CPA-TEST Q&As

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QUESTION 1

Which of the following accounting pronouncements is the most authoritative?

A. FASB Statement of Financial Accounting Concepts.

B. FASB Technical Bulletin.

C. AICPA Accounting Principles Board Opinion.

D. AICPA Statement of Position.

Correct Answer: C

Explanation:

Choice "c" is correct. The AICPA accounting principal board opinion (APBO) is a first floor (category A) of established accounting principle pronouncements.

Choice "a" is incorrect. FASB statement of financial accounting concepts (SFAC or FACs) is a fifth floor (other accounting literature) category.

Choice "b" is incorrect. FASB technical bulletins are a second floor (category B) accounting pronouncement.

Choice "d" is incorrect. AICPA statement of position is a second floor (category B) accounting pronouncement.

QUESTION 2

A company uses the following formula in determining its optimal level of cash.

$$C^* = \sqrt{\frac{2bT}{i}}$$

Where: b = Fixed cost per transaction i = Interest rate on marketable securities T = Total demand for cash over a period of time

This formula is a modification of the Economic Order Quantity (EOQ) formula used for inventory management. Assume that the fixed cost of selling marketable securities is $10 per transaction, and the interest rate on marketable securities is 6 percent per year. The company estimates that it will make cash payments of $12,000 over a one-month period. What is the average cash balance (rounded to the nearest dollar)?

A. $1,000

B. $2,000

C. $3,464

D. $6,928

Correct Answer: C

Explanation: Choice "c" is correct. Like the EOQ, this formula represents the amount of cash brought in by the sale of marketable securities. Also like the EOQ, this cash goes to zero (or the safety level) over time. The average cash (like the average inventory) is one half of the amount collected. Remember also to convert the interest rate to a per month figure of 0.5%

$$C^* = (2bT/i)^{1/2}$$
$$C^* = [2(10)12{,}000/.005]^{1/2}$$
$$C^* = [240{,}000/.005]^{1/2}$$
$$C^* = \$6{,}928$$

$$\text{Average cash} = \$6{,}928/2 = \$3{,}464$$

Choices "a", "b", and "d" are incorrect, per above.

QUESTION 3

An advantage of the net present value method over the internal rate of return model in discounted cash flow analysis is that the net present value method:

A. Computes a desired rate of return for capital projects.

B. Can be used when there is no constant rate of return required for each year of the project.

C. Uses a discount rate that equates the discounted cash inflows with the outflows.

D. Uses discounted cash flows whereas the internal rate of return model does not.

Correct Answer: B

Explanation:

Choice "b" is correct. When using the net present value method of capital budgeting, different hurdle rates

can be used for each year of the project.

Choice "a" is incorrect. The desired rate of return for capital projects is established by management.

Choice "c" is incorrect. The internal rate of return determines the discount rate that will equate the

discounted cash inflows with the outflows, thus resulting in no gain or loss (breakeven).

Choice "d" is incorrect. Both the net present value method and the internal rate of return model are discounted cash flow methods.

QUESTION 4

Knox, president of ABC Corp., contracted with XYZ, Inc. to supply ABC\\'s stationery on customary terms and at a cost less than that charged by any other supplier. Knox later informed ABC\\'s board of directors that Knox was a majority stockholder in XYZ. Quick\\'s contract with XYZ is:

A. Void because of Knox\\'s self-dealing.

B. Void because the disclosure was made after execution of the contract.

C. Valid because of Knox\\'s full disclosure.

D. Valid because the contract is fair to ABC.

Correct Answer: D

Explanation: Choice "d" is correct. If a corporation enters into a contract and a director has a conflict of interest in the transaction, the contract is voidable unless the director makes full disclosure of all of the facts to the disinterested directors or the shareholders, who then approve the transaction, or the director can prove that the transaction was fair to the corporation. The stationery purchase was fair to Quick, since it was purchased at a below-market price. Thus, the contract is valid. Choice "a" is incorrect. A director\\'s self-dealing does not automatically make a contract voiD. The contract can be upheld if it was fair.

Choice "b" is incorrect. A director\\'s self-dealing does not automatically make a contract voiD. The contract can be upheld if it was fair. Choice "c" is incorrect. If a corporation enters into a contract and a director has a conflict of interest in the transaction, the contract is voidable unless the director makes full disclosure of all of the facts to the disinterested directors or shareholders, who then approve the transaction, or the director can prove that the transaction was fair. Mere disclosure after the contract was adopted does not automatically render the contract valid.

QUESTION 5

The objective of performing analytical procedures in planning an audit is to identify the existence of:

A. Unusual transactions and events.

B. Illegal acts that went undetected because of internal control weaknesses.

C. Related party transactions.

D. Recorded transactions that were not properly authorized.

Correct Answer: A

Explanation:

Choice "a" is correct. The objective of performing analytical procedures during planning is to discover

unusual transactions or events that may have an impact on the planning of the financial statement audit.

Choice "b" is incorrect. Analytical procedures are not effective in identifying illegal acts that went undetected due to internal control weaknesses.

Choice "c" is incorrect. Analytical procedures are not effective in identifying related party transactions.

Choice "d" is incorrect. Analytical procedures are not effective as tests of controls to identify unauthorized transactions.