ACCOUNTING 412  
Multiple Choice Practice Set  
Chapters 5, 6, 10 & 16  
April 14, 2005

Name ______________________________ Pledged _____________________________

Please record your answers below.

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1. In assessing the competence of an internal auditor, an independent CPA most likely would obtain information about the
   A) Quality of the internal auditor's working paper documentation.
   B) Organization's commitment to integrity and ethical values.
   C) Influence of management on the scope of the internal auditor's duties.
   D) Organizational levels to which the internal auditor reports.

2. The objective of tests of details of transactions performed as substantive tests is to
   A) Detect material misstatements in the financial statements.
   B) Evaluate whether management's policies and procedures operated effectively.
   C) Identify specific financial statement assertions that satisfy the audit objectives.
   D) Verify that significant deficiencies in the accounting system are discovered.

3. Which of the following matters generally is included in an auditor's engagement letter?
   A) Management's responsibility for the entity's compliance with laws and regulations.
   B) The factors to be considered in setting preliminary judgments about materiality.
   C) Management's liability for illegal acts committed by its employees.
   D) The auditor's responsibility to search for significant internal control deficiencies.

4. An auditor's decision either to apply analytical procedures as substantive tests or to perform tests of transactions and account balances usually is determined by the
   A) Availability of data aggregated at a high level.
   B) Relative effectiveness and efficiency of the tests.
   C) Timing of tests performed after the balance sheet date.
   D) Auditor's familiarity with industry trends.

5. The element of the audit planning process most likely to be agreed upon with the client before implementation of the audit strategy is the determination of the
   A) Timing of inventory observation procedures to be performed.
   B) Evidence to be gathered to provide a sufficient basis for the auditor's opinion.
   C) Procedures to be undertaken to discover litigation, claims, and assessments.
   D) Pending legal matters to be included in the inquiry of the client's attorney.

6. A company sells a particular product only in the last month of its fiscal year. The company uses commission agents for such sales and pays them 6% of their net sales 30 days after the sales are made. The agents' sales were $10 million. Experience indicates that 10% of the sales are usually not collected and 2% are returned in the first month of the new year. The auditor would expect the year-end balance in the accrued commissions payable account to be
   A) $528,000.
   B) $540,000.
   C) $588,000.
   D) $600,000.
7. Which of the following tends to be most predictable for purposes of analytical procedures applied as substantive tests?
   A) Relationships involving balance sheet accounts.
   B) Transactions subject to management discretion.
   C) Relationships involving income statement accounts.
   D) Data subject to audit testing in the prior year.

8. The element of the audit planning process most likely to be agreed upon with the client before implementation of the audit strategy is the determination of the
   A) Methods of statistical sampling to be used in confirming accounts receivable.
   B) Pending legal matters to be included in the inquiry of the client's attorney.
   C) Evidence to be gathered to provide a sufficient basis for the auditor's opinion.
   D) Schedules and analyses to be prepared by the client's staff.

9. An entity's financial statements were misstated over a period of years due to large amounts of revenue being recorded in journal entries that involved debits and credits to an illogical combination of accounts. The auditor could most likely have been alerted to this fraud by
   A) Scanning the general journal for unusual entries.
   B) Performing a revenue cutoff test at year-end.
   C) Tracing a sample of journal entries to the general ledger.
   D) Examining documentary evidence of sales returns and allowances recorded after year-end.

10. Which of the following procedures would an auditor most likely include in the initial planning of an examination of financial statements?
    A) Discussing the examination with firm personnel responsible for providing non-audit services to the client.
    B) Inquiring of the client's attorney as to any claims that are likely to be asserted.
    C) Obtaining a written representation letter from the client's management.
    D) Determining whether necessary internal accounting control procedures are being applied as prescribed.

11. Which of the following procedures would the principal auditor most likely perform after deciding to make reference to another CPA who audited a subsidiary of the entity?
    A) Review the other CPAs working papers and audit programs.
    B) Visit the other CPA and discuss the results of the other CPA's audit procedures.
    C) Make inquiries about the other CPA's professional reputation and independence.
    D) Determine that the other CPA has a sufficient understanding of the subsidiary's internal controls.
12. Which of the following factors most likely would cause a CPA to decide not to accept a new audit engagement?
   A) The CPA's lack of understanding of the prospective client's internal auditor's computer-assisted audit techniques.
   B) Management's disregard of its responsibility to maintain an adequate internal control environment.
   C) The CPA's inability to determine whether related party transactions were consummated on terms equivalent to arm's-length transactions.
   D) Management's refusal to permit the CPA to perform substantive tests before the year-end.

13. Which of the following is the most reliable analytical procedures approach to verification of the year-end financial statement balances of a wholesale business?
   A) Verify depreciation expense by multiplying the depreciable asset balances by one divided by the depreciation rate.
   B) Verify commission expense by multiplying sales revenue by the company's standard commission rate.
   C) Verify interest expense, which includes imputed interest, by multiplying long term debt balances by the year-end prevailing interest rate.
   D) Verify FICA tax liability by multiplying total payroll costs by the FICA contribution rate in effect during the year.

14. The audit client's board of directors and audit committee refused to take any action with respect to an immaterial illegal act which was brought to their attention by the auditor. Because of their failure to act, the auditor withdrew from the engagement. The auditor's decision to withdraw was primarily due to doubts concerning
   A) Adequate financial statement disclosures.
   B) Compliance with the Foreign Corrupt Practices Act.
   C) Scope limitations resulting from their inaction.
   D) Reliance on management's representations.

15. Which of the following factors most likely would lead a CPA to conclude that a potential audit engagement should be rejected?
   A) The details of most recorded transactions are not available after a specified period of time.
   B) Internal control activities requiring segregation of duties are subject to management override.
   C) It is unlikely that sufficient competent evidence is available to support an opinion on the financial statements.
   D) Management has a reputation for consulting with several accounting firms about significant accounting issues.
16. In planning an audit of a new client, an auditor most likely would consider the methods used to process accounting information because such methods
A) Influence the design of the internal control structure.
B) Affect the auditor's preliminary judgment about materiality levels.
C) Assist in evaluating the planned audit objectives.
D) Determine the auditor's acceptable level of audit risk.

17. An IT specialist is least likely to be necessary when
A) Data is shared extensively among systems.
B) The entity participates heavily in electronic commerce.
C) The system has not changed from the prior year.
D) Significant audit evidence is in electronic form.

18. Which of the following most likely would not be considered an inherent limitation of the potential effectiveness of an entity's internal control structure?
A) Incompatible duties.
B) Management override.
C) Mistakes in judgment.
D) Collusion among employees.

19. For certain controls, such as segregation of duties, documentary evidence may not exist. An auditor would most likely test the procedures by
A) Reperformance and corroboration.
B) Observation and inquiry.
C) Inspection and vouching.
D) Confirmation and recomputation.

20. An auditor may decide to assess control risk at the maximum level for certain assertions because the auditor believes
A) Sufficient evidential matter to support the assertions is likely to be available.
B) Evaluating the effectiveness of policies and procedures is inefficient.
C) More emphasis on tests of controls than substantive tests is warranted.
D) Considering the relationship of assertions to specific account balances is more efficient.

21. The concept of reasonable assurance in the context of an entity's internal controls recognizes that
A) Auditors may fail to detect material misstatements.
B) Proper internal controls guarantee that material misstatements will not occur.
C) Proper internal controls preclude fraud.
D) Costs of internal controls should not exceed their benefits.
22. In obtaining an understanding of an entity's internal control system in a financial statement audit, an auditor is **not** obligated to
   A) Determine whether the control procedures have been placed in operation.
   B) Perform procedures to understand the design of the internal control system policies.
   C) Document the understanding of the entity's internal control system components.
   D) Search for significant deficiencies in the operation of the internal control system.

23. In a properly designed internal control system, the same employee may be permitted to
   A) Receive and deposit checks, and also approve write-offs of customer accounts.
   B) Approve vouchers for payment, and also sign checks.
   C) Reconcile the bank statements, and also receive and deposit cash.
   D) Sign checks, and also cancel supporting documents.

24. When communicating internal control-related matters noted in an audit, an auditor's report issued on reportable conditions should indicate that
   A) Errors or fraud may occur and **not** be detected because there are inherent limitations in any internal control system.
   B) The issuance of an unqualified opinion on the financial statements may depend on corrective follow-up action.
   C) The deficiencies noted were **not** detected within a timely period by employees in the normal course of performing their assigned functions.
   D) The purpose of the audit was to report on the financial statements and **not** to provide assurance on internal control.

25. A procedure that would most likely be used by an auditor in performing tests of control procedures that involve segregation of functions and that leave no transaction trail is
   A) Inspection.
   B) Observation.
   C) Reperformance.
   D) Reconciliation.

26. In planning an audit of certain accounts, an auditor may conclude that specific procedures used to obtain an understanding of an entity's internal control system need **not** be included because of the auditor's judgments about materiality and assessments of
   A) Control risk.
   B) Detection risk.
   C) Sampling risk.
   D) Inherent risk.

27. Which of the following would be **least** likely to suggest to an auditor that the client's management may have overridden the internal control system?
   A) Differences are always disclosed on a computer exception report.
   B) Management does **not** correct internal control weaknesses that it knows about.
   C) There have been two new controllers this year.
   D) There are numerous delays in preparing timely internal financial reports.
28. Evidential matter concerning proper segregation of duties ordinarily is best obtained by
A) Preparation of a flowchart of duties performed by available personnel.
B) Inquiring whether control procedures operated consistently throughout the period.
C) Reviewing job descriptions prepared by the Personnel Department.
D) Direct personal observation of the employees who apply control procedures.

29. While substantive tests may support the accuracy of underlying records, these tests
frequently provide **no** affirmative evidence of segregation of duties because
A) Substantive tests rarely guarantee the accuracy of the records if only a sample of the
transactions has been tested.
B) The records may be accurate even though they are maintained by persons having
incompatible functions.
C) Substantive tests relate to the entire period under audit, but compliance tests
ordinarily are confined to the period during which the auditor is on the client’s
premises.
D) Many computerized procedures leave **no** audit trail of who performed them, so
substantive tests may necessarily be limited to inquiries and observation of office
personnel.

30. The program flowcharting symbol representing a decision is a
A) Triangle.
B) Circle.
C) Rectangle.
D) Diamond.

31. An auditor most likely would limit substantive audit tests of sales transactions when
control risk is assessed as low for the existence or occurrence assertion concerning sales
transactions and the auditor has already gathered evidence supporting
A) Opening and closing inventory balances.
B) Cash receipts and accounts receivable.
C) Shipping and receiving activities.
D) Cutoffs of sales and purchases.

32. Which of the following control procedures may prevent the failure to bill customers for
some shipments?
A) Each shipment should be supported by a prenumbered sales invoice that is accounted for.
B) Each sales order should be approved by authorized personnel.
C) Sales journal entries should be reconciled to daily sales summaries.
D) Each sales invoice should be supported by a shipping document.

33. Auditors sometimes use ratios as audit evidence. For example, an unexplained decrease
in the ratio of gross profit to sales may suggest which of the following possibilities?
A) Unrecorded purchases.
B) Unrecorded sales.
C) Merchandise purchases being charged to selling and general expense.
D) Fictitious sales.
34. If the objective of a test of details is to detect overstatements of sales, the auditor should trace transactions from the
   A) Cash receipts journal to the sales journal.
   B) Sales journal to the cash receipts journal.
   C) Source documents to the accounting records.
   D) Accounting records to the source documents.

35. Which of the following statements would an auditor most likely add to the negative form of confirmations of accounts receivable to encourage timely consideration by the recipient?
   A) "This is not a request for payment; remittances should not be sent to our auditors in the enclosed envelope."
   B) "Report any differences on the enclosed statement directly to our auditors; no reply is necessary if this amount agrees with your records."
   C) "If you do not report any differences within 15 days, it will be assumed that this statement is correct."
   D) "The following invoices have been selected for confirmation and represent amounts that are overdue."

36. Which of the following controls most likely would be effective in offsetting the tendency of sales personnel to maximize sales volume at the expense of high bad debt write-offs?
   A) Employees responsible for authorizing sales and bad debt write-offs are denied access to cash.
   B) Shipping documents and sales invoices are matched by an employee who does not have authority to write off bad debts.
   C) Employees involved in the credit-granting function are separated from the sales function.
   D) Subsidiary accounts receivable records are reconciled to the control account by an employee independent of the authorization of credit.

37. Auditors are more concerned with the validity objective for revenues than the completeness objective because:
   A) Clients are more likely to overstate than understate revenues.
   B) Clients are more likely to understate than overstate revenues.
   C) It is difficult to determine when services have been performed.
   D) The allowance for doubtful accounts often is understated.

38. Which of the following strategies most likely could improve the response rate of the confirmation of accounts receivable?
   A) Including a list of items or invoices that constitute the account balance.
   B) Restricting the selection of accounts to be confirmed to those customers with relatively large balances.
   C) Requesting customers to respond to the confirmation requests directly to the auditor by fax or e-mail.
   D) Notifying the recipients that second requests will be mailed if they fail to respond in a timely manner.
39. Customers having substantial year-end past due balances fail to reply after second request forms have been mailed directly to them. Which of the following is the most appropriate audit procedure?
   A) Examine shipping documents.
   B) Review collections during the year being examined.
   C) Intensify the study of the client's system of internal control with respect to receivables.
   D) Increase the balance in the allowance for uncollectible accounts.

40. Which of the following most likely would be the result of ineffective internal control policies and procedures in the revenue process?
   A) Final authorization of credit memos by personnel in the Sales Department could permit an employee defalcation scheme.
   B) Fictitious transactions could be recorded, causing an understatement of revenues and an overstatement of receivables.
   C) Irregularities in recording transactions in the subsidiary accounts could result in a delay in goods shipped.
   D) Omission of shipping documents could go undetected, causing an understatement of inventory.

41. An auditor is reviewing sales cutoff as of March 31, 2003. All sales are shipped FOB destination, and the company records sales three days after shipment. The auditor notes the following items:

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If the client records the required adjustments, the net effect on income in thousands of dollars for the period ended March 31, 2004, is
   A) An increase of 12.
   B) An increase of 8.
   C) A decrease of 12.
   D) A decrease of 8.

42. If the number of days' sales in accounts receivable decreases significantly, which of the following assertions for accounts receivable most likely is violated?
   A) Existence or occurrence.
   B) Completeness.
   C) Rights and obligations.
   D) Presentation and disclosure.
43. Mill Company uses a batch processing method to process its sales transactions. Data on Mill’s sales transaction tapes are electronically sorted by customer number and are subjected to programmed edit checks in preparing its invoices, sales journals, and updated customer account balances. One of the direct outputs of the creation of these tapes most likely would be a:
   A) Report showing exceptions and control totals.
   B) Printout of the updated inventory records.
   C) Report showing overdue accounts receivable.
   D) Printout of the sales price master file.

44. Some firms which dispose of only a small part of their total output by consignment shipments fail to make any distinction between consignment shipments and regular sales. Which of the following would suggest that goods have been shipped on consignment?
   A) Numerous shipments of small quantities.
   B) Numerous shipments of large quantities and few returns.
   C) Large debits to accounts receivable and small periodic credits.
   D) Large debits to accounts receivable and large periodic credits.

45. During a review of a small business entity's internal control system, the auditor discovered that the accounts receivable clerk approves credit memos and has access to cash. Which of the following controls would be most effective in offsetting this weakness?
   A) The owner reviews errors in billings to customers and postings to the subsidiary ledger.
   B) A controller receives the monthly bank statement directly and reconciles the checking accounts.
   C) The owner reviews credit memos after they are recorded.
   D) The controller reconciles the total of the detailed accounts receivable accounts to the amount shown in the ledger

46. Examining a sample of cancelled checks for an authorized signature tests which of the following audit objectives for cash?
   A) Validity.
   B) Completeness.
   C) Valuation.
   D) Accuracy.

47. An auditor should trace bank transfers for the last part of the audit period and first part of the subsequent period to detect whether
   A) The cash receipts journal was held open for a few days after the year-end.
   B) The last check recorded before the year end were actually mailed by the year-end.
   C) Cash balances were overstated because of kiting.
   D) Any unusual payments to or receipts from related parties occurred.
48. 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 posts the receipts to the accounts receivable subsidiary ledger cards.
   B) The cashier makes the daily deposit at a local bank.
   C) The cashier prepares the daily deposit.
   D) The cashier endorses the checks.

49. An auditor ordinarily should send a standard confirmation request to all banks with which the client has done business during the year under audit, regardless of the year-end balance, because this procedure
   A) Provides for confirmation regarding compensating balance arrangements.
   B) Detects kiting activities that may not otherwise be discovered.
   C) Seeks information about indebtedness to the bank.
   D) Verifies securities held by the bank in safekeeping.

50. To gather evidence regarding the balance per bank in a bank reconciliation, an auditor would examine all of the following except the
   A) Cutoff bank statement.
   B) Year-end bank statement.
   C) Bank confirmation.
   D) General ledger.

51. An auditor who is engaged to examine the financial statements of a business enterprise will request a cutoff bank statement primarily in order to
   A) Verify the cash balance reported on the bank confirmation inquiry form.
   B) Verify reconciling items on the client's bank reconciliation.
   C) Detect lapping.
   D) Detect kiting.

52. A company holds bearer bonds as a short-term investment. Responsibility for custody of these bonds and submission of coupons for periodic interest collections probably should be delegated to the
   A) Chief Accountant.
   B) Internal Auditor.
   C) Cashier.
   D) Treasurer.

53. Tracing a sample of remittance advices to entries in the cash receipts journal tests which of the following audit objectives for cash?
   A) Validity.
   B) Completeness.
   C) Valuation.
   D) Cutoff.
54. The auditor should insist that a representative of the client be present during the physical examination of securities in order to
A) Lend authority to the auditor's directives.
B) Detect forged securities.
C) Coordinate the return of all securities to proper locations.
D) Acknowledge the receipt of securities returned.

55. A company has additional temporary funds to invest. The Board of Directors decided to purchase marketable securities and assigned the future purchase and sale decisions to a responsible financial executive. The best person(s) to make periodic reviews of the investment activity should be
A) An investment committee of the Board of Directors.
B) The chief operating officer.
C) The corporate controller.
D) The treasurer.

56. The primary purpose of sending a standard confirmation request to financial institutions with which the client has done business during the year is to
A) Detect kiting activities that may otherwise not be discovered.
B) Corroborate information regarding deposit and loan balances.
C) Provide the data necessary to prepare a proof of cash.
D) Request information about contingent liabilities and secured transactions.

57. When an auditor is unable to inspect and count a client's investment securities until after the balance sheet date, the bank where the securities are held in a safe-deposit box should be asked to
A) Verify any differences between the contents of the box and the balances in the client's subsidiary ledger.
B) Provide a list of securities added and removed from the box between the balance sheet date and the security-count date.
C) Confirm that there has been no access to the box between the balance sheet date and the security-count date.
D) Count the securities in the box so that the auditor will have an independent direct verification.

58. When negotiable securities are of considerable volume, planning by the auditor is necessary to guard against
A) Unauthorized negotiation of the securities before they are counted.
B) Unrecorded sales of securities after they are counted.
C) Substitution of securities already counted for other securities which should be on hand but are not.
D) Substitution of authentic securities with counterfeit securities.
59. Under which of the following circumstances would an auditor be most likely to intensify an examination of a $500 imprest petty cash fund?
A) Reimbursement vouchers are not prenumbered.
B) Reimbursement occurs twice each week.
C) The custodian occasionally uses the cash fund to cash employee checks.
D) The custodian endorses reimbursement checks.

60. As one of the year-end audit procedures, the auditor instructed the client's personnel to prepare a standard bank confirmation request for a bank account that had been closed during the year. After the client's treasurer had signed the request, it was mailed by the assistant treasurer. What is the major flaw in this audit procedure?
A) The confirmation request was signed by the treasurer.
B) Sending the request was meaningless because the account was closed before the year-end.
C) The request was mailed by the assistant treasurer.
D) The CPA did not sign the confirmation request before it was mailed.