Instructional case for auditing students: understanding internal controls and assessing control risk

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ABSTRACT

This instructional case is designed to increase students' abilities to understand a client's business and industry, their system of internal control and to deepen the students' knowledge of the assessment of risk required by current auditing standards. Students are organized into audit teams and each team works with an audit client in the local area. Students take on the role of staff auditors and learn about their client's business and industry and complete an internal control questionnaire in the area of cash, accounts payable or accounts receivable. An internal control narrative is then written by each team followed by a preliminary assessment of control risk. This instructional case is appropriate for senior level accounting majors in the first undergraduate auditing course; however, the assignment could certainly be used at the graduate level in an advanced auditing course, as well.

Keywords: accounting, audit engagement, auditing, case study, control environment, control risk, internal controls

INTRODUCTION

Auditors need a comprehensive understanding of their client's business and industry as well as knowledge about their client's business operations. Auditors must also understand their client's internal controls and assess control risk in order to conduct an adequate audit. Statement on Auditing Standards 109 specifically requires that the auditor identify and assess risks of material misstatement, whether due to fraud or error, based on an understanding of the entity and its environments, including the entity's internal control (AICPA, SAS 109 [2006]). When students read about such requirements in a textbook, the readings often leave the student with a vague or fuzzy understanding. An active learning experience that requires the student to put these concepts into action frequently solidifies the concepts, enhancing and enriching the learning process.

Many accounting students enter public accounting immediately after graduation, most commonly as auditors. These graduates typically begin their employment in the fall just as interim testing and the review of internal controls begins. A first year audit staff accountant's initial assignment will often be a review of the client's internal controls surrounding cash, accounts payable or possibly accounts receivable. The rookie auditors are often handed an internal control questionnaire by their senior or in-charge auditor, and set free. Recent accounting graduates working as novice staff auditors often describe this experience as incredibly intimidating. Most inexperienced staff will claim that completing an internal control questionnaire, while simultaneously listening to the client, taking notes, evaluating comments and speaking with the client is a daunting task. Inexperienced staff also struggle with the evaluation of the information they gather from the questionnaire in the preliminary assessment of control risk.

This instructional case is designed to increase students' abilities to understand a client's business and industry, their system of internal control and to deepen the students' knowledge of the assessment of risk required by current auditing standards. Students are organized into audit teams of three or four members and each team works with an audit client in the local area. Students take on the role of staff auditors and learn about their client's business and industry and complete an internal control questionnaire in the area of cash, accounts payable or accounts receivable (See Appendix A, B and C). An internal control narrative is then written by each team followed by a preliminary assessment of control risk.

AUDIT CLASSROOM CHALLENGES

Accounting students often enter their senior year auditing course expecting more of the same - lengthy discussions of GAAP and applications of those accounting principles involving calculators and precise dollar value answers. It is often a shock to the system, when students learn that the auditing course will involve virtually no numbers, calculators won't be used at all and answers are rarely quantitative. Boyle and Lloyd (2013) refer to auditing as a course whose texture is qualitative rather than quantitative – a course of words rather than numbers, a course that, at times, offers no definitive answers to individual practical problems, e.g. "it all depends". After completing a series of accounting courses, all involving numbers and calculators, the transition to an accounting course with virtually no numbers can be challenging for auditing students. Additionally, auditing concepts, in general, are often difficult for students to grasp due to students' lack of business experience (Fernandes 1994). For example, faculty may lecture regarding the importance of vouchers in the accounts payable cycle, but students often have no understanding of what an actual voucher is. Boyle and Lloyd (2013) go on to note that the lack of "hands-on" experience in the field of auditing hinders the ability of the auditing student to fully assimilate the theoretical constructs embedded within the audit course.

Can auditing faculty aid students in making the transition from a course of numbers to a course of words? Can auditing faculty assist students, who lack business experience, in comprehending concepts that require some business world insight? Enhancing the learning experience by allowing students to see and feel the concepts in a traditional lecture may improve the learning experience. Healy and McCutcheon (2008) documented a number of advantages associated with an "active learning" approach. Using an active learning instructional case in the auditing classroom may augment and improve the learning process.

Auditing standards specifically require that auditors understand their client's internal controls (AICPA, SAS 109 [2006]); auditing faculty, therefore, tend to place great emphasis on the internal control chapters of their textbooks. In a 1997 study, Bryan and Smith (1997) surveyed 223 auditing professors regarding the importance of 34 auditing topics; internal control was ranked third. In 2009, internal control and the risk assessment category was ranked second in a survey of 276 auditing faculty affiliated with the AACSB (Blouch 2009). In 2010, academics and practitioners were surveyed by Armitage and Poyzer (2010) regarding their views of the importance of 41 topics in the first auditing course. Understanding internal control was ranked in the top five by both academics and practitioners. While understanding internal controls is clearly essential, grasping the concept of internal control often eludes students. Without business experience this concept is often fuzzy and vague, yet understanding internal control has been identified as a critical component of an auditing course curriculum (Boyle and Lloyd [2013]).

So senior accounting students must, then, adjust to a course with no numbers, a course involving complex and abstract principles, which require visualizing a system of internal controls that the student has never "seen". Boyle and Lloyd (2013) suggest that the opportunity to see and feel an accounting cycle might create a great synergy for learning in the classroom. Armitage and Poyzer (2010) claim the optimal auditing class is one that can provide students with the underlying theory but also with enough skills and techniques to succeed in their first job. This instructional case offers auditing faculty members a teaching approach that provides students the opportunity to see and feel an accounting cycle, aiding in what Armitage and Poyzer (2010) refer to as the most important job of an accounting professor – choosing the appropriate blend of theory and practice to be included in their class.

TARGETED COURSES

This instructional case was designed and utilized for senior level accounting majors in the first undergraduate auditing course; however, the assignment could certainly be used at the graduate level in an advanced auditing course, as well.

DETAILS FOR INSTRUCTOR

The author uses this instructional case in the first auditing course and initially divides the students into audit teams. Each team is comprised of three or four randomly selected students. While students may prefer to select their own team members the author does not support this approach. When the case was first utilized in class the author permitted the students to form their own teams. This resulted in students self-selecting team members, with strong students gravitating to their friends (who were the stronger students), leaving the poorer students to create their own teams. While the strong student groups produced stellar final deliverables, the weaker student teams struggled to meet even minimal expectations. To enhance the learning process the author therefore prefers random selection of team members. Another reason random group selection is preferred by the author is that audit teams in the real world are not generally driven by member preference, but by client needs, availability of staff, staff talents and skills, and numerous other variables. Students, therefore, need to become comfortable working with team members that are not necessarily their friends, but simply their colleagues.

Each audit team will be required to review the internal control environment (in the area of cash or accounts payable or accounts receivable) of a local business. Each client will therefore utilize the skills of a cash team (3-4 members), accounts payable team (3-4 members) and an accounts receivable team (3-4 members) resulting in each client utilizing the skills of 9 to 12 students. Two clients will generally suffice for a class of eighteen to twenty-four students. The author generally prearranges the clients. Clients are especially willing to take part when they learn that an assessment of control risk will be delivered to the client by each audit team at the conclusion of the audit exercise.

This instructional case generally begins around mid-semester. At this point the author has covered (at a minimum) the chapters on audit services, the CPA profession, auditing standards, audit responsibilities and objectives, audit planning, internal controls, and assessing risk. The author spends significant lecture time on the internal control chapter and the risk assessment chapter as these chapters specifically address the work assigned in the instructional case.

Roughly two weeks before the students begin their audits, the author reviews the instructional case requirements in detail during a class period. After the case requirements are reviewed in class, the students are free to schedule their client visits.

LEARNING OBJECTIVES

After completing this instructional case students should be able to:

1. obtain an understanding of an audit client's business and industry
2. interview an audit client utilizing an internal control questionnaire
3. document their understanding of an audit client's internal controls through the use of an internal control narrative
4. complete a preliminary assessment of control risk

CASE REQUIREMENTS, DELIVERABLES AND DUE DATES

The information below includes the specific instructions given to students. The author uses the Arens textbook and guides the students to appropriate pages in their Arens textbook to aid the students in completing the assignment. Faculty members who adopt this case should substitute the pages in their respective textbook as appropriate.

1. **Prepare an audit team memo entitled "Understanding My Client's Business and Industry". Submit this audit team memo to the Instructor by the end of the 8th week of class (for guidance see Arens text pages 226-231)**

Gain an understanding of your client's business and industry (use your client's website and visit with your client to gather needed information about their business. Visit http:///www.bls.gov/iag/tgs/iag_index_alpha.htm for information about industries)

The audit team's memo entitled "**Understanding My Client's Business and Industry"** should address the following:

- a. What industry is your client in?
  - i. Describe the industry
  - ii. Provide pertinent statistics
- b. What is the nature of your client's business?
  - i. How does your client generate revenue?
    1. Who are your client's major customers?
  - ii. What are your client's largest expenses?
    1. Who are your client's major suppliers?
  - iii. What are your client's major sources of financing?
  - iv. Create an organizational chart, including all employees and owners at your client, their titles and to whom they report.

2. **Complete the Internal Control Questionnaire for your team's business cycle (cash, accounts payable or accounts receivable- See Appendix A, B and C). Submit your team's Internal Control Questionnaire to the Instructor by the end of the 10th week of class (for guidance see Arens text page 369-371)**

Understanding internal controls is fundamental to the audit process. Your review of internal controls will be performed through the use of an internal control questionnaire. Completion of the internal control questionnaire will require field work at your client location. Most questions on the internal control questionnaire require a "yes" or "no" answer (there is room on the questionnaire for you to take notes to document the client's response to each question). Each team member should independently take notes and document the client's response to each question on the questionnaire as this will generate a more complete source of information gathered. A "no" response on the internal control questionnaire generally indicates a potential internal control weakness. Remember that an internal control weakness can be mitigated by a "compensating control" that offsets the absence of a control. Be sure to consider compensating controls as you complete your internal control questionnaire and be mindful that unmitigated weaknesses often represent control risks. Make an appointment, wear professional attire, arrive on time, and conduct yourselves as professionals when you complete your team's internal control questionnaire.

The audit team's internal control questionnaire should:

- Be completed efficiently, thoroughly, and accurately
- Demonstrate a thorough understanding of each of the questions being asked
- Document accurately the client's response to each question
- Appropriately identify potential internal control weaknesses
- Adequately address compensating controls and mitigation of weaknesses, if mitigation exists
- Identify control risks that exist

The accuracy of this document is of utmost importance, since it will be the source document for much of the assigned work to follow.

3. **Write an Internal Control Narrative for your team's business cycle (cash, accounts payable or accounts receivable). Submit your team's Internal Control Narrative to the Instructor by the end of the 12th week of class (for guidance see Arens text page 369)**

A narrative is a written description of a client's internal controls (see Arens page 369). Your team's narrative of your client's accounting system and related controls should:

- Introduce your client and the cycle being audited
- Discuss the origin of every document and record in the system
- Describe all processing that takes place
- Discuss the disposition of every document and record in the system
- Describe controls that exist
- Discuss internal control weakness and their mitigation, if a mitigation exists
- Identify control risks that exist

Your source of information for completing your internal control narrative is your internal control questionnaire. It is therefore vital that your team's documentation of your client's responses to questions was thorough and accurate. Inadequate note taking and documenting during the internal control questionnaire completion phase generally results in a poor internal control narrative. Your internal control narrative should be prepared with objectivity, conciseness and clarity.

4. **Write a team memo entitled "Preliminary Assessment of Control Risk" for your team's business cycle (cash, accounts payable or accounts receivable). Submit your team's "Preliminary Assessment of Control risk" memo to the Instructor by the end of the 12th week of class (for guidance see Arens text page 371-372)**

The auditor obtains an understanding of the design of internal controls to make a preliminary assessment of control risk (see Arens text page 371). After obtaining an understanding of your client's internal controls (through the use of an internal control questionnaire and subsequent writing of an internal control narrative), your audit team can now make a preliminary assessment of control risk. Statement on Auditing Standards 107 defines control risk as the risk that a misstatement will not be prevented or detected on a timely basis by the entity's internal controls (AICPA, SAS 107 [2006]). If the auditor concludes that internal controls are ineffective to prevent or detect misstatements, the auditor would assess control risk as "high". (See Arens text page 271) If the auditor concludes that internal controls are highly effective, the preliminary assessment of control risk would likely be "low".

Your team's memo addressing your preliminary assessment of control risk should:

- Introduce your client and the cycle being audited
- Indicate that the purpose of the memo is to document the team's preliminary assessment of control risk
- Define control risk
- Identify key existing controls- the controls that are expected to have the greatest effect on preventing or detecting misstatement
- Identify and evaluate any:
    - Control deficiencies (see Arens text page 374) (define control deficiencies and list

any)
    - Significant deficiencies (see Arens text 375) (define significant deficiencies and list any)
    - Material weaknesses (see Arens 375) (define material weaknesses and list any)
- Conclude regarding your team's preliminary assessment of control risk- and set preliminary control risk as high, medium, or low, providing adequate support for your assessment

After this memo is graded by the instructor, a final copy of this memo should be sent to the client.

FEEDBACK FROM STUDENTS

Anonymous course evaluations given at the end of the semester have provided feedback concerning the effectiveness of this instructional case. Student comments, for the most part, indicated the project was well received and that students learned a great deal from the experience. The most common negative comment was that more guidance was desired by students prior to beginning the case. The author understands the students' desire to be given explicit guidance but intentionally leaves the instruction vague to replicate the experience that auditing students may soon encounter if they become external auditors in the real world. While significant guidance is almost always preferred by students and inexperienced staff, time constraints and other limitations often require that young auditing professionals be self-starters, who are highly motivated to complete tasks even when specific instruction is limited.

Positive student comments were numerous and indicated the students appreciated the opportunity to interact with clients and gain practical audit experience. In fact, some students noted the instructional case was the most valuable aspect of the Auditing class. Participants felt they had an advantage over students from other universities that had not experienced an active learning case in their auditing classroom. Students indicated the case was relevant and aided them in gaining a greater understanding of an auditor's role and responsibilities. Some students commented that the instructional case was "valuable" and even "amazing".

CONCLUSION

This instructional case was designed to increase students' abilities to understand a client's business and industry, their system of internal control and to deepen the students' knowledge of the assessment of risk required by current auditing standards. Students are organized into audit teams and each team works with an audit client in the local area. Students take on the role of staff auditors and learn about their client's business and industry and complete an internal control questionnaire in the area of cash, accounts payable or accounts receivable. An internal control narrative is then written by each team followed by a preliminary assessment of control risk. This instructional case is appropriate for senior level accounting majors in the first undergraduate auditing course; however, the assignment could certainly be used at the graduate level in an advanced auditing course, as well. Student feedback indicates the instructional case was relevant and aided students in gaining a greater understanding of an auditor's role and responsibilities.

TEACHING NOTES

1. This instructional case assumes that this is an initial audit engagement and therefore prior year work papers are not available
2. The author prearranges two clients for a class of eighteen to twenty-four students.
    a. The author initially meets with each client to discuss the project details and collect contact information for appropriate personnel (usually an owner/manager and a bookkeeper). This contact information will later be distributed to team members
    b. Appropriate client personnel are informed that they will be receiving emails from students to set up meeting dates and times
3. Client meetings are discussed with the class:
    a. Students are making a first impression and representing their University; they should conduct themselves accordingly
    b. Students should wear a suit and be on time
    c. Students should be prepared to chat and make small talk upon meeting their client
    d. Students should be prepared to think "on the fly" during all meetings
4. The author suggests two client meetings:
    a. At the first meeting the students should introduce themselves to both the owner/manager and the bookkeeper. At this meeting the students should speak predominantly with the owner/manager and focus on gaining an understanding of their clients business and industry. The students should focus on gathering information to complete requirement #1 on the internal control questionnaire
        i. Each audit team must have a confirmed initial client visitation appointment by the end of the 6th week of class
            1. This appointment should be arranged via email. The email should introduce team members and the assignment. The email should indicate a date and time that the students would like to meet and inform the client of the estimated time needed for the meeting
        ii. The estimated time needed for this task is less than one hour. Students are made aware that more time than this will cut into the client's workday and possibly cause a back log in the client's work situation. Students must be considerate of their client's time and be prepared to complete their work as efficiently as possible.
    b. At the second client meeting the students should complete the internal control questionnaire. Generally the bookkeeper can adequately respond to the questions on the internal control questionnaire, but some questions may need to be asked of the owner/manager
        i. Each audit team must have a confirmed second client visitation appointment by the end of the 8th week of class
            1. This appointment should be arranged via email. The email should re-introduce team members and the assignment. The email should indicate a date and time that the students would like to meet and inform the client of the estimated time needed for the meeting
        ii. The estimated time needed for this task is one hour. Students are made aware that more time than this will cut into the client's workday and

possibly cause a back log in the client's work situation. Students should be considerate of their client's time and be prepared to complete their work as efficiently as possible.

5. Future client visits are discouraged and should be kept to a minimum. Most student follow up questions can be answered by phone or email.
6. Students generally need some guidance regarding the completion of the internal control questionnaire.
   a. Team members should predetermine which student will ask each question on their internal control questionnaire. The author suggests the questions be equally divided among team members and each student assume a leadership role for the questions assigned to him/her.
   b. Each student should lead the interview for his or her appointed questions.
   c. The author advises students to think about the "5 W's" when completing their questionnaire: who, what, when, where and why-
      i. Who (or what system) is responsible?
      ii. What are they responsible for? (i.e. a reconciliation)
      iii. When is it (the reconciliation) produced? (monthly?)
      iv. Where does it (the reconciliation) get saved or filed?
      v. Why is this done? (what is the purpose of a reconciliation?)
   d. All students should take notes throughout the process to improve the accuracy of the information collected

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APPENDIX A- INTERNAL CONTROL QUESTIONNAIRE- CASH

Background Information

Gain an understanding of your client's business and industry (use your client's website and visit with your client to gather needed information about their business. Visit http:///www.bls.gov/iag/tgs/iag_index_alpha.htm for information about industries)

1. Address the following:
    a. What industry is your client in?
        i. Describe the industry
        ii. Provide pertinent statistics
    b. What is the nature of your client's business?
        i. How does your client generate revenue?
            1. Who are your client's major customers?
        ii. What are your client's largest expenses?
            1. Who are your client's major suppliers?
        iii. What are your client's major sources of financing?
        iv. Create an organizational chart, including all employees and owners at your client, their titles and to whom they report.

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2. Complete the Internal Control Questionnaire below.

	Brief Explanation	Yes or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Are all bank accounts in the company's name included in the general ledger?			
Can bank accounts be opened or closed only by action of the Board of Directors or other authorized party?			
Can authorized signers for cash disbursements be added only by the Board of Directors or other authorized party?			
Are all blank checks kept in a safe place?			
Are all blank checks pre-numbered?			
Is the sequence of blank checks accounted for regularly?			
Are signature plates or signature stamps adequately safeguarded?			

	Brief Explanation	Yes or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Are there limitations on amounts for which single signature and/or multiple signature checks can be written?			
Is cash on hand maintained in a secure place?			
Is petty cash maintained in a secure place?			
Is the amount of cash on hand reasonably low?			
Do procedures for processing and depositing cash receipts adequately provide for restrictive endorsements of checks?			
Do procedures for processing and depositing cash receipts adequately provide for timely deposits of daily receipts or are deposits that are held stored in a secure location?			
Are duplicate deposit slips maintained on file?			
Do procedures for disbursements and check signing adequately provide for approval of disbursements before preparation of checks?			
Do procedures for disbursements and check signing adequately provide for the review of supporting documentation prior to check signing?			
Do procedures for disbursements and check signing adequately provide for cancellation of supporting documentation after payment?			
Are all disbursements (except for petty cash fund expenditures) made by check?			
Do procedures prohibit the signing of blank checks?			

	Brief Explanation	Yes or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Do procedures prohibit drawing checks to "cash"?			
When unusable, are pre-numbered checks mutilated to prevent subsequent use?			
Are unusable checks that have been mutilated kept to account for serial numbers?			
Are bank accounts reconciled periodically (typically monthly)?			
Are bank account reconciliations prepared by an employee not involved in the processing or recording of cash receipts and disbursements?			
Are bank statements delivered to an appropriate individual separate from the individual who reconciles the account?			
Does an official who is not responsible for receipts and disbursements review and approve all reconciliations?			
Does the person who reviews and approves the reconciliations investigate unusual reconciling items?			
Is the review and approval of the reconciliations evidenced by the appropriate reviewer's signature?			
Are there adequate segregation of duties surrounding the cash area so that cash collection and deposit functions are segregated from those functions involving the recording of cash receipts and general ledger entries?			
Are passwords used for individuals who have access to the general ledger and accounting system software?			

	Brief Explanation	Yes Or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Does management review and follow up on overdrafts?			
Does management review weekly cash summaries?			
Are cash transfers approved by management?			
Are electronic payments authorized by management?			
Are electronic payments reviewed by management?			
Is management adequately involved in the company's operations in the area of cash processing?			

APPENDIX B- INTERNAL CONTROL QUESTIONNAIRE- ACCOUNTS PAYABLE

Background Information

Gain an understanding of your client's business and industry (use your client's website and visit with your client to gather needed information about their business. Visit http:///www.bls.gov/iag/tgs/iag_index_alpha.htm for information about industries)

1. Address the following:
    a. What industry is your client in?
        i. Describe the industry
        ii. Provide pertinent statistics
    b. What is the nature of your client's business?
        i. How does your client generate revenue?
            1. Who are your client's major customers?
        ii. What are your client's largest expenses?
            1. Who are your client's major suppliers?
        iii. What are your client's major sources of financing?
        iv. Create an organizational chart, including all employees and owners at your client, their titles and to whom they report.

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2. Complete the Internal Control Questionnaire below.

	Brief Explanation	Yes or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Are purchase orders pre-numbered?			
Is the sequence of numbers for purchase orders accounted for regularly?			
Is there a receiving report that accompanies receipt of goods that is completed after adequate inspection and count of goods?			
Are receiving reports pre-numbered?			
Is the sequence of numbers for receiving reports accounted for regularly?			
Are invoices received from suppliers sequentially numbered as received?			

	Brief Explanation	Yes or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Are sequentially numbered supplier invoices accounted for in sequence and missing invoices investigated on a timely basis?			
Are blank checks pre numbered?			
Is the sequence of blank checks accounted for regularly?			
Are invoices received from suppliers compared with: A) Purchase orders? B) Receiving reports?			
Are vouchers created matching the purchase order, receiving report and invoice?			
Do check signers agree checks to supporting documents prior to signing?			
Are invoices received from suppliers checked for mathematical accuracy?			
Are invoices received from suppliers approved for payment by management?			
Are invoices received from suppliers cancelled after paid?			
Are account coding's for purchases of goods and services reviewed by management?			
Are receipts of goods which cannot be matched to supplier invoices investigated to ensure liabilities are properly recognized?			
Are dual signatures required on large disbursements?			
Is the signing of blank checks prohibited?			
Is preparation of checks payable to "cash" prohibited?			
Is a record of recurring charges maintained and reviewed to avoid duplication or omission of payment?			

	Brief Explanation	Yes or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Are there controls in place to ensure that purchases, payments and payables transactions are entered accurately, completely and only once?			
Are there controls designed to ensure that rejected transactions are promptly isolated, analyzed, and corrected?			
Are goods returned to suppliers properly documented to ensure that proper credit is received?			
Is cutoff for purchases and payments for all goods and services at year-end adequate?			
Are controls in place to ensure that bona fide purchases, payments and payables transactions have not been lost and are completely and accurately processed and reported in the appropriate accounting period?			
Are reconciliations of payables listings to the general ledger prepared?			
Are reconciliations of payables listings reviewed and approved by management?			
Are reconciliations of supplier statements to accounts payable prepared?			
Are reconciliations of supplier statements to accounts payable reviewed and approved?			
Is there adequate segregation of duties in the area of purchases and payables such that purchasing functions are segregated from the invoice processing, accounts payable and general ledger functions?			

	Brief Explanation	Yes Or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Is there adequate segregation of duties in the area of purchases and payables such that receiving functions are segregated from the invoice processing, accounts payable and general ledger functions?			
Is there adequate segregation of duties in the area of purchases and payables such that purchasing and receiving functions are segregated?			
Is there adequate segregation of duties in the area of purchases and payables such that disbursement preparation is segregated from those recording cash disbursements?			
Is there adequate segregation of duties in the area of purchases and payables such that disbursement approval is segregated from those recording cash disbursements?			
Is there adequate segregation of duties in the area of purchases and payables such that disbursement approval is segregated from disbursement preparation functions?			
Does management review individually significant purchases and disbursements?			
Does management perform a detailed fluctuation analysis of selling and administrative expenses?			
Are there password controls to prohibit unauthorized access to purchases, payments and payables transaction processing functions and resultant data records?			

APPENDIX C- INTERNAL CONTROL QUESTIONNAIRE- ACCOUNTS RECEIVABLE

Background Information

Gain an understanding of your client's business and industry (use your client's website and visit with your client to gather needed information about their business. Visit http:///www.bls.gov/iag/tgs/iag_index_alpha.htm for information about industries)

1. Address the following:
    a. What industry is your client in?
        i. Describe the industry
        ii. Provide pertinent statistics
    b. What is the nature of your client's business?
        i. How does your client generate revenue?
            1. Who are your client's major customers?
        ii. What are your client's largest expenses?
            1. Who are your client's major suppliers?
        iii. What are your client's major sources of financing?
        iv. Create an organizational chart, including all employees and owners at your client, their titles and to whom they report.

2. Complete the Internal Control Questionnaire below.

	Brief Explanation	Yes or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Are customer delivery slips pre-numbered?			
Is the sequence of customer delivery slip numbers accounted for regularly?			
Are customer sales invoices pre-numbered?			
Is the sequence of customer sales invoice numbers accounted for regularly?			
Is the mathematical accuracy of customer sales invoices checked?			
Does a formal customer credit policy for all customers exist?			
Are credit limits established for each customer by management?			
Are changes to customer credit limits reviewed and approved by management?			

	Brief Explanation	Yes or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Are customer orders approved for credit before shipment or performance of services?			
Are controls adequate to ensure that all customer deliveries and performance of services are billed (i.e.: are all orders and delivery slips matched to invoices)?			
Are controls adequate to ensure that all customer deliveries and performance of services took place (i.e.: are all invoices matched to orders and delivery slips)?			
Are monthly accounts receivable statements routinely sent to customers?			
Are customer receipts received properly identified by customer name immediately upon receipt?			
Is there adequate physical security over customer receipts before deposit?			
Are customer receipts in the form of check restrictively endorsed?			
Are customer receipts deposited on a timely basis?			
Do deposit slips detail individual customer remittances?			
Are all overdue accounts receivable investigated and appropriately resolved with adequate documentation of action taken?			
Are write-offs of bad debts approved by management?			
Are all customer complaints followed up on a timely basis?			
If a customer wants to return merchandise, is the customer return approved by management?			

	Brief Explanation	Yes or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
For customer returns of merchandise, is a credit memo form used?			
Are credit memo forms pre-numbered?			
Is the sequence of credit memo numbers accounted for regularly?			
Is the mathematical accuracy of credit memos checked?			
Are credit memos matched to receiving documentation indicating goods have actually been returned by the customer?			
Are credit memos approved?			
Are there controls to ensure that revenues, receipts from customers and receivables transactions are entered accurately, completely and only once?			
Are there controls designated to ensure that rejected transactions are promptly isolated, analyzed and corrected?			
Are controls for cut-off of revenues and receipts from customers at year end adequate?			
Are controls in place to ensure that revenues, receipts from customers and receivables transactions have not been lost and are completely and accurately processed?			
Is there adequate segregation of duties in the revenue and receivables area such that sales slip creation and delivery functions are segregated from the accounts receivable, and general ledger functions?			

	Brief Explanation	Yes Or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Is there adequate segregation of duties in the revenue and receivables area such that the invoicing function is separate from the cash functions?			
Is there adequate segregation of duties in the revenue and receivables area such that credit memo, invoicing and cash functions are segregated?			
Is there adequate segregation of duties in the revenue and receivables area such that accounts receivable and general ledger functions are segregated?			
Is there adequate segregation of duties in the revenue and receivables area such that inventory custody and delivery are segregated from order entry and invoicing?			
Is there adequate segregation of duties in the revenue and receivables area such that cash functions are segregated from delivery, invoicing, credit memo processing, accounts receivable and general ledger?			
Is there adequate segregation of duties in the revenue and receivables area such that cash receipts functions are segregated from those for cash disbursements?			
Is there adequate segregation of duties in the revenue and receivables area such that cash collection and deposit preparation functions are segregated from those for recording cash receipts and general ledger entries?			

	Brief Explanation	Yes Or No	If previous column No: Is weakness mitigated? If yes-how? If not=potential control risk
Is there adequate segregation of duties in the revenue and receivables area such that cash receipts functions are segregated from bank reconciliation preparation and approval functions?			
Are there controls over unauthorized access to revenues, receipts from customers, and receivables transaction processing functions and resultant data records?			
Is security administration involving access to the computer system adequate?			
Does management review individually significant sales to customers?			
Does management review individually significant credit memos issued to customers?			
Does management review revenue and gross margins by product, customer, geographical area and sales persons?			
Does management review summary of sales in units?			
Does management review the accounts receivable aging?			