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QUESTION 1

Symbol A most likely represents:

- A. Remittance advice file.
- B. Receiving report file.
- C. Accounts receivable master file.
- D. Cash disbursements transaction file.

Correct Answer: C

Explanation:

Choice "c" is correct. The accounts receivable master file is the file most likely to be affected by sales and cash receipts transactions, as noted immediately above symbol "A" in the flowchart.

Choice "a" is incorrect. Remittance advices are used to update the accounts receivable file, but a separate "remittance advice file" generally is not created.

Choice "b" is incorrect. The inventory/purchase/cash disbursements cycle would include a receiving report file, not the revenue cycle.

Choice "d" is incorrect. Cash disbursements are not part of the revenue cycle.

QUESTION 2

ABC Company presently sells 400,000 bottles of perfume each year. Each bottle costs \$.84 to produce and sells for \$1.00. Fixed costs are \$28,000 per year. The firm has annual interest expense of \$6,000, preferred stock dividends of \$2,000 per year, and a 40 percent tax rate. ABC uses the following formulas to determine the company's leverage.

$$\text{Operating leverage} = \frac{Q(S - VC)}{Q(S - VC) - FC}$$

$$\text{Financial leverage} = \frac{\text{EBIT}}{\text{EBIT} - I - [P + (1 - t)]}$$

$$\text{Total leverage} = \frac{Q(S - VC)}{Q(S - VC) - FC - I - [P + (1 - t)]}$$

Where:

Q	=	Quantity
FC	=	Fixed cost
VC	=	Variable cost
S	=	Selling price
I	=	Interest expense
P	=	Preferred dividends
t	=	Tax rate
EBIT	=	Earnings before interest and taxes

If ABC Company did not have preferred stock, the degree of total leverage would:

- A. Decrease in proportion to a decrease in financial leverage.
- B. Increase in proportion to an increase in financial leverage.
- C. Decrease but not be proportional to the decrease in financial leverage.
- D. Decrease but not have an effect on financial leverage.

Correct Answer: A

Explanation:

Choice "a" is correct. Without preferred stock, the denominator in the total leverage calculation would be larger (because preferred stock is subtracted to arrive at the denominator). The same holds true for financial leverage. Therefore, both financial and total leverage would decrease in proportion.

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

QUESTION 3

Which of the following accurately depicts the auditor's responsibility with respect to Statements on Auditing Standards?

- A. The auditor is required to follow the guidance provided by the Standards, without exception.

- B. The auditor is generally required to follow the guidance provided by Standards with which he or she is familiar, but will not be held responsible for departing from provisions of which he or she was unaware.
- C. The auditor is generally required to follow the guidance provided by the Standards, unless following such guidance would result in an audit that is not cost-effective.
- D. The auditor is generally required to follow the guidance provided by the Standards, and should be able to justify any departures.

Correct Answer: D

Explanation:

Choice "d" is correct. The auditor is generally required to follow the guidance provided by the Standards, and should be able to justify any departures.

Choice "a" is incorrect. On rare occasions, the auditor may depart from the guidance provided by the SASs, but he or she must justify such departures.

Choice "b" is incorrect. Lack of familiarity with a SAS is not a valid reason for departing from its guidance. The auditor is expected to have sufficient knowledge of the SASs to identify those that are applicable to a given audit engagement.

Choice "c" is incorrect. The cost associated with following the guidance provided by a SAS is not an acceptable reason for departing from its guidance.

QUESTION 4

Commercial paper:

- A. Has a maturity date greater than one year.
- B. Is generally sold only through investment banking dealers.
- C. Generally does not have an active secondary market.
- D. Has an interest rate lower than treasury bills.

Correct Answer: C

Explanation:

Choice "c" is correct. Although commercial paper has a secondary market available, it is generally not an active secondary market. Commercial paper is usually sold to the money markets by highly creditworthy companies.

Choice "a" is incorrect. The maturity dates are generally less than 270 days.

Choice "b" is incorrect. Commercial paper can be sold to the money markets through a variety of intermediaries including brokers, dealers, investment brokers, etc. It can also be sold direct from one company to another.

Choice "d" is incorrect. The interest rate on commercial paper is below the prime rate, but generally above the Treasury bill rate.

QUESTION 5

Which of the following ratios would an engagement partner most likely calculate when reviewing the balance sheet in the overall review stage of an audit?

- A. Quick assets/current assets.
- B. Accounts receivable/inventory.
- C. Interest payable/interest receivable.
- D. Total debt/total assets.

Correct Answer: D

Explanation: Choice "d" is correct. During the final review stage of an audit, the auditor focuses on the overall presentation of the financial statements. Total debt/total assets indicates the portion of assets financed by creditors, which is a meaningful ratio to calculate during the final audit review. Choice "a" is incorrect. Quick assets/current assets simply indicates the percentage of current assets that are also "quick" assets. It is not a particularly meaningful ratio. Choice "b" is incorrect. Accounts receivable/inventory is not a meaningful ratio because it compares a

figure based on retail dollars with a cost-based figure.

Choice "c" is incorrect. Interest payable/interest receivable is not a meaningful ratio because these two amounts are not related.

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