

Auditing and Assurance Services, 14e (Arens)

Chapter 14 Audit of the Sales and Collection Cycle: Tests of Controls and Substantive Tests of Transactions

Learning Objective 14-1

1) Which of the following is **not** an account affected by the sales and collection cycle?

- A) Cash
- B) Accounts receivable
- C) Allowance for doubtful accounts
- D) Sales of Accounts Receivables

Answer: D

Terms: Sales and collection cycle

Diff: Easy

Objective: LO 14-1

AACSB: Reflective thinking skills

2) The auditor's objectives for the sales and cash collections activities when the client is primarily an e-commerce business as compared to a "bricks and mortar" business are:

- A) unchanged.
- B) expanded.
- C) mitigated.
- D) decreased.

Answer: A

Terms: Auditor objectives for sales and cash collections

Diff: Moderate

Objective: LO 14-1

AACSB: Analytic skills

3) The overall objective in the audit of the sales and collection cycle is to evaluate whether the account balances affected by the cycle are fairly presented in accordance with Accounting standards.

- A) True
- B) False

Answer: A

Terms: Objective in audit of sales and collection cycle; Account balances fairly presented

Diff: Easy

Objective: LO 14-1

AACSB: Reflective thinking skills

4) The sales and collection cycle applies to businesses that transfer goods to customers or provides services to businesses.

- A) True
- B) False

Answer: A

Terms: Sales and collection cycle

Diff: Moderate

Objective: LO 14-1

AACSB: Reflective thinking skills

Learning Objective 14-2

1) Which of the following is **not** one of the five classes of transactions included in the sales and collection cycle?

- A) Sales returns and allowances
- B) Write-off of uncollectible accounts
- C) Bad debt expense
- D) Interest Income

Answer: D

Terms: Class of transactions; Sales and collection cycle

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

2) What event initiates a transaction in the sales and collection cycle?

- A) receipt of cash
- B) delivery of product to a customer
- C) identification of a new customer
- D) customer request for goods

Answer: D

Terms: Initiates transaction in sales and collection cycle

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

3) A _____ is a document that indicates a request for merchandise by a customer.

- A) sales invoice
- B) vendor invoice
- C) customer order
- D) sales order

Answer: C

Terms: Document indicates request for merchandise

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

4) A _____ is a document that is matched with the customer order to assure that the correct quantity and type of goods are shipped.

- A) sales order
- B) customer order
- C) vendor invoice
- D) sales invoice

Answer: A

Terms: Document matched with customer order

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

5) What critical event must take place before goods can be shipped in order to assure payment can be reasonably expected?

- A) determination of correct delivery address
- B) credit approval
- C) matching of shipping document with sales invoice
- D) receipt of sales order from the customer

Answer: B

Terms: Event must take place in order to assure payment

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

6) Before goods are shipped on account, a properly authorized person must:

- A) prepare the sales invoice.
- B) approve the journal entry.
- C) approve the customer's credit.
- D) verify that the unit price is accurate.

Answer: C

Terms: Goods shipped on account; Properly authorized person

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

7) A document prepared to initiate shipment of the goods sold by an independent shipper is the:

- A) sales order.
- B) bill of lading.
- C) sales invoice.
- D) customer order.

Answer: B

Terms: Document prepared to initiate shipment of goods

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

8) The document used to indicate to the customer the amount of a sale and payment due date is the:

- A) sales invoice.
- B) bill of lading.
- C) purchase order.
- D) sales order.

Answer: A

Terms: Document used to indicate amount of sale and payment due date

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

9) In the sales and collection cycle when is, generally, the earliest point at which revenue can be recognized?

- A) sales approval
- B) credit approval
- C) cash collection
- D) shipment of goods

Answer: D

Terms: Sales and collection cycle; revenue recognized

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

10) Most companies recognize sales revenue when:

- A) sales are invoiced.
- B) goods are received by the customer.
- C) goods are shipped.
- D) Both B and C are correct, depending upon the company's revenue recognition policies.

Answer: C

Terms: Recognize sales revenue

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

11) Which of the following is **not** a business function within the "Sales" class of transactions?

- A) processing customer orders
- B) granting credit
- C) processing and recording sales returns and allowances
- D) shipping goods

Answer: C

Terms: Business function within the sales class of transactions

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

12) The total of the individual account balances in the accounts receivable subsidiary ledger should equal the:

- A) total sales for the period.
- B) balance of the sales account in the general ledger.
- C) total sales less the total cash received for the period.
- D) balance of the accounts receivable account in the general ledger.

Answer: D

Terms: Accounts receivable subsidiary ledger

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

13) In the accounts receivable subsidiary ledger the length of time the account has been due can be useful to the client and the auditor in preparing the:

- A) trial balance.
- B) working trial balance.
- C) accounts receivable trial balance.
- D) aged accounts receivable trial balance.

Answer: D

Terms: Accounts receivable subsidiary ledger

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

14) A document sent to each customer showing his or her beginning accounts receivable balance and the amount and date of each sale, cash payment received, any debit or credit memo issued, and the ending balance is the:

- A) accounts receivable subsidiary ledger.
- B) monthly statement.
- C) remittance advice.
- D) sales invoice.

Answer: B

Terms: Document sent to customer showing beginning accounts receivable balance

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

15) The document that accompanies the customer's payment is the:

- A) credit memo.
- B) remittance advice.
- C) vendor invoice.
- D) monthly statement.

Answer: B

Terms: Document that accompanies customer's payment

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

16) The document that requires adjustments to the customers subsidiary ledger account is the:

- A) bill of lading.
- B) sales invoice.
- C) credit memo.
- D) monthly statement.

Answer: C

Terms: Document that requires adjustment to the customer's account

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

17) A document that initiates shipment of goods and indicates the description of the merchandise, the quantity shipped, and customer name and address is the:

- A) bill of lading.
- B) sales invoice.
- C) picking ticket.
- D) vendor invoice.

Answer: A

Terms: Document that initiates shipment of goods

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

18) The _____ is a contract between a carrier (e.g., a trucking company) and the seller of goods that dictates the details surrounding the shipment of goods.

- A) bill of lading
- B) sales invoice
- C) picking ticket
- D) remittance advice

Answer: A

Terms: Contract that dictates details for shipment of goods

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

19) Some companies have customers send payments directly to a post office box address maintained by a bank. This is called a(n) _____ system.

- A) direct deposit
- B) funds transfer
- C) lockbox
- D) interbank transfer

Answer: C

Terms: Payments sent to post office box

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

20) In designing audit procedures for the sales returns and allowances account, the auditor would primarily rely on the following accounts, except for:

- A) sales returns and allowances transaction file.
- B) accounts receivable master file.
- C) cash receipts journal.
- D) sales returns and allowances will be recorded in all of the above.

Answer: C

Terms: Designing audit procedures sales returns and allowances

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

21) For a firm that practices good internal controls in the sales and collections cycle, the function of indicating credit approval should be recorded on which of the following documents?

- A) sales order
- B) sales invoice
- C) customer order
- D) remittance advice

Answer: A

Terms: Good internal controls in sales and collection cycle; Credit approval

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

22) When posting items from the sales journal, details of the journal and journal totals are posted to which items?

A)

Details of the journal are posted to	Journal totals are posted to
The sales account	The general ledger

B)

Details of the journal are posted to	Journal totals are posted to
The sales account	The accounts receivable subsidiary ledger

C)

Details of the journal are posted to	Journal totals are posted to
The accounts receivable master file	The general ledger

D)

Details of the journal are posted to	Journal totals are posted to
The accounts receivable account in the general ledger	The sales account in the general ledger

Answer: C

Terms: Posting from sales journal; Details of journal and journal totals posted

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

23) Credit memos are normally issued for what purpose(s)?

- A) To adjust the customers balance to the amount owed to the company.
- B) To assist in the aging of accounts receivable.
- C) To reduce customer frustration and sales losses.
- D) To inform the customer of the balance due.

Answer: A

Terms: Credit memos

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

24) Who is generally responsible for opening receipts when a company uses a lockbox to speed the handling of cash receipts?

- A) company personnel
- B) temporary employees in the town where the lockbox is located
- C) bank employees
- D) company controller

Answer: C

Terms: Opening receipts; Lockbox

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

25) One key internal control to prevent fictitious transactions in the sales and collection cycle is:

- A) assign a specific customer number for each customer in the computer files.
- B) to account for the integrity of the numerical sequence of sales orders.
- C) to include the sales price list of all products in the computer files.
- D) having bank reconciliations prepared by one who is independent of the treasury function.

Answer: A

Terms: Internal control; Fictitious transactions in sales and collection cycle

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

26) Which of the following is the appropriate point at which the auditor deems authorization to be critical?

A)

Credit granting	Price authorization	Shipment of goods
Yes	Yes	Yes

B)

Credit granting	Price authorization	Shipment of goods
Yes	No	Yes

C)

Credit granting	Price authorization	Shipment of goods
No	Yes	No

D)

Credit granting	Price authorization	Shipment of goods
Yes	No	No

Answer: A

Terms: Point authorization deemed critical

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

27) Sales should be recorded, at the earliest, when:

- A) the order is received.
- B) the order is received and credit is approved.
- C) credit is approved and it is verified that there is enough inventory to fill the order.
- D) the shipment takes place.

Answer: D

Terms: Sales recorded

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

28) Which of the following would least concern an auditor regarding the lack of a specific authorization to conduct the sales transaction?

- A) granting of credit
- B) shipment of goods
- C) determination of discounts
- D) selling of goods for cash

Answer: D

Terms: Specific authorization to conduct sales transactions

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

29) Smith Manufacturing Company's accounts receivable clerk has a friend who is also a Smith's customer. The accounts receivable clerk has issued fictitious credit memos to his friend for goods supposedly returned. The most effective procedure for preventing this activity is to:

- A) prenumber and account for all credit memorandums.
- B) require receiving reports that provide evidence of returned inventory items to support all credit memorandums before they are approved.
- C) have independent sales and accounts receivable departments.
- D) mail monthly statements to customers.

Answer: B

Terms: Fictitious credit memos; Procedure to prevent activity

Diff: Moderate

Objective: LO 14-2

AACSB: Analytic skills

30) Explain each of the following types of documents and indicate the class of transactions in which they are commonly used.

1. Customer order
2. Shipping document
3. Remittance advice
4. Sales returns and allowance journal
5. Uncollectible account authorization form

Answer:

1. Customer order □ request for merchandise by a customer. Appears in the Sales class of transactions.
2. Shipping document □ document prepared to initiate shipment of goods, indicating the description of the merchandise, the quantity shipped, and other relevant data. Appears in the Sales class of transactions.
3. Remittance advice □ document that is mailed to the customer and typically returned to the seller with payment. Appears in the Cash receipts class of transactions.
4. Sales returns and allowance journal □ journal used to record all sales returns and allowances. It performs the same function as the sales journal. Appears in the Sales returns and allowance class of transactions.
5. Uncollectible account authorization form □ document used internally to indicate authority to write off an account receivable. Appears in the charge off of Uncollectible accounts class of transactions.

Terms: Documents and class of transactions

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

31) You are an audit manager for Rodgers & Co. and have recently taken on as a client Manufacturing Company. You are in the initial stages of planning the audit and have decided to start gathering information about the Sales/Collection Cycle of the business. List below the classes of transactions that you need to gather audit evidence for in designing your audit procedures.

Answer: The five classes of transactions that comprise the sales and collection cycle are:

- Sales (cash and sales on account)
- Cash receipts
- Sales returns and allowances
- Write-off of uncollectible accounts
- Bad debt expense

Terms: Classes of transactions that comprise the sales and collection cycle

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

32) Customer billing is a critical process which auditors must understand. What are the most important aspects of billing and what are the related objectives?

Answer: The most important aspects of billing are:

- To make sure that all shipments made have been billed (completeness),
- That no shipment has been billed more than once (occurrence), and
- That each shipment is billed for the proper amount (accuracy).

Terms: Aspects of billing and related objectives

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

33) Discuss the four business functions that result in sales transactions in a typical sales and collection cycle and, for each function, state the key documents and records involved.

Answer: The four business functions that result in sales transactions, and related documents and records, are:

- *Processing customer orders.* Key documents include customer order and sales order.
- *Granting credit.* Customer order or sales order.
- *Shipping goods.* Shipping document (bill of lading).
- *Billing customers and recording sales.* Sales invoice, sales journal, summary sales report, accounts receivable master file, accounts receivable trial balance, and monthly statements.

Terms: Business functions that result in sales transactions; Sales and collection cycle; Documents

Diff: Challenging

Objective: LO 14-2

AACSB: Analytic skills

34) Match seven of the terms for documents and records (a-k) with the descriptions provided below (1-7):

- a. Customer order form
- b. Sales order
- c. Bill of lading
- d. Sales invoice
- e. Summary sales report
- f. Accounts receivable master file
- g. Monthly statement
- h. Remittance advice
- i. Prelisting of cash receipts
- j. Credit memo
- k. Uncollectible account authorization form

_____ 1. A list prepared when cash is received by someone who has no responsibility for recording sales, accounts receivable, or cash, and has no access to the accounting records. It is used to verify whether cash received was recorded and deposited at the correct amounts and on a timely basis.

_____ 2. A document indicating a reduction in the amount due from a customer because of returned goods or an allowance.

_____ 3. A document prepared to initiate shipment of goods, indicating the description of the merchandise, the quantity shipped, and other relevant data. It is a written contract between the carrier and seller of the receipt and shipment of goods.

_____ 4. A document for communicating the description, quantity, and related information for goods ordered by a customer. This is frequently used to indicate credit approval and authorization for shipment.

_____ 5. A document mailed to the customer and typically returned to the seller with the cash payment.

_____ 6. A document used internally to indicate authority to write-off an account receivable as uncollectible.

_____ 7. A document or electronic record indicating the description and quantity of goods sold, the price, freight charges, insurance, terms, and other relevant data.

Answer:

1. i
2. j
3. c
4. b
5. h
6. k
7. d

Terms: Documents and records

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

35) A sales invoice is a document that usually indicates credit approval.

- A) True
- B) False

Answer: B

Terms: Sales invoice; Credit approval

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

36) Credit should be approved before a customer's order is received.

- A) True
- B) False

Answer: B

Terms: Credit approved

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

37) Credit should be approved before goods are shipped to a customer.

- A) True
- B) False

Answer: A

Terms: Credit approved

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

38) The receipt of a customer order from a customer is the starting point for the entire sales and collection cycle.

- A) True
- B) False

Answer: A

Terms: Customer order; Starting point for sales and collection cycle

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

39) The preparation of a sales invoice is the final step in the sales and collection cycle.

A) True

B) False

Answer: B

Terms: Sales invoice; Final step in sales and collection cycle

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

40) A bill of lading is a special type of sales invoice used when goods are shipped interstate.

A) True

B) False

Answer: B

Terms: Bill of lading; Sales invoice

Diff: Easy

Objective: LO 14-2

AACSB: Reflective thinking skills

41) The shipping point is critical because it is the first point at which company assets are released to another party.

A) True

B) False

Answer: A

Terms: Shipping point critical; Assets released

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

42) A bill of lading is a written contract between the seller and the buyer.

A) True

B) False

Answer: B

Terms: Bill of lading; Written contract

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

43) In a lockbox system, bank employees are responsible for opening cash receipts and maintaining records of all payments made by customers at the lockbox address.

A) True

B) False

Answer: A

Terms: Lockbox system

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

44) Sales transactions are the result of the following five functions in the sales and collection cycle: processing customer orders, granting credit, shipping goods, billing customers, and recording sales.

A) True

B) False

Answer: A

Terms: Sales and collection cycle

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

45) The prelisting of cash receipts should be prepared by the individual who has primary responsibility for the recording of cash receipts.

A) True

B) False

Answer: B

Terms: Prelisting of cash receipts

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

46) A credit memo is a document used internally that indicates authority to write-off an account receivable as uncollectible.

A) True

B) False

Answer: B

Terms: Credit memos

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

47) When a company prepares multi-copy, prenumbered sales invoices at the time customer orders are received, there is a higher likelihood of failure to bill the customers than when sales invoices are prepared only after goods have been shipped.

A) True

B) False

Answer: B

Terms: Prepare prenumbered sales invoices

Diff: Moderate

Objective: LO 14-2

AACSB: Analytic skills

48) The auditor's primary concern about authorization centers on shipment of goods to customers.

A) True

B) False

Answer: B

Terms: Primary concern about authorization

Diff: Moderate

Objective: LO 14-2

AACSB: Reflective thinking skills

Learning Objective 14-3

1) When designing audit procedures, tracing of source documents to the customers subsidiary ledger and subsequently to the general ledger is done to satisfy what assertion?

- A) valuation
- B) cutoff
- C) completeness
- D) classification

Answer: C

Terms: Tracing of source documents; Assertion

Diff: Easy

Objective: LO 14-3

AACSB: Reflective thinking skills

2) Which of the following documents is **not** commonly associated with the "cash receipts" class of transactions?

- A) Remittance advice
- B) Sales order
- C) Prelisting of cash receipts
- D) Cash receipts journal or listing

Answer: B

Terms: Document; Cash receipts class of transactions

Diff: Easy

Objective: LO 14-3

AACSB: Reflective thinking skills

3) When sales invoices are automatically calculated and posted by a computer, the auditor may be able to reduce substantive tests of transactions for which, if any, assertion?

- A) accuracy
- B) existence
- C) completeness
- D) none of the above

Answer: A

Terms: Reduce substantive tests of transactions

Diff: Easy

Objective: LO 14-3

AACSB: Reflective thinking skills

4) In many audits, no substantive tests of transactions are made for the _____ assertion on the grounds that understatement of sales is not a concern.

- A) accuracy
- B) existence
- C) completeness
- D) none of the above

Answer: C

Terms: No substantive tests of transactions; Assertion; understatement of sales

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

5) Which one the following procedures performed for the billing function provides evidence for the completeness assertion?

- A) Making sure that all shipments have been billed.
- B) Making sure that no shipment has been billed more than twice.
- C) Making sure that each shipment is billed at the correct amount.
- D) Making sure that each shipment is billed to the proper customer.

Answer: A

Terms: Procedures; Billing function; Completeness assertion

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

6) Which of the following procedures performed for the billing function may provide evidence that the accounts receivable subsidiary ledger is in agreement with the accounts receivable control account?

- A) Making sure that all shipments have been billed.
- B) Making sure that no shipment has been billed more than twice.
- C) Making sure that each shipment is billed at the correct amount.
- D) Making sure that each shipment is billed to the proper customer.

Answer: C

Terms: Procedure; Billing function; Accounts receivable subsidiary ledger in agreement with the accounts receivable control account

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

7) The document that the accounting staff will use as the primary basis for recording sales transactions and updating the customers accounts receivable subsidiary ledger is the:

- A) sales order.
- B) bill of lading.
- C) sales journal.
- D) sales invoice.

Answer: D

Terms: Document used as primary basis for recording sales transactions

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

8) In determining the level of audit efficiency, once the auditor has identified the key internal controls and identified any deficiencies in order to determine the level of control risk appropriate for a private company client, it is appropriate to decide whether:

- A) substantive tests can be reduced sufficiently to justify costs of performing tests of controls.
- B) substantive tests can be increased sufficiently to justify costs of performing tests of controls.
- C) tests of controls can be increased sufficiently to justify costs of performing substantive tests.
- D) tests of controls can be reduced sufficiently to justify costs of performing substantive tests.

Answer: A

Terms: Audit efficiency; Key internal controls; Deficiencies; Control risk

Diff: Challenging

Objective: LO 14-3

AACSB: Reflective thinking skills

- 9) Which one of the following statements is true? In deciding on substantive tests of transactions:
- A) some procedures are commonly employed on every audit regardless of the circumstances.
 - B) all procedures are dependent on the adequacy of the controls and the results of the tests of controls.
 - C) results obtained in the prior year's audit will not affect the procedures used this year.
 - D) the materiality of the item will not influence the choice of procedures used.

Answer: A

Terms: Substantive tests of transactions

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

- 10) To test for recorded sales for which there were no actual shipments, the auditor vouches from the:

- A) bill of lading to the sales journal.
- B) sales journal to the shipping documents.
- C) sales journal to the accounts receivable subsidiary ledger.
- D) bill of lading to the supporting customer order and sales order.

Answer: B

Terms: Test for recorded sales with no actual shipments

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

- 11) An effective procedure to test for unbilled shipments is to trace from the:

- A) sales journal to the shipping documents.
- B) shipping documents to the sales journal.
- C) sales journal to the accounts receivable ledger.
- D) sales journal to the general ledger sales account.

Answer: B

Terms: Procedure for unbilled shipments

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

- 12) The auditor traces items from the source documents to the journals in order to accumulate audit evidence that will satisfy the:

- A) existence objective.
- B) completeness objective.
- C) ownership objective.
- D) valuation objective.

Answer: B

Terms: Trace items from source documents to journals

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

13) In many audits of sales transactions substantive tests of transactions can be reduced in determining the completeness objective because:

- A) understatements of assets and income are a greater concern than overstatements.
- B) overstatements of assets and income are a greater concern than understatements.
- C) it doesn't matter if income is understated because the savings on income tax offsets the reduced revenue and net income is correct.
- D) the unrecorded sales cause a reduction of accounts receivable; therefore, the ratios of the two financial statements will not be misleading.

Answer: B

Terms: Audit of sales transactions; Substantive tests of transactions; Completeness objective

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

14) To determine that sales are accurately recorded, the unit prices on the duplicate sales invoices are normally compared with:

- A) the original invoices.
- B) an approved master price list.
- C) the amounts recorded in the sales journal for that transaction.
- D) the amounts posted to the customer's account in the accounts receivable master file.

Answer: B

Terms: Sales accurately recorded; Unit prices compared with

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

15) Prenumbered documents are intended to help:

A)

Prevent the failure to bill or record sales	Prevent duplicate billings or recordings of sales
Yes	Yes

B)

Prevent the failure to bill or record sales	Prevent duplicate billings or recordings of sales
No	No

C)

Prevent the failure to bill or record sales	Prevent duplicate billings or recordings of sales
Yes	No

D)

Prevent the failure to bill or record sales	Prevent duplicate billings or recordings of sales
No	Yes

Answer: A

Terms: Prenumbered documents

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

16) Prenumbered documents will only be useful for control purposes if:

A) a different numerical sequence is used for each company.

B) the sequence is accounted for periodically.

C) employees are allowed to use documents out of numerical sequence.

D) the same numerical sequence is used each accounting period.

Answer: B

Terms: Prenumbered documents; Control purposes

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

17) _____ tests are for omitted transactions, while _____ tests are for nonexistent transactions.

A) Tracing, vouching

B) Vouching, tracing

C) Verifying, tracking

D) Tracking, verifying

Answer: A

Terms: Tests for omitted transactions and nonexistent transactions

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

18) Which one of the following best describes the auditors responsibilities regarding appropriate authorizations in the sales/collections cycle?

- A) B, C, and D should all be of concern to the auditor.
- B) Credit must be authorized before the sale.
- C) Goods must be shipped after the authorization.
- D) Prices must be authorized.

Answer: A

Terms: Authorizations in sales/collection cycle

Diff: Challenging

Objective: LO 14-3

AACSB: Reflective thinking skills

19) Which one of the following is of the least concern to the auditor when designing substantive tests of transactions for the sales/collection cycle?

- A) Sales being included in the journal for which no shipment was made.
- B) Sales to related parties, such as officers and subsidiaries.
- C) Sales recorded more than once.
- D) Shipments being made to nonexistent customers and recorded as sales.

Answer: B

Terms: Substantive tests of transactions for sales/collection cycle

Diff: Challenging

Objective: LO 14-3

AACSB: Reflective thinking skills

20) An auditor needs to determine whether all customers of an electric utility company are being billed. The auditor should test from the:

- A) sales register to the accounts receivable ledger.
- B) sales register to the meter department records.
- C) accounts receivable ledger to the sales register.
- D) meter department records to the sales register.

Answer: D

Terms: All customers being billed

Diff: Challenging

Objective: LO 14-3

AACSB: Analytic skills

21) Which one of the following would the auditor consider to be an incompatible operation if the cashier receives remittances from the mailroom?

- A) The cashier prepares the daily deposit.
- B) The cashier makes the daily deposit at a local bank.
- C) The cashier posts the receipts to the accounts receivable subsidiary ledger cards.
- D) The cashier endorses the checks.

Answer: C

Terms: Incompatible operation if cashier receives remittance; Separation of duties

Diff: Challenging

Objective: LO 14-3

AACSB: Reflective thinking skills

22) In designing substantive audit procedures for tests of transactions for sales the auditor needs to test for evidence of misstatements due to errors or fraud. Describe at least 2 potential errors (unintentional) and at least 1 intentional (fraud).

Answer:

1. Unintentional—sales included in the journals for which no shipment was made and sales that were recorded more than once.
2. Intentional (fraud)—shipments made to nonexistent customers and were recorded as sales.

Terms: Substantive audit procedures for tests of transactions for sales; Misstatements; Fraud

Diff: Challenging

Objective: LO 14-3

AACSB: Reflective thinking skills

23) For each of the following potential misstatements, provide one potential audit test that could be used to detect the misstatement.

- Sales included in the journals for which there was no shipment
- Sale recorded more than once
- Shipments made to nonexistent customers and recorded as sales

Answer: The potential audit tests include the following:

- *Sales included in the journals for which there was no shipment.* Vouch selected entries in the sales journal to related copies of shipping and other supporting documents.
- *Sale recorded more than once.* Review a numerically sorted list of recorded sales transactions for duplicate numbers. The auditor can also test for proper cancellation of shipping documents.
- *Shipments made to nonexistent customers and recorded as sales.* Trace customer information on sales invoices to the customer master file.

Terms: Audit test used to detect misstatement

Diff: Challenging

Objective: LO 14-3

AACSB: Reflective thinking skills

24) Separation of duties in the sales/collection cycle should mandate that the credit-granting function be separate from the sales function.

A) True

B) False

Answer: A

Terms: Separation of duties in the sales/collection cycle; credit-granting function

Diff: Easy

Objective: LO 14-3

AACSB: Reflective thinking skills

25) Tracing from source documents to the journal is useful for testing the existence objective.

A) True

B) False

Answer: B

Terms: Tracing; Existence objective

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

26) Tests of controls should never be performed using the client's computer system; that is, all tests of control should be performed either using the auditor's computers or performed manually by the auditor.

A) True

B) False

Answer: B

Terms: Tests of controls

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

27) Management's assertions for sales and collection activities remain the same whether sales are generated through traditional or e-commerce activities.

A) True

B) False

Answer: A

Terms: Management's assertions for sales and collection activities

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

28) Misstatements involving the completeness objective for sales lead to overstatements of assets and income.

A) True

B) False

Answer: B

Terms: Misstatements involving the completeness objective for sales

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

29) Violations of the existence objective for sales are of greater concern to the auditor than violations of the completeness objective.

A) True

B) False

Answer: A

Terms: Violations of the existence objective for sales; violations of the completeness objective

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

30) An effective procedure to test the existence objective for sales is to vouch sales journal entries to copies of sales orders, shipping documents, and sales invoices.

A) True

B) False

Answer: A

Terms: Procedure to test the existence objective for sales

Diff: Moderate

Objective: LO 14-3

AACSB: Reflective thinking skills

31) For each significant internal control deficiency identified by the auditor, he or she should design one or more tests of controls to assess the extent of the deficiency and its effect on the financial statements.

A) True

B) False

Answer: A

Terms: Significant internal control deficiency; Tests of controls

Diff: Challenging

Objective: LO 14-3

AACSB: Analytic skills

32) For effective internal control, it is important that sales be recorded as soon after the customer order is received as possible to prevent the unintentional omission of transactions from the records and to make sure that sales are recorded in the proper period.

A) True

B) False

Answer: B

Terms: Effective internal control

Diff: Challenging

Objective: LO 14-3

AACSB: Reflective thinking skills

33) Footing the sales journal and tracing the totals to the general ledger are tests relating to the accuracy objective for sales.

A) True

B) False

Answer: B

Terms: Accuracy objective

Diff: Challenging

Objective: LO 14-3

AACSB: Reflective thinking skills

Learning Objective 14-4

1) Transaction-related audit objectives are essentially the same for processing credit memos as for sales with certain differences. Which of the following are two key differences?

A) Risk and emphasis on the completeness objective.

B) Materiality and emphasis on the accuracy objective.

C) Risk and emphasis on the classification objective.

D) Materiality and emphasis on the occurrence objective.

Answer: D

Terms: Transaction-related audit objectives; Credit memos

Diff: Challenging

Objective: LO 14-4

AACSB: Reflective thinking skills

2) The transaction-related audit objectives and the client's methods of controlling misstatements are essentially the same for credit memos as for sales with the exception of two differences. What are the two differences from the auditor's perspective?

Answer: The first difference is materiality. In many instances, sales returns and allowances are so immaterial that auditors ignore them. The second difference is the emphasis on the occurrence objective. For sales returns and allowances, auditors usually emphasize testing recorded transactions to uncovering any theft of cash from the collection of accounts receivable that was covered up by fictitious sales returns and allowances.

Terms: Transaction-related audit objectives for credit memos and sales

Diff: Challenging

Objective: LO 14-4

AACSB: Reflective thinking skills

3) When auditors evaluate sales returns and allowances, a primary emphasis is on the objective of occurrence.

A) True

B) False

Answer: A

Terms: Sales returns and allowances; Objective of occurrence

Diff: Easy

Objective: LO 14-4

AACSB: Reflective thinking skills

4) Sales returns and allowances are often ignored by auditors because they are often immaterial.

A) True

B) False

Answer: A

Terms: Sales returns and allowances; Immaterial

Diff: Moderate

Objective: LO 14-4

AACSB: Reflective thinking skills

5) When auditing sales returns and allowances, the emphasis is normally on testing the completeness objective.

A) True

B) False

Answer: B

Terms: Auditing sales returns and allowances; Completeness objective

Diff: Moderate

Objective: LO 14-4

AACSB: Reflective thinking skills

Learning Objective 14-5

1) When an employee who is authorized to make customer entries in the accounts receivable subsidiary ledger, purposefully enters cash received into the wrong customers account that employee may be suspected of:

- A) kiting.
- B) lapping.
- C) floating.
- D) shorting.

Answer: B

Terms: Employee authorized to make customer entries

Diff: Moderate

Objective: LO 14-5

AACSB: Analytic skills

2) An audit procedure that compares the name, amount, and dates shown on remittance advices, either paper or electronic via direct deposit, with cash receipts journal entries and with related duplicate deposit slips would be effective in detecting:

- A) kiting.
- B) lapping.
- C) illicit write-offs of customers as uncollectible accounts.
- D) sales without proper credit authorization.

Answer: B

Terms: Audit procedure compares names with cash receipts journal entries

Diff: Moderate

Objective: LO 14-5

AACSB: Reflective thinking skills

3) To prevent fraud, management should deny cash access to anyone responsible for:

A)

Opening mail from customers	Entering sales transactions	Entering cash receipts transactions
Yes	Yes	Yes

B)

Opening mail from customers	Entering sales transactions	Entering cash receipts transactions
No	NoYes	Yes

C)

Opening mail from customers	Entering sales transactions	Entering cash receipts transactions
No	Yes	Yes

D)

Opening mail from customers	Entering sales transactions	Entering cash receipts transactions
Yes	No	No

Answer: C

Terms: Fraud; Cash access

Diff: Moderate

Objective: LO 14-5

AACSB: Reflective thinking skills

4) The audit procedure referred to as proof of cash receipts is particularly useful to test:

A) time lags in making deposits.

B) whether all recorded cash receipts have been deposited in the bank.

C) whether there are cash receipts that have not been recorded in the journals.

D) the client's reconciliation between cash receipts and bank deposits.

Answer: B

Terms: Audit procedure; Proof of cash receipts

Diff: Moderate

Objective: LO 14-5

AACSB: Analytic skills

5) Which of the following audit procedures would normally be best expected to test the completeness objective (assertion) for sales?

A) Compare shipping documents with sales records.

B) Apply gross profit rates to inventory disposed of during the period.

C) Trace payments received subsequent to the balance sheet date.

D) Send accounts receivable confirmation requests.

Answer: A

Terms: Audit procedures; Test completeness objective (assertion) for sales

Diff: Moderate

Objective: LO 14-5

AACSB: Reflective thinking skills

6) Proper separation of duties is useful to prevent various types of misstatements. Which of the following is **not** an essential separation of duties?

- A) Persons having access to cash should also be responsible for recording sales, accounts receivable, and cash.
- B) Separate the credit-granting function from the sales function.
- C) Personnel doing internal comparisons should be independent of those entering the original data.
- D) Anyone responsible for entering sales and cash receipts transactions information into the computer should be denied access to cash.

Answer: A

Terms: Separation of duties

Diff: Challenging

Objective: LO 14-5

AACSB: Reflective thinking skills

7) Cash receipts from sales on account have been misappropriated. Which of the following acts would conceal this fraud and be least likely to be detected by an auditor?

- A) Understating the sales journal by not recording cash sales.
- B) Overstating the accounts receivable control account by intentionally misstating prices charged for goods sold.
- C) Overstating the accounts receivable subsidiary ledger by not recording payments made by customers.
- D) Understating the cash receipts journal by purposely recording incorrect amounts.

Answer: A

Terms: Cash receipts from sales on account; Misappropriated; Fraud

Diff: Challenging

Objective: LO 14-5

AACSB: Reflective thinking skills

8) Which of the following would offer the best protection for a company that wishes to prevent a reoccurrence of a previously detected "lapping" problem with trade accounts receivable?

- A) Segregate duties so that the bookkeeper in charge of the general ledger has no access to incoming mail.
- B) Segregate duties so that no employee has access to both checks from customers and currency from daily cash receipts.
- C) Have customers send payments directly to the company's depository bank.
- D) Request that customer's payment checks be made payable to the company and addressed to the treasurer.

Answer: C

Terms: Prevent lapping problem

Diff: Challenging

Objective: LO 14-5

AACSB: Reflective thinking skills

9) Preparation of a proof of cash would not be useful in discovering differences between the actual and reported cash balances if the differences were due to:

A) deposits in transit.

B) collections on the company's behalf by the bank which are deposited directly to the company's account.

C) cash receipts that were not recorded in the relevant accounting records.

D) service charges.

Answer: C

Terms: Proof of cash

Diff: Challenging

Objective: LO 14-5

AACSB: Analytic skills

10) When assessing planned control risk for sales, the auditor is concerned about proper authorization at three key points. Discuss each of these three points.

Answer: Credit must be properly authorized before a sale takes place; goods should be shipped only after proper authorization; and prices including base terms, freight, and discounts must be properly authorized.

Terms: Assessing planned control risk; Proper authorization

Diff: Moderate

Objective: LO 14-5

AACSB: Reflective thinking skills

11) The occurrence objective (assertion) is of primary importance when performing transaction testing for sales. List and discuss the three potential misstatements that audit procedures are designed to detect.

Answer: (1) shipments made to nonexistent customers and recorded as sales, (2) sales recorded more than once, and (3) sales included in the journals for which no shipment was made.

Terms: Occurrence objective (assertion); Transaction testing for sales; Potential misstatements

Diff: Moderate

Objective: LO 14-5

AACSB: Reflective thinking skills

12) Explain what lapping means, and discuss the internal control deficiency that allows it to occur. Also discuss the procedures the auditor can perform to detect lapping.

Answer: Lapping, which is a common type of embezzlement, is the postponement of entries for the collection of receivables to conceal an existing cash shortage. The embezzlement is perpetrated by a person who handles cash receipts and then enters them into the computer system. He or she defers recording the cash receipts from one customer and covers the shortages with subsequent receipts from another. These in turn are covered from the receipts of a third customer a few days later. The employee must continue to cover the shortage through repeated lapping, replace the stolen money, or find another way to conceal the shortage. The embezzlement can be easily prevented by segregation of duties and a mandatory vacation policy for employees who hand cash and enter cash receipts into the system. It can be detected by comparing the name, amount, and dates shown on remittance advices with cash receipts, journal entries and related duplicate deposit slips. Because this procedure is relatively time-consuming, it is ordinarily performed only when specific concerns with embezzlement exist because of a deficiency in internal control.

Terms: Lapping; Internal control deficiency

Diff: Challenging

Objective: LO 14-5

AACSB: Reflective thinking skills

13) You are part of the audit team that is auditing Hillsburg Hardware Co. and you have been assigned to the sales and collection business process. You are testing whether the cash received has been recorded in the cash receipts journal. (completeness objective /assertion). List two tests of controls and at least one test of transactions that you would do to satisfy yourself regarding the completeness assertion.

Answer: Control Tests: 1. Observe prelisting of cash receipts. 2. Observe endorsement of incoming checks. 3. Examine file of batch totals to initials of data control clerk. 4. Observe whether monthly statements are sent.

Transaction Tests: 1. Trace amounts of prelisted cash receipts to the cash receipts journal, testing for names, amounts, dates. 2. Compare the prelisting with the duplicate deposit slip.

Terms: Sales and collection business process; Tests of controls and test of transactions for completeness objective/assertion

Diff: Challenging

Objective: LO 14-5

AACSB: Reflective thinking skills

14) In planning the audit, an auditor takes 3 basic steps in determining the audit procedures to be performed for any business cycle or class of transactions in order to gather audit evidence concerning possible misstatement due to error or fraud. List those three basic steps below.

Answer: The three basic steps in designing tests of controls and substantive tests of transactions are:

- Determine key internal controls for each audit objective.
- Design tests of controls for each control used to support a reduced control risk.
- Design substantive tests of transactions to test for monetary misstatements for each objective.

Terms: Audit procedures performed for business cycle or class of transactions

Diff: Challenging

Objective: LO 14-5

AACSB: Reflective thinking skills

15) The most difficult type of cash embezzlement for the auditor to detect is when the cash is stolen before it can be recorded in the cash receipts journal.

A) True

B) False

Answer: A

Terms: Cash embezzlement

Diff: Moderate

Objective: LO 14-5

AACSB: Reflective thinking skills

16) The most important audit concern in the processing and recording cash receipts function is not tracing the cash receipts from customers to their subsidiary ledger accounts.

A) True

B) False

Answer: B

Terms: Audit concern in processing and recording cash receipts function

Diff: Moderate

Objective: LO 14-5

AACSB: Reflective thinking skills

Learning Objective 14-6

1) The auditor would expect that an account receivable from a customer would be written off by the client when which of the following occurs:

- A) the customer files for bankruptcy.
- B) the account is at least six months old.
- C) a collection agency cannot inspire customer to pay the debt.
- D) the client company concludes that an amount is no longer collectible.

Answer: D

Terms: Accounts receivable; Written off

Diff: Challenging

Objective: LO 14-6

AACSB: Reflective thinking skills

2) The auditor's primary concern in performing audit procedures of the write-off of uncollectible accounts relates to the risk that the client writes off customer accounts that have already been collected. The primary control for preventing this fraud is:

- A) examining authorized credit memos.
- B) examining the uncollectible account authorization form.
- C) examining debit memos.
- D) examining the vouchers payable register.

Answer: B

Terms: Audit procedures; Write-off of uncollectible accounts; Fraud

Diff: Challenging

Objective: LO 14-6

AACSB: Reflective thinking skills

3) Generally, audit evidence gathered from the sales and collection cycle is combined with evidence:

- A) as the evidence accumulation process proceeds.
- B) only when all fieldwork processes of the engagement are completed.
- C) only after the audit of the sales and collection cycle is concluded.
- D) after the conclusion of both the cash cycle and the sales and collection cycle.

Answer: A

Terms: Audit evidence; Sales and collection cycle

Diff: Challenging

Objective: LO 14-6

AACSB: Reflective thinking skills