CPA-TEST$^{Q\&As}$

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QUESTION 1

Which of the following is true regarding significant deficiencies in internal control?

A. Auditors must search for them.

B. Auditors must communicate them to management and to those charged with governance.

C. They must be included in the financial statements.

D. They must be disclosed in footnotes.

Correct Answer: B

Explanation:

Choice "b" is correct. The auditor is required to communicate to management and to those charged with governance (the audit committee) any significant deficiencies in internal control that the auditor observes.

Choice "a" is incorrect. The auditor is not obligated to search specifically for significant deficiencies in internal control.

Choice "c" is incorrect. Significant deficiencies in internal control are not typically included in the financial statements, as they relate to controls and not to the presentation and disclosure of financial information.

Choice "d" is incorrect. Significant deficiencies in internal control are not typically included in the footnotes to the financial statements, as they relate to controls and not to the presentation and disclosure of financial information.

QUESTION 2

ABC, Inc. purchased a long-term asset on the last day of the current year. What are the effects of this purchase on return on investment and residual income?

	Return on Investment	Residual income
A.	Increase	Increase
B.	Decrease	Decrease
C.	Increase	Decrease
D.	Decrease	Increase

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: B

Explanation: Choice "b" is correct. The addition of an asset at year end serves to reduce both return on investment and residual income. The addition of an asset increases then denominator in the ROI computation and increases the threshold earnings required using the residual income approach. Both measures would suffer as a result of addition of assets. See illustration below:

Assumptions:

Income	$ 100,000
Assets	$1,000,000
Required return	10%
Additional asset	$ 200,000

Return on Investment

	Before	Purchase	After
Income	$ 100,000		$ 100,000
Assets	$1,000,000	$200,000	$1,200,000
Return	10%		8%

Residual Income

	Before	Purchase	After
Assets	$1,000,000	$200,000	$1,200,000
Required Return	10%		10%
Required Income	$ 100,000		$ 120,000
Income	$ 100,000		$ 100,000
Difference	$ -		$ (20,000)

The purchase of the additional asset reduces ROI from 10% to 8% and produces negative residual income.

Choices "a", "c", and "d" are incorrect, per the above illustration.

QUESTION 3

Park, CPA, was engaged to audit the financial statements of ABC Co., a new client, for the year ended December 31, 20X3. Park obtained sufficient audit evidence for all of ABC\\'s financial statement items except ABC\\'s opening inventory. Due to inadequate financial records, Park could not verify ABC\\'s January 1, 20X3, inventory balances. Park\\'s opinion on ABC\\'s 20X3 financial statements most likely will be:

	Balance sheet	Income statement
A.	Disclaimer	Disclaimer
B.	Unqualified	Disclaimer
C.	Disclaimer	Adverse
D.	Unqualified	Adverse

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: B

Explanation:

Choice "b" is correct. When the auditor is unable to satisfy himself or herself regarding the amount of beginning inventory, he or she must disclaim an opinion on the income statement because of the inability to verify the cost of goods sold during the year. The auditor may, however, still be able to issue an unqualified opinion on the balance sheet, since inventory can be verified as of the balance sheet date.

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

QUESTION 4

Financial reporting by a development stage enterprise differs from financial reporting for an established operating enterprise in regard to footnote disclosures:

A. Only.

B. And expense recognition principles only.

C. And revenue recognition principles only.

D. And revenue and expense recognition principles.

Correct Answer: A

Explanation:

Choice "a" is correct. Financial reporting by a development stage enterprise differs from financial reporting for an established operating enterprise in regard to (more extensive) footnote disclosures only.

Choices "b", "c", and "d" are incorrect. Revenue and expense recognition principles are the same.

Rule: Development stage enterprises should present financial statements in accordance with GAAP and make additional disclosures such as: cumulative net losses, cumulative deficit (as part of equity), cumulative sales and expenses (as part of the income statement), cumulative statement of cash flows and supplementary "shareholders equity."

QUESTION 5

When assessing an internal auditor\\'s competence, a CPA ordinarily obtains information about all of the following, except:

A. Quality of audit documentation.

B. Educational level and professional experience.

C. The audit plan and audit procedures.

D. Access to information about related parties.

Correct Answer: D

Explanation: Choice "d" is correct. The degree of access the independent auditor has to information about related parties provides no information regarding an internal auditor\\'s competence. Choice "a" is incorrect. In evaluating the work of internal auditors, the independent auditor should examine, on a test basis, documentary evidence of the work performed by internal auditors and should consider such factors as whether the scope of the work is appropriate, the audit plan is adequate, audit documentation adequately documents work performed, conclusions reached are appropriate in the circumstances, and any reports prepared are consistent with the results of the work performed. Choice "b" is incorrect. When considering the competence of internal auditors, the independent auditor should inquire about the qualifications of the internal audit staff, including for example, consideration of the client\\'s practices for hiring, training, and supervising internal audit staff. This includes inquiries as to the internal auditor\\'s educational level and professional experience. Choice "c" is incorrect. In evaluating the work of internal auditors, the independent auditor should examine, on a test basis, documentary evidence of the work performed by internal auditors and should consider such factors as whether the scope of the work is appropriate, the audit plan is adequate, audit documentation adequately documents work performed, conclusions reached are appropriate in the circumstances, and any reports prepared are consistent with the results of the work performed.