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**QUESTION 1**

The following costs were incurred by ABC Co., a manufacturer, during 1992:

Accounting and legal fees	\$ 25,000
Freight-in	175,000
Freight-out	160,000
Officers salaries	150,000
Insurance	85,000
Sales representatives salaries	215,000

What amount of these costs should be reported as general and administrative expenses for 1992?

- A. \$260,000
- B. \$550,000
- C. \$635,000
- D. \$810,000

Correct Answer: A

Explanation:

Choice "a" is correct. General and administrative expenses include:

Accounting and legal	\$ 25,000
Officers salaries	150,000
Insurance	85,000
Total	<u>\$260,000</u>

Freight-in is part of cost of sales; freight-out is a selling expense; and sales salaries are selling expenses. Choice "b" is incorrect. Freight-in is part of cost of inventory; freight-out is a selling expense; and sales

salaries are selling expenses.

Choice "c" is incorrect. Freight-in is part of cost of inventory; freight-out is a selling expense; and sales

salaries are selling expenses.

Choice "d" is incorrect. Freight-in is part of cost of inventory; freight-out is a selling expense; and sales

salaries are selling expenses.

**QUESTION 2**

Which of the following statements is not true of the test data approach to testing an accounting system?

- A. Test data are processed by the client's computer programs under the auditor's control.
- B. The test data need consist of only those valid and invalid conditions that interest the auditor.
- C. Only one transaction of each type need be tested.
- D. The test data must consist of all possible valid and invalid conditions.

Correct Answer: D

Explanation:

Choice "d" is correct. While the auditor will frequently use many valid and invalid conditions, it is not feasible to test every possible valid and invalid condition using a test data approach.

Choice "a" is incorrect. Test data consists of a set of fictitious entries or inputs that are processed through the client's computer system under the control of the auditor.

Choice "b" is incorrect. The auditor need only include valid and invalid conditions that interest the auditor. Choice "c" is incorrect. Only one transaction of each type need be tested, as the system should process similar transactions in a consistent manner.

QUESTION 3

On January 1, 20X1, ABC Corp. purchased a machine having an estimated useful life of 10 years and no salvage. The machine was depreciated by the double declining balance method for both financial statement and income tax reporting. On January 1, 20X6, ABC changed to the straight-line method for financial statement reporting but not for income tax reporting. Accumulated depreciation at December 31, 20X5, was \$560,000. If the straight-line method had been used, the accumulated depreciation at December 31, 20X5, would have been \$420,000. ABC's enacted income tax rate for 20X6 and thereafter is 30%. The amount shown in the 20X6 income statement for the cumulative effect of changing to the straight-line method should be:

- A. \$98,000 debit.
- B. \$98,000 credit.
- C. \$140,000 credit.
- D. \$0.

Correct Answer: D

Explanation:

Choice "d" is correct. A change in the method of depreciation is now considered to be both a change in method and a change in estimate. These changes should be accounted for as changes in estimate and handled prospectively. The new depreciation method should be used as of the beginning of the year of



change and should start with the current book value of the underlying asset. No retroactive or retrospective calculations should be made, and no adjustment should be made to retained earnings.

And, certainly, the cumulative effect should not be reflected on the income statement any more.

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

QUESTION 4

At December 31, 20X2, ABC Co. had the following balances in selected asset accounts:

	<u>20X2</u>	<u>Increase over 20X1</u>
Cash	\$ 300	\$100
Accounts receivable, net	1,200	400
Inventory	500	200
Prepaid expenses	100	40
Other assets	400	150
Total assets	<u>\$2,500</u>	<u>\$890</u>

ABC also had current liabilities of \$1,000 at December 31, 20X2, and net credit sales of \$7,200 for the year then ended.

What was the average number of days to collect ABC's accounts receivable during 20X2?

- A. 30.4
- B. 40.6
- C. 50.7
- D. 60.8

Correct Answer: C

Explanation:

Choice "c" is correct. The average number of days to collect accounts receivable is calculated by dividing 365 days by the accounts receivable turnover. Accounts receivable turnover is net credit sales divided by the average accounts receivable:



Average A/R = (beginning A/R + ending A/R) ÷ 2 = (\$1,200 + \$800) ÷ 2 = \$1,000

A/R turnover = \$7,200 ÷ \$1,000 = 7.2

Average number of days in A/R = 365 days ÷ 7.2 = 50.7 days.

Choice "a" is incorrect. The denominator should be net credit sales (\$7,200) divided by average receivables \$1,000), or 7.2, not 12.

Choice "b" is incorrect. The average receivable balance is \$1,000, not \$800. The right-hand column shows the increase over 20X1, so the 20X1 receivable balance was \$1,200 ? \$400, or \$800. Since the 20X2 receivable balance was given as \$1,200, the average receivable balance is \$1,000.

Choice "d" is incorrect. Average inventory (\$1,000), not ending inventory (\$1,200), should be used.

QUESTION 5

When an auditor submits a document containing audited financial statements to a client, and those financial statements include supplementary information required by GAAP, the auditor may choose any of the following options, except:

- A. Express an opinion on the information, if he or she has been engaged to examine such information.
- B. Express negative assurance on the information, if review procedures have been appropriately performed.
- C. Report on whether the information is fairly stated in relation to the financial statements taken as a whole, if appropriate auditing procedures have been applied.
- D. Disclaim an opinion on the information.

Correct Answer: B

Explanation:

Choice "b" is correct. The auditor would not perform a review or express negative assurance on supplementary information required by GAAP that is included in an auditor-submitted document.

Choice "a" is incorrect. The auditor may express an opinion on the information, if he or she has been engaged to examine it.

Choice "c" is incorrect. The auditor may report on whether the information is fairly stated in relation to the financial statements taken as a whole, if appropriate auditing procedures have been applied.

Choice "d" is incorrect. The auditor may disclaim an opinion on the information.