

RATIO CHANGES

Audit engagement partners were comparing notes about changes in clients' financial statement ratios or amounts from the prior years figures. Here is what the partners had discovered.

Client 1. Inventory turnover increased substantially from the prior year. (Select three explanations.)

Client 2. Accounts receivable turnover decreased substantially from the prior year. (Select three explanations.)

Client 3. Allowance for doubtful accounts increased in dollars from the prior year but decreased from the prior year as a percentage of accounts receivable. (Select three explanations.)

Client 4. Long- term debt increased from the prior year, but interest expense increased more than the percentage increase in long- term debt. (Select one explanation.)

Client 5. Operating income increased from the prior year although the company was less profitable than in the prior year. (Select two explanations.)

Client 6. Gross margin percentage was unchanged from the prior year although gross margin increased from the prior year. (Select one explanation.)

Required: Select from the following list the most likely explanation(s) for each audit client.

- A. Items shipped on consignment during the last month of the year were recorded as sales.
- B. A significant number of credit memos for returned merchandise issued during the last month of the year were not recorded.
- C. Year-end inventory purchases were overstated because items received in the first month of the subsequent year were incorrectly included.
- D. Year- end inventory purchases were understated because items received before year- end were incorrectly excluded.
- E. A larger percentage of sales occurred during the last month of the year compared to the prior year.
- F. A smaller percentage of sales occurred during the last month of the year compared to the prior year.
- G. The same percentage of sales occurred during the last month of the year compared to the prior year.
- H. Sales increased at the same percentage as cost of goods sold compared to the prior year.
- I. Sales increased at a lower percentage than cost of goods sold increased compared to the prior year.
- J. Sales increased at a higher percentage than cost of goods sold increased compared to the prior year.
- K. Interest expense decreased compared to the prior year.
- L. The effective income tax rate increased compared to the prior year. m. The effective income tax rate decreased compared to the prior year.
- M. Short- term borrowing was refinanced on a long- term basis at the same interest rate.
- N. Short- term borrowing was refinanced on a long- term basis at lower interest rates.
- O. Short- term borrowing was refinanced on a long- term basis at higher interest rates.