**Chapter 18 Auditing Theory**

Multiple-Choice Questions

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| 1. | The classes of transactions in the acquisition and payment cycle include acquisition of: |
| easy | a. goods. |
| d | b. goods and services. |
|  | c. goods and services, and cash disbursements. |
|  | d. goods and services, cash disbursements, and purchase returns and allowances. |
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| 2. | The overall objective in the audit of the acquisition and payment cycle is: |
| easy | a. to ensure the reliability of the affected accounts. |
| c | b. to ensure the accuracy of the affected accounts. |
|  | c. to evaluate whether the affected accounts are fairly stated in accordance with GAAP. |
|  | d. to evaluate whether fraudulent payments were made. |
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| 3. | The audit of the acquisition and payment cycle often takes \_\_\_\_ time to audit than other cycles. |
| easy | a. less |
| c | b. about the same |
|  | c. more |
|  | d. no less |
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| 4. | What typically initiates the acquisitions and payment cycle? |
| easy | a. Issuance of a purchase requisition or request for purchase of goods/services. |
| a | b. Issuance of payment to vendor. |
|  | c. Approval of a new vendor. |
|  | d. Purchase requisition. |
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| 5. | What typically ends the acquisitions and payment cycle? |
| easy | a. Issuance of a purchase requisition or request for purchase of goods/services. |
| b | b. Issuance of a payment to a vendor. |
|  | c. Approval of a new vendor. |
|  | d. Purchase requisition. |
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| 6.  easy | The receipt of goods and services in the normal course of business represents the date clients normally recognize: |
| b | a. income. |
|  | b. the liability. |
|  | c. warranty assets. |
|  | d. expenses. |
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| 7. | Which of the following accounts is **not** included in the acquisitions class of transactions? |
| easy | a. Inventory. |
| c | b. Prepaid expenses. |
|  | c. Purchase discounts. |
|  | d. Accounts payable. |
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| 8. | A document indicating a reduction in the amount owed to a vendor because of returned goods is: |
| easy | a. a debit memo. |
| a | b. a credit memo. |
|  | c. a receiving room report. |
|  | d. a shipping room report. |
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| 9.  easy | A document used by organizations to establish a formal means of recording and controlling acquisitions which usually contains a package of documents about the acquisition is the: |
| a | a. voucher. |
|  | b. purchase order. |
|  | c. receiving report. |
|  | d. purchase requisition. |
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| 10. | The accounts payable account includes obligations for the acquisition of: |
| easy | a. raw materials. |
| d | b. equipment. |
|  | c. utilities. |
|  | d. all three of the above. |
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| 11.  easy | Comparing expenses to prior years is an effective analytical procedure for accounts payable because expenses from year to year are: |
| d | a. erratic. |
|  | b. variable. |
|  | c. dynamic. |
|  | d. relatively stable. |
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| 12. | The overall objective in the audit of accounts payable is to determine whether accounts payable: |
| easy | a. is fairly stated and properly disclosed. |
| a | b. is overstated. |
|  | c. is understated. |
|  | d. is accurately stated. |
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| 13. | At what point do most companies recognize liabilities in the acquisition and payment cycle? |
| easy | a. The issuance of a purchase order. |
| c | b. Receipt of acknowledgement of order by vendor. |
|  | c. Receipt of goods or services. |
|  | d. The receipt of a vendor statement. |
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| 14.  easy | The computer-generated file which records acquisitions, disbursements and allowances for each vendor is the |
| a | a. Accounts payable master file |
|  | b. Cash disbursements file. |
|  | c. Acquisitions transaction file. |
|  | d. Purchase approval file. |
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| 15. | The is a computer-generated file that includes all acquisition transactions during a given period is the |
| easy | a. Accounts payable file |
| c | b. Cash disbursements file. |
|  | c. Acquisitions transaction file. |
|  | d. Purchase approval file. |

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| 16. | The major balance sheet account in the acquisition and payment cycle is: |
| medium | a. Notes payable. |
| c | b. Accruals payable. |
|  | c. Accounts payable. |
|  | d. Accrued liabilities. |
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| 17.  medium | Which of the following business functions is **not** considered to be part of the acquisitions class of transactions? |
| d | a. Processing purchase orders. |
|  | b. Recognizing liabilities. |
|  | c. Receiving goods and services. |
|  | d. Processing cash disbursements. |
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| 18. | It usually takes more time to audit the acquisition and payment cycle than other cycles because: |
| medium | a. there is a greater possibility of fraud in these transactions. |
| c | b. internal controls in this area are usually the weakest. |
|  | c. of the large number of accounts affected. |
|  | d. there is a greater likelihood of lawsuits against the CPA relating to these accounts. |
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| 19. | A written purchase order is a legal document that is: |
| medium | a. an offer to buy. |
| a | b. not enforceable if it is not in writing. |
|  | c. a binding agreement between purchaser and vendor. |
|  | d. an acceptance of a vendor’s catalog offer to sell. |
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| 20. | For good internal control, the purchasing department should not be responsible for: |
| medium | a. finding the lowest cost vendor. |
| d | b. reviewing vendors’ catalog descriptions and prices for standardized items. |
|  | c. designing the purchase order form. |
|  | d. authorizing the acquisition of goods. |
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| 21.  medium | The accounts payable department usually has responsibility for verifying the propriety of acquisitions by comparing the details on the: |
| c | a. vendor’s invoice and the receiving report. |
|  | b. vendor’s invoice and the purchase requisition. |
|  | c. purchase order, receiving report, and vendor’s invoice. |
|  | d. purchase requisition, purchase order, and receiving report. |
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| 22. | Tests of controls for the acquisition and payment cycle are usually divided into: |
| medium | a. tests of acquisitions and classification. |
| d | b. tests of authorization and acquisition. |
|  | c. tests of authorization and disbursement. |
|  | d. tests of acquisitions and disbursements. |
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| 23.  medium | Many companies do not maintain an accounts payable master file by vendor. These companies pay on the basis of: | | | |
| b | a. vendors’ monthly statements. | | | |
|  | b. individual vendors’ invoices. | | | |
|  | c. the accounts payable account in the general ledger. | | | |
|  | d. dunning letters. | | | |
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| 24.  medium | An important control in the accounts payable and IT departments is to ensure that those personnel who record acquisitions do not have access to: | | | |
| d | a. vendors’ price lists. | | | |
|  | b. the accounts payable master file. | | | |
|  | c. lists of vendors’ names and addresses. | | | |
|  | d. cash, marketable securities, and other easily convertible assets. | | | |
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| 25. | Which of the following is **not** a key control in the acquisition and payment cycle? | | | |
| medium | a. Authorization of purchases. | | | |
| b | b. Authorization of credit. | | | |
|  | c. Timely recording and independent review of transactions. | | | |
|  | d. Authorization of payments. | | | |
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| 26. | Proper authorization for acquisition is essential because it: | | | |
| medium | a. ensures that goods/services are used efficiently by company employees. | | | |
| c | b. ensures that goods/services were purchased from approved vendors. | | | |
|  | c. ensures that goods/services are for authorized company purposes. | | | |
|  | d. ensures that goods/services were purchased at the lowest possible price. | | | |
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| 27. | Which department should initiate a report when goods arrive from a vendor? | | | |
| medium | a. Manufacturing | | | |
| b | b. Receiving | | | |
|  | c. Accounting | | | |
|  | d. Treasury | | | |
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| 28.  medium | After a purchase requisition is approved, a \_\_\_\_\_\_\_\_\_ must be initiated to purchase the goods or services. | | | |
| a | a. purchase order | | | |
|  | b. vendor order | | | |
|  | c. call order | | | |
|  | d. vendor invoice | | | |
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| 29.  medium  b | When a client uses perpetual inventory records, the tests of details of balances for inventory can be significantly reduced if the auditor believes the records are accurate. The controls over the acquisitions included in the records are normally tested as a part of the: | | | |
|  | a. tests of controls. | | | |
|  | b. tests of controls and tests of transactions. | | | |
|  | c. tests of details of balances. | | | |
|  | d. analytical procedures and tests of controls. | | | |
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| 30.  medium  c | Which of the following acquisition transactions is likely to be covered by a general authorization by company policy? | | | |
|  |  | Purchase of office equipment maintenance services |  | Purchase of office buildings for company use | |
|  | a. | Yes |  | Yes |
|  | b. | No |  | No |
|  | c. | Yes |  | No |
|  | d. | No |  | Yes |
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| 31.  medium | The auditor’s internal control objective to determine that “recorded acquisitions are for goods and services received” satisfies the audit objective of: | | | |
| b | a. accuracy. | | | |
|  | b. occurrence. | | | |
|  | c. authorization. | | | |
|  | d. completeness. | | | |
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| 32. | Failure to record the acquisition of goods is a violation of which audit objective? | | | |
| medium | a. Accuracy | | | |
| d | b. Occurrence | | | |
|  | c. Authorization | | | |
|  | d. Completeness | | | |
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| 33.  medium | Once the auditor has decided on the specific procedures, the acquisitions tests and the cash disbursements tests are typically performed: | | | |
| a | a. concurrently. | | | |
|  | b. sequentially. | | | |
|  | c. independently. | | | |
|  | d. separately. | | | |
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| 34.  medium | The internal control that requires that “checks are prenumbered and accounted for” satisfies the objective of: | | | |
| c | a. accuracy. | | | |
|  | b. existence. | | | |
|  | c. completeness. | | | |
|  | d. posting and summarization. | | | |
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| 35. | The most important controls over cash disbursements include all but which of the following? | | | |
| medium | a. Signing of checks by an authorized employee. | | | |
| b | b. Random examination of the supporting documents by the authorized check signer before signing checks. | | | |
|  | c. Separation of responsibilities for signing the checks and performing the accounts payable function. | | | |
|  | d. Prenumbering of checks and investigations of missing checks. | | | |
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| 36.  medium | Because of the importance of tests of controls and substantive tests of transactions for acquisitions and cash disbursements, it is common in this audit area to use: | | | |
| c | a. block sampling. | | | |
|  | b. variables sampling. | | | |
|  | c. attributes sampling. | | | |
|  | d. probability proportional to size sampling. | | | |
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| 37.  medium  a | Because many of the types of errors and irregularities that may be found in the acquisition and payment cycle represent a misstatement of earnings and are of significant concern to the auditor, the tolerable exception rate selected by the auditor will be: | | | |
|  | a. low. | | | |
|  | b. high. | | | |
|  | c. average. | | | |
|  | d. very high. | | | |
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| 38. | The main focus taken by the auditor in verifying liability balances is on the discovery of: |
| medium | a. understated liabilities. |
| c | b. overstated liabilities. |
|  | c. understated or omitted liabilities. |
|  | d. overstated or extraneous liabilities. |
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| 39.  medium | Which of the following tests of controls is least useful in assessing the transaction-related audit objective related to occurrence? |
| c | a. Examine documents in voucher package for occurrence. |
|  | b. Examine supporting documents for indication of approval. |
|  | c. Account for sequence of vouchers. |
|  | d. Attempt to input transactions with valid and invalid vendors. |
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| 40.  medium | The test of details of balances procedure to “trace from account payable list to vendors’ invoices and statements” satisfies the objective of: |
| a | a. occurrence. |
|  | b. completeness. |
|  | c. classification. |
|  | d. detail tie-in. |
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| 41.  medium | By tracing receiving reports issued at and before year-end to vendors’ invoices and making sure they are included in accounts payable, the auditor is testing for: |
| b | a. theft of merchandise by employees. |
|  | b. unrecorded obligations. |
|  | c. lapping. |
|  | d. kiting. |
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| 42. | The extent of a search for unrecorded liabilities largely depends on: |
| medium | a. materiality and inherent risk. |
| b | b. materiality and control risk. |
|  | c. materiality only. |
|  | d. inherent risk only. |
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| 43. | A failure to record acquisitions of goods most likely will affect all but which of the following? |
| medium | a. Accounts payable. |
| d | b. Net income. |
|  | c. Retained earnings. |
|  | d. Cash. |
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| 44.  medium  d | When the client’s physical inventory occurs before the last day of the year, it is still necessary to perform an accounts payable cutoff at the time of the count. In addition, the auditor must verify whether all acquisitions taking place between the count and the end of the year were added to: |
|  | a. the physical inventory. |
|  | b. Accounts Payable. |
|  | c. Accounts Payable and Cost of Goods Sold. |
|  | d. the physical inventory and Accounts Payable. |
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| 45.  medium | When the auditor uses sampling to examine transactions in the acquisition and payment cycle, the tolerable exception rate is typically set at a(n) \_\_\_\_\_\_\_ level. |
| a | a. low. |
|  | b. medium. |
|  | c. high. |
|  | d. indeterminate. |

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| 46. | Which of the following is most reliable for verifying the correct balance of accounts payable? |
| medium | a. Vendors’ invoices. |
| c | b. Vendors’ statements. |
|  | c. Confirmations. |
|  | d. Bills of lading. |
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| 47. | Vendors’ statements and vendors’ invoices are both relatively reliable evidence because they: |
| medium | a. come directly to the auditor without being in client’s possession. |
| b | b. originate from a third party. |
|  | c. validate the effectiveness of the control system. |
|  | d. are compared to and reconciled with sales invoices. |
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| 48.  medium | For effective internal control, the accounts payable department should compare the information on each vendor’s invoice with the: |
| c | a. receiving report and the voucher. |
|  | b. vendor’s packing slip and the voucher. |
|  | c. receiving report and the purchase order. |
|  | d. vendor’s packing slip and the purchase order. |
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| 49.  medium | Which of the following is the most effective control procedure to detect vouchers that were prepared for the payment of goods that were not received? |
| b | a. Count goods upon receipt in storeroom. |
|  | b. Match purchase order, receiving report, and vendor’s invoice for each voucher in accounts payable department. |
|  | c. Compare goods received with goods requisitioned in receiving department. |
|  | d. Verify vouchers for accuracy and approval in internal audit department. |
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| 50. | Cutoff information for inventory acquisitions should be obtained during: |
| medium | a. the interim period prior to year-end. |
| c | b. the interim period immediately following year-end. |
|  | c. the physical observation of inventory. |
|  | d. either the interim period prior to or immediately following year-end.. |
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| 51.  medium  d | Assume that during cutoff testing you determined that the last receiving report number for inventory was 24986. Which of the following receiving report numbers would you not expect to be included in inventory and accounts payable at year-end? |
|  | a. 24980 |
|  | b. 19773 |
|  | c. 23019 |
|  | d. 24990 |
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| 52.  medium | Auditor confirmation of accounts payable balances at the balance sheet date may be unnecessary because: |
| b | a. this is a duplication of cutoff tests. |
|  | b. there is likely to be other reliable external evidence available to support the balances. |
|  | c. accounts payable balances at the balance sheet date may not be paid before the audit is completed. |
|  | d. correspondence with the audit client’s attorney will reveal all legal action by vendors for nonpayment. |
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| 53.  medium | Under which of the following circumstances would it be advisable for the auditor to confirm accounts payable with creditors? |
| c | a. Internal accounting control over accounts payable is adequate, and there is sufficient evidence on hand to minimize the risk of a material misstatement. |
|  | b. Confirmation response is expected to be favorable, and accounts payable balances are of immaterial amounts. |
|  | c. Creditor statements are not available and internal control over payables is unsatisfactory. |
|  | d. The majority of accounts payable balances are with associated companies. |
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| 54.  medium | Internal control is strengthened when the quantity of merchandise ordered is omitted from the copy of the purchase order sent to the: |
| b | a. department that initiated the requisition. |
|  | b. receiving department. |
|  | c. purchasing agent. |
|  | d. accounts payable department. |
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| 55. | Which of the following should sign checks under conditions of effective internal control? |
| medium | a. Treasurer. |
| a | b. Purchasing agent. |
|  | c. Accounts payable clerk. |
|  | d. Person preparing the checks. |
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| 56. | Which of the following is an effective internal accounting control over cash payments? |
| medium | a. Signed checks should be mailed under the supervision of the check signer. |
| a | b. Spoiled checks that have been voided should be disposed of immediately. |
|  | c. Checks should be prepared only by persons responsible for cash receipts and disbursements. |
|  | d. A check-signing machine with two signatures should be used. |
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| 57.  challenging  a | When assets are being verified, auditors focus much of their attention on making sure that the accounts are not overstated. Alternatively, auditors focus their efforts on understatement when auditing liabilities. What is the primary reason for this difference in focus? |
|  | a. Auditors’ legal liability. |
|  | b. GAAP. |
|  | c. GAAS requirements. |
|  | d. All of the above. |
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| 58.  challenging  d | Internal controls that are likely to prevent the client from including as a business expense those transactions that primarily benefit management or other employees rather than the entity being audited satisfy the control objective that: |
|  | a. acquisitions are correctly valued. |
|  | b. existing acquisitions are recorded. |
|  | c. acquisitions are correctly classified. |
|  | d. recorded acquisitions are for goods and services received. |
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| 59.  challenging | A company failed to record an acquisition of merchandise and its related liability, but the merchandise was included in ending inventory. The effect on the financial statements was to: |
| d | a. understate both assets and liabilities. |
|  | b. understate net income and owners’ equity. |
|  | c. understate assets and owners’ equity. |
|  | d. understate liabilities, and overstate both net income and owners’ equity. |
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| 60.  challenging | The test of transactions which requires one to “reconcile recorded cash disbursements with the cash disbursements on the bank statement” satisfies the objective of: |
| b | a. occurrence. |
|  | b. completeness. |
|  | c. accuracy. |
|  | d. posting and summarization. |
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| 61. | Which of the following statements is **false**? |
| challenging | a. The ownership objective is an important part of verifying assets but not liabilities. |
| d | b. In auditing liabilities, the emphasis is on the search for understatements rather than overstatements. |
|  | c. Because of the emphasis on understatements in liability accounts, out-of-period liability tests are important for accounts payable. |
|  | d. The success of the auditor’s search for unrecorded liabilities is not dependent upon the materiality of the potential balance in the account. |
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| 62.  challenging | The purpose of the audit procedure to “examine underlying documentation for subsequent cash disbursements” is to: |
| c | a. uncover liabilities on the balance sheet which should not have been recorded until a subsequent period. |
|  | b. find the documentation relating to a cash disbursement. |
|  | c. uncover payments made in a subsequent accounting period for liabilities that existed at the balance sheet date. |
|  | d. uncover cash disbursements recorded in a subsequent accounting period which should be recorded in this period. |
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| 63.  challenging | To test for cutoff errors which overstate liabilities, the auditor should trace, to vendors’ invoices, the receiving reports issued: |
| a | a. after year-end. |
|  | b. before year-end. |
|  | c. the last day of the fiscal year. |
|  | d. both before and after year-end. |
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| 64.  challenging | In determining that the accounts payable cutoff is correct, it is essential that the cutoff tests be coordinated with the: |
| c | a. confirmation of payables. |
|  | b. tests on long-term liabilities. |
|  | c. observation of inventory. |
|  | d. cash count. |
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| 65.  challenging  a | An inventory acquisition is received late in the afternoon of December 31 after the physical inventory is completed. If the acquisition is included in accounts payable and purchases, but excluded from inventory, the result: |
|  | a. is an understatement of net earnings. |
|  | b. is an overstatement of net earnings. |
|  | c. is an overstatement of working capital. |
|  | d. is an overstatement of owner’s equity. |
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| 66.  challenging | When an acquisition is on an FOB origin basis, the inventory and related accounts payable must be recorded in the current period if the goods were: |
| b | a. received prior to the balance sheet date. |
|  | b. shipped prior to the balance sheet date. |
|  | c. both shipped and received prior to the balance sheet date. |
|  | d. paid for in advance. |
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| 67. | The auditor gets highly reliable evidence about individual transactions by examining: |
| challenging | a. vendors’ invoices. |
| a | b. vendors’ statements. |
|  | c. confirmations of accounts payable balances. |
|  | d. detailed inventory counting instructions. |
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| 68. | Which of the following documents is best for verifying the correct balance in accounts payable? |
| challenging | a. Bills of lading. |
| d | b. Confirmations. |
|  | c. Vendors’ invoices. |
|  | d. Vendors’ statements. |
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| 69. | When goods are received, the receiving clerk should match the goods with the: |
| challenging | a. purchase order and the requisition form. |
| c | b. vendor’s invoice and the receiving report. |
|  | c. vendor’s shipping document and the purchase order. |
|  | d. receiving report and the vendor’s shipping document. |
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| 70. | For effective internal control purposes, the vouchers payable department generally should: |
| challenging | a. obliterate the quantity ordered on the receiving department copy of the purchase order. |
| c | b. stamp, perforate, or otherwise cancel supporting documentation after payment is mailed. |
|  | c. establish the agreement of the vendor’s invoice with the receiving report and purchase order. |
|  | d. ascertain that each requisition is approved as to price, quantity, and quality by an authorized employee. |
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| 71.  challenging | An auditor performs a test to determine whether all merchandise for which the client was billed was received. The population for this test consists of all: |
| b | a. merchandise received. |
|  | b. vendors’ invoices. |
|  | c. canceled checks. |
|  | d. receiving reports. |
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| 72.  challenging | Matching the supplier’s invoice, the purchase order, and the receiving report normally should be the responsibility of the: |
| c | a. warehouse receiving function. |
|  | b. purchasing function. |
|  | c. general accounting function. |
|  | d. treasury function. |
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| 73.  challenging  a | A CPA learns that his client has paid a vendor twice for the same shipment, once based upon the original invoice and once based upon the monthly statement. A control procedure that should have prevented this duplicate payment is: |
|  | a. attachment of the receiving report to the disbursement report. |
|  | b. prenumbering of disbursement vouchers. |
|  | c. use of a limit or reasonableness test. |
|  | d. prenumbering of receiving reports. |
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| 74.  challenging | With respect to a small company’s system of purchasing supplies, an auditor’s primary concern should be to obtain satisfaction that supplies ordered and paid for have been: |
| c | a. requested by and approved by authorized individuals who have no incompatible duties. |
|  | b. used in the course of business and solely for business purposes during the year under audit. |
|  | c. received, counted, and checked to quantities and amounts on purchase orders and invoices. |
|  | d. properly recorded as assets and systematically amortized over the estimated useful life of the supplies. |
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Essay Questions

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| 75.  easy | Tests of controls and tests of transactions for the acquisition and payment cycle are normally divided into two broad areas. What are these areas? |
|  | Answer:  Tests of controls and tests of transactions are usually divided into tests of acquisitions and tests of payments. |
| 76.  easy | Describe vouchers and their purposes. |
|  | Answer:  A voucher is often used to establish a formal means of recording and controlling acquisitions. Vouchers typically include a cover sheet or folder for containing documents and a package of supporting documents such as the purchase order, packing slip, receiving report and vendor invoice. Companies may also include a copy of the check in the voucher package after payment is made. |
| 77.  medium | What are the three important controls over cash disbursements? |
|  | Answer:   * Signing of check by an individual with proper authority. * Separation of responsibilities for signing checks and performing the accounts payable function. * Careful examination of supporting documents by the check signer at the time the check is signed. |

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| 78.  medium | Discuss each of the four business functions that comprise the acquisition and payment cycle. |
|  | Answer:  The four business functions that comprise the acquisition and paymentcycle are:   * *Processing purchase orders*. This function involves the preparation of a purchase requisition and a purchase order to acquire goods and services. * *Receiving goods and services.* When goods are received, a receiving report is prepared that indicates the description of goods, the quantity received, the date received, and other relevant data. * *Recognizing the liability*. In most companies, the liability for acquisitions is recognized when the goods and services are received; in other companies, it is deferred until the vendor’s invoice is received. * *Processing and recording cash disbursements*. This function involves the signing and mailing of the check for payment of the acquisition and recording of the cash disbursement in the cash disbursements journal. |
| 79.  medium | Discuss the key internal controls that should be present in the processing purchase ordersfunction in the acquisitions and payment cycle. |
|  | Answer:  Proper authorization, both general and specific, for acquisition transactions is an essential internal control of the processing purchase orders function. A purchasing department that is independent of the authorization or receiving functions is often established by companies to ensure an adequate quantity of goods and services at a minimum price. Purchase orders should be prenumbered and should include sufficient columns and spaces to minimize the likelihood of unintentional omissions on the form when goods are ordered. |
| 80.  medium | Discuss the key internal controls that should be present in the receiving goods and servicesfunction in the acquisitions and payment cycle. |
|  | Answer:  For good internal control over the receiving goods and services function, most companies require that the receiving department prepares a receiving report when goods are received, one copy of which is sent to the storeroom and another to the accounts payable department. To prevent theft, it is important that the goods be physically controlled from the time of their receipt until their disposal. The personnel in the receiving department should be independent of the storeroom personnel and the accounting department. In addition, the accounting records should transfer responsibility for the goods as they are transferred from receiving to storage and from storage to manufacturing. |
| 81.  medium | How do auditors determine the extent of testing of internal controls in the acquisition and payment cycle? |
|  | Answer:  When auditors intend to rely on controls to support a preliminary control risk below maximum, the auditor performs tests of controls to obtain evidence that controls are operating effectively. As the operating effectiveness improves, the auditor is able to reduce substantive tests. If the company is public, then the auditor must document and tests controls sufficiently to issue an opinion on internal control. |

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| 82.  medium | Discuss the key internal controls that should be present in the “recognizing the liability” function in the acquisitions and payment cycle. |
|  | Answer:  Key internal controls over the recognizing the liability function in the acquisitions and payment cycle include requiring the accounts payable department to verify the propriety of acquisitions by comparing the details on the purchase order, receiving report, and vendor’s invoice to determine that the descriptions, prices, quantities, terms, and freight on the vendor’s invoice are correct. In addition, personnel who record acquisitions should not have access to cash, marketable securities, and other assets. There should also be adequate documents and records, proper procedures for recordkeeping, and independent checks on performance. |
| 83.  medium | Describe purchase requisitions and purchase orders. What is a key difference between the two documents? |
|  | Answer:  Purchase requisitions represent requests for goods and services by an authorized employee. Requisitions may originate from any authorized company employee such as a storeroom supervisor or manufacturing manager. Purchase orders are documents that identify the description, quantity, and other related information for goods or services that the company is purchasing. Unlike requisitions, purchase orders are directed to specific vendors. |
| 84.  medium | Describe the methodology for designing tests of details of balances for accounts payable. |
|  | Answer:  The methodology for designing tests of accounts payable consists of:   1. Set materiality and assess acceptable audit risk and inherent risk for accounts payable. 2. Assess control risk for accounts payable. 3. Design and perform tests of controls and substantive tests of transactions for the acquisition and payment cycle. 4. Design and perform analytical procedures for the acquisition and payment cycle. 5. Design tests of details of accounts payable balance to satisfy balance-related audit objectives. Decide audit procedures to perform, sample size, items to select, and timing of tests. |
| 85.  medium | Explain why the confirmation of accounts payable is less common than confirmation of accounts receivable. |
|  | Answer:  Confirmation of accounts payable is less common than confirmation of accounts receivable because of the availability of vendors’ statements and vendors’ invoices, which are both relatively reliable evidence, when auditing accounts payable. |

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| 86.  medium | Discuss the circumstances in which it is desirable to send confirmation requests to the client’s vendors. |
|  | Answer:  It is desirable to send confirmation requests to the client’s vendors when the client’s internal controls are weak, when vendors’ statements are not available, or when the auditor questions the client’s integrity. |
| 87.  challenging | Discuss the difference in the auditor’s approach to the audit of assets and the audit of liabilities. |
|  | Answer:  The audit of assets is primarily focused on overstatements. The existence of assets is verified via confirmation, physical examination, and examination of supporting documents. On the other hand, the auditor’s approach in verifying liabilities is to focus on understatement. The difference in the auditor’s approaches is primarily driven by the auditor’s legal liability. |
| 88.  challenging | Describe the audit procedures typically used to test for out-of-period liabilities (also referred to as the search for unrecorded accounts payable). |
|  | Answer:  The audit procedures typically used to test for out-of-period liabilities are:   * Examine underlying documentation for subsequent cash disbursement. * Examine underlying documentation for bills not paid several weeks after the year-end. * Trace receiving reports issued before year-end to related vendors’ invoices. * Trace vendors’ statements that show a balance due to the accounts payable trial balance. * Send confirmations to vendors with which the client does business, including zero balance confirmations. |

Other Objective Answer Format Questions

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| 89.  medium | Match seven of the terms for documents and records (a-m) used in the acquisitions and cash disbursement cycle with the descriptions provided below (1-7): |
|  | a. Purchase requisition |
|  | b. Purchase order |
|  | c. Receiving report |
|  | d. Acquisitions journal |
|  | e. Summary acquisitions report |
|  | f. Vendor’s invoice |
|  | g. Debit memo |
|  | h. Voucher |
|  | i. Accounts payable master file |
|  | j. Accounts payable trial balance |
|  | k. Vendor’s statement |
|  | l. Check |
|  | m. Cash disbursements journal |
| g | 1. A document indicating a reduction in the amount owed to a vendor because of returned goods or an allowance granted. |
| f | 2. A document that specifies the details of an acquisition transaction and amount of money owed to the vendor for an acquisition. |
| b | 3. A document prepared by the purchasing department indicating the description, quantity, and related information for goods and services that the company intends to purchase. |
| j | 4. A listing of the amount owed to each vendor at a point in time. |
| h | 5. A document used to establish a formal means of recording and controlling acquisitions; it includes a cover sheet and a package of relevant documents. |
| a | 6. A document used to request goods and services by an authorized employee. |
| m | 7. The listing or report that includes all cash payments for a given period. |
| 90.  easy  b | A vendor’s statement is unreliable and auditors rarely use it.   1. True 2. False |
| 91.  easy  b | The acquisition and payment cycle consists of one class of transactions.   1. True 2. False |
| 92.  easy  b | The cash account is not part of the acquisitions and payment cycle.   1. True 2. False |

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| 93.  easy  b | The acquisition and payment cycle is highly controlled and not well-structured in most companies.  a. True  b. False |
| 94.  easy  a | Most companies recognize a liability when the goods are received by the company.  a. True  b. False |
| 95.  medium  b | The acquisition and payment cycle typically begins with the initiation of a purchase order.  a. True  b. False |
| 96.  medium  b | A bill of lading is normally prepared at the time tangible goods are received and indicates the description of goods, the quantity received, the date received, and other relevant data.  a. True  b. False |
| 97.  medium  b | A document received from the vendor indicating such things as the description and quantity of goods and services received, price including freight, cash discount terms, and date of billing is called the voucher.  a. True  b. False |
| 98.  medium  b | When auditing the acquisitions and cash disbursements cycle, it is usually more efficient for the auditor to reduce the extent of tests of controls and substantive tests of transactions and focus primarily on tests of details of balances, especially when the client has effective internal controls.  a. True  b. False |
| 99.  medium  a | Failure to record the acquisition of goods and services directly affects the balance in Accounts payable and may result in an overstatement of net income and owners’ equity.  a. True  b. False |
| 100.  medium  a | If tests of controls and substantive tests of transactions related to perpetual inventory records reveal controls over perpetuals are effective, the auditor is justified in reducing the extent of tests of details of inventory.  a. True  b. False |
| 101.  medium  a | Because of the importance of tests of controls and substantive tests of transactions for acquisitions and cash disbursements, attributes sampling is commonly used when testing the acquisitions and cash disbursements cycle.  a. True  b. False |
| 102.  medium  a | The balance-related audit objective realizable value is not applicable when auditing Accounts payable.  a. True  b. False |

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| 103.  medium  b | When auditing Accounts payable, the auditor is more concerned about the possibility of overstatements than understatements.  a. True  b. False |
| 104.  medium  b | Examining documents for evidence of internal verification is **not** effective for evaluating the transaction-related audit objective of timing.  a. True  b. False |
| 105.  medium  a | A substantive test of transactions commonly used to test the completeness objective for acquisitions is “Trace from a file of receiving reports to the acquisitions journal.”  a. True  b. False |
| 106.  medium  a | The audit procedure “Test clerical accuracy by footing the journals and tracing postings to general ledger and to accounts payable and inventory master files” is used to test the posting and summarization objective for acquisitions.  a. True  b. False |
| 107.  challenging  a | Auditors are normally more concerned about violations of the completeness objective for acquisitions than about violations of the occurrence objective for acquisitions.  a. True  b. False |
| 108.  challenging  b | To test for overstatement cutoff amounts when auditing Accounts payable, the auditor should trace receiving reports issued before year-end to related vendors’ invoices to make sure they are not recorded as Accounts payable.  a. True  b. False |
| 109.  challenging  a | Receiving reports are normally only used to document the receipt of goods and are not used to document the receipt of services.  a. True  b. False |
| 110.  challenging  a | When performing tests of controls or substantive tests of transactions for acquisitions, vendors’ invoices are more useful than vendors’ statements.  a. True  b. False |
| 111.  challenging  b | When verifying the correct balance in Accounts payable, vendors’ invoices are more useful than vendors’ statements.  a. True  b. False |
| 112.  challenging  a | Auditors primarily emphasize the understatement of liabilities in the audit of Accounts payable because they are concerned about potential legal liability.  a. True  b. False |

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| 113.  challenging  a | The use of statistical sampling is less common for the audit of Accounts payable than for accounts receivable because it is more difficult to define the population and determine the population size in accounts payable.  a. True  b. False |
| 114.  challenging  b | The internal control “Vouchers are prenumbered and accounted for” relates most closely to the occurrence objective for acquisitions.  a. True  b. False |
| 115.  challenging  a | The audit procedure “Examine canceled check for authorized signature, proper endorsement, and cancellation by the bank” is used to test the occurrence objective for cash disbursements.  a. True  b. False |