



MULTIPLE CHOICE QUESTIONS FROM BECKER CPA EXAM REVIEW

7-24 (OBJECTIVES 7-3, 7-5, 7-7) The following questions concern audit evidence and audit documentation. Choose the best response.

- a. According to PCAOB audit standards, audit documentation must be retained for
 - (1) one year.
 - (2) three years.
 - (3) five years.
 - (4) seven years.
- b. Which of the following types of audit evidence is generally the most reliable?
 - (1) A bank statement
 - (2) A bank confirmation
 - (3) Analytical procedures
 - (4) Inquiries made of the audit committee
- c. An auditor most likely would apply analytical procedures in the overall review stage of an audit to
 - (1) identify unusual or unexpected balances that were not previously identified.
 - (2) obtain an understanding of high-risk areas.
 - (3) evaluate the design and implementation of internal control.
 - (4) identify related party transactions that may not have been previously identified.

DISCUSSION QUESTIONS AND PROBLEMS

7-25 (OBJECTIVE 7-4) The following are examples of documentation typically obtained by auditors:

1. Duplicate sales invoices
2. Subsidiary accounts receivable records
3. Vendors' invoices
4. General ledgers
5. Title insurance policies for real estate
6. Notes receivable
7. Bank statements
8. Cancelled payroll checks
9. Cancelled notes payable
10. Payroll time cards
11. Purchase requisitions
12. Articles of incorporation
13. Receiving reports (documents prepared when merchandise is received)
14. Minutes of the board of directors
15. Signed W-4s (Employee's Withholding Exemption Certificates)
16. Remittance advices
17. Signed lease agreements
18. Duplicate copies of bills of lading

- a. Classify each of the preceding items according to type of documentation: (1) internal or (2) external. **Required**
- b. Explain why external evidence is more reliable than internal evidence.

7-26 (OBJECTIVE 7-4) The following are examples of audit procedures:

1. Calculate the ratio of sales commission expense to sales as a test of sales commissions.
2. Review the accounts receivable with the credit manager to evaluate their collectibility.



7-30 (OBJECTIVES 7-3, 7-4) The following are nine situations, each containing two means of accumulating evidence:

1. Confirm receivables with consumers versus confirming accounts receivable with business organizations.
2. Physically examine 3-inch steel plates versus examining electronic parts.
3. Examine duplicate sales invoices when several competent people are checking each other's work versus examining documents prepared by a competent person on a one-person staff.
4. Physically examine inventory of parts for the number of units on hand versus examining them for the likelihood of inventory being obsolete.
5. Discuss the likelihood and amount of loss in a lawsuit against the client with client's in-house legal counsel versus discussion with the CPA firm's own legal counsel.
6. Confirm the oil and gas reserves with a geologist specializing in oil and gas versus confirming a bank balance.
7. Confirm a bank balance versus examining the client's bank statements.
8. Physically count the client's inventory held by an independent party versus confirming the count with an independent party.
9. Obtain a physical inventory count from the company president versus physically counting the client's inventory.

Required

- a. Identify the six factors that determine the reliability of evidence.
- b. For each of the nine situations, state whether the first or second type of evidence is more reliable.
- c. For each situation, state which of the six factors affected the reliability of the evidence.



7-31 (OBJECTIVE 7-4) Following are 10 audit procedures with words missing and a list of several terms commonly used in audit procedures.

Audit Procedures

1. _____ the unit selling price times quantity on the duplicate sales invoice and compare the total to the amount on the duplicate sales invoice.
2. _____ whether the accounts receivable bookkeeper is prohibited from handling cash.
3. _____ the ratio of cost of goods sold to sales and compare the ratio to previous years.
4. _____ the sales journal and _____ the total to the general ledger.
5. _____ the sales journal, looking for large and unusual transactions requiring investigation.
6. _____ of management whether all accounting employees are required to take annual vacations.
7. _____ all marketable securities as of the balance sheet date to determine whether they equal the total on the client's list.
8. _____ the balance in the bank account directly with the East State Bank.
9. _____ a sample of duplicate sales invoices to determine if the controller's approval is included and _____ each duplicate sales invoice to the sales journal for agreement of name and amount.
10. _____ the agreement between Johnson Wholesale Company and the client to determine whether the shipment is a sale or a consignment.

Terms

- | | | |
|------------|--------------|------------|
| a. Examine | e. Recompute | i. Count |
| b. Scan | f. Foot | j. Observe |
| c. Read | g. Trace | k. Inquire |
| d. Compute | h. Compare | l. Confirm |

Required

- a. For each of the 12 blanks in procedures 1 through 10, identify the most appropriate term. No term can be used more than once.
- b. For each of the procedures 1 through 10, identify the type of evidence that is being used.

A discussion with Marilyn Adams, the controller, brings to light two possible explanations. She informs you that the industry gross profit percent in the retail drug industry declined fairly steadily for three years, which accounts for part of the decline. A second factor was the declining percent of the total volume resulting from the pharmacy part of the business. The pharmacy sales represent the most profitable portion of the business, yet the competition from discount drugstores prevents it from expanding as fast as the nondrug items such as magazines, candy, and many other items sold. Adams feels strongly that these two factors are the cause of the decline.

The following additional information is obtained from independent sources and the client's records as a means of investigating the controller's explanations:

	Jones Drugs (\$ in thousands)				Industry Gross Profit Percent for Retailers of Drugs and Related Products
	Drug Sales	Nondrug Sales	Drug Cost of Goods Sold	Nondrug Cost of Goods Sold	
2016	\$5,126	\$9,085	\$3,045	\$6,178	32.7
2015	5,051	7,865	2,919	5,347	32.9
2014	4,821	6,641	2,791	4,522	33.0
2013	4,619	5,732	2,665	3,908	33.2

- Required**
- Evaluate the explanation provided by Adams. Show calculations to support your conclusions.
 - Which specific aspects of the client's financial statements require intensive investigation in this audit?

8-33 (OBJECTIVE 8-4) You have performed preliminary analytical procedures on one of your audit engagements and observed the following independent situations:

- The allowance for obsolete inventory increased from the prior year, but the allowance as a percentage of inventory decreased from the prior year.
- Long-term debt increased from the prior year, but total interest expense decreased as a percentage of long-term debt.
- The dollar amount of operating income is consistent with the prior year, although the entity was more profitable on a net income basis.
- The quick ratio decreased from the prior year, although the amount of cash and net accounts receivable is almost the same as the prior year.

Required Below are possible explanations for each of the observed changes in the financial statement amounts and ratios. For each observed change, select the most likely explanation(s) from the list below. Note: There may be more than one explanation for a given observed change, and an explanation can be used more than once.

- Shipments of inventory sold prior to year end were included in the client's inventory counts as of the balance sheet date.
- Selling and general administrative expenses were lower this year relative to last year.
- Sales have decreased compared to the prior year, and the client is maintaining less inventory as a result.
- Portions of existing long-term debt were refinanced at lower interest rates.
- The effective tax rate decreased, as compared to the prior year.
- The client purchased a large block of inventory on account close to year end.
- Sales increased at a greater percentage than cost of goods sold, as compared to the prior year.
- Client inventory items are off-site on consignment at retailers and are thus excluded from the year-end inventory counts.
- Short-term borrowings were refinanced on a long-term basis at lower interest rates.



8-34 (OBJECTIVE 8-4) In the audit of the Worldwide Wholesale Company, you did extensive ratio and trend analysis as part of preliminary audit planning. Your analytical procedures identified the following:

1. Commission expense as a percent of sales was constant for several years but has increased significantly in the current year. Commission rates have not changed.
2. The rate of inventory turnover has steadily decreased for three years.
3. Inventory as a percent of current assets has steadily increased for four years.
4. The number of days' sales in accounts receivable has steadily increased for three years.
5. Allowance for uncollectible accounts as a percent of accounts receivable has steadily decreased for three years.
6. The absolute amounts of depreciation expense and depreciation expense as a percent of gross fixed assets are significantly smaller than in the preceding year.

- a. Evaluate the potential significance of each of the changes in ratios or trends identified in your analysis on the fair presentation of financial statements.
- b. State the follow-up procedures you would perform for each fluctuation to determine whether a material misstatement exists.

Required

8-35 (OBJECTIVES 8-3, 8-4) Target and Kohl's are chains of stores that cater to customers who desire name-brand goods at lower prices. The Securities and Exchange Commission (SEC) Form 10-K filing rules require management of U.S. public companies to include background information about the business, as well as the most recent financial condition and results of operations. Access each company's most recent Form 10-K. These can be obtained through the SEC Web site (www.sec.gov), or directly from the investor relations section of the Target (www.target.com) and Kohl's (www.kohls.com) Web sites.



- a. Read the description of each company's business in Part I, Item 1 of Form 10-K. Evaluate the similarity of each company as a basis for making financial comparisons.
- b. Each company follows what is called a 52/53 week year in which the fiscal year ends on the Saturday nearest January 31. Given the nature of these companies, does a January 31 year-end make sense? Note that most public companies have a December 31 year-end.
- c. Use the financial statements included in Part II, Item 8 to calculate the gross margin percentage and inventory turnover ratio for each company for the most recent year. Which company has the higher gross margin percentage? Which company has the higher inventory turnover?
- d. Evaluate whether the relation between the gross margin percentage and inventory turnover makes sense given the description of each company's business.

Required

8-36 (OBJECTIVES 8-5, 8-8) You are evaluating audit results for assets in the audit of Roberts Manufacturing. You set the preliminary judgment about materiality at \$50,000. The account balances, performance materiality, and estimated overstatements in the accounts are shown next.

Account	Account Balance	Performance Materiality	Estimate of Total Overstatements
Cash	\$ 50,000	\$ 5,000	\$ 1,000
Accounts receivable	1,200,000	30,000	20,000
Inventory	2,500,000	50,000	?
Other assets	250,000	15,000	12,000
Total	<u>\$4,000,000</u>	<u>\$100,000</u>	<u>?</u>

- a. Assume you tested inventory amounts totaling \$1,000,000 and found \$10,000 in overstatements. Ignoring sampling risk, what is your estimate of the total misstatement in inventory?
- b. Based on the audit of the assets accounts and ignoring other accounts, are the overall financial statements acceptable? Explain.
- c. What do you believe the auditor should do in the circumstances?

Required