

ACC531: Auditing and Assurance Services
Ch 7. Revenue and Collection Cycle – Case Study

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Situation: ABC Corp.

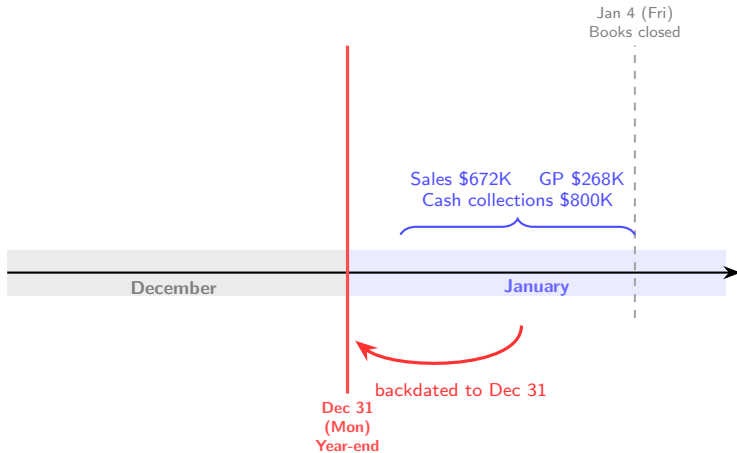
ABC Corp. closes its books **every Friday at 5 p.m.** to prepare weekly reports. This year, December 31 fell on a **Monday** — but the accounting was closed on **Friday, January 4** as usual.

All entries (sales invoices, cash receipts, shipping docs) were **dated December 31**, even though the transactions occurred January 1–4.

Amounts recorded in December (should be January):

- Sales = \$672,000 Gross Profit = \$268,000
- Cash collections from A/R = \$800,000

Case — Timeline



Case — Analysis: Sales and Gross Profit

Sales (\$672,000) & Gross Profit (\$268,000) were recorded in Dec but belong to Jan.

- ❶ What assertion is violated?

Cutoff or Occurrence

- ❷ Is Inventory overstated or understated?

Understated

- ❸ Is Cost of Goods Sold overstated or understated?

Overstated

- ❹ How much?

403,200 (= 672,000 - 268,800)

- ❺ What adjustment entry is needed?

Sales (-R)	672,000
Inventory (+A)	403,200
Accounts Receivable (-A)	672,000
Cost of Goods Sold (-E)	403,200

Case — Analysis: Cash Collections

Cash collections (\$800,000) from A/R were recorded in December but the collections occurred in January.

- ❶ Is Cash overstated or understated?

Overstated

- ❷ Is Accounts Receivable overstated or understated?

Understated

- ❸ What adjustment entry is needed?

Accounts Receivable (+A)	800,000
Cash (-A)	800,000

Auditors should

- understand the client's accounting system — specifically, how and when the books are closed.
- sample transactions close to year-end and perform trace and vouch: compare the date on source documents to the date recorded in the system.
- perform A/R confirmation to detect any A/R balances that customers dispute as already paid.