 Accounting and Auditing Standards

The firm of Bell & Greer, CPAs, has been asked to perform attest services for Trek Corporation (a nonpublic company) for the year ended December 31, Year 5. Bell & Greer has two offices: one in Los Angeles and the other in Newport Beach. Trek Corporation would be audited by the Los Angeles office. For each of the following cases, indicate whether Bell and Greer's independence is definitely impaired. If it is not definitely impaired, but might be under some circumstances, discuss those circumstances.

a. A partner in the Los Angeles office of Bell & Greer has been a long-time personal friend of the chief executive officer of Trek Corporation.

b. The former controller of Trek Corporation became a partner in the Newport Beach office of Bell & Greer on March 15, Year 5, resigning from Trek Corporation on that date.

C. A manager in the Newport Beach office of Bell & Greer is the son of the treasurer of Trek Corporation.

d. A partner in the Los Angeles office of Bell & Greer jointly owns a cattle ranch in Montana with one of the directors of Trek Corporation. The value of the investment is material to both parties.

e. Trek Corporation has not yet paid Bell & Greer for professional services rendered in Year 4. This fee is substantial in amount and is now 15 months past due.

5-37

Analytical procedures are extremely useful throughout the audit.

a.         Explain how analytical procedures are useful in:

1)         The risk assessment stage of the audit

2)         The substantive procedures stage of the audit

3)         Near the end of the audit

b.         List the five sources of information that are available to the auditors in developing expectations for analytical procedures

c.         List and describe four techniques that may be used by the suitors in developing expectations for analytical procedures.

5-50

During your examination of the accounts receivable of Hope Ranch, a new client, you notice that one account is much larger than the rest, and you therefore decide to examine the evidence supporting this customer's account. Comment on the relative reliability and adequacy

of the following types of evidence:

a. Computer printout from accounts receivable subsidiary ledger.

b. Copies of sales invoices in amount of the receivable.

c. Purchase orders received from customer.

d. Shipping documents describing the articles sold.

e. Letter received by client from customer acknowledging the correctness of the receivable in the amount shown on client's accounting records.

f. Letter received by auditors directly from customer acknowledging the correctness of the amount shown as receivable on client's accounting records.

6-24

Morgan, CPA, is approached by a prospective audit client who wants to engage Morgan to perform an audit for the current year. In prior years, this prospective client was audited by another CPA. Identify the specific procedures that Morgan should follow in deciding whether to accept this client.

6-45

Precision Industries, Inc., is a manufacturer of electronic components. When a purchase order

is received from a customer, a sales clerk prepares a serially numbered sales order and sends

copies to the shipping and accounting departments. When the merchandise is shipped to the

customer, the shipping department prepares a serially numbered shipping advice and sends a

copy to the accounting department. Upon receipt of the appropriate documents, the account-

ing department records the sale in the accounting records. All shipments are FOB shipping

point.

a. How can the auditors determine whether Precision Industries, Inc., has made a proper

year-end cutoff of sales transactions?

b. Assume that all shipments for the first five days of the following year were recorded as

occurring in the current year. If not corrected, what effect will this cutoff error have upon

the financial statements for the current year?

7-24.

Management is responsible for designing and maintaining its organization's internal control.

In designing internal control, management must consider controls related to each of the five

maior internal control components: the control environment, risk assessment, the accounting

information system, control activities, and monitoring.

a. Management is considering controls for the following three control environment factors.

For each, describe how the factor contributes to effective internal control.

(1) Integrity and ethical values.

(2) Commitment to competence.

(3) Board independence and effective oversight.

b. Explain how risk assessment contributes to effective internal control, and identify four fac-

tors that result in increased financial reporting risk.

c. Identify the five major objectives of an accounting information system.

d. Describe the purpose of the following two types of control activities.

(1) Performance reviews.

(2) transaction processing.

c. Explain the two types of monitoring and provide an example of each.

7-41

Orange Corp., a high-technology company, utilizes the following procedures for recording

materials and transferring them to work in process.

(1) Upon receipt of raw materials by stores, the storekeeper prepares a stock-in report with

part number and quantities, files the original by date, and sends a copy to accounting.

(2) The inventory accounting clerk uses the stock-in report to post the perpetual inventory

records using standard costs and files the stock-in report by date.

(3) Raw materials requisitions, which show part number and quantity, are prepared by the

manufacturing clerk and approved by the supervisor of manufacturing. A copy of the

requisition is sent to accounting, and the original is filed by job order.

(4) The inventory accounting clerk reviews the requisitions for completeness, transfers the

cost from raw materials to work in process, and files the requisitions by date.

Prepare a flowchart that describes the client's system of recording raw materials and transfer-

ring them to work in process.

8-22.

A primary requirement of effective internal control is a satisfactory plan of organization.

Explain the characteristics of a satisfactory plan of organization for an information systems

department, including the relationship between the department and the rest of the organization.

8-33

The Ultimate Life Insurance Company has a database system that stores policy and payment

information. The company is now planning to provide its branch offices with terminals that

have online access to the central IT facility.

a. Define a database.

b. Give one fundamental advantage of a database.

c. Describe three security measures to safeguard the database system from improper access

through the terminals.

9-29

CPAs may decide to apply nonstatistical or statistical techniques to audit testing.

a. List and explain the advantages of applying statistical sampling techniques to audit testing.

b. List and discuss the decisions involving professional judgment that must be made by the

CPAs in applying statistical sampling techniques to tests of controls.

c. You have applied attributes sampling to the client's pricing of the inventory and discovered

from your sampling that the sample deviation rate exceeds your tolerable rate. Discuss the

courses of action you take.

10-26

Fluid Controls, Inc., a manufacturing company, has retained you to perform an audit for the

year ended December 31. Prior to the year-end, you begin to obtain an understanding of the

new client's controls over business processes related to the cash account.

You find that nearly all the company's cash receipts are in the form of checks received

through the mail, but there is no prelisting of cash receipts before they are recorded in the

accounts. Also, the incoming mail is opened either by the cashier or by the employee maintaining the accounts receivable subsidiary ledger, depending on which employee has time available. The controller stresses the necessity of flexibility in assignment of duties to the

20 employees comprising the office staff, in order to keep all employees busy and achieve

maximum economy of operation.

a. Explain how prelisting of cash receipts strengthens internal control.

b. List specific duties that should not be performed by an employee assigned to prelist the

cash receipts in order to avoid any opportunity for that employee to conceal embezzlement

of cash receipts.