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QUESTION 1

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
	30	
Inventory	500	200
Prepaid expenses	100	40
Other assets	<u>400</u>	<u>150</u>
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 is ABC's acid-test ratio at December 31, 20X2?

- A. 1.5
- B. 1.6
- C. 2.0
- D. 2.1

Correct Answer: A

Explanation:

Choice "a" is correct. The acid-test ratio is calculated by taking the current assets excluding inventory and prepaid expenses and dividing by current liabilities. In this case, cash and accounts receivable (\$300 + \$1,200 = \$1,500) are divided by current liabilities (\$1,000), resulting in a ratio of \$1,500/\$1,000, or 1.5.

Choice "b" is incorrect. The numerator in the acid-test ratio formula includes only cash and accounts receivable. It would not include prepaid expenses.

Choice "c" is incorrect. The numerator in the acid-test ratio formula includes only cash and accounts receivable. It would not include inventory.

Choice "d" is incorrect. The numerator in the acid-test ratio formula includes only cash and accounts receivable. It would not include inventory and prepaid expenses.



QUESTION 2

Which of the following best describes the responsibility of the auditor to report significant deficiencies and material weaknesses in an attest engagement to examine the effectiveness of a nonissuer's internal control?

- A. The auditor must communicate both significant deficiencies and material weaknesses.
- B. The auditor must communicate material weaknesses, but need not disclose significant deficiencies.
- C. The auditor must communicate significant deficiencies, but need not separately identify material weaknesses.
- D. Neither significant deficiencies nor material weaknesses are required to be communicated.

Correct Answer: A

Explanation:

Choice "a" is correct. In an attest engagement to examine the effectiveness of an entity's internal control, the auditor must communicate both significant deficiencies and material weaknesses to management and those charged with governance.

Choice "b" is incorrect. The auditor is required to communicate significant deficiencies.

Choices "c" and "d" are incorrect. Both significant deficiencies and material weaknesses are required to be communicated to management and those charged with governance.

QUESTION 3

Conner purchased 300 shares of Zinco stock for \$30,000 in 1980. On May 23, 1994, Conner sold all the stock to his daughter Alice for \$20,000, its then fair market value. Conner realized no other gain or loss during 1994. On July 26, 1994, Alice sold the 300 shares of Zinco for \$25,000.

What was Alice's recognized gain or loss on her sale?

- A. \$0
- B. \$5,000 long-term gain.
- C. \$5,000 short-term loss.
- D. \$5,000 long-term loss.

Correct Answer: A

Explanation: Choice "a" is correct. Alice has a realized gain of \$5,000 on the transaction: \$25,000 sales price less \$20,000 purchase price. However, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her. Thus, Alice can reduce her gain by up to \$10,000, but not below zero. Here, the gain is \$5,000, so it is reduced to zero. Conner should have sold the stock in the open market so that he could deduct the



entire loss. Alice could then have purchased the stock in the open market. Choice "b" is incorrect. \$5,000 is Alice's realized long-term gain on the sale. However, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her. Choice "c" is incorrect. Alice has a realized gain of \$5,000 on the sale. However, since she is related to Conner, her holding period includes his holding period. Therefore, her realized gain is long-term. In addition, she can reduce the gain, but not below zero, by the amount of loss her father could not deduct on the sale to her. Choice "d" is incorrect. Alice can reduce the gain by the amount of loss her father could not deduct on the sale to her. However, she cannot reduce the gain below zero.

QUESTION 4

Which of the following items does not pertain to the control environment?

- A. Management's philosophy and operating style.
- B. Participation of those charged with governance.
- C. The accounting records.
- D. Personnel policies and practices.

Correct Answer: C

Explanation:

Choice "c" is correct. The accounting records pertain to the information and communication system, not to the control environment.

Choices "a", "b", and "d" are incorrect, as management's philosophy and operating style, participation of those charged with governance, and personnel policies and practices are all part of the control environment.

QUESTION 5

The principle measure of non-diversifiable risk included in the CAPM formula is the beta coefficient. The beta coefficient measures the volatility or risk inherent in an investment by:

- A. Computing the ratio of changes in earnings per share to changes in sales.
- B. Computing the ratio of stock price to earnings per share.
- C. Computing the ratio of percentage changes in a stock's price to percentage changes in overall market values during the same period.
- D. Computing the ratio of percentage changes in the expected value of alpha equivalents to derivative fluctuations.

Correct Answer: C

Explanation:

Choice "c" is correct. The beta coefficient represents the measure of a particular stock's percentage



change compared to the percentage change in the market over the same period. The equation for the beta coefficient is as follows:

% ? in Stock Price

% ? in Market price

Choice "a" is incorrect. The percentage change in earnings per share related to a percentage change in sales represents the degree of combined leverage.

Choice "b" is incorrect. The ratio of stock price to earnings per share is the price earnings ratio.

Choice "d" is incorrect. Choice "d" represents a word salad distracter of nonsense terms.

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