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QUESTION 1

Property acquisitions that are misclassified as maintenance expense would most likely be detected by an internal accounting control system that provides for:

- A. Investigation of variances within a formal budgeting system.
- B. Review and approval of the monthly depreciation entry by the plant supervisor.
- C. Segregation of duties of employees in the accounts payable department.
- D. Examination by the internal auditor of vendor invoices and canceled checks for property acquisitions.

Correct Answer: A

Explanation: Choice "a" is correct. Investigation of variances in a formal budget might show maintenance costs over budget or acquisition costs under budget, either of which would trigger an investigation. Choice "b" is incorrect. Review of journal entries relating to depreciation would not disclose acquisitions misclassified as maintenance expense, since no depreciation would be recorded for the misclassified items. Choice "c" is incorrect. Segregation of duties in the accounts payable department would have no effect on the account classification of an approved invoice. Choice "d" is incorrect. Since the internal auditor would be looking at invoices and checks related to recorded property acquisitions, he or she would not be likely to identify payments that were erroneously excluded from the property account.

QUESTION 2

According to the FASB conceptual framework, which of the following situations violates the concept of reliability?

- A. Data on segments having the same expected risks and growth rates are reported to analysts estimating future profits.
- B. Financial statements are issued nine months late.
- C. Management reports to stockholders regularly refer to new projects undertaken, but the financial statements never report project results.
- D. Financial statements include property with a carrying amount increased to management's estimate of market value.

Correct Answer: D

Explanation: Choice "d" is correct. Management's estimate of market value lacks verifiability, which is a component of reliability. SFAC 2 para. 89 Choice "a" is incorrect. Communicating data on segments to analysts does not violate the concept of reliability. Choice "b" is incorrect. Issuing financial statements nine months late violates timeliness, which is a component of relevance, not reliability. SFAC 2 para. 56 Choice "c" is incorrect. Neglecting to report results of new projects violates full disclosure, not reliability.

QUESTION 3

Corbin Inc. can issue three-month commercial paper with a face value of \$1,000,000 for \$980,000. Transaction costs would be \$1,200. The effective annualized percentage cost of the financing, based on a 360-day year, would be:

- A. 2.16%

B. 8.48%

C. 8.65%

D. 8.00%

Correct Answer: C

Explanation:

Choice "c" is correct. The cost to issue the commercial paper is the \$20,000 original issue discount (\$1 million - \$980,000), plus transaction costs of \$1,200 for a total of \$21,200. Therefore, it costs \$21,200 to borrow \$980,000 for 3 months. The 3-month interest cost is 2.16% ($\$21,200 / \$980,000$).

The annual interest cost is 8.65%.

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

QUESTION 4

An accountant's report on a review of pro forma financial information should include a:

A. Statement that the entity's internal control was not relied on in the review.

B. Disclaimer of opinion on the financial statements from which the pro forma financial information is derived.

C. Caveat that it is uncertain whether the transaction or event reflected in the pro forma financial information will ever occur.

D. Reference to the financial statements from which the historical financial information is derived.

Correct Answer: D

Explanation:

Choice "d" is correct. The accountant's report on a review of pro forma financial information should include a reference to the financial statements from which the historical information is derived and a statement as to whether such financial statements were audited or reviewed.

Choice "a" is incorrect. No statement on the entity's internal control is necessary.

Choice "b" is incorrect. If the auditor has audited the financial statements from which the pro forma financial information is derived, an opinion on those statements may be expressed.

Choice "c" is incorrect. The report on a review of pro forma financial information would include an

Explanation: of the objective and limitations of the information, but would not discuss the uncertainty surrounding occurrence of the transaction or event.

QUESTION 5

In a member managed LLC, the apparent authority of a member to bind the LLC in dealing with third parties:

- A. Would permit a member to submit a claim against the LLC to arbitration.
- B. Must be derived from the express powers and purposes contained in the operating agreement.
- C. Will be effectively limited by a formal resolution of the members of which third parties are aware.
- D. Will be effectively limited by a formal resolution of the members of which third parties are unaware.

Correct Answer: C

Explanation:

Choice "c" is correct. This is really an agency question on apparent authority. Apparent authority is authority that a third party reasonably believes an agent has. If the third party is aware of a restriction on the agent's authority, the third party cannot reasonably believe that the agent has the restricted authority.

Choice "a" is incorrect. Submitting a claim to arbitration is an extraordinary act and so is not within a member's apparent authority.

Choice "b" is incorrect. Apparent authority is derived from what the reasonable person believes is the authority of a member, not the express powers and purposes contained in the operating agreement.

Choice "d" is incorrect. A formal resolution of the members will not be effective to destroy apparent authority if third parties are unaware of the resolution.

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