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QUESTION 1

Freeman, a single individual, reported the following income in the current year:

Guaranteed payment from services rendered to a partnership \$50,000 Ordinary income from a S corporation \$20,000

What amount of Freeman's income is subject to self-employment tax?

- A. \$0
- B. \$20,000
- C. \$50,000
- D. \$70,000

Correct Answer: C

Explanation: Choice "c" is correct. Guaranteed payments are reasonable compensation paid to a partner for services rendered (or use of capital) without regard to his ratio of income. Earned compensation is subject to self-employment tax. Payments not guaranteed are merely another way to distribute partnership profits. The ordinary income reported from an S corporation are taxable income to the individual or their own individual tax return but is not subject to self-employment tax. The ordinary income reported from a partnership may be subject to self-employment tax (if to a general partner).

QUESTION 2

According to the FASB conceptual framework, which of the following is an essential characteristic of an asset?

- A. The claims to an asset's benefits are legally enforceable.
- B. An asset is tangible.
- C. An asset is obtained at a cost.
- D. An asset provides future benefits.

Correct Answer: D

Explanation:

Choice "d" is correct. An asset provides future benefits.

Rule: According to the FASB conceptual framework, assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

QUESTION 3

If a publicly held company issues financial statements that purport to present its financial position and results of operations but omits the statement of cash flows, the auditor ordinarily will express a(an):



- A. Disclaimer of opinion.
- B. Qualified opinion.
- C. Review report.
- D. Unqualified opinion with a separate explanatory paragraph.

Correct Answer: B

Explanation:

Choice "b" is correct. If a company issues financial statements that purport to present financial position and results of operations but omits the related statement of cash flows, the auditor will normally conclude that the omission requires qualification of the opinion.

Choice "a" is incorrect. If the company fails to present its statement of cash flows, this is considered inadequate disclosure. The auditor would not issue a disclaimer of opinion for inadequate disclosure.

Choice "c" is incorrect. The auditor would not issue a review report when performing an audit.

Choice "d" is incorrect. The auditor cannot issue an unqualified report if the client omits a statement of cash flows from the financial statements.

QUESTION 4

A perfectly inelastic supply curve in a competitive market:

- A. Means the equilibrium price must be zero.
- B. Implies a vertical demand curve.
- C. Exists when firms cannot vary input usage.
- D. Says the market supply curve is horizontal.

Correct Answer: C

Explanation:

Choice "c" is correct. Price elasticity of supply is calculated the same way as demand except that quantity supplied is measured:

$$\text{Price elasticity of supply \%} = \frac{\% \text{ Change in Q supplied}}{\text{Change in price}}$$

Perfectly inelastic supply curves are also vertical representing that supply is insensitive to changes in price;



i.e., the quantity supplied will not change as price changes.

Perfectly inelastic supply curves would exist if firms cannot vary input usage. Regardless of price, the firm has to use all inputs if it produces at all.

Choices "a", "b", and "d" are incorrect, as they are far-out distractors.

QUESTION 5

Which of the following controls is most likely to prevent the improper disposition of equipment?

- A. A separation of duties between those authorized to dispose of equipment and those authorized to approve removal work orders.
- B. The use of serial numbers to identify equipment that could be sold.
- C. Periodic comparison of removal work orders to authorizing documentation.
- D. A periodic analysis of the scrap sales and the repairs and maintenance accounts.

Correct Answer: A

Explanation: Choice "a" is correct. Separation of duties between those authorized to dispose of equipment and those authorized to approve removal work orders is most likely to prevent the improper disposition of equipment. Choice "b" is incorrect. Serial number tracking is a good audit and control activity but it will not prevent improper dispositions of equipment. Choices "c" and "d" are incorrect. Periodic comparison of removal work orders to authorizing documentation and periodic analysis of scrap sales and the repairs and maintenance accounts may identify improper dispositions that have already occurred, but such procedures will not prevent improper dispositions.