Accounting & Taxation
Vol. 11, No. 1, 2019, pp. 59-70
ISSN: 1944-592X (print)
ISSN: 2157-0175 (online)

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www.theIBFR.com

AN INTERNAL CONTROL EVALUATION TOOL FOR PROPERTY EXPENDITURES

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ABSTRACT

This paper presents a previously unpublished tool for conducting the initial assessment of internal control objectives and activities for the expenditures cycle of companies with income-producing properties. Variations of this tool are used by Certified Public Accounting firms in their independent audits of such companies. We discuss the tool's potential usefulness to both independent auditors and executives of such companies, as well as the tool's place within the existing literature on internal control. How the quality of the tool could be assessed is also discussed.

JEL: M42, M41, M10

KEYWORDS: Internal Control, Expenditures, Income Producing Properties

INTRODUCTION

This paper offers a tool that is potentially useful to internal and external/independent auditors and the managers of companies with income-producing properties (i.e., income-producing real estate) to help determine whether important internal control activities for expenditures are in place.The income producing property industry is dominated by the REITs (Real Estate Investment Trusts). This sector of the industry accounts for assets of over $650 billion in the United States. Of the approximately 1,000 companies in this sector, about 170 are publicly traded (First Research, 2013).A strong system of internal control is important to independent auditors as well as their auditees. U.S. Generally Accepted Auditing Standards (GAAS) require independent auditors to assess the strength of all of their audit clients' systems of internal control, and to test any controls that the auditor intends to rely upon. Generally speaking, the stronger the client's system of internal control, the less time the overall audit will take, and the less costly the audit will be to the client. In extreme cases, if the client's internal controls are especially weak, the auditor might not be able to render an opinion on the client's financial statements. Publicly traded companies have additional requirements for maintaining a strong system of internal controls. U.S. GAAS requires auditors of public companies to conduct an integrated audit of both the client's internal control over financial reporting, as well as its financial statements, conducted in accordance with PCAOB Auditing Standard No. 5 (AS 5) (PCAOB, 2007).

Internal control is important to the executives and managers of publicly traded companies for several reasons. First, as mentioned above, in extreme cases, if internal controls are weak enough, the auditor might not be able to issue an opinion on the client's financial statements. This would be an adverse outcome for any client, since the client would not receive a required report (e.g., in order to obtain financing). For a publicly traded company, such an outcome could result in the Securities and Exchange Commission (SEC) either suspending trading of the company's stock, or delisting the company's stock altogether. That's because an SEC-mandated annual filing of a public company's financial statements that are not accompanied by an unmodified ("clean") audit opinion is considered by the SEC to be a

deficient filing. In addition, the Sarbanes-Oxley Act of 2002 (SOX) (U.S. House of Representatives 2002), Section 404, requires the management of publicly traded companies to assess and report on the operating effectiveness and design of their company's internal control system on an annual basis. Independent auditors are required to issue an adverse opinion on the client's internal control over financial reporting if the auditors find a material internal control weakness. As discussed below, the presence and possible disclosure of internal control weaknesses has adverse implications to investors and other stakeholders. For example, Cheng, Goh and Kim (2018) find that operational efficiency is lower for companies with material internal control weaknesses than for companies without such weaknesses. Finally, the cost to public companies of compliance with SOX Section 404 is considerable. Krishnan et al. (2008) estimate that the mean total initial cost to companies of complying with Section 404 of SOX is $2.2 million (estimated median total initial compliance cost is $1.2 million).

Internal control over the expenditures cycle is especially important to both auditors and managers, because frauds related to the expenditure process remain among the most common frauds that occur in practice (Verver 2013). Internal control and internal control related variables are used in many empirical studies that focus on internal controls in general rather than on internal control over a specific process or in a particular industry. Such studies are essential to understanding how internal control interacts with other variables in the business environment. Auditors and executives of companies, on the other hand, have a pressing need to know whether that company's internal controls accomplish what they need to accomplish. Auditing textbooks provide guidance with respect to internal control in general, and with respect to specific cycles, such as the expenditures cycle. Auditors could benefit from authoritative and reasonably comprehensive guidance about specific internal control objectives and control activities for specific industries, but this kind of specific guidance is not always available.

This paper provides a tool that can be used by internal and external auditors as well as managers of companies with income producing properties to help make an initial assessment as to whether important internal control activities are in place, and whether important internal control objectives are being met for the expenditures cycle. The authors are unaware of any other publicly available tool of this kind. The remainder of this paper is organized as follows. First, we review the literature on internal control, both in general, and also specific to the expenditures cycle for companies with income-producing properties. Second, our methodology is described. Third, the expenditure process internal control evaluation tool is presented. Fourth, we describe how one might go about assessing the usefulness of the tool. Finally, concluding comments are provided.

LITERATURE REVIEW

Internal control and internal control related variables are used in many recent empirical studies that do not focus on internal control over the expenditures process, or on companies with income-producing properties. For example, Kravet et al. (2018) investigate managers' decisions to, on a temporary basis, exempt newly acquired businesses from the requirements of Section 404 of the Sarbanes-Oxley Act. Section 404 requires public companies to include in their filings with the SEC a report which contains management's assessment of the effectiveness of internal control over financial reporting. Kravet et al. (2018) provide evidence as to the merits of such internal control audits. The authors find that managers are more likely to choose the exemption when they expect compliance costs to be higher. They find moderately strong evidence of managers using the exemption in order to avoid inquiries into value-reducing deals. However, they find that exemption use is associated with several unfavorable post-acquisition outcomes. These outcomes include lower return on assets, and higher probabilities of restated financial statements and goodwill impairments. The authors find evidence consistent with non-exemption helping to promptly identify and correct control problems in the acquired business, and with investors having a generally negative view of exemption use.

Basu et al. (2018) investigate why some firms undergoing initial public offerings (IPOs) choose to disclose their internal control weaknesses (ICWs), as well as corrective progress, in their prospectuses prior to the IPO, despite being exempt at the time of the IPO from having to do so under the requirements of SOX Sections 404 and 302. They also investigate the association between such disclosures and IPO underpricing. Findings show that IPO firms that choose to disclose both ICWs and corrective progress have higher risks associated with possible litigation. The authors also find that IPO firms choosing to make such disclosures are more likely to be audited by auditors with industry specialization, and they have a higher likelihood of having audit committees before the IPO, compared with firms that do not choose to disclose such information. They find lower IPO underpricing for firms that disclose ICWs and corrective progress. Results are consistent with the disclosure of ICWs and corrective progress reducing information asymmetry between uninformed and informed investors.

Tan and Yu (2018) investigate in an experimental setting the effects of both the extent to which management accepts responsibility for internal control weaknesses, and the source of the internal control breach (internal or external) on investor reactions to reports on internal control associated with SOX Section 404. The authors' predictions are based on the triangle model of responsibility (Schlenker, Britt, Pennington, Murphy, and Doherty 1994), which predicts that the extent to which investors hold management responsible for a regrettable event is determined by the links between three factors: management, the regrettable event, and applicable accounting standards/regulations or the public's expectations. Their experiment studies how the source of the breach (internal vs. external) lessens the effectiveness of management's acceptance of responsibility for the breach (higher vs. lower). Their results show that a greater (vs. lesser) acceptance of responsibility on the part of management is a more effective strategy in the case of an "external" breach, but not in the case of an "internal" breach. Additional experiments suggest that this result is caused by the strength of the triangle links related to the internal vs. external breaches, rather than by the source of the breaches per se.

Cheng, Goh and Kim (2018) investigate whether internal control over financial reporting has an effect on the company's operational efficiency. Their results show that operational efficiency is significantly lower for companies with material weaknesses in internal control, as compared with companies without such weaknesses. They also show that the correction of material weaknesses leads to an increase in operational efficiency. Additionally, results show that the adverse effect of material weaknesses on operational efficiency is greater for companies that have a stronger demand for higher quality information for decision making, for more severe weaknesses, and to some extent, for smaller companies. Bauer, Henderson & Lynch (2018) examine whether the quality of a supplier's internal control is associated with the duration of supplier-customer relationships. Internal controls affect the quality of information, so they affect whether partners in a supply chain can rely on the information sharing systems needed in order for the partners to reliably contract with each other. The authors use SOX-related disclosures of ICWs as a proxy for poor internal control quality, and use U.S. GAAP-mandated disclosures of major customers to identify customer-supplier pairs. The authors find that poor internal control quality increases the probability of later termination of the supplier-customer relationship. They also find that timely correction of control weaknesses lowers the likelihood of relationship termination. Finally, they find that the effect of internal control quality on relationship termination is driven by control weaknesses affecting customer contracting. Overall results are consistent with customers regarding strong supplier controls as important aspects of contracting that can significantly affect supply chain relationships.

Darrough, Huang & Zur (2018) study whether internal control disclosures required by sections 302 and 404 of SOX have an effect on the corporate control market. The authors hypothesize that acquiring companies with ICWs make less-than-optimal acquisition decisions because of inferior information generated by their poor-quality controls over financial reporting. They predict that acquirers with ICWs will have a greater chance of misestimating the value of the companies they wish to acquire or the possible synergies that could result from mergers. As a result, they predict that such acquirers overpay

for consummated deals. The authors use a treatment group of acquisitions made by companies with disclosed ICWs, and two matched control groups of acquisitions by firms without ICW disclosures. Results show that acquirers with ICWs have a significantly greater negative market reaction to acquisition announcements, and that they have less favorable future performance than the two control groups with no ICW disclosures. They conclude that ineffective internal control over financial reporting interferes with decision making with respect to mergers and acquisitions. There are many high-quality sources of normative information about internal control in general (e.g., Louwers et al. 2018, Ch. 5; Arens et al. 2017, Ch. 11; Whittington & Pany 2014, Chs. 7 & 8), as well as internal control for the expenditures process in general (e.g., Louwers et al. 2018, Ch. 8; Arens et al. 2017, Ch. 18; Whittington & Pany 2014, Ch. 14). Such information is of interest to auditors and accountants, as well as to executives and board members who are responsible for the effectiveness of a company's internal control system. However, we could find no generally available source of information about the specific internal control activities that should be present in the expenditures cycle for a company with income-producing properties.

While the internal control components specified by the COSO (2013) framework should be present in all organizations, the specific internal control activities that should be present in a given organization will depend on the outcome of the organization's risk assessment (e.g., Louwers et al. 2018:183). Since companies with income-producing properties face some common risks that companies in other industries do not face (e.g., damage by tenants to rental properties), it follows that there will be internal control activities appropriate to companies with income-producing properties that will not be as commonly seen in other industries. This is true in general, and for specific cycles such as the expenditures cycle.The American Institute of Certified Public Accountants (AICPA) has published a series of Audit and Accounting Guides, and, in earlier years, AICPA Accounting Guides and AICPA Industry Audit Guides. These guides typically deal with accounting and/or auditing issues of a particular type, and/or in specific industries. For example, there are specific Audit and Accounting guides for airlines (AICPA 2016), state and local governments (AICPA 2018a) and entities in the health care industry (AICPA 2018b). In addition, there is a specific Audit and Accounting Guide for revenue recognition (AICPA 2019), and there are specific Audit Guides covering analytical procedures (AICPA 2017a) and Audit Sampling (AICPA 2017b). However, there is no specific Audit or Accounting guide covering companies with income-producing properties, or an Audit or Accounting guide specifically devoted to expenditures.

Several prior papers have presented internal control checklists for specific industries – both in general, and for specific cycles. For example, Orchard and Butterfield (2009) present an internal control evaluation tool (across various cycles) for the construction industry. Orchard and Butterfield (2011) present an internal control evaluation tool for the revenue cycle in the homebuilding industry. Similarly, Orchard and Hoag (2014) present an internal control evaluation tool for the revenue cycle for manufacturers, while Orchard (2010) does the same for the advertising revenue cycle in the newspaper and magazine publishing industry.

METHODOLOGY

The authors were granted access to industry-specific internal control tools (similar to checklists) used by a large Certified Public Accounting firm in its audits of clients in various industries. This firm agreed to let the authors publish these tools as part of their research, on the condition that the name of the firm as well as other identifying information remain confidential. This CPA firm modifies these tools in order to fit the circumstances of specific audit engagements and specific clients. In other words, these tools serve as a foundation for the firm in writing a list of specific controls that ought to be present for a specific client in a specific industry. We have modified the format of material provided by the CPA firm in order to provide clarity for the reader. Specifically, the material provided by the CPA firm is an Excel spreadsheet, with specific internal control activities listed in the left column, and the internal control objectives listed on the top row. In the firm's materials, the cell at the intersection of a given row and

column is either blank, or contains either the word "partial," or the word "full" (see below). Most of the cells are empty, indicating that that particular control activity does not help achieve that particular control objective. Our tables only present information for the combinations of rows and columns for which the given control activity, if functioning as intended, either partially or fully achieves the given control objective.

The Expenditures Process Internal Control Evaluation Tool

In May 2013, COSO issued a revision version of its original (1992) internal control framework. The COSO (2013) framework's definition of internal control is "a process…designed to provide reasonable assurance regarding the achievement of objectives related to operations, reporting, and compliance." Specifically, these objectives relate to the efficiency and effectiveness of operations (including the safeguarding of assets against loss), internal and external financial and nonfinancial reporting, and compliance with regulations and laws that apply to the entity (COSO, 2013). According to COSO's (2013) framework, internal control consists of the following five integrated components: (a) Risk Assessment; (b) the Control Environment; (c) Information and Communication; (d) Control Activities, and (e) Monitoring. The tool presented below fits within the "Risk Assessment" and "Control Activities" components of COSO's framework, and should be helpful to both independent auditors and managers of income-producing properties who are interested in assessing important control risks and in identifying key control activities that might provide benefits that exceed their costs to the entity (Orchard and Hoag, 2014). The evaluation tool is presented in Tables 1 and 2.

Because the laws and regulations that apply to entities vary from one entity to another, and from one legal jurisdiction to another, the evaluation tool relates primarily to COSO's (2013) control objectives dealing with the reliability of reporting and the efficiency and effectiveness of operations rather than with legal or regulatory compliance (Orchard and Hoag, 2014). Table 1 provides a listing of suggested control activities for the expenditure process, while Table 2 provides a listing of significant control objectives for that process. Most control objectives in Table 2 are accompanied by several two- or three-character alphanumeric codes, each of which corresponds to a control activity shown in Table 1. The number part of each code in Table 2 corresponds to a particular control activity (shown in Table 1 in numerical order). The letter part of each code in Table 2 ("P" or "F") denotes whether the control activity that is referred to (assuming it is operating in an effective manner) "partially" or "fully" satisfies the related internal control objective. Independent auditors might wish to consider whether a company's omission of a critical internal control activity increases audit risk.

Table 1: Suggested Control Activities

Ref.	Control Activity
1	A responsible party reconciles expenditures and related accounts in the general ledger to the supporting detail (for example, depreciation expenditures to the property system, and salaries expenditures to payroll records) and resolves differences in a timely manner. Management, independent employees, or internal auditors perform direct tests (other than via analytical review) of the recording and reconciliation of these expenditures and related accounts.
2	Actual expenditures are assessed relative to the budget at regular intervals; management examines and signs off on significant variances.
3	Management approval is necessary for all purchase orders. Higher level management approval is necessary for unusual purchases (for example, capital expenditures or standing orders) and for all purchases in excess of established limits. The Board of Directors must approve certain stipulated types of purchases, and this approval must be documented in an appropriate manner.
4	Purchase orders are prenumbered sequentially. A responsible person accounts for the sequence of purchase orders processed.
5	Management reviews and approves purchase orders prior to mailing to the supplier.
6	Management reviews reports detailing overrides of established purchase order prices, terms, and conditions and approves these overrides.
7	Purchase orders are batched. Input that is batched is balanced. Batches that are out-of-balance are promptly corrected.
8	Management reviews documentation supporting a payment before approving the payment. Supporting documentation is canceled promptly after payment has been made.
9	Credit notes, invoices and other adjustments associated with accounts payable are validated and edited; identified errors are promptly corrected.
10	Purchase order data are validated (and edited); identified errors are promptly corrected.
11	Transactions that affect accounts payable (such as invoices and credit notes) are put in batches, and batched data to be entered are balanced. Batches that are not in balance are promptly balanced.
12	Goods received are matched manually or on-line with invoices and/or purchase order details. Long-outstanding receiving reports, invoices and/or purchase orders are investigated in a timely manner and, if appropriate, accrued. Documents are canceled promptly when matched, or when the invoice is paid in order to prevent reuse.
13	Disbursements (especially those near the end of an accounting period) are examined in order to ensure that they are completely and consistently recorded in the appropriate accounting period.
14	Statements sent from suppliers are regularly reconciled to the applicable accounts in the accounts payable subsidiary ledger; discrepancies are scrutinized.
15	Invoices not matched to receiving reports (or other appropriate supporting documentation in the case of services received) are investigated. Payments on unmatched invoices require specific management approval.
16	Management reviews recorded purchases (receipts of goods) based on its knowledge of day-to-day activity.
17	Goods receipt vouchers (proof-of-delivery documentation) are prenumbered; the sequence of such vouchers is accounted for.
18	Data that are conveyed from the purchase order entry subsystem to the receiving and/or accounts payable system are reconciled between systems; all errors identified are corrected promptly.
19	Data on goods received are batched. Batched data to be entered are balanced. Batches that are not in balance are promptly balanced.
20	Managers review an aged accounts payable analysis and investigates any unusual items.
21	A list is prepared at the conclusion of the accounting period of outstanding purchase orders for which ownership of the goods changes prior to (rather than at the time of) delivery. This is done to help ensure that such transactions get recorded in the proper accounting period. Management reviews this list.
22	Notes related to returned goods are matched to credit notices; differences are promptly investigated.
23	Goods returned notes are prenumbered sequentially. The sequence of goods returned notes is accounted for and long outstanding unmatched goods returned notes are reviewed and investigated.
24	Credit notes and supplier invoices received (particularly near the conclusion of a fiscal period) are carefully examined and/or reconciled to make sure that they are completely and consistently recorded in the appropriate accounting period.
25	Goods received (particularly near the conclusion of a fiscal period) are carefully examined and/or reconciled to make sure that they are completely and consistently recorded in the appropriate accounting period.
26	Goods returned (particularly those returned near the conclusion of a fiscal period) are carefully examined and/or reconciled in order to make sure that return transactions are recorded in a consistent and complete manner in the proper accounting period.
27	Suppliers that the entity has not purchased from for a long enough period of time are examined and, if appropriate, flagged for deletion by the software.
28	Changes that have been made to the supplier master file are compared to approved source documents to make sure they were recorded accurately.
29	Management reviews a list of payments to be made to suppliers prior to payment.
30	Checks are prenumbered sequentially, and a responsible person accounts for the sequence of checks processed. Spoiled checks are voided to prevent reuse and filed for later inspection.
31	Individuals who make electronic funds transfers are authorized to do so by management.
32	A purchase requisition authorization list is maintained, which specifies the maximum amounts for which individuals are authorized to approve purchase requisitions.
33	Someone independent of the purchase order entry process compares purchase order entry data to source documents.
34	Management monitors statistics on deliveries of goods that are rejected due to missing or nonmatching purchase orders. Management should identify the reason for the rejection and process adjustments where necessary.
35	Purchase requisitioning, purchasing, and accounts payable functions are carried out by an integrated application system. The general ledger is updated automatically for transactions in which goods are received or disbursements made.
36	Management reviews and approves credit notes and adjustments prior to posting to accounts payable.
37	The purchases and accounts payable system will not allow users to make adjustments to supplier accounts in excess of original order amounts or approved limits.

38	Significant changes to the supplier master file are not made without the approval of management.
39	A log is kept of all requests to change data in the supplier master file. A responsible party reviews the log to make sure that all changes requested are made in a timely fashion.
40	Management periodically reviews supplier master file data for ongoing relevance as well as accuracy.
41	Requests that data in the supplier master file be changed are presented on prenumbered forms. A responsible party accounts for the numerical sequence of these forms in order to make sure that all changes requested are made in a timely fashion.
42	Data in the supplier master file are validated and, if necessary, edited. Identified errors are promptly corrected.
43	Electronic queues are used by management to approve credit notes and adjustments; access to the queues is requested by logical security.
44	Access to unissued purchase requisitions and purchase orders is limited to authorized personnel only.
45	Management reviews for propriety all recorded nonsystematic debits to accounts payable (e.g., those originating from sources other than a disbursements journal).
46	Check preparers restrictively endorse the checks to make sure that the funds are paid to the named payee.
47	Management periodically reviews returned paid checks for unauthorized signatures, alterations, and/or endorsements.
48	Batch input data for payments are balanced, and discovered errors are promptly corrected.
49	Criteria for selecting suppliers are specified and disseminated by management to make sure that goods and services are only procured from appropriately approved vendors.
50	Criteria for making purchases are specified and disseminated by management to make sure that goods and services purchased are appropriately authorized.
51	Invoices for services received are official and transmitted with appropriate supporting documentation.
52	A responsible party edits and validates disbursement input data. Any errors identified are corrected promptly.
53	The entity's software restricts to authorized personnel the capability of creating, changing, or cancelling purchase orders or outline agreements (standing purchase orders).
54	The functionality of the software's approved vendor list will only allow specific materials to be purchased from suppliers included in the vendor list for the specific material.
55	The entity's software limits the ability to change, create or vendor master records to authorized personnel.
56	The software is used to authorize outline agreements (that is, standing purchase orders), purchase orders, and unusual purchases (e.g., capital expenditures).
57	The exchange rate table is centrally maintained. Values in the exchange rate table are approved by management. The entity's software restricts to authorized personnel the capability of modifying this table.
58	The entity's software limits to authorized individuals the ability to input, change, or cancel transactions that would result in goods being received.
59	The entity's software edits and validates financial documents on-line.
60	The entity's software limits to authorized individuals the ability to delete, change, or create vendor pricing information.
61	The entity's software validates and edits payment transactions online.
62	The entity's software automatically computes any foreign currency translation amounts based on amounts in the table of exchange rates, which is centrally maintained.
63	The entity's software restricts to authorized personnel the capability for inputting, changing, cancelling, or releasing vendor invoices for payment.
64	The entity's software edits and validates purchase orders, contracts, and outline agreements (that is, standing purchase orders) on-line.
65	The entity's software automatically matches vendor invoice transactions to receipts of goods and purchase orders. It then posts the invoices to the appropriate vendor account in Accounts Payable and to the Accounts Payable control account in the general ledger. Alternatively, the software can automatically generate and post vendor invoices once the receiving report is posted.
66	The software's payment run parameter specification is approved by management; the software restricts to approved personnel the capability of modifying the payment run parameter specification or initiating a payment run.
67	Reports generated by the entity's software of changes to vendor master records are compared to a manual log of requested changes and/or authorized source documents to make sure that all valid changes were entered correctly and in a timely manner.
68	The entity's software restricts to authorized individuals the capability to enter vendor invoices that don't have a receiving report and/or a purchase order as support.
69	The entity's software restricts to approved personnel the capability of releasing invoices for payment that have been blocked from being paid, either for a specified vendor or for an individual invoice.
70	The entity's software limits to authorized individuals the ability to change, create, or cancel purchase requisitions.
71	The entity's software edits and validates purchase requisitions on-line.
72	A responsible party regularly reviews the software's reported information about gaps in the sequence of numbered documents.
73	Bank statements are reconciled to the cash account in the general ledger regularly.
74	The entity's software limits to authorized individuals the capability of deleting, changing, or creating contracts, delivery schedules and sales orders.
75	The entity's software validates and edits order entry transactions online.

This table presents a list of suggested control activities for the expenditure process in companies with income-producing properties. Each activity in Table 1 either partially or fully satisfies one or more of the control objectives in Table 2 below. Please see Table 2, and the description beneath Table 2 (or the text), to see which control activities partially or fully satisfy a given control objective.

Table 2: Control Objectives & Suggested Control Activities

Control Objectives	Control Activities
Purchase orders are placed only for accepted requisitions.	3F, 5F, 6P, 32P, 35P, 44P, 49P, 50P, 53P, 54P, 56P, 69F
Purchase orders are entered accurately.	7P, 10P, 33F, 34P, 58P, 63P
All issued purchase orders issued are entered and processed.	4F, 7P, 34P, 35F, 70P
Amounts credited to accounts payable are for goods received.	1P, 2P, 12F, 15F, 16F, 67P
Amounts credited to accounts payable are for services received.	1P, 2P, 51F, 67P
Amounts related to accounts payable are recorded and correctly calculated.	1P, 2P, 9P, 14F, 16F, 18P, 19P, 35P, 57P, 58P, 61P,
All dollar amounts related to goods received are processed and input to accounts payable.	2P, 11P, 12F, 14F, 16F, 17F, 18P, 19P, 35P, 71P
All amounts billed to the company for services received are processed and input to accounts payable.	2P, 11P, 14F, 18P, 35P, 71P
All amounts billed to the company for services or goods received are journalized in the proper accounting period.	1P, 12F, 14F, 21P, 24F, 25F, 72P
Accounts payable amounts are only adjusted for legitimate cause.	14F, 36F, 37P, 43F, 45F, 55P, 59F, 62P, 67P
Adjustments to accounts payable (such as credit notes) are accurately calculated and then recorded.	9P, 11P, 14F, 37P, 57P, 58P
All legitimate adjustments to accounts payable (for example, for credit notes) are input and processed.	11P, 14F, 22P, 23P, 35P, 71F
Adjustments to accounts payable (such as for credit notes) are journalized in the correct accounting period.	14F, 21P, 24F, 26F
Assets and liabilities reflect the existing economic conditions and business circumstances in agreement with the accounting policies being used.	None
Financial information is not presented in a misleading way, and all facts needed for fair presentation as well as consistency with applicable standards (e.g. GAAP) or legal mandates are disclosed.	None
Disbursements are only made for services and goods received.	2P, 8F, 29F, 31P, 47P, 64P, 65P, 68P
Disbursements are sent to the proper suppliers.	8P, 29P, 46F, 47P, 64P
Disbursements are correctly recorded and calculated.	2P, 8F, 11P, 14F, 48P, 52P, 58P, 60F, 65P, 72P, 73P
All disbursements are recorded.	14F, 20P, 30F, 64P, 71P, 72F, 74F
Disbursements are journalized in the accounting period in which payment is released.	13F, 72F
Only legitimate modifications are made to the data in the supplier master file.	28F, 38P, 40P, 55P, 58P, 59F
All legitimate modifications to data in the supplier master file are entered and processed.	39F, 40P, 41F, 66P, 71P
Changes made to the supplier master file are accurate.	28F, 40P, 42P, 58P, 66F
Changes made to data in the supplier master file are made in a timely fashion.	39F, 40P, 41F, 66F
Supplier master file data remains pertinent.	27P, 40P, 66P

This table presents a list of significant internal control objectives for the expenditures process for companies with income-producing properties. For most of these control objectives, the table lists (in the Control Activities column) several alphanumeric codes. Each code corresponds to a control activity shown in Table 1. The number part of each code in Table 2 corresponds to a particular control activity (shown in Table 1 in numerical order). The letter part of each code in Table 2 ("P" or "F") denotes whether the control activity referred to (assuming it is operating in an effective manner) "partially" or "fully" satisfies the related internal control objective.

ASSESSMENT

This tool is being used by the large CPA firm that granted the authors access to their materials. Positive Accounting Theory (Watts & Zimmerman 1986) seeks to predict and explain accounting methods that are actually in use, assuming for the most part that current accounting choices are rational, if not optimal. From the perspective of Positive Accounting Theory, then, the use of this tool by the large CPA firm is evidence of its usefulness to the auditing profession. Another method of assessing the tool's usefulness could be to compare the controls in the tool with controls generally prescribed for the expenditures cycle by auditing textbooks. We infer usefulness since the controls in the tool are consistent with the controls prescribed by auditing textbooks, but with increased specificity to companies with income-producing properties. The tools' internal control activities seem to partially or fully achieve the intended control objectives for income producing properties.

CONCLUDING COMMENTS

This paper offers an instrument useful for evaluating internal control over the expenditure cycle of companies which manage income-producing properties. By providing a benchmark for comparative purposes, this instrument is potentially useful to both independent auditors who are carrying out a preliminary evaluation of internal, and to business managers with possible concerns about the effectiveness of their company's internal control system. The expenditure process internal control evaluation tool provides a framework for auditors and managers of income-producing properties in assessing control risks and identifying key control activities. The authors were granted access to industry-specific internal control tools used by a large CPA firm in its audits of clients in various industries, and given permission to publish these tools as part of the authors' research, on the condition that the name of the firm and other identifying information remain confidential. This evaluation tool can be useful to auditors of companies with income-producing properties, as well as to controllers or CFOs of companies with income-producing properties who might not be completely satisfied with the effectiveness of their internal control over the expenditures process. The dynamic nature of the business environment and the necessary periodic monitoring of the system of internal control to ensure proper performance (COSO, 2013) contribute to the usefulness of this evaluation tool.

Several limitations should be noted. This internal control evaluation tool is not intended to be a comprehensive guide to internal control over the expenditure process for companies with income-producing properties. Although the tool emphasizes control objectives concerned with the reliability of financial reporting and the efficiency and effectiveness of operations, it does not emphasize controls that might be deemed necessary by independent auditors conducting audits of compliance with government regulations. The tool does not emphasize controls for "Yellow Book" audits subject to Generally Accepted Government Auditing Standards that might apply due to client contracts with governmental agencies such as the U.S. Department of Housing and Urban Development. As noted previously, the tool focuses on the risk assessment and control activities components of internal control and does not emphasize the auditor's assessment of the client's control environment, information and communication, and monitoring components of internal control. The tool is intended for auditors seeking to conduct their audits in accordance with U.S. GAAS, and will only apply in other jurisdictions to the extent that applicable U.S. auditing standards apply in those jurisdictions. Future research in this area relating to controlling risk and identifying key control activities include examining governmental and non-profit organizations, particularly areas where risk and controls differ due to the non-profit orientation of these types of entities. Publication of other internal control tools of this type actually used by auditors when auditing specific cycles in specific industries would add to our common knowledge of how audits are being conducted.

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ACKNOWLEDGEMENTS

The authors thank the managers of a large anonymous Certified Public Accounting firm for permitting the authors to use their firm's internal control documents in the author's research.

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