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

Version: Demo

QUESTION 1

The corporate veil is most likely to be pierced and the shareholders held personally liable if:

A. The corporation has elected S corporation status under the Internal Revenue Code.

B. The shareholders have commingled their personal funds with those of the corporation.

C. An ultra vires act has been committed.

D. A partnership incorporates its business solely to limit the liability of its partners.

Correct Answer: B

Explanation: Choice "b" is correct. Generally, a corporation is treated as an entity distinct from its shareholders and shareholders are not liable for the corporation\\'s debts. However, where the shareholders do not treat the corporation as a distinct entity, such as where they commingle their personal funds with the corporation\\'s funds, courts are likely to ignore the corporate form as well. Choice "a" is incorrect. An election to be taxed like a partnership under Subchapter S is not grounds to pierce the corporate veil. Choice "c" is incorrect. An ultra vires act is one beyond the corporation\\'s powers. The persons who authorized the ultra vires act can be held personally liable for damages caused, but it is not a ground for piercing the corporate veil. Choice "d" is incorrect. Limiting personal liability is the main reason to incorporate. It is a ground for piercing the corporate veil only if it is done fraudulently (i.e., to avoid paying present creditors).

QUESTION 2

Reclassification adjustments must be shown in the financial statement that discloses comprehensive income:

A. To show what portion of comprehensive income is from the realization of current assets.

B. To show the tax effect of items of comprehensive income.

C. To avoid double counting in comprehensive income items, which are currently displayed in net income.

D. To avoid including transactions with shareholders in items of comprehensive income.

Correct Answer: C

Explanation:

Choice "c" is correct. Reclassification entries may be necessary to avoid double counting an item

previously reported as comprehensive income (i.e., unrealized gain), which are now reported as part of net

income (i.e., realized gain).

Choice "a" is incorrect. The classification of assets as current or non-current has no bearing on reporting

comprehensive income.

Choice "b" is incorrect. All items of comprehensive income must be shown net of the related tax effects,

but it is not done with reclassification adjustments.

Choice "d" is incorrect. Transactions with shareholders such as paying dividends and issuing capital stock

are not included in comprehensive income, thus, reclassification adjustments are not necessary to exclude

them.

QUESTION 3

ABC Industries, a vertically integrated producer and retailer of high end audio visual equipment has mapped out its overall business process as beginning with product development followed by product testing then raw materials purchasing then manufacturing and assembly, and, finally, sales and service. Finance staff at ABC Industries are trying to evaluate the efficiency and the effectiveness of each process and the relationship between each process. This evaluation is often referred to as:

A. Process improvement.

B. Continuous quality improvement.

C. Value chain analysis.

D. Benchmarking.

Correct Answer: C

Explanation:

Choice "c" is correct. The process of developing macro level flow charts of business processes that

produce products or services and then identifying the value added by each process is referred to as value

chain analysis.

Choice "a" is incorrect. Process improvement represents the results of total quality management efforts.

Choice "b" is incorrect. Continuous quality improvement represents an unswerving focus on customer

satisfaction and quality, not necessarily the specific steps associated with value chain analysis.

Choice "d" is incorrect. Benchmarking relates to determining best practices and, often, using those practices as standards.

QUESTION 4

In an attest engagement, use of the accountant\\'s report should be restricted to specified parties in all of the following situations, except:

A. When the criteria used to evaluate the subject matter are appropriate for only a limited number of parties.

B. When reporting on an assertion about the subject matter instead of reporting directly on the subject matter.

C. When reporting directly on the subject matter and a written assertion has not been provided.

D. When reporting on an agreed-upon procedures engagement.

Correct Answer: B

Explanation:

Choice "b" is correct. There is no requirement that the accountant\\'s report be restricted to specified parties

when reporting on an assertion about the subject matter instead of reporting directly on the subject matter.

Choice "a" is incorrect, since use of the accountant\\'s report should be restricted to specified parties when

the criteria used to evaluate the subject matter are appropriate for only a limited number of parties.

Choice "c" is incorrect, since use of the accountant\\'s report should be restricted to specified parties when

reporting directly on the subject matter and a written assertion has not been provided.

Choice "d" is incorrect, since use of the accountant\\'s report should be restricted to specified parties when

reporting on an agreed-upon procedures engagement.

QUESTION 5

Tracing copies of computer-prepared sales invoices to copies of the corresponding computer-prepared shipping documents provides evidence that:

A. Shipments to customers were properly billed.

B. Entries in the accounts receivable subsidiary ledger were for sales actually shipped.

C. Sales billed to customers were actually shipped.

D. No duplicate shipments to customers were made.

Correct Answer: C

Explanation: Choice "c" is correct. Tracing from invoices to shipping documents would provide evidence that sales billed to customers were actually shipped. An invoice for which the corresponding shipping documents could not be located might be indicative of fictitious sales (i.e., sales that were recorded but never actually shipped). Choice "a" is incorrect. The auditor would need to start with shipping documents and trace to invoices to ensure that shipments were properly billed. Choice "b" is incorrect. An invoice may exist for which no entry was made in the accounts receivable subsidiary ledger. Therefore, the auditor would need to trace from entries in the accounts receivable subsidiary ledger (and not from invoices) to shipping documents, to obtain evidence that recorded receivables were for sales actually shipped. Choice "d" is incorrect. Tracing from invoices to shipping documents would not necessarily indicate when a duplicate shipment was made, as the auditor would not necessarily realize that two sets of shipping documents related to the same invoice.

QUESTION 6

In assessing the objectivity of internal auditors, an independent auditor should:

A. Evaluate the quality control program in effect for the internal auditors.

B. Examine documentary evidence of the work performed by the internal auditors.

C. Test a sample of the transactions and balances that the internal auditors examined.

D. Determine the organizational level to which the internal auditors report.

Correct Answer: D

Explanation: Choice "d" is correct. When assessing the internal auditors\\' objectivity, the auditor should obtain information about whether the internal auditor reports to an officer of sufficient status to ensure broad audit coverage and adequate consideration of, and action on, the findings and recommendations of the internal auditors. Choice "a" is incorrect. A quality control program would impact the competence of the internal audit staff, not their objectivity. Choice "b" is incorrect. Examining documentary evidence produced by the internal auditors would help the auditor evaluate the quality and effectiveness of the internal auditors\\' work, but would not help assess objectivity. Choice "c" is incorrect. Testing a sample of transactions and balances examined by the internal auditors would help the auditor evaluate the quality and effectiveness of the internal auditors\\' work, but would not help assess objectivity.

QUESTION 7

Why would a firm generally choose to finance temporary assets with short-term debt?

A. Matching the maturities of assets and liabilities reduces risk.

B. Short-term interest rates have traditionally been more stable than long-term interest rates.

C. A firm that borrows heavily long term is more apt to be unable to repay the debt than a firm that borrows heavily short term.

D. Financing requirements remain constant.

Correct Answer: A

Explanation: Choice "a" is correct. Matching the maturities of current assets with liabilities as they come due is designed to ensure liquidity and reduce risk of cash shortages. Temporary assets (such as inventories, generally, and seasonal inventories, specifically) might be financed with short term debt such that the earnings from the sales of those temporary assets could be used to liquidate the related obligations as they come due and ensure that cash is available to meet cash flow requirements. Choice "b" is incorrect. Interest rate risks would likely motivate a firm to use longer term financing than short-term financing. Choice "c" is incorrect. Matching cash inflows with cash outflows are more influential in determining a firm\\'s ability to repay debt rather than the length of the obligation. Choice "d" is incorrect. Long-term rather than short-term debt promotes consistent finance charges. The requirements for financing itself are driven by business practice, not by the maturity of financial instruments used.

QUESTION 8

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. ABC Corp.\\'s directors are elected by its:

A. Officers.

B. Outgoing directors.

C. Stockholders.

Correct Answer: C

Explanation:

Choice "c" is correct. Directors are elected by the stockholders.

QUESTION 9

The auditor should obtain sufficient knowledge of the client\\'s information and communication system relevant to financial reporting to understand all of the following, except:

A. Classes of transactions in the entity\\'s operations that are significant to the financial statements, and how those transactions are processed, from initiation to inclusion in the financial statements.

B. The financial reporting process, including development of significant accounting estimates and inclusion of appropriate disclosures.

C. The means the entity uses to communicate roles, responsibilities, and significant matters relating to financial reporting.

D. Control activities related to each account balance, transaction class, and disclosure component in the financial statements or to every assertion relevant to them.

Correct Answer: D

Explanation:

Choice "d" is correct. Ordinarily, audit planning does not require an understanding of the control activities

related to each account balance, transaction class, and disclosure component in the FS or to every

assertion relevant to them.

Choice "a" is incorrect. The auditor is required to understand significant classes of transactions and how

they are processed.

Choice "b" is incorrect. The auditor is required to understand the financial reporting process.

Choice "c" is incorrect. The auditor is required to understand the methods used by the entity to

communicate matters relevant to financial reporting.

QUESTION 10

An accountant\\'s standard report issued after compiling the financial statements of a nonissuer should state that:

A. I am not aware of any material modifications that should be made to the accompanying financial statements.

B. A compilation consists principally of inquiries of company personnel and analytical procedures.

C. A compilation is limited to presenting in the form of financial statements information that is the representation of management.

D. A compilation is substantially less in scope than an audit in accordance with GAAS, the objective of which is the expression of an opinion.

Correct Answer: C

Explanation: Choice "c" is correct. An accountant\\'s standard report issued after compiling the financial statements of a nonissuer should state that "a compilation is limited to presenting in the form of financial statements information that is the representation of management." Choice "a" is incorrect. A review report (and not a compilation report) states that, "I am not aware of any material modifications that should be made to the accompanying financial statements." Choice "b" is incorrect. A review report (and not a compilation report) states that a review "consists principally of inquiries of company personnel and analytical procedures." Choice "d" is incorrect. A review report (and not a compilation report) states that a review "is substantially less in scope than an audit in accordance with GAAS, the objective of which is the expression of an opinion."

QUESTION 11

Which of the following sales should be reported as a capital gain?

A. Sale of equipment.

B. Real property subdivided and sold by a dealer.

C. Sale of inventory.

D. Government bonds sold by an individual investor.

Correct Answer: D

Explanation: Choice "d" is correct. Government bonds held by an individual investor are considered capital assets in the hands of the investor. When these types of security investments are sold, the resulting gain or loss is reported as capital. Choice "a" is incorrect. In this case, we must assume that the BEST answer is option "d" (as that option would ALWAYS result in capital gain or loss treatment) and that the examiners are assuming that the equipment is depreciable equipment that has been used in a business for over one year. [If the equipment had been considered a personal asset by the examiners and had sold for a gain, it would also be a capital asset that sold for a capital gain, and there would be two correct answers. Remember that the correct answer is the option that best answers the question.] Depreciable equipment used in a business and held for over one year falls under the category of Section 1245 property. When Section 1245 assets are sold at a gain, all the accumulated depreciation on the asset is recaptured as ordinary income (the same category as the depreciation expense was deducted against), and any remaining gain (typically, in practice, this is not the case, though, as the asset would have had to sell for an amount greater than its purchase price) is capital gain under Code Section 1231. [Note that Section 1245 applies only to gains. If the asset had sold for a loss, the loss would have been ordinary under Section 1231.] Choice "b" is incorrect. Real property sold by a dealer is considered inventory and results in ordinary income or ordinary losses upon sale. Inventory is not a capital asset and is not afforded the capital gain benefits. Choice "c" is incorrect. Inventory is not a capital asset and is not afforded the capital gain benefits. The sale of inventory results in ordinary income or loss (e.g., gross profit on sales) being reported on the tax return, as inventory is an asset held for sale in the ordinary course of business.

QUESTION 12

The average collection period for a firm measures the number of days: A. After a typical credit sale is made until the firm receives the payment.

B. It takes a typical check to "clear" through the banking system.

C. Before a typical account becomes delinquent.

D. In the inventory cycle.

Correct Answer: A

Explanation:

Choice "a" is correct. The average collection period for a firm measures the number of days after a typical

credit sale is made until the firm receives the payment.

Choice "b" is incorrect. "Float" measures the number of days it takes a typical check to "clear" through the

banking system.

Choice "c" is incorrect. "Credit period (term)" measures the number of days before a typical account

becomes delinquent.

Choice "d" is incorrect. "Average days sales in inventory" measures the number of days in the inventory

cycle.