



# CPA-TEST<sup>Q&As</sup>

Certified Public Accountant Test: Auditing and Attestation, Business Environment and Concepts, Financial Accounting and Reporting, Regulation

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**QUESTION 1**

Dunn, CPA, is auditing the financial statements of ABC Co. ABC uses Quick Service Center (QSC) to process its payroll. Price, CPA, is expressing an opinion on a description of the controls placed in operation at QSC regarding the processing of its customers' payroll transactions. Dunn expects to consider the effects of Price's report on the ABC engagement. Price's report should contain a (an):

- A. Description of the scope and nature of Price's procedures.
- B. Statement that Dunn may assess control risk based on Price's report.
- C. Assertion that Price assumes no responsibility to determine whether QSC's controls are suitably designed.
- D. Opinion on the operating effectiveness of QSC's internal controls.

Correct Answer: A

Explanation:

Choice "a" is correct. Price, CPA (the "service auditor") should include in his or her report a description of the scope and nature of the procedures performed.

Choices "b" and "d" are incorrect. A report on controls placed in operation does not provide an opinion on operating effectiveness, and therefore may not be used to assess control risk.

Choice "c" is incorrect. A report on controls placed in operation includes a statement that, "our examination included procedures to obtain reasonable assurance about whether the controls were suitably designed."

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**QUESTION 2**

Gillie, Taft, and Dall are partners in an architectural firm. The partnership agreement is silent about the payment of salaries and the division of profits and losses. Gillie works full-time in the firm, and Taft and Dall each work half time. Taft invested \$120,000 in the firm, and Gillie and Dall invested \$60,000 each. Dall is responsible for bringing in 50% of the business, and Gillie and Taft 25% each. How should profits of \$120,000 for the year be divided?

- A. Gillie \$60,000, Taft \$30,000, Dall \$30,000.
- B. Gillie \$40,000, Taft \$40,000, Dall \$40,000.
- C. Gillie \$30,000, Taft \$60,000, Dall \$30,000.
- D. Gillie \$30,000, Taft \$30,000, Dall \$60,000.

Correct Answer: B

Explanation:

Choice "b" is correct. \$40,000 ? \$40,000 ? \$40,000 (equally).

Rule: In the absence of an agreement to the contrary, the profits will be shared equally regardless of



investment of money or time.

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

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### QUESTION 3

Under which of the following conditions is the supplier most able to influence or control buyers?

- A. When the supplier's products are not differentiated.
- B. When the supplier does not face the threat of substitute products.
- C. When the industry is controlled by a large number of companies.
- D. When the purchasing industry is an important customer to the supplying industry.

Correct Answer: B

Explanation: Choice "b" is correct. When there are few good substitutes for a supplier's product, the supplier has market power (think of a monopoly). As a result, the supplier is better able to control buyers and act as a price setter rather than a price taker. Choice "a" is incorrect. When supplier's products are not differentiated, buyers will be indifferent about which supplier they purchase from. In other words, if firms sell identical products (think of perfect competition) the product of one firm is a perfect substitute for the product of another firm. In this case, firms are price takers, not price setters. Choice "c" is incorrect. When there are a large number of firms, no one firm has much market power. This is the case of either perfect competition (if all firms sell identical products) or monopolistic competition

(if all firms sell slightly differentiated products).

Choice "d" is incorrect. If the purchasing industry is an important customer of the supplier, the purchasing industry (i.e. the buyer) will have some market power. This will diminish the ability of the supplier to influence or control the buyer.

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### QUESTION 4

An auditor is required to obtain an understanding of the entity's business, including business cycles and reasons for business fluctuations. What is the audit purpose most directly served by obtaining this understanding?

- A. To enable the auditor to accurately identify significant deficiencies.
- B. To assist the auditor to accurately interpret information obtained during an audit.
- C. To allow the auditor to more accurately perform tests of controls.
- D. To decide whether it will be necessary to perform analytical procedures.

Correct Answer: B

Explanation: Choice "b" is correct. As part of audit planning, the auditor should obtain an understanding of the entity's business. This understanding enables the auditor to better understand events, transactions, and practices that may affect the financial statements, to plan and perform appropriate audit tests, and to properly understand and evaluate the results of those tests. Choice "a" is incorrect. Obtaining an understanding of the entity's business would not be



particularly helpful in identifying significant deficiencies. Significant deficiencies in internal control are typically identified during the fieldwork stage of the audit. Choice "c" is incorrect. Obtaining an understanding of the entity's business would not result in a more accurate performance of tests of controls. Accurate performance of audit tests is dependent upon factors such as existence of an appropriate audit trail, client cooperation, training and supervision of audit staff, etc. Choice "d" is incorrect. Analytical procedures are always required in an audit during the planning and overall review stages.

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#### QUESTION 5

In September 1996, ABC Co.'s operating plant was destroyed by an earthquake. Earthquakes are rare in the area in which the plant was located. The portion of the resultant loss not covered by insurance was \$700,000. ABC's income tax rate for 1996 was 40%. In its 1996 income statement, what amount should ABC report as extraordinary loss?

- A. \$0
- B. \$280,000
- C. \$420,000
- D. \$700,000

Correct Answer: C

Explanation: Choice "c" is correct. For a loss to be reported as an extraordinary loss, the event causing the loss must be both unusual in nature and infrequent in occurrence. The earthquake in this case does meet these criteria so the loss is reported net of income tax effect as an extraordinary loss of \$420,000 (60% of the total \$700,000 loss). APB 30.11, .19-.26 Choice "a" is incorrect. Review the criteria for reporting an extraordinary loss.

Choice "b" is incorrect. This is the tax effect of the loss. Review your calculations. Choice "d" is incorrect. It is not appropriate to report the full loss as an extraordinary loss.

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