

Companies generally use a voucher system to authorize payment. The appropriate department issues pre-numbered vouchers for each payable item. The person requesting the voucher attaches the supporting documents and proper approvals. Dividing the labor among the approving parties, voucher preparers, and check writers is wise. Also, the open accounts payable items should be reconciled to the general ledger account at the end of each month.

Companies generally control miscellaneous liabilities, such as accrued wages, commissions, taxes, deferred credits, and withheld payroll taxes, by comparing the accrual to the actual expense item. A company should periodically clear those items and verify that it does so. The disbursements are subject to the regular procedure that employees, other than those handling the accruals or reconciliation of the accrued accounts, should make disbursements.

Because premium auditors rely heavily on payroll records, that area of internal control deserves careful study. Exhibit 6-15 provides an example of a questionnaire to evaluate internal control of payroll processing.

## Revenues

Determining revenues is different from valuing and verifying assets and liabilities. The assets and liabilities are balance accounts at one point in time, but revenues relate to a period of time and represent a total for that period. Also, in most businesses, revenues represent an accumulation of many transactions that the organization must properly record in terms of time and value.

The AICPA defines “revenues” in Accounting Terminology Bulletin No. 2 as follows:

Revenue results from the sale of goods and the rendering of services and is measured by the charge made to customers, clients, or tenants for goods and services furnished to them. It also includes gains from the sale or exchange of assets (other than stock in trade), interest and dividends earned on investments, and other increases in the owners' equity except those arising from capital contributions and capital adjustments.<sup>8</sup>

In most companies, revenues are a result of credit sales. In some, such as retail stores, revenues are a result of cash transactions. Each type of transaction presents unique internal control considerations.

The receipt of the customer's order initiates the credit sale. That order can come from contact with the customer in the field or office, by mail, or from a company sales representative or the Internet. Authorized personnel should check the order for accuracy and approve the order. The credit department should then approve the order's credit terms. The company might use copies of the sales order for the following:

- Authorization to release the goods from inventory
- Authorization for shipping by the shipping department
- Basis for the billing by the billing department
- Recording of the transaction by the accounting department



**EXHIBIT 6-15****Internal Control Questionnaire—Payroll**

1. Do different persons perform the following tasks?
  - a. Approve hours worked
  - b. Prepare payrolls
  - c. Distribute paychecks
  - d. Maintain custody of unclaimed wages
  - e. Hire and terminate employees
2. Does someone outside of the payroll department check payroll totals against independently compiled labor distribution totals?
3. Are clerical operations in preparation of payrolls double-checked before payment?
4. Are appropriate payroll-related records maintained for accumulated employee benefits (vacations, pension data, and so on)?
5. Is the general ledger distribution of labor periodically reconciled to the payroll register?
6. Are responsibilities for payroll segregated from those for the general ledger?
7. Are payroll disbursements made from an imprest bank account?
8. If a separate payroll bank account is maintained,
  - a. Are all checks pre-numbered and accounted for?
  - b. Is the supply of unused checks adequately safeguarded and in the custody of persons who do not sign checks manually, control the use of facsimile signature plates, or operate the facsimile signature machine?
  - c. Are spoiled checks mutilated to prevent reuse and kept on file for subsequent inspection?
  - d. Are controls over the use of the facsimile signature plates adequate where a check-signing machine is used?
  - e. Does the board of directors designate the check signers?
  - f. Is the signing of checks before they are prepared prohibited?
  - g. Is the amount for which checks can be drawn limited, or is a check protector used?
9. Is the payroll bank account reconciled by someone who has no other function with respect to the payroll?
10. If payment is made by cash,
  - a. Do employees who do not prepare payrolls or approve hours worked prepare pay envelopes?
  - b. Are receipts obtained?
11. Are completed payrolls adequately reviewed and approved before disbursements? (For example—compared with previous periods?)
12. Are confidential executive payrolls adequately controlled? (For example—approved by an executive other than the preparer of the payroll?)
13. What control is exercised over back pay and unclaimed wages?
14. Are advances to sales personnel periodically evaluated on the basis of current sales performance?



Once the company has processed the sales order, an invoice for the goods can be prepared based on data received regarding the goods ordered and the goods shipped. The appropriate personnel should make comparisons between the invoice and the amounts ordered and shipped. The employees who record the invoice for the sales register and the accounts receivable ledger should be different from the employees who prepare the sales orders, shipping orders, and invoices. That general procedure for receiving and recording sales orders varies by company, depending on the special circumstances involved in the creation of sales. Auditors should look for a properly coordinated division of responsibilities to ensure checks and balances among the various steps in the sales process.

Cash sales are handled differently. In the normal cash sale in a retail store, the same person who accepts the cash also gives the merchandise to the customer. The control of cash sales is closely related to inventory control. If a company properly controls and accounts for inventory, an automatic check of the cash sales should result. If obtaining inventory control over cash sales is impractical, the company must use other measures to maintain cash flow. Many retail stores use the retail inventory method, which, in effect, charges the goods into inventory at retail prices. A company obtains aggregate control under that method by comparing total beginning and ending inventory with the actual cash sales. That method makes the salespeople accountable for any differences in the value of stock on hand. A second effective control is having the employee making the sale issue a sales invoice and then having central cashiers receive the money.

### Costs and Expenses

Another basic audit goal is matching expense to revenue. To ensure that costs and expenses are properly handled, budget procedures, cost-accounting procedures, and general expense control must be implemented.

The company accomplishes budget control by comparing actual expenses with budgeted amounts and following up on variances to identify waste and to improve performance. The company can also identify nonbudgeted or unauthorized expenditures.

The system of cost accounting can help monitor costs and expenses by distributing expenditures among inventory, capital items, and cost of sales. Costs can be distributed by product, operation, department, process, or organizational unit. A company might even distribute direct and indirect costs. Whatever cost system a company uses, it should periodically review the accuracy and timeliness of the results to ensure that the system provides the information needed for expense analysis.

General expense control should ensure that expenses are legitimate and authorized. It should also provide accurately recorded and classified expenses for reporting purposes. The accounting system should have clear, written procedures for classifying expenses and for determining expense items as compared to expenditures for assets. Those procedures ensure that the system

