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Chapter 12, Problem 9P

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Problem

Figure depicts the activities performed in the revenue cycle by the Newton Hardware Company.

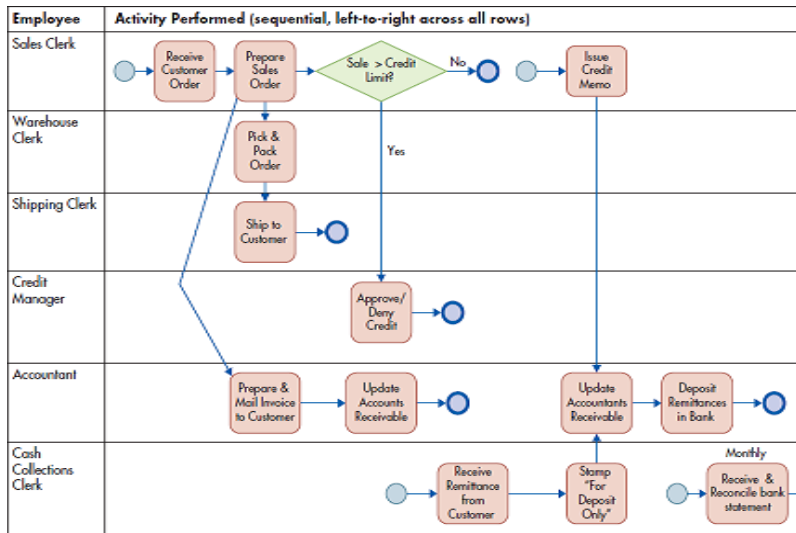
REQUIRED

a. Identify at least three weaknesses in Newton Hardware's revenue cycle. Explain the resulting threat, and suggest methods to correct the weakness.

b. Identify ways to use IT to streamline Newton's revenue cycle activities. Describe the control procedures required in the new system. (CPA Examination, adapted)

FIGURE

Newton Hardware Company Revenue Cycle Procedures



Step-by-step solution

Step 1 of 3

a. Identify weaknesses in the revenue cycle from the given scenario. Then identify respective threats and controls for each weakness.

Weakness	Threat	Control
Lack of credit approval upon sale	Sales going uncollected	Credit approval process overseen by department other than sales clerk
Items are released from warehouse	Sales going	Good should not be released until

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prior to credit approval	uncollected	after credit approval
Bookkeeper A prepares invoices without confirmation of what was actually shipped and when it was shipped	Invoicing errors	Reconciliation of shipping information with sales orders prior to invoicing.
Bookkeeper A does both the invoicing and write-offs	Potential for fraud	Someone independent of invoicing should be the one to authorize write-offs and credit memos
Bookkeeper B does not verify that all sales orders and shipping advices have been invoiced	Invoicing errors/failure to invoice	Reconciliation of sales order and shipping information with invoicing.
Bookkeeper C creates postings and maintains all ledgers	Lack of review for correctness and accuracy	Have items reviewed by another bookkeeper before posting
Collection clerk deposits checks and reconciles bank statement	Possible theft cover-up possibility	Have bank reconciliations performed by one of the bookkeepers

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Step 2 of 3

b. Ways that information technology could be used to improve the revenue cycle activities in the given scenario are:

1. Entry of sales orders from customers into the system as they are requested. This will allow for credit checks to occur at the time of order instead of after the fact.
2. System notification to all the departments involved in the transaction when an order is placed.
3. Real-time update of the order and its status as it moves through the system/process.

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Step 3 of 3

Control procedures required for the new system include:

1. Access controls
2. Segregation of duties
3. Various checks and balances; for example completeness checks on orders taken
4. Requirements for review and approval of transactions by someone other than the person initiating it

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