Chapter 12
Revenue- and Inventory-Related Financial Statement Frauds

Instructions: There are 46 multiple choice questions on this quiz. You may choose any 25 (but only 25) questions to answer. Please ensure your Scantron has your Name and Chapter 12 quiz written in. Please return only your Scantron. You should retain this quiz form for final exam study purposes. This is a take home quiz. We will review answers next week.

MULTIPLE CHOICE

1. Revenue-related financial statement fraud is prevalent for all of the following reasons except:
   a. There are numerous accounting methods for recognizing revenue.
   b. Revenue-recognition policies are unlikely to be reviewed by financial statement auditors.
   c. Net income can be easily manipulated by using revenue accounts.
   d. Judgment can significantly affect the amount of revenue recognized by an entity.

2. The practice of __________ involves selling unused assets while promising to buy them back at roughly the same price
   a. Improper cutoff
   b. Refreshing transactions
   c. Channel stuffing
   d. Round-tripping
   e. None of the above

3. Which of the following is not a fraud scheme affecting the revenue accounts?
   a. Related-party transactions
   b. Side agreements
   c. Double counting
   d. Lapping

4. Which of the following are not revenue-related fraud symptoms?
   a. Analytical symptoms
   b. Lifestyle symptoms
   c. Control symptoms
   d. Tips and complaints
   e. All of the above are revenue-related fraud symptoms

5. Which of the following is not a typical analytical symptom of revenue fraud?
   a. Revenue appears too high
   b. Discounts appear too low
   c. Allowance for doubtful accounts appears too high
   d. Bad debt expense appears too low
   e. All of the above are typical analytical symptoms of revenue fraud
6. Which of the following is **not** a typical behavioral or verbal symptom of revenue fraud?
   a. Inconsistent or vague responses from management arising from revenue inquiries
   b. Denied access to facilities, employees, or records related to revenue-related audit evidence
   c. Unusual delays by the entity in providing revenue-related information
   d. Untrue responses by management to queries about revenue-related accounts
   e. All of the above are typical symptoms

7. Which of the following are ways to proactively search for fraud symptoms?
   a. Responding to customer complaints regarding sales terms.
   b. Investigating anomalies noticed when sampling transactions for routine control testing.
   c. Exploring claims of a disgruntled employee that were received in an exit interview.
   d. None of the above.

8. Common ways of performing “within-statement” analysis include all of the following except:
   a. Comparing a firm’s account balances from period to period
   b. Comparing relationships between account balances from period to period
   c. Comparing financial results with industry averages from period to period
   d. All of the above are common ways of performing “within-statement” analysis

9. _______ involves examining percentage changes in account balances from period to period.
   a. Horizontal analysis
   b. Change statement analysis
   c. Ratio analysis
   d. None of the above

10. Horizontal analysis is **not** typically performed on the _________.
    a. Balance sheet
    b. Income statement
    c. Statement of cash flows
    d. None of the above

11. Which of the following ratios is **not** commonly used to discover revenue-related analytical fraud symptoms?
    a. Asset turnover ratio
    b. Earnings per share
    c. Gross profit ratio
    d. Accounts receivable turnover
    e. All of the above are commonly used to discover revenue-related analytical fraud symptoms

12. Which of the following is false concerning “topside” journal entries used to commit financial statement fraud?
    a. Upper management usually records the journal entry
    b. Entries are recorded directly to the subsidiary ledger
    c. The journal entry may be recorded after normal business hours.
    d. All of the above are false
13. Under SAS 99, financial statement auditors are required to make inquiries of all of the following individuals or groups about possible fraudulent activity or red flags except:
   a. Management
   b. Audit committee members
   c. Internal audit personnel
   d. Financial statement auditors must make inquiries of all of the above

14. Potential whistle-blowers are hesitant to come forward with information for all of the following reasons except:
   a. They don’t know who to tell
   b. They don’t feel it’s their responsibility
   c. They don’t want to wrongly accuse someone
   d. They are afraid of “whistle-blower” repercussions

15. Which of the following is not a common inventory-related fraud scheme?
   a. Capitalizing costs that should be expensed
   b. Cutoff problems
   c. Consigned inventory
   d. All of the above are inventory-related fraud schemes

16. Auditors realize that XYZ is experiencing increasing levels of inventory while its competitors’ inventory levels remain stable. All of the following are likely explanations except:
   a. The increase in inventory is a result of poor management decisions
   b. The increase in inventory is a result of increased sales expectations
   c. The increase in inventory is a result of fraud
   d. All of the above are possible explanations

17. Which of the following is not a typical symptom of revenue fraud?
   a. managers and other company officers are living a lavish lifestyle
   b. management overrides significant internal control activities related to the revenue cycle
   c. revenue-related ledgers do not balance
   d. the company has numerous large customers

18. Which of the following is most likely to be indicative of a potential revenue fraud?
   a. a sudden increase in the sales discount percentage
   b. a high sales return percentage
   c. a rapidly increasing asset turnover ratio
   d. a rapidly decreasing working capital turnover ratio

19. According to the text, what is the unique reason that the accounts receivable turnover ratio is so widely used in analyzing revenue?
   a. significant revenues and receivables will almost always affect this ratio
   b. it is easy to compute
   c. the data is readily available
   d. the accounts receivable turnover ratio is not a widely used ratio in analyzing revenue
20. When analyzing ratios, what is typically the most important aspect to evaluate?
   a. the size of the ratio
   b. the direction of the ratio
   c. the change in the ratio
   d. the complexity of the ratio

21. Possible methods of determining whether inventory is properly valued are:
   a. talking to the workers who handle the inventory
   b. communicating with vendors about inventory costs
   c. speaking with large customers about inventory quality and product returns
   d. all of the above

22. Which of the following is not a reason why revenue fraud is common?
   a. It is easy to manipulate net income using revenue and A/R accounts
   b. There are acceptable alternatives for recognizing revenue
   c. Organizations differ, the types of revenue they generate differ, and each revenue type requires specific recognition
   d. auditors focus more on balance sheet accounts than on revenue accounts

23. Which of the following is most likely to be indicative of a potential inventory fraud?
   a. a sudden increase in the inventory turnover ratio
   b. a sharp decrease in gross profit margin
   c. a sudden decrease in number of days’ sales in inventory
   d. a sudden increase in number of days’ sales in inventory

24. Which of the following fraud symptoms is least helpful in detecting and often not relevant in financial statement fraud in large organizations?
   a. Behavioral or verbal flags
   b. Tips and complaints
   c. Extravagant lifestyles
   d. Analytical symptoms

25. Overstating ending inventory has the following effect on cost of goods sold and net income, respectively.
   a. Overstated, overstated
   b. Understated, overstated
   c. Overstated, understated
   d. No effect on either account

26. Which fraud is most difficult to perpetrate for multiple years?
   a. Overstating inventory – because last year’s overstatement must be offset in the current year.
   b. Overstating inventory – because physical assets are easily audited making it easy to detect inventory fraud in the long run
   c. Overstating revenue – because auditors focus the most attention on revenue recognition
   d. Overstating revenue – because it is difficult to create fake cash year after year
27. According to a study sponsored by The Committee of Sponsoring Organizations (COSO), the most common way to manipulate revenue accounts is by:
   a. Reclassifying expenses as revenues
   b. Recording fictitious revenues
   c. Inappropriately reducing sales returns and allowances
   d. Prematurely recording revenue

28. Which accounts are most commonly manipulated in a financial statement fraud?
   a. Revenues/receivables
   b. Inventory/COGS
   c. Long-term liabilities
   d. Short-term liabilities

29. Revenues and receivables can be manipulated by:
   a. Fictitious sales
   b. Topside journal entries
   c. Misstating work completed on a long-term construction contract
   d. Two of the above
   e. All of the above

30. ________ are orders for goods that are stored by the seller, often, because the buyer is not ready or able to receive the goods at the time of the order.
   a. Sham sales
   b. Side agreements
   c. Consignment sales
   d. Bill and hold sales
   e. Related party transactions

31. The first task understanding how fraud can be perpetrated in a company is to:
   a. Determine how each transaction could be misstated
   b. Evaluate the integrity of management
   c. Analyze and diagram the various transactions
   d. Interview employees throughout the company
   e. Understand the business

32. Regarding related-party transactions, fraud occurs when:
   a. The transactions are not properly disclosed.
   b. Assets are transferred between related parties.
   c. Business deals or arrangements are made between two parties that create a conflict of interest in a business setting.
   d. all of the above

33. __________ is a practice that suppliers use to encourage customers to buy extra inventory so as to increase current-year sales.
   a. Kiting
   b. Channel stuffing
   c. Redating transactions
   d. Partial shipments
34. When might a fraud scheme be used to understate revenue and net income?
   a. In order to manage or smooth income
   b. To allow a company to pay lower income taxes
   c. To improve key financial statement ratios
   d. Two of the above
   e. All of the above

35. An example of a(n) _________ is a lack of segregation of duties:
   a. Analytical symptom
   b. Accounting symptom
   c. Control symptom
   d. Lifestyle symptom
   e. None of the above

36. An example of a(n) _________ is a change in behavior to cope with the stress involved with committing fraud.
   a. Analytical symptom
   b. Accounting symptom
   c. Control symptom
   d. Lifestyle symptom
   e. Behavior symptom

37. An example of a(n) _________ is discovering that ledgers don’t balance.
   a. Analytical symptom
   b. Accounting symptom
   c. Control symptom
   d. Lifestyle symptom
   e. None of the above

38. Which of the following is an analytical symptom of potential revenue fraud?
   a. Sales returns appear too high
   b. Accounts receivable appear too low
   c. Significant new, unknown customers
   d. Two of the above
   e. All of the above

39. Benford’s law (see page 176 of Albrecht) + would most likely assist an auditor when looking for:
   a. Analytical symptom
   b. Accounting symptom
   c. Control symptom
   d. Lifestyle symptom
   e. None of the above
40. Which of the following is necessary in order to determine if an analytical symptom exists?
   a. Ratio analysis
   b. A change statement
   c. Vertical analysis
   d. An expectation

41. The least effective method for comparing account balances from period to period is:
   a. To focus on and calculate changes in the actual financial statement numbers (raw data)
   b. Perform horizontal analysis
   c. Study the statement of cash flows
   d. None of the above

42. When the sales return ratio becomes unexpectedly _______, it is a signal that fraud or other problems could be occurring.
   a. Low
   b. High

43. Which of the following can be used to simultaneously view the relationships between all numbers on the balance sheet or income statement?
   a. Horizontal analysis
   b. Vertical analysis
   c. Ratio analysis
   d. All of the above

44. Smart fraudsters will avoid financial statement fraud involving the overstatement of ______ because of the compounding effect from period to period.
   a. Revenue
   b. Accounts receivable
   c. Inventory
   d. Fixed assets

45. Inventory fraud often involves overstating inventory and/or understating cost of goods sold. The result is a decrease in the:
   a. Gross profit ratio
   b. Inventory turnover ratio
   c. Number of days sales in inventory
   d. Two of the above
   e. All of the above

46. According to a COSO-sponsored study, most companies committing financial statement fraud had all of the following characteristics except:
   a. The companies were large
   b. The companies had inactive audit committees
   c. The companies had family members among directors or officers
   d. All of the above