 10/40) Section 9.2

4.2.2 RISKS AND INTERNAL CONTROL OVER A CASH SALE

As stated in Jackson & Stent (2014:10/40), the main risk associated with cash sales transactions is theft. This risk is increased in smaller businesses which do not always have the resources to implement the necessary internal controls.

Study

Jackson & Stent (2014:10/40–10/42) sections 9.1 and 9.3

ACTIVITY 1

The following are a few things that can go wrong with cash sales transactions:

1. Cash sales could be recorded but the cash not deposited.
2. Cash could be received from customers but the cash sales transactions are not recorded.
3. Cash could be stolen after the cash register is “cashed up” for the day.
4. Customers could leave without paying for goods taken.

5. An armed robbery could take place, resulting in cash stolen from cash registers.

REQUIRED

Describe the internal controls that could be implemented to mitigate these risks.

FEEDBACK ON ACTIVITY 1

Reference: Jackson & Stent (2014:10/40–10/42) Section 9.3

The internal controls that could be implemented to mitigate the risks mentioned are:

Things that can go wrong	Internal control
1. Cash sales could be recorded but the cash not deposited in the cash register drawer.	The cash in the cash register should be reconciled to the total daily cash sales entered on the cash register till roll. The till roll in the cash register should not be alterable.
2. Cash could be received from customers, but the cash sales transaction not recorded.	Physical safeguards should be in place, for example signage encouraging customers to request a receipt. Cash receipts should be sequentially numbered.
3. Cash could be stolen after the cash register is "cashed up" for the day.	Whenever cash is transferred from the custody of one person to another, it should be counted, reconciled, documented and signed for by both parties in a safe location. Cash should not be allowed to accumulate and should be banked daily.
4. Customers could leave without paying for goods taken.	Physical safeguards should be in place, for example limited entry and exit points and security guards at the exit points requesting to sign off on cash sale receipts.
5. An armed robbery could take place, resulting in cash being	Physical safeguards should be in place, for example security guards and

stolen from cash registers.	surveillance cameras. Cash should not be allowed to accumulate and should be banked daily so that the minimum amount of cash is exposed to the risk of theft.

SUMMARY

In this learning unit you learned about the stages of a cash sale transaction, as well as the risks associated with cash sales. The internal controls over cash sales transactions were also explained and applied.

CONCLUSION

In this topic, **Revenue and receipts cycle**, we explained and applied the activities, functions and documents in the revenue and receipts cycle. The risks and internal control in this cycle were also explained and applied, as well as internal control over credit sales transactions in a computerised environment.

In the next topic we will explain and apply the acquisitions and payments business cycle, as well as the applicable internal controls in the cycle.