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QUESTION 1

Which one of a firm's sources of new capital usually has the lowest after tax cost?

- A. Retained earnings.
- B. Bonds.
- C. Preferred stock.
- D. Common stock.

Correct Answer: B

Explanation: Choice "b" is correct. Because debt is a cheaper source of financing than equity, bonds will be the cheapest form of financing. In addition, the company issuing bonds receives a tax deduction for interest paid. This further reduces the cost of bond financing. Choices "a", "c", and "d" are incorrect, per above.

QUESTION 2

When evaluating capital budgeting analysis techniques, the payback period emphasizes:

- A. Liquidity.
- B. Profitability.
- C. Net income.
- D. The accounting period.

Correct Answer: A

Explanation:

Choice "a" is correct. The payback period is the time period required for cash inflows to recover the initial investment. The emphasis of the technique is on liquidity (i.e., cash flow).

Choices "b", "c", and "d" are incorrect, per the above Explanation.

QUESTION 3

A transaction that is unusual, but not infrequent, should be reported separately as a(an): A. Extraordinary item, net of applicable income taxes.

- B. Extraordinary item, but not net of applicable income taxes.
- C. Component of income from continuing operations, net of applicable income taxes.
- D. Component of income from continuing operations, but not net of applicable income taxes.

Correct Answer: D

Explanation:

Choice "d" is correct. A transaction that is unusual, but not "infrequent" should be reported separately as a component of continuing operations, (gross) but not net of applicable income taxes.

Choices "a" and "b" are incorrect. An extraordinary item has to be both "unusual" and "infrequent."

Choice "c" is incorrect, per "d" above.

QUESTION 4

All of the following are components of the formula used to calculate gross domestic product, except:

- A. Household income.
- B. Foreign net export spending.
- C. Government spending.
- D. Gross investment.

Correct Answer: A

Explanation:

Choice "a" is correct. Gross domestic product (GDP) is calculated in two different ways. The first, which is the expenditure approach and can be used to answer this question, is the mnemonic GICE, or government purchases plus private domestic investment plus personal consumption expenditures plus net exports.

Household income is the only one of the answers that is not included in this mnemonic.

Choice "b" is incorrect. Foreign net export spending is included in the mnemonic (E) for GDP; although, it is called simply net exports in the mnemonic and not foreign net export spending.

Choice "c" is incorrect. Government spending is included in the mnemonic (G) for GDP.

Choice "d" is incorrect. Gross investment is included in the mnemonic (I) for GDP, although it is called private domestic investment in the mnemonic.

QUESTION 5

When auditing an entity's financial statements in accordance with Government Auditing Standards (the Yellow Book), an auditor is required to report on:

- I. Recommendations for actions to improve operations.

II.

The scope of the auditor's tests of compliance with laws and regulations.

A.

I only.

B.

II only.

C.

Both I and II.

D.

Neither I nor II.

Correct Answer: B

Explanation:

Choice "b" is correct. When auditing an entity's financial statements in accordance with Government Auditing Standards, an auditor is required to report on the scope of the auditor's testing of compliance with laws and regulations, but not on recommendations for actions to improve operations.

Choices "a", "c", and "d" are incorrect based on the above Explanation.

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