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IIA Certified Internal Auditor Part 2 (Practice of Internal Auditing CIA Part 2)

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QUESTION: 480

Confirmations are a highly regarded form of information. Confirmation is most effective in addressing the existence assertion for the

- A. Addition of a milling machine to a machine shop.
- B. Sale of merchandise during regular course of business.
- C. Inventory held on consignment.
- D. Granting of a patent for a special process developed by the organization.

Answer: C

When inventories are held by an outside custodian, such as a consignee, the internal auditor ordinarily obtains direct confirmation in writing from the custodian. Confirmation of consigned goods is most likely to be effective for the existence and rights-and-obligations assertions.

QUESTION: 481

Observation is considered a reliable engagement procedure, but one that is limited in usefulness. However, it is used in a number of different engagement situations. Which of the following statements is true regarding observation as an engagement technique?

- A. It is the most effective engagement methodology to use in filling out internal control questionnaires.
- B. It is the most persuasive methodology to learn how transactions are really processed during the period under review.
- C. It is rarely sufficient to satisfy any assertion other than existence.
- D. It is the most persuasive technique for determining if fraud has occurred.

Answer: C

Observation is effective for verifying whether particular assets such as inventory or equipment exist at a given date. However, it is of limited use in addressing other assertions. Thus, it provides less persuasive information about the assertions of completeness, rights, valuation, and presentation and disclosure. For example, merely observing inventory does not determine whether the engagement client has rights in it.

QUESTION: 482

One engagement procedure for an engagement to evaluate facilities and equipment is to test the accuracy of recorded depreciation. Which of the following is the best source of information that the equipment in question is in service?

- A. A review of depreciation policies and procedures.
- B. A comparison of depreciation schedules with a listing of insurance appraisals for the same equipment.

- C. A comparison of depreciation schedules with the maintenance and repair logs for the same equipment.
- D. A review of inventory documentation for the equipment.

Answer: C

The maintenance and repair records provide information that equipment exists and is in use. Equipment in service is more likely to require maintenance than retired equipment. However, the best information is the internal auditor's direct observation.

QUESTION: 483

Which of the following documents provides the most persuasive information concerning the existence and valuation of a receivable?

- A. A credit approval document supported by the customer's audited financial statements.
- B. A copy of a sales invoice to the customer in the engagement client's records.
- C. A positive confirmation received directly from the customer.
- D. A customer's purchase order in the engagement client's records related to the credit sale.

Answer: C

A positive confirmation by the debtor is the most reliable information other than payment that the receivable is a valid asset and that it is properly valued. This information is especially reliable because the customer has no incentive to confirm a nonexistent obligation and because the documentation has not been under the engagement client's control.

QUESTION: 484

A bank internal auditor wanted to verify the accuracy of the general ledger balance of a depository account. One engagement procedure used in this process was to mail positive confirmations to statistically sampled depositors. However, the number of replies received was not adequate to form a valid conclusion about the account's accuracy. What action should the internal auditor take to accomplish this objective?

- A. Assume that the no replies represent tacit agreements by the depositor, document the results, and perform no further work on this engagement procedure.
- B. Expand the original confirmation sample to include additional depositors.
- C. Verify accuracy of the depositors' addresses. Retail confirmation requests a second time with a notation indicating that it is a second request.
- D. Mail negative confirmation requests to all non-replies and document results of testing. If necessary, telephone depositors to inquire about any disagreement with balances confirmed.

Answer: C

A positive confirmation asks the debtor for a reply. It may ask the respondent to state whether (s)he agrees with the information given or request that the recipient fill in the account balance or provide other information. The latter type of positive confirmation is called a blank form. The negative confirmation asks for a response only when the debtor disagrees. Positive confirmation is therefore useful when an internal auditor wants to obtain documentary information to verify account balances. If the internal auditor fails to receive positive confirmation, alternative procedures including second and third requests should be employed.

QUESTION: 485

Which of the following statements describes an internal control questionnaire?

- A. It provides detailed information regarding the substance of the control system.
- B. It takes less of the engagement client's time to complete than other control evaluation devices.
- C. It requires that the internal auditor be in attendance to properly administer it.
- D. It provides indirect information that might need corroboration.

Answer: D

An internal control questionnaire consists of a series of questions about the controls designed to prevent or detect errors or irregularities. Answers to the questions help the internal auditor to identify specific policies and procedures relevant to specific assertions. They also help in the design of tests of controls to evaluate their effectiveness. The questionnaire provides a framework to assure that specific concerns are not overlooked, but it is not a sufficient means of understanding the entire system. Thus, the evidence obtained is indirect and requires corroboration by means of observation, interviews, flowcharting, examination of documents, etc.

QUESTION: 486

During interviews with the inventory management personnel, an internal auditor learned that salespersons often order inventory for stock without receiving the approval of the vice president of sales. Also, detail testing showed that there are no written approvals on purchase orders for replacement parts. The results of detail testing are a good example of

- A. Indirect information.
- B. Circumstantial information.
- C. Corroborative information.
- D. Subjective information.

Answer: C

Corroborative information is evidence from a different source that supplements and confirms other information. For example, oral testimony that a certain procedure was not performed may be corroborated by the absence of documentation.

QUESTION: 487

Which of the following engagement objectives will be accomplished by tracing a sample of accounts receivable debit entries to customer invoices and related shipping documents?

- A. Sales are properly recorded.
- B. Sales are billed at the correct prices.
- C. Accounts receivable represent valid sales.
- D. Customer credit is approved.

Answer: C

By vouching sales transactions from the accounts receivable ledger back to the sales invoices, the internal auditor verifies that these accounts receivable are properly supported by sales. These sales should then be vouched back to related customer orders and traced forward to shipping documents. The purpose is to detect fictitious sales and assure that each sale is properly documented and posted to the accounts receivable subsidiary ledger. The latter objective also requires sales invoices to be traced to the accounts receivable subsidiary ledger.

QUESTION: 488

Management believes that some specific sales commissions for the year were too large. The accuracy of the recorded commission expense for specific salespersons is best determined by

- A. Computation of selected sales commissions.
- B. Calculating commission ratios.
- C. Use of analytical procedures.
- D. Tests of overall reasonableness.

Answer: A

Sales commission is based on the application of a ratio to the amount of the sale. The best information about the accuracy of sales commission expense for specific individuals is to recompute the amounts derived from a sample of transactions. These tests should be done at the same time as procedures testing accrued liabilities.

QUESTION: 489

An internal auditor traces copies of sales invoices to shipping documents to determine that

- A. Customer shipments were billed.
- B. Sales that are billed were also shipped.
- C. Shipments to customers were also recorded as receivables.
- D. The subsidiary accounts receivable ledger was updated.

Answer: B

If the invoices in the sample can be correctly matched with shipping documents, some assurance is given that items billed are also shipped.

QUESTION: 490

A large manufacturer has a transportation division that supplies gasoline for the organization's vehicles. Gasoline is dispensed by an attendant who records the amount issued on a serially prenumbered gasoline disbursement form, which is then given to the accounting department for proper recording. When the quantity of gasoline falls to a certain level, the service station attendant prepares a purchase requisition and sends it to the purchasing department where a purchase order is prepared and recorded in a gasoline purchases journal. Which of the following engagement procedures best determines whether gasoline disbursements are fully recorded?

- A. Compare the gasoline purchase requisitions with the gasoline disbursement records.
- B. Select a number of gasoline purchases from the gasoline purchases journal and compare them with their corresponding purchase orders. Ascertain that the purchases are serially prenumbered, are matched with purchase requisitions, and are authorized by someone independent of employees of the service station.
- C. Perform analytical procedures comparing this period's gasoline consumption with prior periods.
- D. Match the quantity of gasoline disbursed according to disbursement forms with an independent reading of quantity disbursed at the pump.

Answer: D

Physical information is best obtained through direct observation or inspection by the internal auditor. Because the gasoline disbursement forms are prenumbered, the internal auditor is able to match them with the independent reading of quantity disbursed at the pump to test the completeness of disbursement records.

QUESTION: 491

To control daily operating costs, an organization decreased the number of times a messenger service was used each day. Despite those measures, the monthly bill continued

to increase. What procedure should the internal auditor use to detect whether improper services were being billed?

- A. Reconcile a sample of messenger invoices to pickup receipts.
- B. Test the mathematical accuracy of a sample of messenger invoices.
- C. Scan ledger accounts and messenger invoices.
- D. Observe daily use of the messenger service.

Answer: A

When the amount charged for a service increases as an entity reduces its use of the service, the possibility exists that the entity is being charged for service not received. The internal auditor should reconcile a sample of messenger invoices to pickup receipts. By multiplying the number of trips authorized by the charge per trip, any discrepancy can be identified.

QUESTION: 492

To determine whether credit controls are inconsistently applied, preventing valid sales to creditworthy customers, the internal auditor should

- A. Confirm current accounts receivable.
- B. Trace postings on the accounts receivable ledger.
- C. Analyze collection rates and credit histories.
- D. Compare credit histories for those receiving credit and for those denied credit.

Answer: D

Credit policy should maximize profits by balancing bad debt losses and the increase in sales derived from granting credit. One concern in an engagement to review credit management is whether credit policies and procedures are fairly administered.

QUESTION: 493

To test whether debits to accounts receivable represent valid transactions, the internal auditor should trace entries from the

- A. Sales journal to the accounts receivable ledger.
- B. Accounts receivable ledger to the cash receipts journal.
- C. Accounts receivable ledger to sales documentation.
- D. Cash receipts documentation to the accounts receivable ledger.

Answer: C

By vouching sales transactions from the accounts receivable ledger back to the sales invoices, the internal auditor verifies that these accounts receivable are properly supported by sales. These sales should then be vouched back to related customer orders and traced forward to shipping documents. The purpose is to detect fictitious sales and assure that each sale is properly documented and posted to the accounts receivable subsidiary ledger. The latter objective also requires sales invoices to be traced to the accounts receivable subsidiary ledger.

QUESTION: 494

Cash receipts should be deposited on the day of receipt or the following business day. Select the most appropriate engagement procedure to determine that cash is promptly deposited.

- A. Review cash register tapes prepared for each sale.
- B. Review the functions of cash handling and maintaining accounting records for proper separation of duties.
- C. Compare the daily cash receipts totals with the bank deposits.
- D. Review the functions of cash receiving and disbursing for proper separation of duties.

Answer: C

A standard control over the cash receipts function is to require that daily cash receipts be deposited promptly and intact. Hence, the total of cash receipts for a day should equal the bank deposit because no cash disbursements are made from the daily receipts. To determine whether cash receipts are promptly deposited, the internal auditor should compare the daily cash receipts totals with bank deposits.

QUESTION: 495

Which of the following engagement procedures will provide the least relevant information for determining that payroll payments were made to bona fide employees?

- A. Reconcile time cards in use to employees on the job.
- B. Examine canceled checks for proper endorsement and compare to personal records.
- C. Test for segregation of the authorization for payment from the hire/fire authorization.
- D. Test the payroll account bank reconciliation by tracing outstanding checks to the payroll register.

Answer: D

A payroll account proof tests the completeness assertion. However, it has no bearing on the validity of the transactions.

QUESTION: 496

Which of the tests provides the least significant information when testing for suspected fraudulent sales?

- A. Tracing a sample of inventory removal slips from inventory through billing to the sales journal.
- B. Performing analytical tests of sales by comparing sales and gross margins overtime.
- C. Performing analysis of write-offs and sales returns, and comparing the amounts over the past several years.
- D. Confirming sales transactions with customers and investigating nonresponses.

Answer: A

Tracing a sample of inventory removal slips is least likely to provide evidence of fraudulent sales because it applies to transactions that have apparently been properly authorized and documented.

QUESTION: 497

The most reliable information an internal auditor can assess when determining an organization's legal title to inventories is

- A. Monthly gross profit and inventory levels.
- B. Purchase orders.
- C. Paid vendor invoices.
- D. Records of inventories stored at off-site locations.

Answer: C

Mere possession of inventory does not signify that another party does not have a claim to it. For example, the inventory may be held on consignment. Payment of vendor invoices is the culmination of the purchases-payables cycle. The paid invoice evidences the purchaser's ownership of the inventory.

QUESTION: 498

An internal auditor has set an engagement objective of ascertaining the reasonableness of the increases in rental revenue resulting from operating costs passed on to the lessee by the landlord. The internal auditor has already inspected the lease contract to determine that such costs are allowed. Which of the following engagement procedures will best meet this objective?

- A. Inspection of documents.
- B. Observation.
- C. Inquiry.
- D. Analytical review.

Answer: D

Computation of the rates of increase in operating costs passed through to the lessee from period to period in relation to inflation rates provides an initial view of the reasonableness of the increases.

QUESTION: 499

An internal auditor has set an engagement objective of determining whether the planned rate of return on investment in international operations has been achieved. Which of the following engagement procedures will best meet this objective?

- A. Inspection of documents.
- B. Observation.
- C. Inquiry.
- D. Analytical review.

Answer: D

By comparing the rate of return achieved with the budget for international operations for the last several time periods, the internal auditor can determine the variances from budget and determine the adequacy of the return on the investment.

QUESTION: 500

Which of the following is the most appropriate engagement procedure to test the processing of interbank transfers?

- A. Analyze a sample of interbank transfers throughout the period including period-end reconciliations.
- B. Obtain cutoff bank statements for each bank account and reconcile them to accounting records.
- C. Send bank confirmation requests to each bank in which accounts are maintained and reconcile the completed forms to accounting records.
- D. Trace all bank deposits recorded in accounting records near the end of the fiscal period to supporting documentation and to bank statements.

Answer: A

If the engagement objective is to test compliance with processing procedures, the appropriate procedure is to examine a sample of transfers and trace them to the accounting records, including the period-end bank reconciliation for each account.

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