

DUMPS ARENA

Certified Public Accountant Test: Auditing and Attestation, Business Environment and Concepts, Financial Accounting and Reporting, Regulation

Test Prep CPA-Test

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Topic Break Down

Topic	No. of Questions
Topic 1, Auditing and Attestation	500
Topic 2, Business Environment and Concept	527
Topic 3, Financial Accounting and Reporting	145
Topic 4, Regulation	69
Total	1241

QUESTION NO: 1

At December 31, 20X2, ABC Co. had the following balances in selected asset accounts:

	<u>20X2</u>	<u>Increase over 20X1</u>
Cash	\$ 300	\$100
Accounts receivable, net	1,200	400
Inventory	500	200
Prepaid expenses	100	40
Other assets	400	150
Total assets	<u>\$2,500</u>	<u>\$890</u>

ABC also had current liabilities of \$1,000 at December 31, 20X2, and net credit sales of \$7,200 for the year then ended. What was the average number of days to collect ABC's accounts receivable during 20X2?

- A. 30.4
- B. 40.6
- C. 50.7
- D. 60.8

ANSWER: C**Explanation:**

Choice "c" is correct. The average number of days to collect accounts receivable is calculated by dividing 365 days by the accounts receivable turnover. Accounts receivable turnover is net credit sales divided by the average accounts receivable:

$$\begin{aligned} \text{Average A/R} &= (\text{beginning A/R} + \text{ending A/R}) \div 2 = (\$1,200 + \$800) \div 2 = \$1,000 \\ \text{A/R turnover} &= \$7,200 \div \$1,000 = 7.2 \\ \text{Average number of days in A/R} &= 365 \text{ days} \div 7.2 = 50.7 \text{ days.} \end{aligned}$$

Choice "a" is incorrect. The denominator should be net credit sales (\$7,200) divided by average receivables \$1,000), or 7.2, not 12.

Choice "b" is incorrect. The average receivable balance is \$1,000, not \$800. The right-hand column shows the increase over 20X1, so the 20X1 receivable balance was \$1,200 – \$400, or \$800. Since the 20X2 receivable balance was given as \$1,200, the average receivable balance is \$1,000. Choice "d" is incorrect. Average inventory (\$1,000), not ending inventory (\$1,200), should be used.

QUESTION NO: 2

Investment and property schedules are presented for purposes of additional analysis in an auditor submitted document. The schedules are not required parts of the basic financial statements, but accompany the basic financial statements. When reporting on such additional information, the measurement of materiality is the:

- A. Same as that used in forming an opinion on the basic financial statements taken as a whole.
- B. Lesser of the individual schedule of investments or schedule of property taken by itself.
- C. Greater of the individual schedule of investments or schedule of property taken by itself.
- D. Combined total of both the individual schedules of investments and property taken as a whole.

ANSWER: A**Explanation:**

Choice "a" is correct. When reporting on additional information accompanying the audited financial statements, the measure of materiality would be the same as that used in forming an opinion on the financial statements taken as a whole.

Choices "b", "c", and "d" are incorrect, based on the above explanation.

QUESTION NO: 3

In 19X4, Smith, a divorced person, provided over one half the support for his widowed mother, Ruth, and his son, Clay, both of whom are U.S. citizens. During 19X4, Ruth did not live with Smith. She received \$9,000 in Social Security benefits. Clay, a 25 year-old full-time graduate student, and his wife lived with Smith. Clay had no income but filed a joint return for 19X4, owing an additional \$500 in taxes on his wife's income. How many exemptions was Smith entitled to claim on his 19X4 tax return?

- A. 4
- B. 3
- C. 2
- D. 1

ANSWER: C**Explanation:**

Choice "c" is correct. Smith is entitled to an exemption for himself. He is also entitled to an exemption for his mother Ruth (qualifying relative). Ruth has \$9,000 in Social Security payments during 19X4, but since that is her only income, the Social Security is not taxable, and nontaxable income does not count in calculating whether an exemption can be taken for a dependent. Clay cannot be taken as a dependent because he filed a joint return with his wife. Since the joint return was filed for a purpose other than simply claiming a refund, the joint return prevents Smith from claiming an exemption for Clay. An exemption cannot be taken for Clay's wife because she filed a joint return with Clay. Smith is entitled to two exemptions.

Choice "a" is incorrect. Clay cannot be taken as a dependent because he filed a joint return with his wife. Since the joint return was filed for a purpose other than simply claiming a refund, the joint return prevents Smith from claiming an exemption for Clay. An exemption cannot be taken for Clay's wife because she filed a joint return with Clay.

Choice "b" is incorrect. Clay cannot be taken as a dependent because he filed a joint return with his wife. Since the joint return was filed for a purpose other than simply claiming a refund, the joint return prevents Smith from claiming an exemption for Clay. An exemption cannot be taken for Clay's wife because she filed a joint return with Clay.

Choice "d" is incorrect. Smith is entitled to an exemption for his mother, Ruth. Ruth has \$9,000 in Social Security payments during 19X4, but because that is her only income, the Social Security income is not taxable, and nontaxable income does not count in calculating whether an exemption can be taken for a dependent.

QUESTION NO: 4

The inflation rate measures:

- A. The rate at which nominal GDP increases.
- B. How the price of a particular good changes over time.
- C. How nominal interest rate changes over time.
- D. The rate at which the overall price level increases.

ANSWER: D**Explanation:**

Choice "d" is correct. The inflation rate measures the rate of increase in the overall price level in the economy.

Choice "a" is incorrect. The inflation rate is associated with price level changes not changes in the nominal value of output.

Choice "b" is incorrect. Inflation refers to a sustained increase in the overall price level. Not the price of a particular good.

Choice "c" is incorrect. The inflation rate is associated with price level changes not interest rate changes.

QUESTION NO: 5

Which of the following best describes a CPA's engagement to report on a nonissuer's internal control over financial reporting?

- A. An attestation engagement to examine and report on management's written assertions about the effectiveness of its internal control.
- B. An audit engagement to render an opinion on the entity's internal control.
A prospective engagement to project, for a period of time not to exceed one year, and report on the expected benefits of the entity's internal control.
- C. A consulting engagement to provide constructive advice to the entity on its internal control.

ANSWER: A

Explanation:

Choice "a" is correct. An engagement to report on an entity's internal control is best described as an attestation engagement to examine and report on management's written assertions about the effectiveness of its internal control.

Choice "b" is incorrect. An audit involves expressing (or disclaiming) an opinion on historical financial statements. An engagement to report on internal control is an attestation engagement and not an audit.

Thus, the engagement is covered under the attestation standards rather than GAAS.

Choice "c" is incorrect. A prospective engagement is not appropriate for a report on internal control. In fact, the CPA's report includes an "inherent limitations" paragraph stating that projections of the internal control evaluation to the future are risky, since conditions or the degree of compliance may change.

Choice "d" is incorrect. In a consulting engagement, the practitioner develops findings, conclusions, and recommendations, but does not report on an assertion that is the responsibility of another party. When a CPA reports on an entity's internal control, he or she is in effect reporting on management's assertion.

QUESTION NO: 6

Which of the following is not considered a factor that increases the bargaining power of the customer?

- A. Much information is available to the customer to compare and contrast features of all products on the market.
- B. One group of customers makes up a large volume of the firm's business.
- C. Strategic alliances have been formed with suppliers and other firms.
- D. Several alternate suppliers (sellers) of the product exist.

ANSWER: C**Explanation:**

Choice "c" is correct. When strategic alliances exist between a supplier and other firms that is a situation, which increases the bargaining power of the suppliers.

Choices "a", "b", and "d" are incorrect because they all are factors that increase the bargaining power of the customer, which are:

- Customers make up a large volume of a firm's business.
- There is much information available to customers.
- The buyers have low switching costs.
- There are a high number of alternate suppliers (sellers) of the product.

QUESTION NO: 7

A firm with a higher degree of operating leverage when compared to the industry average implies that the:

- A. Firm has higher variable costs.

- B. Firm's profits are more sensitive to changes in sales volume.
- C. Firm is more profitable.
- D. Firm uses a significant amount of debt financing.

ANSWER: B

Explanation:

Rule: Operating leverage is the presence of fixed costs in operations, which allows a small change in sales to produce a larger relative change in profits.

Choice "b" is correct. A firm with a higher degree of operating leverage when compared to the industry average implies that the firm's profits are more sensitive to changes in sales volume. Choice "a" is incorrect. Higher variable costs imply a lower degree of operating leverage.

Choice "c" is incorrect. Profits will depend upon sales.

Choice "d" is incorrect. A firm using a significant amount of debt financing has a higher degree of "financial leverage."

QUESTION NO: 8

Eugene Entrepreneur developed his waste collections and disposal business from one truck 20 years ago to a fleet of 2,000 trucks serving an entire region today. Gene is looking to retire and knows that he cannot find a suitable buyer for the entire business. Gene has developed a series of short range plans with his senior management group that include generous bonuses, funded in part by deferred repair and maintenance expenses and prior earnings, sales of business segments where possible or transfers of assets to the counties and municipalities that had engaged the waste collection and disposal service.

Gene has frozen all new capital investment. The mission that Eugene Entrepreneur has mapped out for his company can best be described as:

- A. Build.
- B. Hold.
- C. Harvest.
- D. Sunset.

ANSWER: C

Explanation:

Choice "c" is correct. Eugene Entrepreneur has mapped out a harvest mission for his company. As Gene retires and pulls assets and value from the company, he is clearly taking a short-term view toward reaping immediate benefit.

Choice "a" is incorrect. A "build" mission anticipates that the business is positioned to expand markets or market share and is characterized by a long-term view that promotes investment.

Choice "b" is incorrect. A "hold" mission contemplates that the business is trying to hold on to current market share and is characterized by appropriate investment and competitive positioning. Choice "d" is incorrect. The term "sunset" mission is a distracter.

QUESTION NO: 9

Under the uniform capitalization rules applicable to property acquired for resale, which of the following costs should be capitalized with respect to inventory if no exceptions are met?

	<u>Marketing costs</u>	<u>Off-site storage costs</u>
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

- A. Option A
- B. Option B
- C. Option C
- D. Option D

ANSWER: D**Explanation:**

Choice "d" is correct. Under the uniform capitalization rules, purchasers of inventory for resale may deduct their marketing costs but must capitalize their off-site storage costs. Choices "a", "b", and "c" are incorrect. Marketing costs are deductible, but off-site storage must be capitalized.

QUESTION NO: 10

The element of the audit planning process most likely to be agreed upon with the client before implementation of the audit strategy is the determination of the:

- A. Evidence to be gathered to provide a sufficient basis for the auditor's opinion.
- B. Procedures to be undertaken to discover litigation, claims, and assessments.
- C. Pending legal matters to be included in the inquiry of the client's attorney.
- D. Timing of inventory observation procedures to be performed.

ANSWER: D

Explanation:

Choice "d" is correct. In order to observe the physical inventory count, the auditor would have to coordinate schedules with the client. This timing is usually agreed upon before implementation of the audit strategy.

Choice "a" is incorrect. It would not be appropriate for the client to be involved in determining the amount of evidence necessary to provide a basis for an opinion.

Choice "b" is incorrect. It would not be appropriate for the client to be involved in determining the procedures necessary to obtain evidence about litigation, claims and assessments.

Choice "c" is incorrect. Determination of the pending legal matters to be included in a letter to the client's attorney would not generally be made during the planning stage of the audit.

QUESTION NO: 11

For the next 2 years, a lease is estimated to have an operating net cash inflow of \$7,500 per annum, before adjusting for \$5,000 per annum tax basis lease amortization, and a 40% tax rate. The present value of an ordinary annuity of \$1 per year at 10% for 2 years is \$1.74. What is the lease's after-tax present value using a 10% discount factor?

- A. \$2,610
- B. \$4,350
- C. \$9,570
- D. \$11,310

ANSWER: D

Explanation:

Choice "d" is correct. Present value is based on the cash flows of an activity. Amortization is a non-cash expense that is considered only for its tax shield; therefore, the only relevant amounts are the \$7,500 operating net cash inflow and the tax paid.

PV of cash inflow, $\$7,500 \times 1.74$	\$13,050
PV of cash outflow for tax $(\$7,500 - \$5,000) \times 40\% \times 1.74$	(1,740)
After-tax PV	<u>\$11,310</u>

After-tax PV \$11,310 Choice "a" is incorrect. Amortization expense of \$5,000 is a non-cash expense and is not used to compute after-tax present value. It is used to determine the cash paid for taxes.

Choice "b" is incorrect. Amortization is a non-cash expense. It is not considered in the calculation, except to the extent it creates a tax shield. The tax shield reduces the amount of taxes paid out by the company.

Choice "c" is incorrect. Present value is based on the cash flows of an activity. Amortization is a noncash expense that is considered only for its tax shield; therefore, the only relevant amounts are the \$7,500 operating net cash inflow and the tax paid.

QUESTION NO: 12

The principle measure of non-diversifiable risk included in the CAPM formula is the beta coefficient. The beta coefficient measures the volatility or risk inherent in an investment by:

- A. Computing the ratio of changes in earnings per share to changes in sales.
- B. Computing the ratio of stock price to earnings per share.
- C. Computing the ratio of percentage changes in a stock's price to percentage changes in overall market values during the same period.
- D. Computing the ratio of percentage changes in the expected value of alpha equivalents to derivative fluctuations.

ANSWER: C**Explanation:**

Choice "c" is correct. The beta coefficient represents the measure of a particular stock's percentage change compared to the percentage change in the market over the same period. The equation for the beta coefficient is as follows:

% Δ in Stock Price

% Δ in Market price

Choice "a" is incorrect. The percentage change in earnings per share related to a percentage change in sales represents the degree of combined leverage.

Choice "b" is incorrect. The ratio of stock price to earnings per share is the price earnings ratio. Choice "d" is incorrect. Choice "d" represents a word salad distracter of nonsense terms.

QUESTION NO: 13

In determining the number of documents to select for a test to obtain assurance that all sales returns have been properly authorized, an auditor should consider the tolerable rate of deviation from the control activity. The auditor should also consider the:

- I. Likely rate of deviations.
 - II. Allowable risk of assessing control risk too high.
- A. I only.
 - B. II only.
 - C. Both I and II.
 - D. Either I or II.
 - E. Likely rate of deviations.
 - II. Allowable risk of assessing control risk too high.

ANSWER: A**Explanation:**

Choice "a" is correct. In determining the number of sample items to select in a test of controls, the auditor would also consider the likely rate of deviations. The higher the expected rate, the greater the number of items selected.

Choices "b", "c", and "d" are incorrect. The process of establishing the number of sample items to select in a test of controls would include the consideration of the allowable risk of assessing control risk too low, not too high.

QUESTION NO: 14

Sound internal control dictates that, immediately upon receiving checks from customers by mail, a responsible employee should:

- A. Add the checks to the daily cash summary.
- B. Verify that each check is supported by a prenumbered sales invoice.
- C. Prepare a duplicate listing of checks received.
- D. Record the checks in the cash receipts journal.

ANSWER: C**Explanation:**

Choice "c" is correct. Upon receipt of cash, a remittance listing should be prepared.

Choice "a" is incorrect. Recording the check in the daily cash summary would ordinarily be done by a second party after the initial listing has been prepared.

Choice "b" is incorrect. Verifying that each check is supported by a valid invoice is not necessary.

Choice "d" is incorrect. Recording the check in the cash receipts journal would ordinarily be done by a second party after the initial listing has been prepared.

QUESTION NO: 15

An accountant's compilation report on a financial forecast should include a statement that:

- A. The forecast should be read only in conjunction with the audited historical financial statements.
- B. The accountant expresses only limited assurance on the forecasted statements and their assumptions.
- C. There will usually be differences between the forecasted and actual results.
- D. The hypothetical assumptions used in the forecast are reasonable in the circumstances.

ANSWER: C

Explanation:

Choice "c" is correct. The accountant's compilation report on a client's financial forecast should include a caveat that the prospective results may not be achieved.

Choice "a" is incorrect. The historical financial statements upon which the forecast is based need not be audited, nor must they accompany the forecast compilation.

Choice "b" is incorrect. The accountant expresses no assurance in the compilation report on forecasted statements.

Choice "d" is incorrect. A compilation of a financial forecast would not include evaluation of the support for the assumptions underlying the forecast.

QUESTION NO: 16

When the overall price level is rising, nominal interest rates tend to be:

- A. Unaffected by changes in the price level.
- B. Falling.
- C. Rising.
- D. None of the above.

ANSWER: C**Explanation:**

Choice "c" is correct. The relationship between nominal interest rates and inflation can be seen by rearranging the equation for real interest rates as follows:

Nominal Interest Rate = Real Interest Rate + Inflation

Thus, if real interest rates do not change, a 1% increase in the inflation rate will lead to a 1% increase in nominal interest rates.

QUESTION NO: 17

Which of the following is not an audit procedure that the independent auditor would perform concerning litigation, claims, and assessments?

- A. Obtain assurance from management that it has disclosed all unasserted claims that the lawyer has advised are probable of assertion and must be disclosed.
- B. Confirm directly with the client's lawyer that all claims have been recorded in the financial statements.
- C. Inquire of and discuss with management the controls adopted for identifying, evaluating, and accounting for litigation, claims, and assessments.

D. Obtain from management a description and evaluation of litigation, claims, and assessments existing at the balance sheet date.

ANSWER: B

Explanation:

Choice "b" is correct. The independent auditor would not confirm directly with the client's lawyer that all claims have been recorded in the financial statements. Management has the responsibility to include all claims in the financial statements, not the lawyers. The purpose of a legal letter is to obtain outside corroboration of the information furnished by management concerning litigation, claims, and assessments.

Choice "a" is incorrect. The auditor should obtain assurance from management that it has disclosed all unasserted claims that the lawyer has advised are probable of assertion and must be disclosed.

Choice "c" is incorrect. The auditor should inquire of and discuss with management the controls adopted for identifying, evaluating, and accounting for litigation, claims, and assessments. Choice "d" is incorrect. The auditor should obtain from management a description and evaluation of litigation, claims, and assessments existing at the balance sheet date.

QUESTION NO: 18

Gillie, Taft, and Dall are partners in an architectural firm. The partnership agreement is silent about the payment of salaries and the division of profits and losses. Gillie works full-time in the firm, and Taft and Dall each work half time. Taft invested \$120,000 in the firm, and Gillie and Dall invested \$60,000 each. Dall is responsible for bringing in 50% of the business, and Gillie and Taft 25% each. How should profits of \$120,000 for the year be divided?

- A. Gillie \$60,000, Taft \$30,000, Dall \$30,000.
- B. Gillie \$40,000, Taft \$40,000, Dall \$40,000.
- C. Gillie \$30,000, Taft \$60,000, Dall \$30,000.
- D. Gillie \$30,000, Taft \$30,000, Dall \$60,000.

ANSWER: B

Explanation:

Choice "b" is correct. \$40,000 – \$40,000 – \$40,000 (equally).

Rule: In the absence of an agreement to the contrary, the profits will be shared equally regardless of investment of money or time. Choices "a", "c", and "d" are incorrect, per the above rule.

QUESTION NO: 19

When determining net present value in an inflationary environment, adjustments should be made to:

- A. Increase the discount rate, only.
- B. Increase the estimated cash inflows and increase the discount rate.

- C. Increase the estimated cash inflows but not the discount rate.
- D. Decrease the estimated cash inflows and increase the discount rate.

ANSWER: B

Explanation:

Choice "b" is correct.

Rule: In an inflationary environment, future cash flows (except for cash flows generated from the tax effect of depreciation) should be increased to the extent of predicted inflation. For internal consistency, an inflationary factor should also be added to the discount rate. Choices "a", "c", and "d" are incorrect, per the above

QUESTION NO: 20

In 1990, ABC Corp., a closely held corporation, was formed by Adams, Frank, and Berg as incorporators and stockholders. Adams, Frank, and Berg executed a written voting agreement which provided that they would vote for each other as directors and officers. In 1994, stock in the corporation was offered to the public. This resulted in an additional 300 stockholders. After the offering, Adams holds 25%, Frank holds 15%, and Berg holds 15% of all issued and outstanding stock. Adams, Frank, and Berg have been directors and officers of the corporation since the corporation was formed. Regular meetings of the board of directors and annual stockholders meetings have been held.

For this question refer to the formation of ABC Corp. and the rights and duties of its stockholders, directors, and officers.

- A. Adams, Frank, and Berg must be elected as directors because they own 55% of the issued and outstanding stock.
- B. Adams, Frank, and Berg must always be elected as officers because they own 55% of the issued and outstanding stock.
- C. Adams, Frank, and Berg must always vote for each other as directors because they have a voting agreement.

ANSWER: C

Explanation:

Choice "c" is correct. Shareholders in a voting agreement must vote their shares in accordance with the agreement. There is no requirement that majority shareholders be elected as directors or officers.

Business Cycles and Reasons for Business Fluctuations