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Following are multiple choice questions recently released by the AICPA. These questions were released by the AICPA with letter answers only. Our editorial board has provided the accompanying explanations.

Please note that the AICPA generally releases questions that it does NOT intend to use again. These questions and content may or may not be representative of questions you may see on any upcoming exams.

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**1. CPA-05554**

Pinecrest Co. had variable costs of 25% of sales, and fixed costs of \$30,000. Pinecrest's break-even point in sales dollars was

- a. \$24,000
- b. \$30,000
- c. \$40,000
- d. \$120,000

**ANSWER:**

Choice "c" is correct. Break even analysis can be used to calculate the required sales dollars to produce breakeven using the following formula:

$$\text{Sales} = \frac{\text{Fixed Cost}}{\text{Contribution Margin Ratio}}$$

(contribution margin expressed as a percentage of revenue)

The fact pattern indicates that variable costs are 25% of sales. By extension, contribution must be 75% of sales (100%-25%). Break even in sales dollars is computed using the formula above based upon fixed costs given at \$30,000:

$$\begin{aligned} \text{Sales} &= \$30,000 \div 75\% \\ \text{Sales} &= \$40,000 \end{aligned}$$

Choice "a" is incorrect per computation above.

Choice "b" is incorrect. The proposed answer implies that there are no variable costs.

Choice "d" is incorrect. The proposed answer of \$120,000 divides fixed costs by variable costs expressed as a percentage of sales in error.

**2. CPA- CPA-05555 (adapted)**

Which of the following statements is correct regarding the declaration of a stock dividend by a corporation having only one class of par value stock?

- a. A stock dividend is prohibited in such a corporation.
- b. A stock dividend increases a stockholder's proportionate share of corporate ownership.
- c. A stock dividend causes a decrease in the assets of the corporation.
- d. A stock dividend is a corporation's ratable distribution of additional shares of stock to its stockholders.

**ANSWER:**

Choice "d" is correct. Stock dividends are dividends in the corporation's own authorized but unissued shares given to existing shareholders on account of their shares.

Choice "a" is incorrect. Despite the fact that a stock dividend in a corporation with only one class of par value stock does not change a shareholder's proportional ownership or affect capitalization of the corporation, nothing prohibits a corporation—even a corporation with only one class of par value stock—from declaring a stock dividend.

Choice "b" is incorrect. With a stock dividend, when there is only one class of stock, each shareholder receives a proportionate amount of stock, resulting in each shareholder owning the same percentage of the corporation after the dividend is issued as they owned before the dividend was issued.

Choice "c" is incorrect. When a stock dividend is issued in a corporation's own stock, no assets are distributed and the solvency of the corporation remains the same.

**3. CPA-05556**

What is the doctrine under which a corporation is made liable for the torts of its employees, committed within the scope of their employment?

- a. Respondeat superior.
- b. Ultra vires.
- c. Estoppel.
- d. Ratification.

**ANSWER:**

Choice "a" is correct. A principal, including a corporation, can be held liable for an employee's tort committed within the scope of employment under the doctrine of respondent superior.

Choice "b" is incorrect. Ultra vires is a doctrine limiting a corporation's power to act outside the scope of its stated purposes or statutory powers.

Choice "c" is incorrect. A corporation by estoppel is recognition of a corporate entity where there was no valid incorporation because the other party to the transaction treated the entity as if it were a corporation.

Choice "d" is incorrect. Ratification occurs when a principal agrees to be bound by a previously unauthorized contract entered into by an agent on the principal's behalf.

**4. CPA-05557**

Which of the following is usually a benefit of transmitting transactions in an electronic data interchange (EDI) environment?

- a. Elimination of the need to continuously update antivirus software.
- b. Assurance of the thoroughness of transaction data because of standardized controls.
- c. Automatic protection of information that has electronically left the entity.
- d. Elimination of the need to verify the receipt of goods before making payment.

**ANSWER:**

Choice "b" is correct. One of the benefits of EDI is that transactions are transmitted in a standardized manner with the same controls at all times because the transmission is done by an application system instead of by a person (unless the application controls are changed in some manner). What the word "thoroughness" might mean is unclear. It might mean that all (as opposed to just some) transactions are transmitted or it might mean something else. It's hard to tell, but that does not keep us from answering the question correctly. The other choices are certainly incorrect.

Choice "a" is incorrect. EDI does not have anything to do with antivirus software. It certainly does not eliminate the need to update antivirus software continuously; that need is still there. Virus software (actually the virus definitions, not necessarily the software itself) needs to be updated regularly; most anti-virus software vendors provide updated virus definitions on at least a weekly basis.

Choice "c" is incorrect. EDI has nothing to do with the automatic protection of information that has left the entity, electronically or in any other manner. Once data or information has left the entity, the entity can do nothing more to protect it. Any protection (such as encryption) would have to have been applied to the data or information before that data or information left the entity.

Choice "d" is incorrect. EDI does not have anything to do with the need to verify receipt of goods before making payment. Purchased goods should normally be received before payment is made (unless some kind of advance payment is being made). Once goods are received or payment is authorized by another means, the payment can be made, with manually or by EDI, as appropriate.

Many of the released IT questions are not some of the best examples of questions we have received (maybe that is one reason why they were released). This question is a perfect example of that kind of problem. The majority of the incorrect choices for a good question should have at least a chance of being correct and thus a chance of being selected by a candidate without the requisite knowledge; in this question, the incorrect choices are not even close and the correct answer can be obtained by a candidate with only the very slightest idea of what EDI is. However, remember that points can be obtained even for poorly-written questions, and points on all questions count the same.

**5. CPA-05558**

Which of the following is an electronic device that separates or isolates a network segment from the main network while maintaining the connection between networks?

- a. Query program.
- b. Firewall.
- c. Image browser.
- d. Keyword.

**ANSWER:**

Choice "b" is correct. A firewall is an "electronic device" (a firewall may actually be both hardware and software and not just hardware) that prevents unauthorized users from gaining access to network resources. A firewall isolates a private network of some type from a public network (or a network segment from the main network). It also maintains a (controlled) connection between those two networks.

Choice "a" is incorrect. A query program has nothing to do with connecting networks or with separating or isolating a network segment from the main network. A query program is a program that allows a user to obtain information from a database or other data source.

Choice "c" is incorrect. An image browser is a program that displays a stored graphical image. It has nothing to do with connecting networks or with separating or isolating a network segment from the main network. An image browser is used to display information from a database or other data source.

Choice "d" is incorrect. In computer programming, a keyword is a word or identifier that has a particular meaning to the programming language being used. For example, some people have seen things like (IF... THEN) in some basic programming languages (FORTRAN, COBOL, Visual Basic, and many others). Both IF and THEN are keywords, and they cannot be used in that language out of their specified context. Alternatively, in a search, a keyword is a word that is used to find information somewhere that contains that word. Either way, however, a keyword has nothing to do with connecting networks or with separating or isolating a network segment from the main network.

**6. CPA-05559**

Leslie, Kelly, and Blair wanted to form a business. Which of the following business entities does **not** require the filing of organization documents with the state?

- a. Limited partnership.
- b. Joint venture.
- c. Limited liability company.
- d. Subchapter S corporation.

**ANSWER:**

Choice "b" is correct. A joint venture is like a partnership. A partnership or joint venture can be formed without filing any documents with the state.

Choice "a" is incorrect. Formation of a limited partnership requires the filing of a certificate of limited partnership with the state.

Choice "c" is incorrect. A limited liability company may be formed only by filing articles of organization with the state.

Choice "d" is incorrect. A corporation—including a Subchapter S corporation—may be formed only by filing articles of incorporation with the state.

**7. CPA-05560**

Which of the following partners of a limited liability partnership (LLP) may avoid personal liability when a partner commits a negligent act?

- a. All the partners.
- b. The supervisor of the negligent partner.
- c. All the partners other than the negligent partner.
- d. All the partners other than the supervisor of, and, the negligent partner.

**ANSWER:**

Choice "d" is correct. LLP partners are liable only for their own negligence and the negligence of anyone who commits a wrongful act under the partner's direct control.

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

**8. CPA-05561**

Under the Revised Uniform Partnership Act, which of the following have the right to inspect partnership books and records?

- a. Employees.
- b. Former partners.
- c. Inactive partners.
- d. Transferees of partners' interests.

**ANSWER:**

Choice "c" is correct. Every partner in a partnership—whether active or inactive—has the right to inspect the partnership's books and records.

Choice "a" is incorrect. Only a partner has a right to inspect the partnership's books and records; an employee of the partnership has no such right.

Choice "b" is incorrect. Only current partners have a right to inspect the partnership's books and records; former partners do not have such a right.

Choice "d" is incorrect. Only partners have a right to inspect a partnership's books and records. A transferee of a partner's interest has only the partner's right to distributions.

**9. CPA-05562**

Card Bicycle Co. has prepared production and raw materials budgets for next year. At the end of this year, the finished product inventory is expected to include 2,000 bicycles, and raw material inventory is expected to include 3,000 bicycle tires. Each finished bicycle requires two tires. The marketing department provided the following data from the sales budget for the first quarter:

	<u>January</u>	<u>February</u>	<u>March</u>
Expected bicycle sales (units)	12,000	16,000	18,000

The company inventory policy is to have finished product inventory equal to 20% of the following month's sales requirements, and raw material equal to 10% of the following month's production requirements. In the January budget for raw materials, how many tires are expected to be purchased?

- 24,200
- 26,120
- 26,600
- 26,680

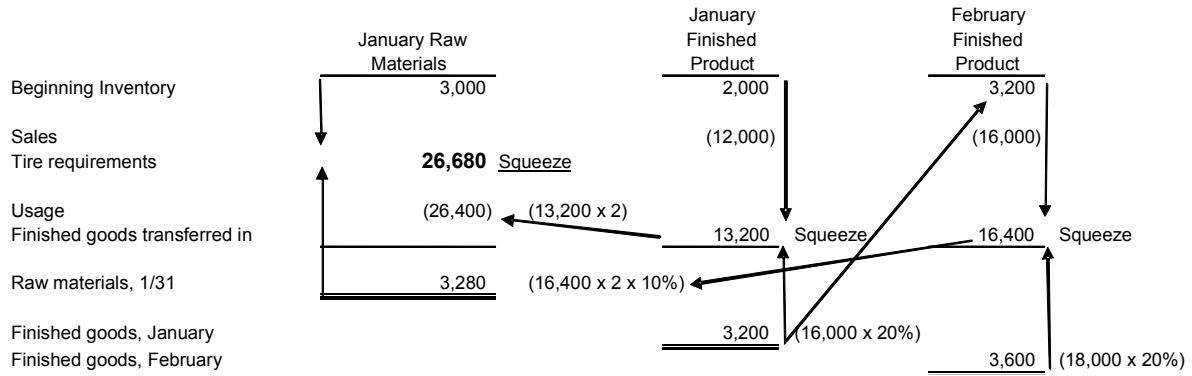
**ANSWER:**

Choice "d" is correct. January tire requirements are 26,680 tires. NOTE that this question is very detailed and quite confusing in parts. We suspect that it will be rare for something of this nature to appear frequently on the CPA exam (which is likely a reason they released the question).

There are multiple steps in computing the raw materials requirements.

- Determine the amount of raw materials transferred out by computing the amount of finished goods transferred in:
  - Compute the ending balance of January Finished Product at 3,200 (February sales x 20%) per company policy.
  - Use the beginning balance (given) and January sales (given) to squeeze out 13,200 bicycles transferred in.
  - Multiply 13,200 by 2 tires per bicycle to arrive at the number of tires transferred out of Work in Process in January.
- Use January ending finished product data and March sales data to arrive at February production requirements and, by extension, the required ending balance for January's raw materials inventory:
  - January finished goods ending balance is February finished goods beginning balance.
  - Compute the ending balance of February Finished Product at 3,600 (March sales x 20%) per company policy.
  - Use the beginning balance (computed) and February sales (given) to squeeze out 16,400 bicycles transferred in (production requirements).
  - Multiply 16,400 by 2 tires per bicycle to arrive at the number of tires needed for production requirements in February and multiply by 10% to compute the raw materials ending balance for January at 3,280 in accordance with company policy.
- Compute tire requirements (purchases) for January based on computed ending balance and computed transfers to finished goods in January and beginning inventory (given):
  - Ending balance, 3,280 + Raw materials transferred to finished goods, 26,400 – beginning inventory, 3,000 = 26,680 tires purchased.

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Choice "a" is incorrect. The proposed solution anticipates purchases will be equal to the amount of sale in January (x 2) plus the change in inventory if we incorrectly assume production requirements for February are also equal to sales.

Choice "b" is incorrect per the above computations.

Choice "c" is incorrect. The proposed solution bases raw materials ending inventory upon January rather than February production requirements.

**10. CPA-05563**

A distributed processing environment would be most beneficial in which of the following situations?

- a. Large volumes of data are generated at many locations and fast access is required.
- b. Large volumes of data are generated centrally and fast access is **not** required.
- c. Small volumes of data are generated at many locations, fast access is required, and summaries of the data are needed promptly at a central site.
- d. Small volumes of data are generated centrally, fast access is required, and summaries are needed monthly at many locations.

**ANSWER:**

Choice "a" is correct. A distributed (or decentralized) processing environment would be the most beneficial when large volumes of data are generated at many (remote) locations and fast access to the data is required. In centralized processing, there is always some delay (however small these days) in transmitting large volumes of data or transactions to the central site to be processed and then to be able to access the processed information. Decentralized processing eliminates that particular problem (although it does present other problems). Note that there seems to be an implied assumption in this question that the (remote) locations need access only to their own local data and not to all of the data for all locations. This choice seems to be better than choice "c".

Choice "b" is incorrect. If large volumes of data are generated centrally, centralized processing would probably be more beneficial, regardless of whether or not fast access to that data is required. This choice implies that little, if any, data or transactions are generated at the remote locations so there would be no real need for distributed processing.

Choice "c" is incorrect. If summaries of the data are needed "promptly" at the central site, centralized processing MIGHT be more beneficial. Since only small volumes of data are generated at the remote locations, there would probably not be much delay in transmitting that data to the central location and probably not much delay in accessing that data. Since only summaries of the data are needed at the central location, those summaries could probably be readily prepared at the remote locations. This choice is the next best, and a case could certainly be made that the choice is correct. The decision could readily come down to summaries of "what" data. Is it summaries of all of the data generated by all locations or summaries of only the data generated by the remote location? If the former is what is meant, centralized processing would be more beneficial. If the latter is what is meant, distributed processing would probably be more beneficial.

Choice "d" is incorrect. If summaries of the data are needed "monthly" at the remote sites, centralized processing MIGHT be more beneficial. However, there is no way to tell in this choice how much data is generated at the remote locations. From the way the question in total is written, an assumption might be made that there is only a small volume of data at the remote locations. If there is a large volume of data at the remote locations, decentralized processing might be more beneficial because fast access is required.

**Note:** This question is rather vague and ambiguous. Candidates should not have to make too many assumptions or read too much into the question. Unfortunately, with question, you do.

**11. CPA-05564**

Why would a firm generally choose to finance temporary assets with short-term debt?

- a. Matching the maturities of assets and liabilities reduces risk.
- b. Short-term interest rates have traditionally been more stable than long-term interest rates.
- c. A firm that borrows heavily long term is more apt to be unable to repay the debt than a firm that borrows heavily short term.
- d. Financing requirements remain constant.

**ANSWER:**

Choice "a" is correct. Matching the maturities of current assets with liabilities as they come due is designed to ensure liquidity and reduce risk of cash shortages. Temporary assets (such as inventories, generally, and seasonal inventories, specifically) might be financed with short term debt such that the earnings from the sales of those temporary assets could be used to liquidate the related obligations as they come due and ensure that cash is available to meet cash flow requirements.

Choice "b" is incorrect. Interest rate risks would likely motivate a firm to use longer term financing than short-term financing.

Choice "c" is incorrect. Matching cash inflows with cash outflows are more influential in determining a firm's ability to repay debt rather than the length of the obligation.

Choice "d" is incorrect. Long-term rather than short-term debt promotes consistent finance charges. The requirements for financing itself are driven by business practice, not by the maturity of financial instruments used.

**12. CPA-05565**

Which of the following is a disadvantage of participative budgeting?

- a. It is more time consuming.
- b. It decreases motivation.
- c. It decreases acceptance.
- d. It is **less** accurate.

**ANSWER:**

Choice "a" is correct. Participative budgeting requires input from multiple stakeholders and spreads the decision-making process over multiple layers of managers and individuals. Implementing this approach effectively is time consuming. Authoritative (top down) budgeting is faster.

Choice "b" is incorrect. Participative budgeting promotes empowerment of a wide range of individuals in the organization, and motivation will likely increase, not decrease.

Choice "c" is incorrect. Participative budgeting requires buy-in by a wide range of individuals in the organization, and acceptance will likely increase, not decrease.

Choice "d" is incorrect. Participative budgeting requires input from the individuals most responsible for the details of the operation. Thus, it tends to be more accurate.

**13. CPA-05566**

The optimal capitalization for an organization usually can be determined by the

- a. Maximum degree of financial leverage (DFL).
- b. Maximum degree of total leverage (DTL).
- c. Lowest total weighted-average cost of capital (WACC).
- d. Intersection of the marginal cost of capital and the marginal efficiency of investment.

**ANSWER:**

Choice "c" is correct. The optimal capitalization for an organization usually can be determined by the lowest total weighted-average cost of capital (WACC). Capitalization at WACC serves to maximize shareholder's equity.

Choice "a" is incorrect. The degree of financial leverage relates to the risk assumed by a firm using fixed debt service costs to finance operations not comprehensively to capital structure.

Choice "b" is incorrect. The degree of total leverage relates the risk assumed by a firm using a combination of both debt services costs to finance operations and fixed costs to operate the business, not comprehensively to capital structure.

Choice "d" is incorrect. The intersection of the marginal cost of capital and the marginal efficiency of investment does not indicate optimal capitalization.

**14. CPA-05567**

Ryan Co. projects the following monthly revenues for next year:

January	\$100,000	July	\$250,000
February	500,000	August	275,000
March	425,000	September	300,000
April	450,000	October	350,000
May	575,000	November	400,000
June	300,000	December	525,000

Ryan's terms are net 30 days. The company typically receives payment on 80% of sales the month following the sale and 17% is collected two months after the sale. Approximately 3% of sales are deemed bad debt. What amount represents the expected cash collection in the second calendar quarter of next year?

- a. \$1,450,000
- b. \$1,393,750
- c. \$1,325,000
- d. \$1,234,250

**ANSWER:**

Choice "b" is correct. Expected cash collections in the second calendar quarter are computed as follows:

Sales month	Amount	Percentage	Collection month			Total
			April	May	June	
February	500,000	17%	85,000	-	-	85,000
March	425,000	80%	340,000	-	-	340,000
March	425,000	17%	-	72,250	-	72,250
April	450,000	80%	-	360,000	-	360,000
April	450,000	17%	-	-	76,500	76,500
May	575,000	80%	-	-	460,000	460,000
Total			425,000	432,250	536,500	<b>1,393,750</b>

Choice "a" is incorrect per the above computation. This proposed solution assumes 100% collections of March, April, and May revenues during the quarter ended June 30.

Choice "c" is incorrect per the above computation. This proposed solution is purely the sum of revenue amounts for the first quarter.

Choice "d" is incorrect, per the above computation.

**15. CPA-05568**

Which of the following budgets provides information for preparation of the owner's equity section of a budgeted balance sheet?

- a. Sales budget.
- b. Cash budget.
- c. Capital expenditures budget.
- d. Budgeted income statement.

**ANSWER:**

Choice "d" is correct. The budgeted income statement produces anticipated accrual basis net income or loss and is added to beginning owner's equity to generate the owner's equity section of the budgeted balance sheet.

Choice "a" is incorrect. The sales budget is the starting point for all operating and cash flow budgets but does not directly provide information for preparation of the owner's equity section of the budgeted balance sheet.

Choice "b" is incorrect. The cash budget reconciles the budgeted income statement to the change in cash and displays cash flow requirements but does not directly provide information for preparation of the owner's equity section of the budgeted balance sheet.

Choice "c" is incorrect. The capital expenditures budget describes the amounts that will be paid for long-lived assets but does not directly provide information for preparation of the owner's equity section of the budgeted balance sheet.

**16. CPA-05569**

Super Sets, Inc. manufactures and sells television sets. All sales are finalized on credit with terms of 2/10, n/30. Seventy percent of Super Set customers take discounts and pay on day 10, while the remaining 30% pay on day 30. What is the average collection period in days?

- a. 10
- b. 16
- c. 24
- d. 40

**ANSWER:**

Choice "b" is correct. The average collection period represents the weighted average of the periods that accounts receivable are outstanding and is computed as follows:

$$\text{Customers paying on day 10} \times 70\% = 7$$

$$\text{Customers paying on day 30} \times 30\% = \underline{9}$$

$$\text{Average collection period in days} \quad \underline{\underline{16}}$$

Choice "a" is incorrect per the above computation.

Choice "c" is incorrect. This proposed solution mismatches the percentages and the days and represents the sum of the products of  $30 \times 70\%$  and  $10 \times 30\%$ .

Choice "d" is incorrect. This proposed solution is purely the sum of the two customer payment patterns presented, 10 and 30.

**17. CPA-05570**

Net present value as used in investment decision-making is stated in terms of which of the following options?

- a. Net income.
- b. Earnings before interest, taxes, and depreciation.
- c. Earnings before interest and taxes.
- d. Cash flow.

**ANSWER:**

Choice "d" is correct. Net present value, like most capital budgeting techniques, focuses on cash flow. Cash flow is a pure measure of financial performance that isolates relevant information for decision making. The amount of cash the firm takes in and pays out for an investment affects the amount of cash the firm has available for operations and other activities.

Choice "a" is incorrect. Net present value focuses on cash flows. Net income distorts financial results useful for capital budgeting decisions with non-cash items, such as depreciation, as well as with sunk costs.

Choice "b" is incorrect. Net present value focuses on cash flows. Earnings before interest, taxes, and depreciation often approximates cash flow but still distorts financial results with earnings rather than the cash flow data most useful for capital budgeting.

Choice "c" is incorrect. Net present value focuses on cash flows. Earnings before interest and taxes distort financial results with non-cash data (depreciation) as well as earnings data rather than the cash flow data most useful for capital budgeting.

**18. CPA-05571**

To prevent interrupted information systems operation, which of the following controls are typically included in an organization's disaster recovery plan?

- a. Backup and data transmission controls.
- b. Data input and downtime controls.
- c. Backup and downtime controls.
- d. Disaster recovery and data processing controls.

**ANSWER:**

Choice "c" is correct. It is difficult at best to figure out what the word "controls" is doing in any of these choices in a disaster recovery question. So let's just ignore it; it really does not make any difference to the answer. In addition, and more importantly, we have to make sure that we note the word "uninterrupted" in the question. We have to assume that the disaster recovery being referenced here is more stringent than either the hot site recovery or cold site recovery discussed in the text (i.e., the ability to recover from a disaster instantaneously with absolutely no downtime of any kind). This type of disaster recovery would normally be some kind of "mirror" facility, where two identical processing facilities are maintained at different geographical locations and all transactions are processed simultaneously at both facilities, and where either facility can take over instantaneously for the other if one is lost. This kind of disaster recovery is normally quite expensive, but it is sometimes worth it in some businesses. Downtime (or the complete lack thereof) is a key factor in the disaster recovery plan. Backup is always essential in any disaster recovery plan. Choice "c" is the only choice with both downtime and backup.

Choice "a" is incorrect. Backup is always essential in any disaster recovery plan. These days, data transmission is an integral part of normal processing and of disaster recovery, and data transmission would definitely be important in any disaster recovery plan (normal data transmission has to be re-established at the disaster recovery facility, and this sometimes is one of the more difficult things to do). However, this choice does not include the word "downtime" and this choice is thus not as good as choice "c" because it does not address the "uninterrupted" factor.

Choice "b" is incorrect. Data input controls (and here the word does have meaning) have little to do with disaster recovery. Data input controls are an essential part of normal processing, and the normal controls would be available in the recovered applications once they are recovered. Downtime is addressed in this choice, but the inclusion of the data input controls makes this choice not as good as choice "c".

Choice "d" is incorrect. It is difficult to determine what this choice even means, with or without the word "controls." It is, thus, not as good as choice "c".

**19. CPA-05572**

Which of the following is correct regarding the consumer price index (CPI) for measuring the estimated decrease in a company's buying power?

- a. The CPI is measured only once every 10 years.
- b. The products a company buys should differ from what a consumer buys.
- c. The CPI measures what consumers will pay for items.
- d. The CPI is skewed by foreign currency translations.

**ANSWER:**

Choice "b" is correct. The consumer price index measures the costs of a market basket of specific goods commonly purchased by consumers. It measures consumer buying power and is not distorted by items generally bought by industry.

Choice "a" is incorrect. The **Consumer Price Indexes (CPI)** represents monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

Choice "c" is incorrect. The Consumer Price Index measures what has been paid for items, **not** what consumers will pay for items.

Choice "d" is incorrect. The Consumer Price Index measures what has been paid by consumers in over eighty urban areas in the United States. The amounts paid are denominated in US dollars and would not be skewed by foreign currency translations.

**20. CPA-05573**

Berry, Drake, and Flanigan are partners in a general partnership. The partners made capital contributions as follows: Berry, \$150,000; Drake, \$100,000; and Flanigan, \$50,000. Drake made a loan of \$50,000 to the partnership. The partnership agreement specifies that Flanigan will receive a 50% share of profits, and Drake and Berry each will receive a 25% share of profits. Under the Revised Uniform Partnership Act and in the absence of any partnership agreement to the contrary, which of the following statements is correct regarding the sharing of losses?

- a. The partners will share equally in any partnership losses.
- b. The partners will share in losses on a pro rata basis according to the capital contributions.
- c. The partners will share in losses on a pro rata basis according to the capital contributions and loans made to the partnership.
- d. The partners will share in losses according to the allocation of profits specified in the partnership agreement.

**ANSWER:**

Choice "d" is correct. Under the Revised Uniform Partnership Act, unless agreed otherwise, partners share losses in the same manner that they share profits.

Choice "a" is incorrect. Under the Revised Uniform Partnership Act, unless agreed otherwise, partners share losses in the same manner that they share profits. Here, the partners agreed to share profits in a 2:1:1 ratio. Thus, losses will be shared in that manner rather than equally.

Choice "b" is incorrect. Under the Revised Uniform Partnership Act, unless agreed otherwise, partners share losses in the same manner that they share profits. They are not shared in accordance with the partners' capital contributions.

Choice "c" is incorrect. Under the Revised Uniform Partnership Act, unless agreed otherwise, partners share losses in the same manner that they share profits. They are not shared in accordance with the partners' capital contributions or loans.

**21. CPA-05574**

What is the cost of ending inventory given the following factors?

Beginning inventory	\$5,000
Total production costs	60,000
Cost of goods sold	55,000
Direct labor	40,000

- a. \$5,000
- b. \$10,000
- c. \$45,000
- d. \$50,000

**ANSWER:**

Choice "b" is correct. The ending inventory in a manufacturing environment is computed as follows (using the data from the fact pattern provided):

Beginning inventory	\$ 5,000
Add: Production costs*	<u>60,000</u>
Total Manufacturing costs available	65,000
Subtract: Cost of good sold	<u>(55,000)</u>
Ending inventory	<u>\$10,000</u>

\* Total production costs include direct labor, direct material and applied overhead. The information provided regarding direct labor for \$40,000 is a distracter.

Choice "a" is incorrect. The proposed solution appears to suggest that the value of inventory does not change.

Choice "c" is incorrect. The proposed solution appears to suggest that the value of inventory is the sum of direct labor charges and beginning inventory.

Choice "d" is incorrect. The proposed solution double counts direct labor and combines it with the total production costs figure in deriving ending inventory.

**22. CPA-05575**

Which of the following statements is true regarding Transmission Control Protocol and Internet Protocol (TCP/IP)?

- a. Every TCP/IP-supported transmission is an exchange of funds.
- b. TCP/IP networks are limited to large mainframe computers.
- c. Every site connected to a TCP/IP network has a unique address.
- d. The actual physical connections among the various networks are limited to TCP/IP ports.

**ANSWER:**

Choice "c" is correct. TCP/IP is the network protocol upon which the Internet is based. Knowing only that, some or all of the incorrect choices can be readily eliminated. If nothing else, the odds of guessing correctly are improved. There is detail on TCP/IP in the B4 Technical Addendum; however, TCP/IP is not discussed in the main text. The "addresses" referenced in this choice refer to network addresses, which are unique. Network addresses are discussed in the B4 Technical Addendum also; they are not discussed in the main text.

Choice "a" is incorrect. TCP/IP is not limited to exchanges of funds. The Internet is used for a lot more than just exchanges of funds, although it is certainly used for that. Knowing only that TCP/IP is the basis for the Internet, and nothing else, this choice can be readily eliminated.

Choice "b" is incorrect. TCP/IP is not limited to large (or even small) mainframe computers. It can and is used by any type of computer. Knowing only that TCP/IP is the basis for the Internet, and nothing else, this choice can be readily eliminated.

Choice "d" is incorrect. The actual physical connections among the various networks are not limited to TCP/IP ports. There are plenty of other "ports" that are used for Internet communications. Ports are discussed in the B4 Technical Addendum; they are not discussed in the main text. This choice is probably the next best choice since it takes just a little more knowledge to eliminate it.

Note: Remember that the B4 Technical Addendum should be a part of your review for the CPA Exam!

**23. CPA-05576**

Bander Co. is determining how to finance some long-term projects. Bander has decided it prefers the benefits of no fixed charges, no fixed maturity date and an increase in the credit-worthiness of the company. Which of the following would best meet Bander's financing requirements?

- a. Bonds.
- b. Common stock.
- c. Long-term debt.
- d. Short-term debt.

**ANSWER:**

Choice "b" is correct. Common stock is an equity security that conveys ownership. Common stock does not require any payment, it does not mature and, because it increases equity while having no effect on debt, it decreases the debt equity ratio and increases the credit-worthiness of the firm.

Choice "a" is incorrect. Bonds are debt instruments that require specific fixed payments, mature at a specific time and increase debt. Immediately after issue, increases in debt increase the debt equity ratio and decrease credit worthiness.

Choice "c" is incorrect. Long-term debt requires specific fixed payments, includes maturity at a specific time and (by definition), increases debt. Immediately after issue, increases in debt increase the debt equity ratio and decrease credit worthiness.

Choice "d" is incorrect. Short-term debt requires specific fixed payments, includes maturity at a specific time and, by definition, increase debt. Immediately after issue, increases in debt increase the debt equity ratio and decrease credit worthiness.

**24. CPA-05577 ADAPTED**

A city ordinance that freezes rent prices may cause

- a. The demand curve for rental space to fall.
- b. The supply curve for rental space to rise.
- c. The quantity demanded of rental space exceeds the quantity supplied.
- d. The quantity supplied of rental space exceeds the quantity demanded.

**ANSWER:**

Choice "c" is correct. A city ordinance that freezes rent prices (such as rent control and rent stabilization in New York City) may cause the quantity demanded for rental space to exceed the quantity supplied. This occurs if the rent controlled price is set below the market clearing price. At the controlled price, the quantity supplied will be constrained due to the low rent prices for the rent-controlled and rent-stabilized properties; builders will not want to build and rent properties for less than they are worth on the open market. The quantity demanded for the rental space will still be artificially high due to the city ordinance, which sets the controlled price below the market price. Thus, the quantity demanded will exceed the quantity supplied. New York City rent control is a perfect example of the effect of a price ceiling and the problems that it can cause.

Choice "a" is incorrect. A city ordinance that freezes rent prices will not cause the demand curve for rental space to fall. Price changes cause movements along the demand curve, not shifts in the demand curve.

Choice "b" is incorrect. A city ordinance that freezes rent prices will not cause the supply curve for rental space to rise. Price changes cause movements along the supply curve, not shifts in the supply curve.

Choice "d" is incorrect. A city ordinance that freezes rent prices will not cause the quantity supplied to exceed the quantity demanded. This choice is backwards.

**25. CPA-05578**

Crisper, Inc. plans to sell 80,000 bags of potato chips in June, and each of these bags requires five potatoes. Pertinent data includes:

	<u>Bags of potato chips</u>	<u>Potatoes</u>
Actual June 1 inventory	15,000 bags	27,000 potatoes
Desired June 30 inventory	18,000 bags	23,000 potatoes

What number of units of raw material should Crisper plan to purchase?

- a. 381,000
- b. 389,000
- c. 411,000
- d. 419,000

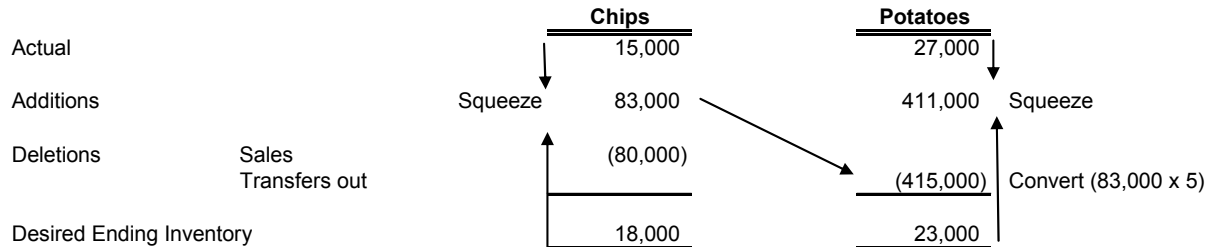
**ANSWER:**

Choice "c" is correct. The fact pattern provides beginning and ending finished goods and raw material data as well as finished goods sales data.

Begin by computing the amount of finished product (chips) completed during the period by squeezing \$83,000 in additions from the beginning and ending inventory and sales of chips data.

Assume that the additions to finished goods were transferred out of raw materials (potatoes) at the rate defined in the fact pattern, 5 potatoes per bag of chips (5 potatoes x 83,000 = 415,000).

Squeeze the 411,000 planned potatoes purchases of raw materials from the beginning and ending raw materials inventory provided and the 415,000 potatoes transfer amount derived from finished good data as follows:



Choice "a" is incorrect per the above calculation.

Choice "b" is incorrect per the above calculation.

Choice "d" is incorrect per the above calculation.

**26. CPA-05579**

The following is selected information from the records of Ray, Inc.:

Purchases of raw materials	\$ 6,000
Raw materials, beginning	500
Raw materials, ending	800
Work-in-process, beginning	0
Work-in-process, ending	0
Cost of goods sold	12,000
Finished goods, beginning	1,200
Finished goods, ending	1,400

What is the total amount of conversion costs?

- a. \$5,500
- b. \$5,900
- c. \$6,100
- d. \$6,500

**ANSWER:**

Choice "d" is correct. Conversion costs (labor and overhead) are equal to \$6,500 and are derived from the relationship between the finished goods and work in process inventory.

- Beginning (\$1,200) and ending (\$1,400) finished goods inventory and cost of goods sold (\$12,000) are used to squeeze costs of goods manufactured of \$12,200
- Cost of goods manufactured (\$12,200) is then used in combination with beginning and ending WIP inventories of \$0 to derive total costs incurred (\$12,200) and then, in combination with materials (\$5,700) the conversion costs of \$6,500 as follows:

	Work in Process		Finished Goods
Beginning Inventory	-		1,200
Material	5,700	↓	
Labor	6,500		
Overhead	6,500		
Total incurred	12,200	↑	
Total manufacturing costs available	12,200		
Less: Ending Work in Process	-		
Costs of goods sold, manufactured	<u>12,200</u>	←	12,200
Less: Ending Finished Goods			<u>(1,400)</u>
Cost of goods sold			<u>12,000</u>

Squeeze

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

**27. CPA-05580**

Which of the following costing methods provide(s) the added benefit of usefulness for external reporting purposes?

- I. Variable.
  - II. Absorption.
- a. I only.
  - b. II only.
  - c. Both I and II.
  - d. Neither I nor II.

**ANSWER:**

Choice "b" is correct. Absorption costing methods represent generally accepted accounting principles generally used for the presentation of external financial statements and are, therefore, for the benefit of external users.

Choice "a" is incorrect. Variable (sometimes called direct) costing is used for the benefit of internal users. Variable costs excludes fixed costs from product (inventoried) costs and thereby produces a contribution margin based income statement highly useful to internal managers in computing break even points and other analysis of performance.

Choice "c" is incorrect. Although item II, absorption costing is designed for external reporting, item I, variable costing primarily benefits internal managers.

Choice "d" is incorrect. Although item I, variable costing is not designed to add usefulness to external users, item II is designed for that purpose.

**28. CPA-05581**

Which of the following nonvalue-added costs associated with manufactured work in process inventory is most significant?

- a. The cost of materials that **cannot** be traced to any individual product.
- b. The cost of labor that **cannot** be traced to any individual product.
- c. The cost of moving, handling, and storing any individual product.
- d. The cost of additional resources consumed to produce any individual product.

**ANSWER:**

Choice "c" is correct. Value added costs are those resource uses that provide value to the consumer. The cost of inventorying products, generally moving, handling and storing them, does not add value to the product and is generally considered one of the most significant non-value activities/costs that a manufacturer should reduce because it can be controlled.

Choice "a" is incorrect. Costs of materials that cannot be traced to an individual product are often not controllable and are thus less manageable than inventory costs.

Choice "b" is incorrect. Costs of labor that cannot be traced to an individual product are often not controllable and are thus less manageable than inventory costs.

Choice "d" is incorrect. The incremental costs of producing an individual product is a variable cost that remains fixed per unit over the relevant range. This incremental cost can not be controlled and is less significant than inventory costs.

**29. CPA-05582**

Fil and Breed are 50% partners in F&B Cars, a used-car dealership. F&B maintains an average used-car inventory worth \$150,000. On January 5, National Bank obtained a \$30,000 judgement against Fil and Fil's child on a loan that Fil had cosigned and on which Fil's child had defaulted. National sued F&B to be allowed to attach \$30,000 worth of cars as part of Fil's interest in F&B's inventory. Will National prevail in its suit?

- a. No, because the judgement was **not** against the partnership.
- b. No, because attachment of the cars would dissolve the partnership by operation of law.
- c. Yes, because National had a valid judgement against Fil.
- d. Yes, because Fil's interest in the partnership inventory is an asset owned by Fil.

**ANSWER:**

Choice "a" is correct. A partner has no right to possess partnership property except for partnership purposes. Thus, a personal creditor of a partner has no right to attach items of partnership property to satisfy a partner's personal debt.

Choice "b" is incorrect. There is no such rule. If the partnership were liable for the individual partner's debt, the cars could be attached and the partnership would not be dissolved.

Choice "c" is incorrect. A partner has no right to possess partnership property except for partnership purposes. Thus, a personal creditor of a partner has no right to attach items of partnership property to satisfy a partner's personal debt.

Choice "d" is incorrect. A partner has no right to possess partnership property except for partnership purposes. Thus, a personal creditor of a partner has no right to attach items of partnership property to satisfy a partner's personal debt.

**30. CPA-05583**

Which of the following corporate actions is subject to shareholder approval?

- a. Election of officers.
- b. Removal of officers.
- c. Declaration of cash dividends.
- d. Removal of directors.

**ANSWER:**

process.

Choice "a" is incorrect. Officers are selected by the directors rather than by the shareholders.

Choice "b" is incorrect. Because officers are selected by the directors, generally they may be removed only by the directors.

Choice "c" is incorrect. Dividends generally can be declared only by the directors; shareholders usually do not have any right to declare or vote on a distribution.

**31. CPA-05584**

Which of the following configurations of elements represents the most complete disaster recovery plan?

- a. Vendor contract for alternate processing site, backup procedures, names of persons on the disaster recovery team.
- b. Alternate processing site, backup and off-site storage procedures, identification of critical applications, test of the plan.
- c. Off-site storage procedures, identification of critical applications, test of the plan.
- d. Vendor contract for alternate processing site, names of persons on the disaster recovery team, off-site storage procedures.

**ANSWER:**

Choice "b" is correct. All of the factors listed in the various choices are important for disaster recovery, but this question asks for the "most complete" disaster recovery plan. Any disaster plan must include an alternate processing site (of some kind), backup (of some kind) of programs and data, and a test of the plan. Normally, there must be some identification of critical applications; although, it is certainly possible in certain situations for "all" applications to be considered critical. This choice contains all of the required factors and is, thus, the best choice.

Choice "a" is incorrect. A vendor contract for an alternate processing site is normally included in a disaster recovery plan; however, it is possible for an organization to use its own facilities so that an outside vendor is not necessary. The names of persons on the disaster recovery team are not essential; the individuals involved could be identified by position and not by name. Also, testing of the plan must be included in the disaster recovery plan, and it is not in this choice.

Choice "c" is incorrect. A disaster recovery plan has to include some sort of alternate processing site, and this choice does not include that factor. In addition, backup is missing. Offsite storage tends to imply backup (since there has to be something to store offsite), but backup is not specifically included. So this choice is thus not as good as choice "b".

Choice "d" is incorrect. An alternate processing site, backup, and testing are not included in this choice.

**32. CPA-05585**

What type of computerized data processing system would be most appropriate for a company that is opening a new retail location?

- a. Batch processing.
- b. Real-time processing.
- c. Sequential-file processing.
- d. Direct-access processing.

**ANSWER:**

Choice "b" is correct. In this question, a new "retail" location is being opened. Retail locations will normally have a large number of small transactions (think of a convenience store selling beer and chips), and that might make batch processing look to be most appropriate. However, it is important to know the current status of inventory so that inventory (what is and what is not selling) can be properly replenished (think of Walmart and its supply chain systems) and so that quick price reductions can be made for inventory that is not selling. This last factor makes real-time processing most appropriate.

Choice "a" is incorrect. There is nothing wrong with batch processing, but batch processing would probably not be used these days in the situation described in the question. In the past, batch processing was used to upload transaction data from individual stores to the retailer's centralized processors (with the remainder of the processing being done centrally and possibly in batch); however, real time processing would be better (and more expensive). This kind of decision is almost always a cost/benefit decision. It would certainly be possible, in this situation, to have the retail store transactions uploaded after the close of business in batch, further processing of the transactions to be done centrally in batch, and new inventory figures transmitted back to the store in batch after the central processing is complete.

Choice "c" is incorrect. Sequential file processing is almost totally restricted to batch processing. Sequential file processing was used extensively in the "good old days" but it is seldom used these days for major application files, which are almost always disk files and allow direct access. Tapes (which are the normal sequential files) are normally restricted to backups and storage for very large amounts of data that are too expensive to be stored on disk and for which there is no real need for relatively quick access.

Choice "d" is incorrect. This choice would have been better worded as "direct access file" processing (or it means absolutely nothing). Reworded, direct access file processing is the opposite of sequential file processing. It would most certainly be used in the "retail" applications, but that does not mean it is the correct answer.

**33. CPA-05586**

Which of the following terms represents the residual income that remains after the cost of all capital, including equity capital, has been deducted?

- a. Free cash flow.
- b. Market value-added.
- c. Economic value-added.
- d. Net operating capital.

**ANSWER:**

Choice "c" is correct. Economic value-added is a residual income technique used for capital budgeting and performance evaluation. It represents the residual (excess) income of project earnings in excess of the cost of capital (including cost of equity) associated with invested capital.

Choice "a" is incorrect. Free cash flow is defined as operating cash flows net of dividends paid to preferred shareholders and capital expenditures—it is not a residual income technique.

Choice "b" is incorrect. Market value added is defined as the difference between the market value of company's stock and the adjusted book value of the equity and debt invested in the company—it is not a residual income technique.

Choice "d" is incorrect. Net operating capital is a term generally synonymous with working capital—it is not a residual income technique.

**34. CPA-05587**

What should be examined to determine if an information system is operating according to prescribed procedures?

- a. System capacity.
- b. System control.
- c. System complexity.
- d. Accessibility to system information.

**ANSWER:**

Note to Students: The terms referenced in this question do not show up (or rarely show up) in practice and are confusing in that we have to apply assumptions about what they must mean. Therefore, they are not included in our text or in the Technical Addendum for B4. The most likely explanation about why this question was released is that it was not answered correctly by candidates and that it will not be used again. However, we are going to use this question as a learning experience for our students. What do you do when you are faced with a question that does not make a whole bunch of sense? Generally, you try to eliminate answers that could not be correct and do your best to choose among the remaining alternatives. Remember, you need a 75% to PASS... questions like this one rarely show up.

Choice "b" is correct. This question is asking if the system is operating according to "prescribed procedures." It is difficult to determine what the words "prescribed procedures" and "system control" even mean. We pretty much have to assume that "prescribed procedures" means that the system is operating "correctly" or is producing the correct results. With that interpretation, the best way that the correct answer can be obtained is by eliminating the other choices as being incorrect. Choice "b" is then the only one left.

Choice "a" is incorrect. System capacity is a factor in operating a system (system capacity normally means processor capacity (i.e., how many transactions can the processor or processors process in a certain period of time), but it has nothing directly to do with whether the system is operating correctly. A system can have the capacity to generate a large number of incorrect answers. This choice can be eliminated.

Choice "c" is incorrect. System complexity is a factor in operating a system, but it theoretically has nothing to do with whether the system is operating correctly. It is true that the more complex a system, the less chance there is that it will operate correctly. Complexity breeds errors. However, that does not make this choice the correct answer.

Choice "d" is incorrect. Accessibility to system information is a factor in operating a system, but it has nothing to do with whether the system is operating correctly. Somewhat like system capacity, a system can be less than optimal in that it does not provide the (desired) access to system information (assumed here to be the application data in the system or information about how the system is operating), but that does not mean that the system is not operating correctly. It just may not be meeting some of its accessibility requirements.

**35. CPA-05588**

Which of the following formulas should be used to calculate the economic rate of return on common stock?

- a.  $(\text{Dividends} + \text{change in price}) \div \text{beginning price}$ .
- b.  $(\text{Net income} - \text{preferred dividend}) \div \text{common shares outstanding}$ .
- c.  $\text{Market price per share} \div \text{earnings per share}$ .
- d.  $\text{Dividends per share} \div \text{market price per share}$ .

**ANSWER:**

Choice "a" is correct. The economic rate of return on common stock measures the dividend income and capital growth in relation to the initial investment, the beginning price of the stock.

Choice "b" is incorrect. The proposed solution is earnings per share, a ratio generally computed as the earnings available to common share holders (net income after payment of preferred shares) divided by the common shares outstanding.

Choice "c" is incorrect. Market price per share divided by earnings per share is the price/ earnings or P/E ratio, not the economic rate of return on common stock.

Choice "d" is incorrect. The dividends per share divided by the market price per share does not represent the economic rate of return on common stock, the ratio includes change in stock value in the denominator rather than the numerator of the equation.

**36. CPA-05589**

Fargo, Mfg., a small business, is developing a budget for next year. Which of the following steps should Fargo perform first?

- a. Forecast Fargo's sales volume.
- b. Determine the price of Fargo's products.
- c. Identify costs of Fargo's forecasted sales volume.
- d. Compute the dollar amount of Fargo's forecasted sales.

**ANSWER:**

Choice "a" is correct. Forecast of sales volume is the first step in the budget development process. Sales volumes will drive product supply requirements and, by extension, purchasing and inventory requirements.

Choice "b" is incorrect. Product pricing will serve as a basis for projecting sales revenue based on sales volume. Pricing will generally be set at a rate to cover costs that were forecast based upon sales volume amounts that were projected first.

Choice "c" is incorrect. Identifying the costs of goods manufactured to sustain sales volume would be computed based upon the forecast of sales volume. Sales volume is forecasted first.

Choice "d" is incorrect. The dollar volume is Fargo's forecasted sales is projected as price times sales volume. Price is generally set at a level to cover cost of goods sold, an amount dependent upon sales volume. Sales volume is forecasted first.

**37. CPA-05590**

What is the effect when a foreign competitor's currency becomes weaker compared to the U.S. dollar?

- a. The foreign company will have an advantage in the U.S. market.
- b. The foreign company will be disadvantaged in the U.S. market.
- c. The fluctuation in the foreign currency's exchange rate has **no** effect on the U.S. company's sales or cost of goods sold.
- d. It is better for the U.S. company when the value of the U.S. dollar strengthens.

**ANSWER:**

Choice "a" is correct. As a foreign competitor's currency becomes weaker compared to the US dollar, the product becomes less expensive in US dollars. The less expensive product will have the advantage in the US market.

Choice "b" is incorrect. As a foreign competitor's currency becomes weaker compared to the US dollar, the product becomes less expensive in US dollars. The less expensive product will have the advantage in the US market, not a disadvantage.

Choice "c" is incorrect. Foreign currency exchange rates impact both sales and possibly cost of goods sold of a competing domestic company. Sales within US markets will deteriorate as the currency of foreign competitors deteriorates and makes the domestic company's goods more expensive. As a foreign competitor's currency appreciates, sales within US markets by a domestic company should also increase as goods manufactured in the US become less expensive. Cost of goods sold may fluctuate if foreign suppliers are used.

Choice "d" is incorrect. It is better for a US company when the value of the US dollar weakens, not strengthens. A weak US dollar makes domestic goods relatively less expensive than imported goods.

**38. CPA-05591**

Which of the following factors is inherent in a firm's operations if it utilizes only equity financing?

- a. Financial risk.
- b. Business risk.
- c. Interest rate risk.
- d. Marginal risk.

**ANSWER:**

Choice "b" is correct. Business risk represents the risk associated with the unique circumstances of a particular company, as they might affect the shareholder value of that company. If an entity purely uses its own cumulative earnings in capitalizing its operations, it is exposed to the risks of its own unique circumstances.

Choice "a" is incorrect. Financial risk, also called default risk, relates to the exposure of lenders to the failure of borrowers to repay principal and interest on debt. An entity using its own cumulative earnings in capitalizing its operations is not exposed to default risk.

Choice "c" is incorrect. A business that exclusively uses equity capitalization would not be exposed to the risk that the value of its financial instruments will change as a result of changes in interest rates.

Choice "d" is incorrect. Incremental changes in risk would be limited if a firm exclusively used its own equity financing to capitalize its operations.

**39. CPA-05592**

What is strategic planning?

- a. It establishes the general direction of the organization.
- b. It establishes the resources that the plan will require.
- c. It establishes the budget for the organization.
- d. It consists of decisions to use parts of the organization's resources in specified ways.

**ANSWER:**

Choice "a" is correct. Strategic planning is the creation of an overall strategic plan for an organization to achieve its overall "business objectives." The strategic plan will establish the general direction of the organization.

Choice "b" is incorrect. Strategic planning will not establish the resources that the plan will require. The resources that the plan will require are part of the implementation of the strategic plan, not part of the plan itself.

Choice "c" is incorrect. Strategic planning will not establish the budget for the organization. Budgets are even further down implementing the plan than are the resources that the plan will require.

Choice "d" is incorrect. Strategic planning does not consist of decisions to use parts of the organization's resources in specified ways. Again, these decisions are part of the implementation of the strategic plan, not part of the plan itself.

**40. CPA-05593**

The following table contains Emerald Corp.'s quarterly revenues, in thousands, for the past three years. During that time, there were no major changes to Emerald's selling strategies and total capital investment.

<u>Year</u>	<u>1st Qtr.</u>	<u>2nd Qtr.</u>	<u>3rd Qtr.</u>	<u>4th Qtr.</u>
Year 1	500	500	550	750
Year 2	525	550	600	800
Year 3	550	525	625	850

Which of the following statements best describes the likely cause of the fluctuations in Emerald's revenues and the best response to those fluctuations?

- The fluctuations are from changes in the economy, and Emerald should examine its cost structure for potential changes.
- The fluctuations are from changes in the economy, and Emerald should manage its inventories and cash flow to match the cycle.
- The fluctuations are from the seasonal demand for Emerald's products, and Emerald should examine its cost structure for potential changes.
- The fluctuations are from the seasonal demand for Emerald's products, and Emerald should manage its inventories and cash flow to match the cycle.

**ANSWER:**

Choice "d" is correct. Relatively stable demand over a three year period in each of the first three quarters of the year followed by an increase of between 40 and 50 percent in the final quarter of the year over average sales in the first three quarters in each of the three years presented is indicative of seasonal fluctuations in demand for Emerald's product that would require appropriate inventory management.

Choice "a" is incorrect. The consistent volume levels and fluctuation percentages displayed for the activity in each quarter for each year are indicative of changes in seasonal demand rather than changes in the economy generally.

Choice "b" is incorrect. The consistent volume levels and fluctuation percentages displayed for the activity in each quarter for each year are indicative of changes in seasonal demand rather than changes in the economy generally.

Choice "c" is incorrect. Relatively stable demand over a three year period in each of the first three quarters of the year followed by an increase of between 40 and 50 percent in the final quarter of the year over average sales in the first three quarters in each of the three years presented is indicative of seasonal fluctuations in demand for Emerald's product. The company should be more attentive to the timing of inventory purchases to meet demand, however, rather than the company's overall cost structure.

**41. CPA-05594**

The CFO of a company is concerned about the company's accounts receivable turnover ratio. The company currently offers customers terms of 3/10, net 30. Which of the following strategies would most likely improve the company's accounts receivable turnover ratio?

- a. Pledging the accounts receivable to a finance company.
- b. Changing customer terms to 1/10, net 30.
- c. Entering into a factoring agreement with a finance company.
- d. Changing customer terms to 3/20, net 30.

**ANSWER:**

Choice "c" is correct. The accounts receivable turnover ratio is expressed as  $\text{Sales} \div \text{Accounts Receivable}$ . A reduction in accounts receivable would serve to improve (increase) the turnover ratio. Factoring (selling) receivables would serve to reduce the amount of accounts receivable (indicating more rapid collections) thereby increasing (improving) the company's accounts receivable.

Choice "a" is incorrect. Pledging accounts receivable does not impact either sales or accounts receivable. There would be no improvement in the accounts receivable turnover ratio.

Choice "b" is incorrect. Changing the customer terms from 3/10, net 30 to 1/10, net 30 would actually reduce discount incentives to pay timely. Accounts receivable would likely remain the same or be higher. There would be no improvement in the company's accounts receivable turnover ratio.

Choice "d" is incorrect. Changing the customer terms from 3/10, net 30 to 3/20, net 30 would actually reduce incentives to pay timely by increasing the amount of time in which the customer could capitalize on the discount. Accounts receivable would likely remain the same or be higher. There would be no improvement in the company's accounts receivable turnover ratio.

**42. CPA-05595**

Which of the following artificial intelligence information systems **cannot** learn from experience?

- a. Neural networks.
- b. Case-based reasoning systems.
- c. Rule-based expert systems.
- d. Intelligent agents.

**ANSWER:**

Choice "c" is correct. Artificial intelligence is discussed in the B4 Technical Addendum; it is not discussed in the main text. Rule-based expert systems are based on rules that are built into the system. The only way that those systems can "learn" is if the rules are updated by some external party. That is not really the "system" that is learning.

Choice "a" is incorrect. Neural networks are networks that are based (as much as possible) on the human brain. The human brain can learn from experience, and neural networks can learn (at least theoretically).

Choice "b" is incorrect. Case-based reasoning systems are systems that reason based on past problems that are similar. This reasoning is a form of learning.

Choice "d" is incorrect. Intelligent agents (in an artificial intelligence sense) are agents that assist users and act on their behalf. The "intelligent" aspect means, or at least implies, that the agent can learn from what is happening or what has happened.

**43. CPA-05596**

Which of the following allows customers to pay for goods or services from a web site while maintaining financial privacy?

- a. Credit card.
- b. Site draft.
- c. E-cash.
- d. Electronic check.

**ANSWER:**

Choice "c" is correct. Electronic payment systems are discussed in the B4 Technical Addendum; they are not discussed in the main text. E-cash is currency in an electronic form that moves outside the normal channels of money. It maintains financial privacy just like real cash does.

Choice "a" is incorrect. A credit card cannot be used to pay for goods or services while maintaining (complete) financial privacy. While a particular site may be very secure, the mere fact of presenting the credit card does not maintain financial privacy.

Choice "b" is incorrect. A "site draft" (which is actually a "sight draft" which means that it can be seen) is a draft (see R6 Commercial Paper); it is a negotiable instrument that is payable on demand. It does not maintain (complete) financial privacy any more than a check does.

Choice "d" is incorrect. An electronic check does not maintain financial privacy any more than a paper check does.

**44. CPA-05597**

A project has an initial outlay of \$1,000. The projected cash inflows are:

Year 1	\$200
Year 2	200
Year 3	400
Year 4	400

What is the investment's payback period?

- a. 4.0 years.
- b. 3.5 years.
- c. 3.4 years.
- d. 3.0 years.

**ANSWER:**

Choice "b" is correct. The payback period is computed as the number of years required to fully recover the original investment with out respect to the time value of money. With uneven cash flows, the payback period is computed by development of a cumulative payback balance converted to years as follows:

	<u>Cash Inflow</u>		<u>Years Required</u>	=	<u>Adjusted Cash Inflow</u>	<u>Cumulative Cash Inflow</u>
Year 1	\$200	x	1.0	=	\$200	\$ 200
Year 2	\$200	x	1.0	=	\$200	\$ 400
Year 3	\$400	x	1.0	=	\$400	\$ 800
Year 4	\$400	x	<u>0.5</u>	=	\$200	\$1,000
<b>Payback period</b>			<b><u>3.5</u></b>			

Choice "a" is incorrect. Although the payback occurs in the fourth year, only half the year is required. The payback period is 3.5 not 4.0 years.

Choice "c" is incorrect. Although the payback occurs in the fourth year, half the year is required. The payback period is 3.5 not 3.4 years.

Choice "d" is incorrect. The payback occurs in the fourth year. The payback period is 3.5 not 3.0 years.

**45. CPA-05598**

Which of the following is a requirement for a small business corporation to elect S corporation status?

- a. It has only one class of stock.
- b. It has at least one partnership as a shareholder.
- c. It has international ownership.
- d. It has more than 75 shareholders.

**ANSWER:**

Choice "a" is correct. A corporation may elect to be taxed like a partnership under Subchapter S only if it has only one class of stock.

Choice "b" is incorrect. A corporation can elect S corporation status only if its shareholders are individuals, estates, or certain types of trusts.

Choice "c" is incorrect. Foreign shareholders generally are prohibited in an S corporation.

Choice "d" is incorrect. An S corporation can have up to 100 shareholders.

**46. CPA-05599**

The president of a company has signed a \$10 million contract with a construction company to build a new corporate office. Which of the following corporate documents sets forth the scope of authority under which this transaction is governed?

- a. Certificate of Incorporation.
- b. Charter.
- c. By-laws.
- d. Proxy statement.

**ANSWER:**

Choice "c" is correct. The bylaws usually contain the rules for running the corporation.

Choice "a" is incorrect. A certificate of incorporation usually is a document issued by the state confirming that a corporation has properly been formed. It usually does not include much detail on powers of intracorporate persons.

Choice "b" is incorrect. This is a possible choice, but not as good an answer as "a". A corporation's charter (called articles of incorporation in many states) sets out certain required information, but it may include any other information provided it is not illegal. However, usually details about intracorporate power are set out in bylaws rather than the charter.

Choice "d" is incorrect. A proxy statement is a request to shareholders to allow their shares to be voted by a specified person in a specified way. It has nothing to do with a corporate president's authority.

**47. CPA-05600**

Which of the following effects would a lockbox most likely provide for receivables management?

- a. Minimized collection float.
- b. Maximized collection float.
- c. Minimized disbursement float.
- d. Maximized disbursement float.

**ANSWER:**

Choice "a" is correct. A lockbox system expedites cash inflows (minimizes collection float) by having a bank receive payments from a company's customers directly, via mailboxes to which the bank has access. Payments that arrive in these mailboxes are deposited into the company's account immediately.

Choice "b" is incorrect. Lockboxes minimize rather than maximize collection float.

Choice "c" is incorrect. Lockbox systems relate to collection rather than disbursement float.

Choice "d" is incorrect. Lockbox systems relate to collection rather than disbursement float.

**48. CPA-05601**

On June 30, 2003, a company is preparing the cash budget for the third quarter. The collection pattern for credit sales has been 60% in the month of sale, 30% in the first month after sale, and the rest in the second month after sales. Uncollectible accounts are negligible. There are cash sales each month equal to 25% of total sales. The total sales for the quarter are estimated as follows: July, \$30,000; August, \$15,000; September, \$35,000. Accounts receivable on June 30, 2003, were \$10,000. What amount would be the projected cash collections for September?

- a. \$21,375
- b. \$28,500
- c. \$30,125
- d. \$37,250

**ANSWER:**

Choice "c" is correct. Cash collections for the month of September are computed as follows using the fact pattern described above.

<u>Month</u>	<u>Total Sales</u>	<u>Cash Sales (25%)</u>	<u>Net Credit Sales</u>	<u>July</u>	<u>August</u>	<u>September</u>
June		-	10,000	7,500	2,500	
July	30,000	7,500	22,500	13,500	6,750	2,250 (22,500 x 10%)
August	15,000	3,750	11,250		6,750	3,375 (11,250 x 30%)
September	35,000	8,750	26,250			15,750 (26,250 x 60%)
September receivables collections						21,375
September cash sales						8,750 (35,000 x 25%)
<b>Total cash collections</b>						<b>\$ 30,125</b>

Choice "a" is incorrect. The proposed solution excludes cash sales as a component of cash collections.

Choice "b" is incorrect, per the above calculation.

Choice "d" is incorrect. The proposed solution anticipates that all sales are credit sales collected over a three month period and ignores the cash collection percentage in error.

**49. CPA-05602**

Quick Co. was analyzing variances for one of its operations. The initial budget forecast production of 20,000 units during the year with a variable manufacturing overhead rate of \$10 per unit. Quick produced 19,000 units during the year. Actual variable manufacturing costs were \$210,000. What amount would be Quick's flexible budget variance for the year?

- a. \$10,000 favorable.
- b. \$20,000 favorable.
- c. \$10,000 unfavorable.
- d. \$20,000 unfavorable.

**ANSWER:**

Choice "d" is correct. The flexible budget variance is \$20,000 unfavorable and represents the difference between actual performance and the budget at the achieved volume. Actual expenses are greater than the computed budget. The variance is unfavorable and is computed as follows:

	Actual	Flexible Budget @ Actual	Master Budget
Production		19,000	20,000
Overhead rate		\$ 10.00	\$ 10.00
Actual costs	\$ 210,000	\$ 190,000	\$ 200,000
	<div style="display: flex; justify-content: center; align-items: center; gap: 20px;"> <span style="font-size: 2em;">}</span> <span style="font-size: 2em;">}</span> </div>		
	<p><b>\$ (20,000)</b> <b>Flexible budget variance</b></p>		<p>\$ 10,000 Volume variance</p>

Choice "a" is incorrect. The proposed answer is the volume variance, not the flexible budget variance. The volume variance is \$10,000 favorable and represents the difference between the master budget (the budget at the initial volume forecast for the budget) and the flexible budget (the budget at the achieved volume). Because the achieved volume is less than the planned volume, the volume variance is favorable.

Choice "b" is incorrect. The flexible budget variance is \$20,000 unfavorable because actual expenditures are greater than budget amounts.

Choice "c" is incorrect. The flexible budget variance is \$20,000 unfavorable, not \$10,000 unfavorable.