



# Fraud Examination: Cash Collections, Receivables, Cash Disbursements and Payables

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**Course #1105A**

**Auditing**

**2 Credit Hours**

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# **FRAUD EXAMINATION: CASH COLLECTIONS, RECEIVABLES, CASH DISBURSEMENTS AND PAYABLES**

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The revenue and collection accounting cycle covers sales, sales returns, accounts receivable, account write-offs, and cash collections. This course covers audit procedures and fraud identification techniques appropriate for cash collections and receivables. It also covers procedures to perform for audit evidence related to cash disbursements and payables.

## **LEARNING ASSIGNMENTS AND OBJECTIVES**

*As a result of studying each assignment, you should be able to meet the objectives listed below each individual assignment.*

### **SUBJECTS**

#### **Cash Collections and Receivables Cash Disbursements and Payables**

Study the course materials from pages 1 to 78

Complete the review questions at the end of each chapter

Answer the exam questions 1 to 10

#### **Objectives:**

- Identify audit procedures and fraud identification techniques appropriate for cash collections and receivables.
- Recognize procedures to perform for audit evidence related to cash disbursements and payables.

### **NOTICE**

This course is sold with the understanding that the publisher is not engaged in rendering legal, accounting, or other professional advice and assumes no liability whatsoever in connection with its use. Since laws are constantly changing, and are subject to differing interpretations, we urge you to do additional research and consult appropriate experts before relying on the information contained in this course to render professional advice.

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## EXAM OUTLINE

- **TEST FORMAT:** The final exam for this course consists of 10 multiple-choice questions and is based specifically on the information covered in the course materials.
- **ACCESS FINAL EXAM:** Log in to your account and click Take Exam. A copy of the final exam is provided at the end of these course materials for your convenience, however you must submit your answers online to receive credit for the course.
- **LICENSE RENEWAL INFORMATION:** This course qualifies for **2** CPE hours.
- **PROCESSING:** You will receive the score for your final exam immediately after it is submitted. A score of 70% or better is required to pass.
- **CERTIFICATE OF COMPLETION:** Will be available in your account to view online or print. If you do not pass an exam, it can be retaken free of charge.

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# CHAPTER 1: CASH COLLECTIONS AND RECEIVABLES

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## Chapter Objective

### After completing this chapter, you should be able to:

- Identify audit procedures and fraud identification techniques appropriate for cash collections and receivables.

The revenue and collection accounting cycle covers sales, sales returns, accounts receivable, account write-offs, and cash collections. This chapter contains sections on:

- (1) typical control activities in the cycle
- (2) the audit evidence available in management reports and data files, and
- (3) case story-style explanations concerning discovery of errors and frauds.

Special notes in the chapter cover:

- (1) the existence assertion,
- (2) using confirmations,
- (3) bank reconciliation with attention to lapping and kiting, and
- (4) bank transfer and proof of cash analyses.

## REVENUE AND COLLECTION CYCLE: TYPICAL ACTIVITIES

The basic activities in the revenue and collection cycle are:

- (1) receiving and processing customer orders, including credit granting;
- (2) delivering goods and services to customers;
- (3) billing customers and accounting for accounts receivable;
- (4) collecting and depositing cash received from customers; and
- (5) reconciling bank statements.

Exhibit 8-1 shows the activities and transactions involved in a revenue and collection cycle. As you follow the exhibit, you can track some of the elements of a control system.



to the master files for additions, deletions, and other changes must be limited to responsible persons. If these controls fail, orders might be processed for fictitious customers, credit might be approved for bad credit risks, and packing slips might be created for goods that do not exist in the inventory.

When a customer order passes these authorizations, the system: (1) creates a record in the pending order master file, (2) produces a packing slip that is transmitted to the stockroom and shipping department, and (3) updates the inventory master file to show the commitment (removal) of the inventory. At this stage, the pending order and the packing slip should be numbered in a numerical sequence so the system can determine later whether any transactions have not been completed (completeness objective of control). The packing slip is the storekeeper's authorization to release goods to the shipping department and the shipping department's authorization to release goods to a trucker or to the customer.

Another authorization in the system is the price list master file. It contains the product unit prices for billing customers. Persons who have power to alter this file have the power to authorize price changes and customer billings.

### **Price Manipulation**

The company's computer programmer was paid off by a customer to cause the company to bill the customer at prices lower than list prices. The programmer wrote a subroutine that was invoked when the billing system detected the customer's regular code number. This subroutine instructed the computer billing system to reduce all unit prices 9.5 percent. The company relied on the computer billing system, and nobody ever rechecked the actual prices billed.

#### Custody

Physical custody of goods starts with the storeroom or warehouse where inventory is kept. Custody is transferred to the shipping department upon the authorization of the packing slip that orders storekeepers to release goods to the shipping area. As long as the system works, custody is under accountability control. However, if the storekeepers or the shipping department personnel have the power to change the quantity shown on the packing slip, they can cause errors in the system by billing the customer for too small or too large a quantity. (This power combines custody with a recording function. A computer record or "log" of such changes will create an electronic paper trail.)

"Custody" of accounts receivable records themselves implies the power to alter them directly or enter transactions to alter them (e.g., transfers, returns and allowance credits, write-offs). Personnel with this power have a combination of authorization and recording responsibility. (A computer "log" of such entries will create an electronic paper trail.)

#### Recording

When delivery or shipment is complete, the shipping personnel enter the completion of the transaction in a terminal, and the system (1) produces a bill of lading shipping document, which is evidence of an actual delivery/shipment; (2) removes the order from the pending order master file; and (3) produces a sales invoice (prenumbered the same as the order and packing slip) that bills the customer for the quantity shipped, according to the bill of lading. Any personnel who have the power to enter or alter these