

## **Substantive Audit Testing: Expenditure Cycle**

### **MULTIPLE CHOICE:**

1. Auditor confirmation of accounts payable balances at the balance sheet date may be unnecessary because
  - a. This is a duplication of cutoff tests.
  - b. Accounts payable balances at the balance sheet date may not be paid before the audit is completed.
  - c. Correspondence with the audit client's attorney will reveal all legal action by vendors for nonpayment.
  - d. There is likely to be other reliable external evidence to support the balances.

ANSWER: D

2. What form of analytical review might uncover the existence of obsolete merchandise?
  - a. Inventory turnover rates.
  - b. Decrease in the ratio of gross profit to sales.
  - c. Ratio of inventory to accounts payable.
  - d. Comparison of inventory values to purchase invoices.

ANSWER: A

3. A weakness in internal accounting control over recording retirements of equipment may cause the auditor to
  - a. Inspect certain items of equipment in the plant and trace those items to the accounting records.
  - b. Review the subsidiary ledger to ascertain whether depreciation was taken on each item of equipment during the year.
  - c. Trace additions to the "other assets" account to search for equipment that is still on hand but no longer being used.
  - d. Select certain items of equipment from the accounting records and locate them in the plant.

ANSWER: D

4. When auditing inventories of raw materials, purchased parts, and/or merchandise inventory, the auditor's most effective means for evaluating the valuation assertion is to
  - a. Examine recent invoices from vendors, along with freight bills and compare with client's unit costs, as adjusted for freight and discount.

- b. Compare purchases with prior year and with industry averages and account for significant fluctuations.
- c. Trace quantities from tags or count sheets to final inventory listings.
- d. Scan inventory listings for large extended amounts, and trace related quantities to auditor's copy of the inventory tag or listing.

ANSWER: A

5. The auditor tests the quantity of materials charged to work in process by tracing these quantities to
- a. Cost ledgers.
  - b. Perpetual inventory records.
  - c. Receiving reports.
  - d. Material requisitions.

ANSWER: D

6. The most effective means for the auditor to determine whether a recorded intangible asset possesses the characteristics of an asset is to
- a. Vouch the purchase by reference to underlying documentation.
  - b. Inquire as to the status of patent applications.
  - c. Evaluate the future revenue-producing capacity of the intangible asset.
  - d. Analyze research and development expenditures to determine that only those expenditures possessing future economic benefit have been capitalized.

ANSWER: C

7. Which of the following accounts would most likely be reviewed by the auditor to gain reasonable assurance that additions to the equipment account are not understated?
- a. Repairs and maintenance expense.
  - b. Depreciation expense.
  - c. Gain on disposal of equipment.
  - d. Accounts payable.

ANSWER: A

8. The most significant audit step in substantiating additions to the office furniture account balance is
- a. Examination of vendors' invoices and receiving reports for current year's acquisitions.

- b. Review of transactions near the balance sheet date for proper period cutoff.
- c. Calculation of ratio of depreciation expense to gross office equipment cost.
- d. Comparison to prior year's acquisitions.

ANSWER: A

9. Instead of taking a physical inventory count on the balance sheet date, the client may take physical counts prior to the year end if internal controls are adequate and
- a. Computerized records of perpetual inventory are maintained.
  - b. Inventory is slow moving.
  - c. CBIS error reports are generated for missing pre-numbered inventory tickets.
  - d. Obsolete inventory items are segregated and excluded.

ANSWER: A

10. The probability of a significant idle capacity loss increases under which of the following conditions?
- a. Sales and production have increased significantly during the period under audit.
  - b. Sales have declined somewhat, but production has remained constant in anticipation of a sales recovery in the following accounting period.
  - c. Sales and production have declined materially during the period under audit.
  - d. The client has increased its overhead absorption rate effective at the beginning of the following accounting period.

ANSWER: C

11. Which of the following is not one of the independent auditor's objectives regarding the audit of inventories?
- a. Verifying that inventory counted is owned by the client.
  - b. Verifying that the client has used proper inventory pricing.
  - c. Ascertaining the physical quantities of inventory on hand.
  - d. Verifying that all inventory owned by the client is on hand at the time of the count.

ANSWER: D

12. An auditor is verifying the existence of newly acquired fixed assets recorded in the accounting records. Which of the following is the best evidence to help achieve this objective?
- a. Documentary support obtained by vouching entries to subsidiary records and invoices.
  - b. Physical examination of a sample of newly recorded fixed assets.
  - c. Oral evidence obtained by discussions with operating management.
  - d. Documentary support obtained by reviewing titles and tax returns.

ANSWER: B

13. The auditor's primary means of obtaining corroboration of management's information concerning litigation is a
- a. Letter of audit inquiry to the client's lawyer.
  - b. Letter of corroboration from the auditor's lawyer upon review of the legal documentation.
  - c. Confirmation of claims and assessments from the other parties to the litigation.
  - d. Confirmation of claims and assessments from an officer of the court presiding over the litigation.

ANSWER: A

14. Which of the following audit procedures is not designed primarily to test for the correctness of purchases and sales cutoff?
- a. Observe shipping and receiving areas during physical inventory observation and relate goods to the last receipt and shipment for the year. Determine that these are the final entries in the purchases and sales records for the year.
  - b. Examine sales and purchases invoices for a few days before and after year end. Compare with dates of receipt and shipment and with freight terms to determine that the transactions were recorded in the proper accounting period.
  - c. Record last document numbers (sales invoice, voucher, check, receiving report) for the year and relate to goods in shipping and receiving areas at year end.

- d. Trace client's unit costs to the auditor's copies of audited price lists.

ANSWER: D

15. The accuracy of perpetual inventory records may be established in part by comparing perpetual inventory records with
- a. Purchase requisitions.
  - b. Receiving reports.
  - c. Purchase orders.
  - d. Vendor payments.

ANSWER: B

16. An auditor's observation of physical inventories at the main plant at year-end would provide direct evidence to support which of the following objectives?
- a. Accuracy of the priced out inventory.
  - b. Evaluation of lower of cost or market test.
  - c. Identification of obsolete or damaged merchandise to evaluate allowance for obsolescence.
  - d. Determination of goods on consignment at another location.

ANSWER: C

17. When auditing merchandise inventory at year end, the auditor performs a purchase cutoff test to obtain evidence that
- a. All goods purchased before year end are received before the physical inventory count.
  - b. No goods held on consignment for customers are included in the inventory balance.
  - c. No goods observed during the physical count are pledged or sold.
  - d. All goods owned at year end are included in the inventory balance.

ANSWER: D

18. Which of the following would be the best procedure to determine whether purchases were properly authorized?
- a. Discuss authorization procedures with personnel in the controller's and purchasing functions.
  - b. Review and evaluate a flowchart of purchasing procedures.

- c. Determine whether a sample of entries in the purchase journal is supported by properly executed purchase orders.
- d. Vouch payments for selected purchases to supporting receiving reports.

ANSWER: C

19. In a manufacturing company, which one of the following audit procedures would give the least assurance of the valuation of inventory at the audit date?
- a. Testing the computation of standard overhead rates.
  - b. Examining paid vendors' invoices.
  - c. Reviewing direct labor rates.
  - d. Obtaining confirmation of inventories pledged under loan agreements.

ANSWER: D

20. In conducting a search for unrecorded liabilities, the auditor should do all but the following:
- a. Examine paid invoices for a short period following the balance sheet date and trace to client's year-end adjustment for unrecorded liabilities.
  - b. Examine unpaid invoices for a short period following the balance sheet date and trace to client's year-end adjustment for unrecorded liabilities.
  - c. Examine prior year's audit workpapers to ascertain that adjustments for unrecorded liabilities have not been overlooked.
  - d. Examine invoices paid a few days prior to the balance sheet date.

ANSWER: D

21. An attorney responding to an auditor as a result of the client's letter of audit inquiry may appropriately limit the response to
- a. Items which have high probability of being resolved to the client's detriment.
  - b. Asserted claims and pending or threatened litigation.
  - c. Legal matters subject to unsettled points of law, uncorroborated information, or other complex judgments.
  - d. Matters to which the attorney has given substantive attention in the form of legal consultation or representation.

ANSWER: D

22. Which of the following errors is most likely to be detected by examining unrecorded expenditure invoices on randomly selected dates during the month after fiscal year-end?
- a. Sales are overstated for the current month.
  - b. Expenses are overstated for the fiscal year just ended.
  - c. Accounts payable are understated at fiscal year end.
  - d. Accounts payable are overstated at fiscal year end.

ANSWER: C

23. Patentex developed a new secret formula which is of great value because it resulted in a virtual monopoly. Patentex has capitalized all research and development costs associated with this formula. Greene, CPA, who is examining this account, will probably
- a. Confer with management regarding transfer of the amount from the balance sheet to the income statement.
  - b. Confirm that the secret formula is registered and on file with the county clerk's office.
  - c. Confer with management regarding a change in the title of the account to "goodwill."
  - d. Confer with management regarding ownership of the secret formula.

ANSWER: A

24. In auditing inventories, a major objective relates to the existence assertion. Of the following audit procedures relating to inventories, which does not support the existence assertion?
- a. The auditor observes the client's inventory and performs test counts as appropriate.
  - b. The auditor confirms inventories not on the premises.
  - c. The auditor performs a lower of cost or market test for major categories of inventory.
  - d. The auditor reviews the client's inventory-taking instructions for such matters as proper arrangement of goods, separation of consigned goods, and limits on movements of goods during inventory.

ANSWER: C

25. When perpetual inventory records are maintained in

quantities and in dollars, and internal accounting control over inventory is weak, the auditor would probably

- a. Want the client to schedule the physical inventory count at the end of the year.
- b. Insist that the client perform physical counts of inventory items several times during the year.
- c. Increase the extent of tests for unrecorded liabilities at the end of the year.
- d. Have to disclaim an opinion on the income statement for that year.

ANSWER: A

26. In auditing plant assets and accumulated depreciation for proper valuation, the auditor should do all except the following:
- a. Recalculate depreciation expense on a test basis.
  - b. Physically inspect major plant assets additions.
  - c. Vouch major additions by reference to underlying documentation.
  - d. Vouch repairs and maintenance expense on a test basis.

ANSWER: B

27. The primary reason an auditor requests letters of inquiry be sent to a client's attorneys is to provide the auditor with
- a. A description and evaluation of litigation, claims, and assessments that existed at the date of the balance sheet.
  - b. An expert opinion as to whether a loss is possible, probable, or remote.
  - c. The opportunity to examine the documentation concerning litigation, claims, and assessments.
  - d. Corroboration of the information furnished by management concerning litigation, claims, and assessments.

ANSWER: D

28. To verify the proper value of costs charged to real property records for improvements to the property, the best source of evidence would be:
- a. Inspection by the auditor of real property improvements.
  - b. A letter signed by the real property manager asserting the propriety of costs incurred.



- c. Original invoices supporting entries into the accounting records.
- d. A comparison of billed amounts to contract estimates.

ANSWER: C

29. When auditing contingent liabilities, which of the following procedures would be least effective?
- a. Reading the minutes of the board of directors.
  - b. Reviewing the bank confirmation letter.
  - c. Examining customer confirmation replies.
  - d. Examining invoices for professional services.

ANSWER: C

30. An auditor should obtain evidential matter relevant to all the following factors concerning third-party litigation against a client except the
- a. Period in which the underlying cause for legal action occurred.
  - b. Probability of an unfavorable outcome.
  - c. Jurisdiction in which the matter will be resolved.
  - d. Existence of a situation indicating an uncertainty as to the possible loss.

ANSWER: C

31. Purchase cutoff procedures should be designed to test whether or not all inventory
- a. Purchased and received before the end of the year was paid for.
  - b. Ordered before the end of the year was received.
  - c. Purchased and received before the end of the year was recorded.
  - d. Owned by the company is in the possession of the company at the end of the year.

ANSWER: C

32. Which of the following accounts would contain the best data for an auditor performing an analytical review to evaluate the reasonableness of the annual payroll?
- a. Payroll taxes expense.
  - b. Payroll taxes withheld.
  - c. Sales and cost of goods sold.
  - d. United Way payable and credit union payable.

ANSWER: A

33. When there are few property and equipment transactions during the year, the continuing auditor usually makes a
- Complete review of the related internal controls and assesses control risk relative to them.
  - Complete review of the related internal controls and performs analytical review tests to verify current year additions to property and equipment.
  - Preliminary review of the related internal controls and performs a thorough examination of the balances at the beginning of the year.
  - Preliminary review of the related internal controls and performs extensive tests of current year property and equipment transactions.

ANSWER: D

34. An audit procedure applicable to testing the year-end cutoff of liabilities is
- Tracing recorded liabilities to supporting documents.
  - Preparing an aging schedule for accounts payable.
  - Reviewing the general journal for unusual entries recorded immediately after year-end.
  - Examining vendor invoices received subsequent to year-end for shipment date and terms of shipment.

ANSWER: D

35. An auditor has accounted for a sequence of inventory tags and is now going to trace information on a representative number of tags to the physical inventory sheets. The purpose of this procedure is to obtain assurance that
- The final inventory is valued at cost.
  - All inventory represented by an inventory tag is listed on the inventory sheets.
  - All inventory represented by an inventory tag is bona fide.
  - Inventory sheets do not include untagged inventory items.

ANSWER: B

36. An auditor analyzes repairs and maintenance accounts primarily to obtain evidence in support of the audit

assertion that all

- a. Non-capitalizable expenditures for repairs and maintenance have been properly charged to expense.
- b. Expenditures for property and equipment have not been charged to expense.
- c. Non-capitalizable expenditures for repairs and maintenance have been recorded in the proper period.
- d. Expenditures for property and equipment have been recorded in the proper period.

ANSWER: B

37. Unrecorded liabilities are most likely to be found during the review of which of the following documents?
- a. Unpaid bills.
  - b. Shipping records.
  - c. Bills of lading.
  - d. Unmatched sales invoices.

ANSWER: A

38. For manufactured inventories, the valuation assertion is best tested by
- a. Comparing unit prices with recent vendors' invoices.
  - b. Tracing unit costs appearing on final inventory listings to auditor's copy of audited finished goods unit costs.
  - c. Testing for purchases and sales cutoff.
  - d. Inquiring as to inventory obsolescence.

ANSWER: B

39. The auditor may conclude that depreciation charges are insufficient by noting
- a. Large amounts of fully depreciated assets.
  - b. Continuous trade-ins of relatively new assets.
  - c. Excessive recurring losses on assets retired.
  - d. Insured values greatly in excess of book values.

ANSWER: C

40. To test the accuracy of the current year's depreciation charges, an auditor should rely most heavily on
- a. Vouching of the current year's fixed asset acquisitions.
  - b. Comparison of depreciation schedule detail with schedules supporting the federal income tax return.

- c. Tracing of totals from the depreciation schedule to properly approved journal entries and ledger postings.
- d. Re-computation of depreciation for a sample of plant assets.

ANSWER: D

41. The audit procedure of analyzing the repairs and maintenance accounts is primarily designed to provide evidence in support of the audit proposition that all
- a. Expenditures for fixed assets have been recorded in the proper period.
  - b. Capital expenditures have been properly authorized.
  - c. Non-capitalizable expenditures have been properly expensed.
  - d. Expenditures for fixed assets have been capitalized.

ANSWER: D

42. An auditor might use several different procedures to test for the proper accounting for retirement of plant and equipment. Which of the following tests would be the most effective in providing evidence about the retirement of fixed assets?
- a. Analysis of debits to the accumulated depreciation account.
  - b. Analysis of debits to the fixed asset account.
  - c. Determination of whether fully depreciated assets still in use are included in the asset accounts.
  - d. Examination of the cash account for unusual entries.

ANSWER: A

43. The auditor is most likely to seek information from the plant manager with respect to the
- a. Adequacy of the provision for uncollectible accounts.
  - b. Appropriateness of physical inventory observation procedures.
  - c. Existence of obsolete machinery.
  - d. Deferral of procurement of certain necessary insurance coverage.

ANSWER: C

44. In performing an audit on the existence of inventory contained in a warehouse, an auditor is primarily concerned with

- a. Observing and testing the number of units on hand.
- b. Determining if the value of the inventory is reasonable.
- c. Identifying the ownership of the inventory.
- d. Locating slow moving items contained in inventory.

ANSWER: A

45. Which of the following audit procedures would provide the least reliable evidence that the client has legal title to inventories?
- a. Confirmation of inventories at locations outside the client's facilities.
  - b. Analytical review of inventory balances compared to purchasing and sales activities.
  - c. Observation of physical inventory counts.
  - d. Examination of paid vendors' invoices.

ANSWER: B

46. An auditor would most efficiently test for the misclassification of capital acquisitions as expenses by
- a. Taking a physical tour of plant facilities before starting an audit.
  - b. Reviewing company capital acquisition policies with purchasing personnel.
  - c. Tracing capital additions back to source documents.
  - d. Scanning repair and maintenance records and investigating large dollar-value entries.

ANSWER: D

**COMPLETION:**

47. Inventory in transit from vendor to client should be added to the client's physical inventory provided the goods were shipped prior to year end and the transportation terms were F.O.B. \_\_\_\_\_.

ANSWER: SHIPPING POINT

48. Inventory in transit from the client to customers should be excluded from the client's inventory provided the goods were shipped prior to year end and the transportation terms were F.O.B. \_\_\_\_\_.

ANSWER: SHIPPING POINT

49. Goods were received prior to year end and included in the physical inventory. The purchase, however, was not recorded until the following accounting period. Net income, in this instance, was \_\_\_\_\_ (overstated or understated).

ANSWER: OVERSTATED

50. Although goods were shipped prior to year end, and excluded from the ending inventory, the sale was not recorded until the following accounting period. Net income in this instance, was \_\_\_\_\_ (overstated or understated) by the amount of the \_\_\_\_\_ (selling price or gross profit)

ANSWER: UNDERSTATED, SELLING PRICE

51. The purpose for analyzing plant asset additions simultaneously with the repairs accounts is to detect material \_\_\_\_\_ errors.

ANSWER: CLASSIFICATION

52. The most effective means for evaluating the valuation assertion as it relates to depreciation expense is to \_\_\_\_\_ depreciation on a test basis.

ANSWER: RECOMPUTE (RECALCULATE)

53. Examining documentation supporting major plant asset additions is commonly referred to as \_\_\_\_\_ plant asset additions.

ANSWER: VOUCHING

53. Just as plant asset accounts are audited simultaneously with repairs expense, the intangible asset accounts should be audited simultaneously with \_\_\_\_\_ expense. In both cases, the objective is to detect \_\_\_\_\_ errors.

ANSWER: RESEARCH AND DEVELOPMENT, CLASSIFICATION

55. The letter of audit inquiry to the client's legal counsel is a form of \_\_\_\_\_.

ANSWER: CONFIRMATION

56. To gain assurance as to proper valuation of accruals, the auditor should \_\_\_\_\_ them on a test basis.

ANSWER: RECALCULATE (RECOMPUTE)

### MATCHING:

57. Match each of the listed objectives with the auditing procedure that best meets the objective.

- A. Inspect major additions on a test basis
- B. Examine paid and unpaid invoices for a short period following the balance sheet date
- C. Confirm inventories in public warehouses and goods out on consignment.
- D. Control auditor's copies of inventory tags and account for all tag numbers, both used and unused. Trace to final inventory listings on final audit
- E. Recompute liabilities for product warranty, pensions, profit-sharing, bonuses, and vacation pay
- F. Test inventory for proper cutoff
- G. Note inventory condition during observation of the physical inventory, and perform inventory turnover tests as part of analytical procedures
- H. Relate intangible assets to revenue produced by them
- I. Vouch additions to intangible asset accounts
- J. Physically inspect intangible assets
- K. Vouch debits to property, plant, and equipment accounts

- \_\_\_\_\_ 1. Verify existence of inventories in distant warehouses
- \_\_\_\_\_ 2. Determine that inventories are owned by the client
- \_\_\_\_\_ 3. Verify existence of recorded plant asset acquisitions
- \_\_\_\_\_ 4. Determine that ordinary repairs have not been improperly capitalized
- \_\_\_\_\_ 5. Verify existence of recorded intangible assets
- \_\_\_\_\_ 6. Ascertain whether recorded intangible assets possess

future economic benefit

- \_\_\_\_\_ 7. Determine that all significant liabilities are reflected on the balance sheet
- \_\_\_\_\_ 8. Determine the reasonableness of management's estimates relating to accrued liabilities
- \_\_\_\_\_ 9. Evaluate ending inventory balances for possible obsolescence
- \_\_\_\_\_ 10. Verify that client has not added nonexistent inventory after the physical inventory has been completed

**SOLUTION:**

1. C
2. F
3. A
4. K
5. I
6. H
7. B
8. E
9. G
10. D

**PROBLEM/ESSAY:**

58. Compact Computers, Inc. manufactures and sells personal computers through various retail distributors. The company took a physical inventory as of December 31, 2002 and adjusted its perpetual records to agree with the physical inventory, by debiting "Computers" and crediting "Cost of Goods Sold." The following is a summary of postings to the "Computers" and "Cost of Goods Sold" accounts:

|              |         | <u>COMPUTERS</u> |           |              |
|--------------|---------|------------------|-----------|--------------|
|              |         | Debits           | Credits   |              |
| 1/2/02       | Balance | 145,000          | 3,000,000 | 1/2-12/31/02 |
| 1/2-12/31/02 |         | 3,100,000        |           |              |
| 12/31/02     | AJE     | 120,000          |           |              |

| <u>COST OF GOODS SOLD-COMPUTERS</u> |         |
|-------------------------------------|---------|
| Debits                              | Credits |



1/2/02-12/31/02      3,000,000                      120,000 AJE 12/31/02

Compact sells all computers at cost plus 30% of cost. In auditing the finished goods inventory, Tracy Jordan obtained the following additional information:

1. Included in 2002 sales were 200 computers sold to Max Depot on 12/31/02 and shipped FOB shipping point. The computers were excluded from Compact's 12/31/02 physical inventory and were received by Max Depot on 1/3/03. The selling price was \$1,800 per computer.
2. Enroute to Compact Computers on 12/31/02 were 30 computers sold to Circuit Town in November and found to be defective. Compact Computers pays for freight charges on all returns. Although the computers were on Compact's railroad siding on December 31, they were not included in the 12/31/02 physical inventory and the return was not recorded until 1/02/03. The computers were originally sold to Circuit Town for \$2,100 each. With minor rework, the computers should be fully saleable again. The reimbursable freight charges paid by Circuit Town were \$620.
3. Compact manufactured 200 computers to order under a private label for Rears & Sawbuck. The computers were completed on 12/28/02 and were placed in the loading area awaiting pickup by Rears & Sawbuck's truck. The selling price of the computers was \$1,900 each. The sale was recorded in 2003, and the computers were included in the 12/31/02 inventory.

REQUIRED:

- a. Draft necessary audit adjustments based on the above information.
- b. Calculate the corrected amount of Compact's 12/31/02 inventory of computers.

SOLUTION:

a.

(1) No adjustment necessary. Title to goods passed on 12/31/02 inasmuch as freight terms were F.O.B. shipping point. Sales properly recorded and goods properly excluded from ending inventory.

(2) Sales Returns and Allowances                      63,000

**Chapter 12 Substantive Audit Testing: Expenditure**

|   |                  |           |
|---|------------------|-----------|
| Accounts receivable   | 63,000           |           |
| Inventory of Computers  | 48,462           |           |
| Cost of Goods Sold  |                  | 48,462    |
| Transportation-in   | 620              |           |
| Freight Payable   |                  | 620       |
| To record return of computers not received until 2003, but for which title passed to Compact in 2002. |                  |           |
| (3) Accounts Receivable   | 380,000          |           |
| Sales   |                  | 380,000   |
| To record 2002 sale to Rears and Sawbuck erroneously recorded in 2003                                 |                  |           |
| Cost of Goods Sold  | 292,308          |           |
| Inventory of Computers  |                  | 292,308   |
| To relieve inventory for sale of computers to Rears & Sawbuck.  |                  |           |
| b. Corrected balance in "Computers" inventory account   |                  |           |
| 12/31/00: Balance per general ledger  | \$500,000        |           |
| Audit adjustment (2)  | 48,462           |           |
| Audit adjustment (3)  | <u>(292,308)</u> |           |
| 12/31/00: Audited balance   |                  | \$121,154 |
|   |                  | =====     |

59. Genstone Pools Sells in-ground swimming pools and hot tubs. The company also installs the pools and tubs that it sells. Abe Booker, Gemstone's controller, prepared the following adjusting journal entry at 9/30/03, the close of Gemstone's fiscal year:

|   |                          |        |          |
|---|--------------------------|--------|----------|
| 9/30/00   | Pool Inventory           | 86,000 |          |
|   | Tub Inventory            | 43,000 |          |
|   | Office Supplies          | 3,500  |          |
|   | Prepaid Insurance        | 14,200 |          |
|   | Accounts Payable         |        | 74,000   |
| To record the following year-end invoices from vendors: |                          |        |          |
|   | Acquatic Industries:     |        | \$86,000 |
|   | Pools received 10/2/00,  |        |          |
|   | shipped by Acquatic on   |        |          |
|   | 9/29/00 FOB destination. |        |          |

|                                     |        |
|-------------------------------------|--------|
| Sudsy Tubs, Inc.:                   | 43,000 |
| Hot tubs received 10/1/03.          |        |
| Shipped by vendor 9/29/03           |        |
| FOB shipping point.                 |        |
| Peerless Office Supplies:           | 3,500  |
| Office supplies received in         |        |
| October; bill received in September |        |
| but not recorded until October.     |        |
| Brooks Insurance:                   | 14,200 |
| Liability and casualty insurance    |        |
| for period 10/1/03-9/30/04.         |        |

Samantha Brown, Gemstone's independent auditor, examined October, 2003 vouchers and discovered the following charges:

| <u>Date</u><br><u>Recorded</u> | <u>Amount</u> | <u>Payee</u>            | <u>Explanation</u>  |
|--------------------------------|---------------|-------------------------|---|
| 10/2/00                        | \$5,000       | Foible & Fall           | Legal retainer for services not yet performed   |
| 10/2/00                        | \$36,000      | Vinyl, Inc.             | Pool liners shipped by vendor 9/29/00 FOB destination, received 10/1. Liners not included in Gemstone's 9/30/00 inventory |
| 10/4/00                        | \$12,200      | T&L Advertising         | Invoice for September media advertising   |
| 10/6/00                        | \$14,000      | Clark County Treasurer  | Fiscal year 2003 real estate taxes. Lien date 10/1/02.  |
| 10/8/00                        | \$15,400      | Hoskins Hardware Supply | Pool repair parts shipped to Gemstone on 9/29 FOB shipping point. Received 10/2 and excluded from 9/30 physical inventory |

a. Record necessary audit adjustments.

b. Identify other audit procedures Brown should perform to satisfy herself that all accounts payable have been recorded as of 9/30/00.

SOLUTION:

a.

AJE #1

|                  |        |        |
|------------------|--------|--------|
| Accounts Payable | 86,000 |        |
| Pool Inventory   |        | 86,000 |

To reverse client adjustment recording inventory for which title did not pass until October.

AJE #2

|                  |       |       |
|------------------|-------|-------|
| Accounts Payable | 3,500 |       |
| Office Supplies  |       | 3,500 |

To decrease office supplies for October purchase.

AJE #3

|                        |        |        |
|------------------------|--------|--------|
| Advertising Expense    | 12,200 |        |
| Real Estate Taxes      | 14,000 |        |
| Repair Parts Inventory | 15,400 |        |
| Accounts Payable       |        | 41,600 |

To adjust accounts payable for fiscal 2004 vouchers pertaining to fiscal 2003.

b.

Other audit procedures:

1. Examine unvouchered invoices not yet processed by Gemstone for additional charges pertaining to fiscal 2003.
2. Examine last year's audit adjustment for unrecorded liabilities to locate items possibly overlooked in the current year's audit.