ACC531: Auditing and Assurance Services
Ch8. Acquisition and Expenditure Cycle

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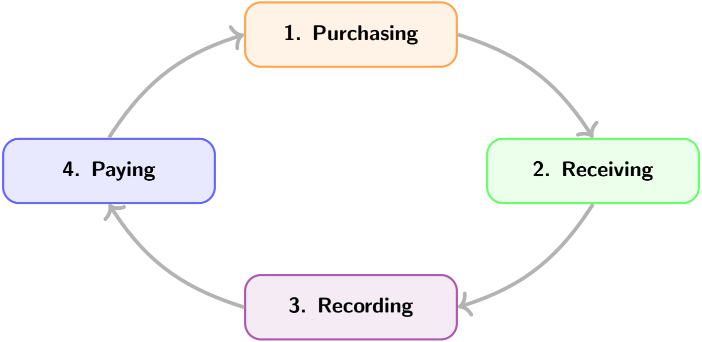
Acquisition and Expenditure Cycle: Typical Activities

LO 8-1

Describe the acquisition and expenditure cycle, including typical source documents.

The Acquisition and Expenditure Cycle

- The **acquisition & expenditure cycle** covers all activities from identifying a need for goods or services through payment to the vendor.
- ____ and ________ are the most significant accounts.
- Affects **more GL accounts** than any other cycle: A/P, expenses, fixed assets, prepaid, inventory, accrued liabilities.



Cycle Overview: Four Activities

#	Activity	Key Risk
1	Purchasing goods/services	Kickbacks[1] & ___________ vendors
2	Receiving goods/services	Quantity/quality discrepancies
3	Recording A/P and expense	Completeness and _____
4	Paying the vendor (Ch6)	________ vendors

[1] A *kickback* is a secret payment—cash, gifts, or other benefits—that a vendor gives to a company's employee to win the company's business.

Step 1: Purchasing Goods and Services

Phase Goal: Identify the need and place a valid, authorized order with an approved vendor.

Key Source Documents

- **Purchase Requisition**: ______ request from department; includes account to be charged and authorization signature.
- ________ **Vendor List**: Only vendors inspected and authorized by the organization; multi-department approval required.
- **Purchase Order (PO)**: ______ authorization of the purchase; sent to selected vendor.

Fraud Risks in Purchasing

- _________: vendor provides gifts/payments to purchasing agent.
- ____ **companies**: fictitious vendors created to collect fraudulent payments.
- _______ **of interest**: employee holds ownership interest in a supplier.

Document: Purchase Requisition

A **Purchase Requisition** is an ______ request from a department to the ________ department. It includes the ________ to be charged and requires an authorization signature from someone with budget ________.

PURCHASE REQUISITION (Internal)

Requesting Dept: Accounting — Date: Nov 1, 2026
Account #: 5200 (Office Supplies) — Req #: REQ-0419

Description	**Est. Unit Price / Qty**
Copy paper, A4	$35.00 / 10 cases

Recommended Vendor: Office Depot
Authorization Signature: J. Smith (Acctg Mgr)

The **Approved Vendor List** is an ______ system file of vendors that have been reviewed and authorized by multiple departments (purchasing, quality control, production). Adding a vendor requires multi-department sign-off to prevent ______ arrangements.

APPROVED VENDOR LIST (IT System)

Last Updated: Oct 28, 2026 Maintained by: Purchasing Dept

Vend #	Vendor Name	Status	Approved By
V-044	Office Depot	**Active**	Purchasing, QC
V-045	Staples Inc.	**Active**	Purchasing, QC
V-046	PrintCo LLC	**Review**	Purchasing only
V-047	FastSupply	**Inactive**	Removed: 2025

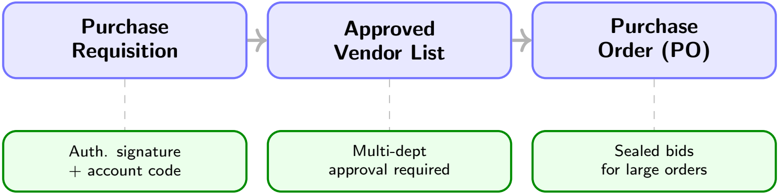
A **Purchase Order (PO)** is the formal ___________ of a purchase, sent by the _____ to the selected ______. It is the vendor's authority to ship goods and the buyer's commitment to pay.

PURCHASE ORDER (Sent to Vendor)

From: Acme Corp | PO #: PO-2042
To: Office Depot | Date: Nov 2, 2026
Ref Req: REQ-0419 | Auth: J. Smith (Purchasing)

Description	**Qty**	**Unit Price**	**Total**
Copy Paper A4 (cases)	10	$35.00	$350.00
Payment Terms: Net 30	Deliver by: Nov 5, 2026		

Purchasing: Document Flow



- ________: purchases above threshold require bids from $\geq$3 vendors; submitted in sealed envelopes to prevent bid manipulation.
- ________ **POs**: authorize future deliveries in installments; automatic replenishment systems generate system-level POs.

Step 2: Receiving Goods or Services

Phase Goal: Verify delivery and document what was actually received.

Key Source Documents

- ____________: A document from the carrier confirming what was shipped and to whom.
- _______________: Prepared by the ________ dept after independent inspection of quantity and quality.

Key Control: Blind Purchase Order

- A blind PO omits the quantity from the copy given to the receiving department.
- Forces receiving personnel to perform an __________ count rather than rubber-stamping the expected quantity.
- Prevents quantity discrepancies from going _________.

Document: Bill of Lading

A **Bill of Lading (BOL)** is a document issued by the ______ that confirms the goods were picked up from the supplier and identifies the consignee (the receiving company). The receiving department checks that the PO number on the BOL matches before accepting the shipment.

BILL OF LADING

Shipper: Office Depot Carrier: FedEx BOL #: 55821
Consignee: Acme Corp (Receiving Dock) Date: Nov 4, 2026
Ref PO: **PO-2042**

Description	**Pkgs**	**Weight (lbs)**
Copy Paper A4, cases	10	500
Carrier Signature: J. Brown (FedEx Driver)		

Document: Receiving Report (Blind)

A **Receiving Report** records the actual quantity and condition of goods received. A **blind** copy intentionally omits the _______ from the ___, forcing the receiving clerk to perform an independent physical _____.

RECEIVING REPORT

Vendor: Office Depot RR #: RR-1188
Ref PO: PO-2042 (Blind — qty not shown) Date: Nov 4, 2026

Description	Qty Received (independent count)
Copy Paper A4	**10** of 10 cases

Condition: **Good**
Inspector: R. Jones (Receiving Dept)

Step 3: Recording the Asset/Expense and Liability

Phase Goal: Record A/P correctly in the right period with the right amount.

Key Source Documents

- **Vendor Invoice**: Bill from the vendor requesting payment.
- **Voucher Package**: PO + Vendor Invoice + Receiving Report + Voucher; A/P records the liability only when all three _____.

Key Risk: Unrecorded Liabilities

- Goods received but not yet invoiced may go unrecorded, __________ A/P and overstating income.
- Automation reduces errors but auditors must evaluate bot controls.

A **Vendor Invoice** is the bill sent by the ______ to the _____ requesting payment. The A/P department matches it to the ___ and ________ report before recording the liability.

VENDOR INVOICE

From: Office Depot
To: Acme Corp
Ref PO: PO-2042

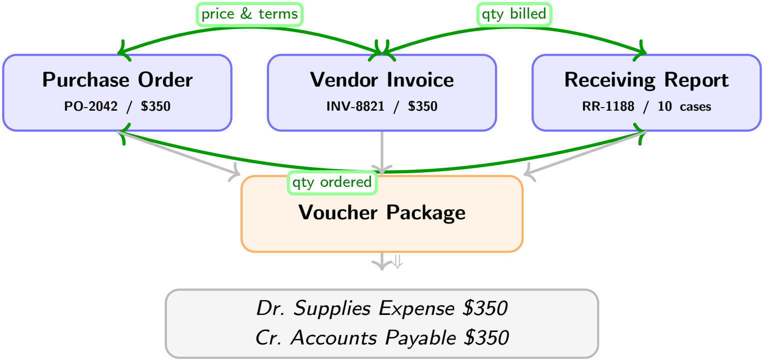
Invoice #: INV-8821
Invoice Date: Nov 3, 2026
Payment Terms: Net 30

Description	Qty	Unit Price	Total
Copy Paper A4 (cases)	10	$35.00	$350.00

Amount Due: $350.00 Due by: Dec 3, 2026

Document: Voucher Package

The **Voucher Package** combines all three documents into a single package. A/P records the liability ________ all three agree (three-way match).



If any document is missing or amounts disagree, the system flags an ________ and holds payment.

Step 4: Paying the Vendor

Phase Goal: Issue payment only for valid, authorized obligations to approved vendors.

Key Source Documents

- **Voucher Package**: ________ package triggers the payment process.
- **Check / EFT**: Payment instrument prepared by A/P and _____ by treasury.

Key Controls in Payment

- **Separation of duties**: Person who approves the voucher should _______ the check.
- **Cancel documents**: Voucher package stamped *PAID* after payment to prevent ________ payment.
- Covered in detail in **Ch6** (Cash Disbursements cycle).

Practice Questions

1. Which document formally authorizes a purchase and is sent to the vendor? _
   - **A)** Purchase requisition
   - **B)** Receiving report
   - **C)** Purchase order
   - **D)** Voucher package

2. [T/F] A blind purchase order omits the quantity so receiving personnel must independently count the goods received. _

3. [T/F] The approved vendor list is controlled solely by the purchasing department without input from other departments. _

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Significant Accounts and Relevant Assertions

LO 8-2

Identify significant accounts and relevant assertions related to the acquisition and expenditure cycle.

Significant Accounts: Overview

- An account is **significant** if there is a reasonable chance it could contain a MM.
- Individuals may also attempt to run **personal expenses** through A/P — validity of expenses is also a risk.
- **Completeness** and **Cutoff** are typically the most significant, relevant assertions for A/P and expenses.

Significant Account	(Key)Relevant Assertions
Accounts Payable	Completeness, Cutoff, Valuation
Various Expenses	Completeness, Cutoff, Accuracy, Classification

Accounts Payable: Primary Assertions

- ____________: Are all purchases recorded? Unrecorded A/P understates liabilities and overstates income.
- ______: Are liabilities recorded in the correct period? Goods received before period end must be recorded as A/P even if the invoice has not arrived.
- _________: Is A/P recorded at the correct amount? Total cost must include all components — purchase price, freight, _____, and _____.

Other A/P Risks

- **Existence**: Fictitious vendors or A/P already paid but not removed.
- **Duplicate payments**: Same invoice paid twice.
- **Unauthorized items**: Personal expenses routed through A/P.
- Weak **separation of duties** increases embezzlement risk — person approving invoices should not control payments.

Expenses: Primary Assertions

- ____________: Are all expenses recorded? Unrecorded expenses understate costs and overstate income.
- ______: Are expenses recorded in the correct period? Expenses incurred before period end must be accrued even if not yet invoiced.
- ________: Are expenses recorded at the correct amount? Amounts must agree to invoices or work orders.

Note

- Same direction of risk as A/P — management has incentive to __________ expense recognition to improve reported results.

Expenses: Other Assertions

- ____________: Is the expense recorded in the right account?
- Misclassification can distort ____________ even when net income is unchanged — e.g., shifting an operating expense to capex boosts EBITDA without affecting the bottom line.
- For example, WorldCom improperly capitalized expenses to boost EBITDA.[2]

[2] Capitalizing expenses as assets
$\rightarrow$ 1) overstating A, EBITDA, NI, RE; 2) understating E.

Practice Questions

1. For accounts payable, which assertion is typically the most significant risk in the acquisition and expenditure cycle? _
   - **A)** Completeness
   - **B)** Existence
   - **C)** Presentation
   - **D)** Valuation

2. [T/F] Misclassifying an operating expense as a capital expenditure does not change net income and therefore is not an audit concern. _

3. [T/F] The cutoff assertion for accounts payable requires that liabilities be recorded in the period when goods are received, even if the vendor invoice has not yet arrived. _

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Risk of Material Misstatement

LO 8-3

Discuss the risk of material misstatement in the acquisition and expenditure cycle.

WCGW Framework: Five Primary Concerns

What Could Go Wrong (WCGW) in the expenditure and acquisition cycle:

1. **Completeness**: Have __ liabilities and expenses/assets been recorded?
2. **Cutoff**: Recorded in the ______ period?
3. **Occurrence/Obligation**: Do liabilities reflect ______ obligations?
4. **Valuation**: Recorded at the proper _______?
5. **Classification**: Recorded in the proper _______?

WCGW Table: Accounts Payable

Assertion	What Could Go Wrong?
Completeness	Liabilities are ___ recorded.
Cutoff	Liabilities recorded in the ________ period.
Existence	Liabilities may ___ represent actual obligations.
Presentation	Liabilities ___ properly disclosed.
Valuation	Liabilities recorded at an ________ amount.

WCGW Table: Expenses

Assertion	What Could Go Wrong?
Completeness	______ expenses are recorded.
Cutoff	Expenses recorded in the incorrect _____.
Accuracy	Expenses recorded at an incorrect ______.
Classification	Expenses improperly recorded in the _____ account.[3]

[3] Classification errors can distort EBITDA and core earnings metrics used by investors without affecting net income.

Key Risk: Unrecorded Liabilities

- A/P is not recorded until the **three-way match** is completed.[4]
- When documents fail to match, recording may be delayed or omitted — __________ expenses and __________ profits.
- MGT may intentionally ____ expense recording beyond the purchase period to ______ reported results.
- **Noncancelable purchase commitments**: if market forces cause a permanent decline in value of ordered goods, _____ must be recognized immediately — even before goods are received.

> Auditor Alert
>
> - Search for **unrecorded liabilities**: inspect receiving reports near period end, review subsequent cash disbursements, and confirm with vendors.

[4] PO + invoice + receiving report

Practice Questions

1. A company receives goods on December 30 but does not record the liability until January 5 when the invoice arrives. This failure most directly relates to which assertion? _
   - **A)** Existence
   - **B)** Cutoff
   - **C)** Valuation
   - **D)** Classification

2. [T/F] Under the WCGW framework, the completeness assertion for A/P addresses the risk that liabilities are recorded in the wrong period. _

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Internal Control Activities

LO 8-4

Identify important internal control activities present in a properly designed system to mitigate the risk of material misstatements for each relevant assertion in the acquisition and expenditure cycle.

Internal Controls: Overview

- Control activities govern the **nature, timing, and extent** of substantive procedures the auditor will apply.
- Affected accounts beyond A/P and expenses include:
  - prepaid expenses
  - fixed assets
  - inventory
  - accrued liabilities
  - supplies
- Four categories of internal control in the expenditure cycle:
  1. **Authorization controls**
  2. **Separation of duties**
  3. **Detailed checking activities** (three-way match)
  4. **Periodic reconciliations**

Authorization Controls

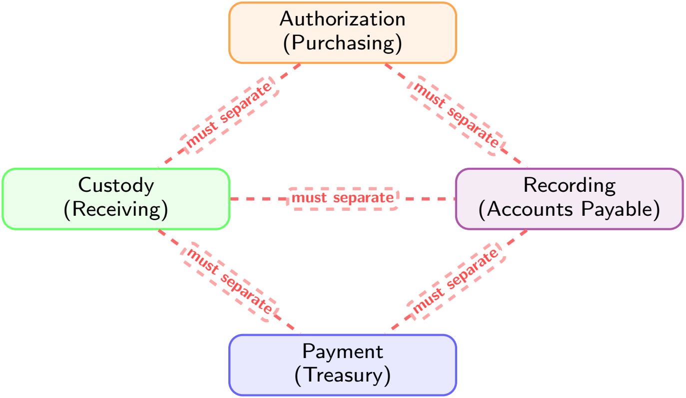
Proper Authorization for Purchases

- ________ **vendor list**: Only authorized vendors may receive purchase orders; requires multi-department approval to add new vendors.
- **Sealed competitive** ____: Required for purchases above a dollar threshold ($\geq$3 bids); bids opened at a publicly announced time.
- **Authorized personnel**: Purchase requisitions and POs may only be initiated by personnel with appropriate ________ limits.
- **Master file access**: Vendor master file changes ________ to authorized persons only.

Red Flag

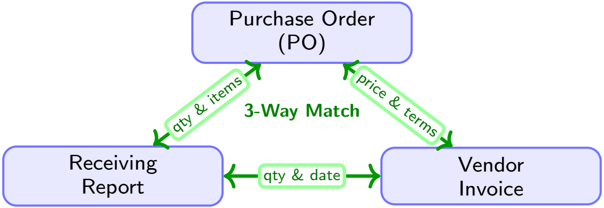
- A single person who can add vendors AND approve purchases creates the opportunity for ________ and shell company fraud.

Separation of Duties



Combining any two functions opens the door for undetected fraud — e.g., someone who both **authorizes** purchases and **records** them can conceal fictitious transactions.

The Three-Way Match



Mismatches signal a control breakdown: wrong price, ________ items, or _________ receipt.

- System generates ________ reports: unmatched receiving reports (potential unrecorded liabilities) and unmatched invoices (potential fictitious billing).

Internal Controls: A/P and Expenses[5]

Sig. Acc.	Assertion	Key Control Activity
A/P	Completeness	___________ receiving reports; sequence checked
	Cutoff	Payables in first weeks matched to period-___ receiving reports
	Existence	___________; vendor on approved vendor list
	Valuation	Prices agreed to approved price list; invoice math verified
Expenses	Completeness	___________ vouchers, POs, checks; sequence verified
	Cutoff	Actual expenses compared to budgeted amounts
	Accuracy	Matched to vendor invoices or work orders
	Classification	Reviewed to confirm recorded in proper _______

[5] Based on Louwers Exhibit 8.5.

Custody and Periodic Reconciliations

Custody Controls

- Physical assets locked; signature required upon receipt
- Blank documents (POs, checks) must be secured
- Restricted access to vendor master file

Periodic Reconciliations

- A/P trial balance $\leftrightarrow$ A/P control account
- A/P records $\leftrightarrow$ vendors' monthly statements
- Unmatched POs, RRs, and invoices reviewed
- Physical inventory $\leftrightarrow$ inventory records
- Fixed asset physical count $\leftrightarrow$ asset records

Practice Questions

1. The three-way match control requires agreement among which three documents? __
   - **A)** Requisition, purchase order, and check
   - **B)** Purchase order, vendor invoice, and receiving report
   - **C)** Receiving report, check, and voucher
   - **D)** Approved vendor list, purchase order, and check

2. [T/F] A blind purchase order strengthens control over receiving by requiring the receiving department to independently count goods rather than relying on the quantity shown in the PO. __

3. [T/F] Prenumbering purchase orders helps primarily with the valuation assertion for accounts payable. __

4. [T/F] Periodic comparison of accounts payable records to vendors' monthly statements is an example of a reconciliation control. __

Summary

- **Cycle**: Four steps — purchasing, receiving, recording, and payment (Ch6).
- **Key accounts**: A/P (completeness, cutoff, valuation) and Expenses (completeness, cutoff, accuracy, classification).
- **Top risk**: Unrecorded liabilities; classification errors that distort core earnings.
- **Key controls**: Approved vendor list, blind POs, three-way match, separation of duties, and periodic reconciliations.