

# An Internal Control Evaluation Tool For Advertising Revenue In The Newspaper And Magazine Publishing Industry

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## ABSTRACT

*Even before the recent economic downturn, the newspaper and magazine publishing industry had been experiencing unprecedented change, with some companies facing an immediate need to either invent a new business model or else cease operations. The current economic slowdown has, in many cases, exacerbated those challenges. These trends have had the effect of increasing the risk of fraudulent financial reporting. The revenue cycle continues to be one of the most important areas for auditors to examine for possible fraud and one for which strong, comprehensive internal controls are especially important (AICPA 2002). This paper presents an internal control review checklist for advertising revenue in the newspaper and magazine publishing industry. This checklist may be used by independent auditors as a general benchmark in performing a preliminary evaluation of a company's internal controls over advertising revenue. In instances where important internal controls on the checklist have been omitted from the client's system, the auditor should consider whether the omission increases audit risk. The checklist may also be used by CFOs or controllers in the industry to help determine whether their company's internal control system is adequate.*

**Keywords:** Internal Control, Advertising Revenue, Newspaper and Magazine Publishing

## INTRODUCTION

Advertising revenue is the single most important revenue source for both newspaper publishers and magazine publishers (hereafter, newspaper and magazine publishers), with ad revenue providing over 70% of newspaper revenue and almost 60% of magazine revenue overall (Hoovers 2010a, 2010b). This paper presents a checklist that may be used by both independent auditors as well as managers in the newspaper and magazine publishing industry to help determine whether important internal controls over advertising revenue are in place. This checklist is potentially useful to auditors of both publicly-traded and privately held newspaper and magazine publishers, as well as to controllers or CFOs of newspaper and magazine publishing companies who may have concerns about the quality of their company's internal controls over advertising revenue. The checklist is important and timely because current economic conditions in general, as well as those in the newspaper and magazine publishing industry, make it likely that audit risk has increased in recent years for many of these publishers. Because the revenue cycle continues to be one of the primary areas affected by fraud and abuse (AICPA 2002), internal control over advertising revenue in these industries is particularly important today.

## INDUSTRY BACKGROUND

The publishing industry may be thought of being comprised of separate industries, each typically publishing in different media. Thus, one might consider there to be separate industries for newspapers and news organizations, periodicals, books, music, directories (such as telephone directories), and academic publishing, as well as for firms publishing solely on the internet. This paper is concerned solely with the newspaper and magazine publishing industry.

The newspaper industry is highly concentrated in terms of its market concentration, in that the top 50 companies control almost 80% of the U.S. market. The magazine industry is only somewhat less concentrated, in that the 50 largest magazine publishing companies generate about 70% of U.S. industry revenues. The two industries vary in terms of how capital intensive vs. labor intensive they are. In particular, the newspaper industry is fairly labor intensive, with average annual revenue of approximately \$120,000 per worker. By contrast, the magazine industry is more capital intensive, with average annual revenue per worker of approximately \$315,000 (Hoovers 2010a, 2010b).

Profits in the newspaper publishing industry tend to depend on the overall health of the economy, while profits in the magazine publishing industry are driven by growth in consumer income. The profits of individual companies in both industries depend largely on marketing expertise (Hoovers 2010a, 2010b).

**Table 1: Control Objectives and Suggested Control Activities**

<b>Control Objectives</b>	<b>Control Activities</b>
Advertising sales orders are only processed within approved customer credit limits.	23P, 26F, 27P, 37P
Advertising sales orders are approved by management as to rates and terms of sale.	28F, 38F
Advertising orders and cancellations of advertising orders are input accurately.	29P, 30-32F, 39P
Advertising sales order entry data is transferred completely and accurately to the advertising placement and invoicing activities.	33F, 34P
All advertising insertion ("sales") orders received from customers are input and processed.	30P, 32F, 34F, 36P
Invoices are generated using authorized terms and rates.	3P, 8F, 17F, 28F, 33P, 38P
Invoices are accurately calculated and recorded.	9P, 14P, 33P, 52F, 53F
Credit notes and adjustments to accounts receivable are accurately calculated and recorded (including "make-good" promises).	9P, 13F, 14P, 15P, 42P
All advertisements placed in an issue are invoiced.	1P, 4F, 8F, 40F, 43F
Credit notes for all "make-good" promises and rate base adjustments to accounts receivable are issued in accordance with organization policy.	10F, 42F
Invoices relate to valid advertisements.	8F, 22P, 41F
All credit notes relate to a "make-good" promise or other valid adjustments.	10F, 11P, 42P
All invoices issued are recorded.	7P, 35F, 43F
All credit notes issued are recorded.	11F, 22P
Invoices are recorded in the appropriate period.	1F, 7P
Credit notes issued are recorded in the appropriate period.	2F, 11F
Advertising accounts receivable reflect the existing business circumstances and economic conditions in accordance with the accounting policies being used.	54F
Advertising sales and advertising accounts receivable information is appropriately presented and all information that is necessary for fair presentation and compliance with professional standards or legal requirements is disclosed.	55F
Cash receipts are recorded in the period in which they are received.	16F, 44-46F
Cash receipts data are entered for processing accurately.	22P, 44F, 45F, 46-48P
All cash receipts data are entered for processing.	22P, 44F, 45F, 46P, 48P, 49F
Cash receipts data are valid and are entered for processing only once.	44F, 46P, 49P
Cash discounts are accurately calculated and recorded.	50F, 51F
Timely collection of accounts receivable is monitored.	5P, 6F
Only valid changes are made to the customer master file.	12P, 18F, 24P
All valid changes to the customer master file are input and processed.	19F, 24P, 25F
Changes to the customer master file are accurate.	18F, 20P, 24P
Changes to the customer master file are processed in a timely manner.	19F, 24P, 25F
Customer master file data remain pertinent.	21P, 24P

## RECENT TRENDS

The recent economic slowdown, which began in December 2007, has affected most sectors of the publishing industry, including the newspaper and magazine publishing industries. Recent newspaper and magazine revenue declines have been attributable in large part to competition from the internet (Langeveld 2010). Overall magazine circulation declined by 1.2% in the first half of 2009 (Clifford 2009), perhaps due largely to the effects of the recession. Weekly newsmagazines have recently suffered, with U.S. News & World Report announcing in late 2008 a change to a monthly format, Businessweek being sold to Bloomberg News in 2009 for a few million dollars, and Newsweek being put up for sale in May 2010 by its owner, The Washington Post Company (Folkenflik 2010). Many news magazines and newspapers have launched online versions in an attempt to compete with online providers, but online ad revenues for many newspapers are a fraction of their print counterparts, and as a result, many newspapers have had to cut editorial staff significantly or even cease operations (Carr 2008, Perez-Pena 2009). Online publishers appear to be benefitting from the general shift of advertising dollars from print to online media: it was reported that in 2010, for the first time, advertisers spent more for online ads than for print ads (Smillie 2010).

## THE ADVERTISING REVENUE CYCLE REVIEW CHECKLIST

Tables 1 and 2 present a checklist of control objectives and activities that should be useful to readers who wish to conduct a preliminary review of a newspaper or magazine publishing company's internal controls over advertising revenues. Table 1 lists important control objectives for the advertising revenue cycle. Each objective is followed by alphanumeric characters which reference the control activities listed in Table 2. The numeric portion of each two- or three-character sequence refers to the control activities (listed numerically in Table 2). The letter portion of each sequence ("F" or "P") indicates whether the referenced control activity, if being carried out as intended, "fully" or "partially" meets that internal control objective.

**Table 2: Suggested Control Activities**

1	Goods shipped at, before, or after the end of an accounting period are scrutinized and/or reconciled to ensure complete and consistent recording in the appropriate accounting period including raising and recording of the related invoices including issuing and recording of the related invoices.
2	Goods returned by customers at, before, or after the end of an accounting period are scrutinized and/or reconciled to ensure complete and consistent recording in the appropriate accounting period.
3	List prices of composed products are automatically calculated based on the list prices of components of such products.
4	Goods in consignment are confirmed regularly and the statements are reconciled to inventory records and general ledger.
5	Accounts receivable aging reports are prepared regularly and analyzed.
6	Collection procedures established by management for overdue accounts are performed as intended.
7	Recorded sales, gross margins, and miscellaneous receipts are compared to budget regularly; management reviews and approves significant variances.
8	Data input to the invoicing subsystem is compared to priced order and shipment data per the separate, nonintegrated order entry and/or shipping applications; differences require management approval before invoices can be processed.
9	Invoice and credit note data are edited and validated; identified errors are corrected promptly.
10	A policy has been established regarding criteria for issuing credit notes; compliance with this policy is monitored.
11	Credit notes are sequentially prenumbered; the sequence of credit notes is accounted for.
12	Significant changes to the customer master file are approved by management.
13	Management approves credit notes, bad debt write-offs and other adjustments to accounts receivable.
14	Invoice and credit note input data are balanced; out-of-balance batches are corrected promptly.
15	Management monitors the nature, volume and amounts of recorded credit notes, write-offs, and other adjustments to accounts receivable.
16	Cash receipts at, before, or after the end of an accounting period are scrutinized and/or reconciled to ensure complete and consistent recording in the appropriate accounting period.
17	The system maintains both current and "prior" approved prices. Orders and invoices are priced using the price in effect at the time of order placement or shipment, depending on the organization's policies and procedures.
18	Recorded changes to customer master file data are compared to authorized source documents or confirmed with customers to ensure that they were input accurately.
19	Requests to change customer master file data are logged; the log is reviewed to ensure that all requested changes are processed in a timely manner.

20	Customer master file input data are edited and validated; identified errors are corrected promptly.
21	Reports of customers who have not placed orders within a specified period of time are reviewed to ensure that customer master file data remains pertinent.
22	Statements of customer accounts receivable are mailed periodically to customers.
23	Customers' financial position and creditworthiness are monitored.
24	Customer master file data are periodically reviewed by management for accuracy and on-going pertinence.
25	Requests to change customer master file data are submitted on prenumbered forms; the numerical sequence of such forms is accounted for.
26	Orders are not processed if the customer's credit limit will be exceeded.
27	Orders are not processed for "blocked" accounts.
28	Sales orders and/or invoice terms and prices are based on an approved price list. Exceptions to standard pricing and discounts require specific management approval. Overrides of standard pricing and terms are reported and investigated by management.
29	Order entry and order cancellation data are edited and validated; identified errors are corrected promptly.
30	Recorded orders and cancellations are confirmed with customers.
31	Recorded order entry and order cancellation data are compared to source documents by an individual who is independent of the order entry process.
32	Customers enter and/or cancel orders automatically using EDI protocols.
33	Data transferred from the order entry subsystem to the shipping and invoicing subsystems are balanced; identified errors are corrected promptly.
34	Orders are sequentially numbered. The sequence of orders processed is accounted for.
35	Invoices are sequentially prenumbered. The sequence of invoices processed is accounted for.
36	Order entry transactions are batched and batch input data are balanced; out-of-balance batches are corrected promptly.
37	Customers are assigned credit limits based on an assessment of their creditworthiness and ability to pay for goods or services.
38	Significant or unusual sales orders are specifically approved by management as to prices and terms.
39	Order cancellation data are matched to the original order.
40	Management reviews relevant sales, accounts receivable, cost of sales and inventory reports related to order entry, shipping, invoicing, and accounts receivable; significant unusual relationships are monitored and acted upon.
41	Invoices are approved, based on comparison to priced order and shipping source documents.
42	All returned goods are logged when received. The log details such items as customers, goods, defects, inspections, and assessment by quality control. Return details per the log are compared to credit notes issued to ensure that credit is issued in the correct period and in accordance with company policy.
43	Shipments of goods to customers are logged. The log is used to ensure that all shipments are invoiced and that all invoices are recorded.
44	Cash sales are recorded using a cash register. Customers are provided with a copy of the register receipt and total daily receipts per the register are balanced to cash deposited to the bank.
45	Shipment of goods ordered via EDI initiates an automatic draft on the customer's account.
46	Bank statements are reconciled to the general ledger regularly.
47	Cash receipts input data are edited and validated; identified errors are corrected promptly.
48	Cash receipts transactions are batched and batch input data are balanced; out of balance batches are corrected promptly.
49	Customers are provided with a form acknowledging receipt of any cash payments (i.e., a cash receipt form) and cash receipts forms are balanced to cash deposited to the bank. Cash receipt forms are sequentially prenumbered and the sequence of such forms is accounted for.
50	Available cash discounts are automatically calculated by the application system, using standard programmed algorithms and established terms of sale.
51	Management reviews the level of recorded discounts granted to customers.
52	Pricing of recorded invoices, including discounts applied, is independently recalculated.
53	Invoices and/or sales orders are automatically priced by the application system, using standard programmed algorithms, including the calculation of discounts, if applicable.
54	Before financial statements are issued, management will approve the amount of an adjusting entry to the allowance for doubtful accounts receivable and its supporting documentation, to ensure that the amount in that allowance is reasonable in light of current business circumstances and economic conditions.
55	Before financial statements are issued, the senior accounting officer will indicate that he or she agrees that the advertising sales revenue and advertising accounts receivable information is appropriately presented, and that all information necessary for fair presentation and compliance with professional standards or legal requirements is disclosed.

## SUMMARY AND CONCLUSION

This paper presents an internal control review checklist for the advertising revenue cycle in the newspaper and magazine publishing industry. This checklist will be useful, as a benchmark for comparative purposes, to both independent auditors conducting a preliminary evaluation of internal control, as well as industry managers who may have concerns about the adequacy of their company's internal control system. The recent economic downturn in general, as well as recent challenges in the industry from online content providers, make the checklist especially important and timely.

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