QUESTION SECTION

AUDITING AND ATTESTATION

1. CPA-03107

On February 25, a CPA issued an auditor's report expressing an unqualified opinion on financial statements for the year ended January 31. On March 2, the CPA learned that on February 11, the entity incurred a material loss on an uncollectible trade receivable as a result of the deteriorating financial condition of the entity's principal customer that led to the customer's bankruptcy. Management then refused to adjust the financial statements for this subsequent event. The CPA determined that the information is reliable and that there are creditors currently relying on the financial statements. The CPA's next course of action most likely would be to:

a. Notify the entity's creditors that the financial statements and the related auditor's report should no longer be relied on.
b. Notify each member of the entity's board of directors about management's refusal to adjust the financial statements.
c. Issue revised financial statements and distribute them to each creditor known to be relying on the financial statements.
d. Issue a revised auditor's report and distribute it to each creditor known to be relying on the financial statements.

2. CPA-03209

May an accountant accept an engagement to compile or review the financial statements of a not-for-profit entity if the accountant is unfamiliar with the specialized industry accounting principles, but plans to obtain the required level of knowledge before compiling or reviewing the financial statements?

	Compilation	*Review*
a.	No	No
b.	Yes	No
c.	No	Yes
d.	Yes	Yes

3. CPA-02897

Which of the following statements reflects an auditor's responsibility for detecting errors and fraud?

a. An auditor is responsible for detecting employee errors and fraud, but not for discovering fraud involving employee collusion or management override.
b. An auditor should plan the audit to detect errors and fraud that are caused by departures from GAAP.
c. An auditor is not responsible for detecting errors and fraud unless the application of GAAS would result in such detection.
d. An auditor should design the audit to provide reasonable assurance of detecting errors and fraud that are material to the financial statements.

4. CPA-02493

Which of the following circumstances most likely would cause an auditor to believe that material misstatements may exist in an entity's financial statements?

a. Accounts receivable confirmation requests yield significantly fewer responses than expected.
b. Audit trails of computer-generated transactions exist only for a short time.
c. The chief financial officer does **not** sign the management representation letter until the last day of the auditor's fieldwork.
d. Management consults with other accountants about significant accounting matters.

5. CPA-02873

An auditor desired to test credit approval on 10,000 sales invoices processed during the year. The auditor designed a statistical sample that would provide 1% risk of assessing control risk too low (99% confidence) that not more than 7% of the sales invoices lacked approval. The auditor estimated from previous experience that about 2 1/2% of the sales invoices lacked approval. A sample of 200 invoices was examined and 7 of them were lacking approval. The auditor then determined the upper deviation rate to be 8%.

In the evaluation of this sample, the auditor decided to increase the level of the preliminary assessment of control risk because the:

a. Tolerable rate (7%) was less than the upper deviation rate (8%).
b. Expected deviation rate (7%) was more than the percentage of errors in the sample (3 1/2%).
c. Upper deviation rate (8%) was more than the percentage of errors in the sample (3 1/2%).
d. Expected deviation rate (2 1/2%) was less than the tolerable rate (7%).

6. CPA-02734

An internal auditor's work would most likely affect the nature, timing, and extent of an independent CPA's auditing procedures when the internal auditor's work relates to assertions about the:

a. Existence of contingencies.
b. Valuation of intangible assets.
c. Existence of fixed asset additions.
d. Valuation of related party transactions.

REGULATION

7. CPA-01812

Astor, a cash-basis taxpayer, died on February 3. During the year, the estate's executor made a distribution of $12,000 from estate income to Astor's sole heir and adopted a calendar year to determine the estate's taxable income. The following additional information pertains to the estate's income and disbursements for the year:

Estate income	
Taxable interest	$65,000
Net long-term capital gains allocable to corpus	5,000
Estate disbursements	
Administrative expenses attributable to taxable income	14,000
Charitable contributions from gross income to a public charity, made under the terms of the will	9,000

For the calendar year, what was the estate's distributable net income (DNI)?

a. $39,000
b. $42,000
c. $58,000
d. $65,000

8. CPA-01511

Which of the following services may a CPA perform in carrying out a consulting service for a client?

I. Analysis of the client's accounting system.
II. Review of the client's prepared business plan.
III. Preparation of information for obtaining financing.

a. I and II only.
b. I and III only.
c. II and III only.
d. I, II, and III.

9. CPA-01289

On September 10, Harris, Inc., a new car dealer, placed a newspaper advertisement stating that Harris would sell 10 cars at its showroom for a special discount only on September 12, 13, and 14. On September 12, King called Harris and expressed an interest in buying one of the advertised cars. King was told that five of the cars had been sold and to come to the showroom as soon as possible. On September 13, Harris made a televised announcement that the sale would end at 10:00 PM that night. King went to Harris' showroom on September 14 and demanded the right to buy a car at the special discount. Harris had sold the 10 cars and refused King's demand. King sued Harris for breach of contract. Harris' best defense to King's suit would be that Harris':

a. Offer was unenforceable.
b. Advertisement was not an offer.
c. Television announcement revoked the offer.
d. Offer had not been accepted.

10. CPA-01656

Under the UCC Secured Transactions Article, if a debtor is in default under a payment obligation secured by goods, the secured party has the right to:

	Peacefully repossess the goods without judicial process	*Reduce the claim to a judgment*	*Sell the goods and apply the proceeds toward the debt*
a.	Yes	Yes	Yes
b.	No	Yes	Yes
c.	Yes	Yes	No
d.	Yes	No	Yes

11. CPA-01352

Dart Inc., a closely held corporation, was petitioned involuntarily into bankruptcy under the liquidation provisions of Chapter 7 of the Federal Bankruptcy Code. Dart contested the petition.

Dart has not been paying its business debts as they became due, has defaulted on its mortgage loan payments, and owes back taxes to the IRS. The total cash value of Dart's bankruptcy estate after the sale of all assets and payment of administration expenses is $100,000.

Dart has the following creditors:

- Fracon Bank is owed $75,000 principal and accrued interest on a mortgage loan secured by Dart's real property. The property was valued at and sold, in bankruptcy, for $70,000.
- The IRS has a $12,000 recorded judgment for unpaid corporate income tax.
- JOG Office Supplies has an unsecured claim of $2,000 that was timely filed.
- Nanstar Electric Co. has an unsecured claim of $1,200 that was not timely filed.
- Decoy Publications has a claim of $15,000, of which $2,000 is secured by Dart's inventory that was valued and sold, in bankruptcy, for $2,000. The claim was timely filed.

Which of the following creditors must join in the filing of the involuntary petition?

I. JOG Office Supplies.
II. Nanstar Electric Co.
III. Decoy Publications.

a. I, II, & III.
b. II & III.
c. I & II.
d. III only.

BUSINESS

12. CPA-03237

Jeb, a member in J & S LLC, sold his interest in the LLC to Chris without obtaining the other member's consent. Absent an agreement to the contrary, Chris:

I. May participate in the management of J & S.
II. May receive Jeb's share of J & S' profits.
III. Is not entitled to anything since Jeb did not obtain the other member's consent.

a. I only.
b. I and II only.
c. II only.
d. III only.

13. CPA-03722

Long Lake Golf Course has raised green fees to a nine-hole game due to an increase in demand.

	Previous Rate	New Rate	Average Games Played at Previous Rate	Average Games Played at New Rate
Regular weekday	$10	$11	80	70
Senior citizen	6	8	150	82
Weekend	15	20	221	223

Which of the following is correct?

a. The regular weekday and weekend demand is inelastic.
b. The regular weekday and weekend demand is elastic.
c. The senior citizen and weekend demand is inelastic.
d. The senior citizen demand is elastic and weekend demand is inelastic.

14. CPA-03761

Which of the following is **not** true about the purchasing power parity theory of explaining changes in exchange rates?

a. Purchasing power of a common currency in different economies for similar products will remain the same.
b. Inflationary forces on foreign and domestic currencies will cause the exchange rates to automatically adjust to ensure that a common currency will have identical or similar purchasing power in each economy for similar goods.
c. Interest rates include a premium or discount that ensures purchasing power parity.
d. The purchasing power parity theory is presented in both absolute and relative form.

15. CPA-03347

In order to increase production capacity, Gunning Industries is considering replacing an existing production machine with a new technologically improved machine effective January 1, 1997. The following information is being considered by Gunning Industries.

- The new machine would be purchased for $160,000 in cash. Shipping, installation, and testing would cost an additional $30,000.
- The new machine is expected to increase annual sales by 20,000 units at a sales price of $40 per unit. Incremental operating costs are comprised of $30 per unit in variable costs and total fixed costs of $40,000 per year.
- The investment in the new machine will require an immediate increase in working capital of $35,000.
- Gunning uses straight-line depreciation for financial reporting and tax reporting purposes. The new machine has an estimated useful life of five years and zero salvage value.
- Gunning is subject to a 40 percent corporate income tax rate.

Gunning uses the net present value method to analyze investments and will employ the following factors and rates.

Present	Present Value of $1 at 10%	Present Value of an Ordinary Annuity of $1 at 10%
1	.909	.909
2	.826	1.736
3	.751	2.487
4	.683	3.170
5	.621	3.791

The overall discounted cash flow impact of Gunning Industries' working capital investment for the new production machine would be:

a. $(7,959)
b. $(10,680)
c. $(13,265)
d. $(35,000)

16. CPA-04608

Which of the following statements is (are) correct for access controls?

I. Access controls limit access to program documentation, data files, programs, and computer hardware.
II. Passwords should consist of words that can be found in a common dictionary and should be of a maximum length so that they can be easily remembered.
III. A backdoor is a means of access to a program or system that bypasses normal security mechanisms. Backdoors should be maintained so that there can be quick access to the system or program for emergency situations.

a. I and II only are correct.
b. I only is correct.
c. III only is correct.
d. II and III only are correct.

17. CPA-03484

Lankip Company produces two main products and a byproduct out of a joint process. The ratio of output quantities to input quantities of direct material used in the joint process remains consistent from month to month. Lankip has employed the physical-volume method to allocate joint production costs to the two main products. The net realizable value of the byproduct is used to reduce the joint production costs before the joint costs are allocated to the main products. Data regarding Lankip's operations for the current month are presented in the chart below. During the month, Lankip incurred joint production costs of $2,520,000. The main products are not marketable at the split-off point and, thus, have to be processed further.

	First Main Product	*Second Main Product*	*Byproduct*
Monthly output in pounds	90,000	150,000	60,000
Selling price per pound	$ 30	$ 14	$ 2
Process costs	$ 540,000	$660,000	

The amount of joint production cost that Lankip would allocate to the Second Main Product by using the physical-volume method to allocate joint production costs would be:

a. $1,260,000
b. $1,500,000
c. $1,575,000
d. $1,650,000

18. CPA-04601

Which of the following statements is **not** correct for segregation of duties in an IT environment?

a. The IT department is a support group in that it normally does not initiate or authorize transactions.
b. Segregation of duties in an IT environment normally revolves around granting and/or restricting access to production data and/or production programs.
c. The duties of system analysts and application programmers should never be combined.
d. Segregation of duties in an IT environment is defined as dividing responsibilities for different portions of a transaction among several different people.

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FINANCIAL

19. CPA-00460

On December 1, 1995, Money Co. gave Home Co. a $200,000, 11% loan. Money paid proceeds of $194,000 after the deduction of a $6,000 nonrefundable loan origination fee. Principal and interest are due in 60 monthly installments of $4,310, beginning January 1, 1996. The repayments yield an effective interest rate of 11% at a present value of $200,000 and 12.4% at a present value of $194,000. What amount of income from this loan should Money report in its 1995 income statement?

a. $0
b. $1,833
c. $2,005
d. $7,833

20. CPA-00267

Nola Co. has adopted Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities.* Nola has a portfolio of marketable equity securities which it does not intend to sell in the near term. How should Nola classify these securities, and how should it report unrealized gains and losses from these securities?

	Classify as	*Report as a*
a.	Trading securities	Component of income from continuing operations
b.	Available-for-sale securities	Component of other comprehensive income
c.	Trading securities	Component of other comprehensive income
d.	Available-for-sale securities	Component of income from continuing operations

21. CPA-00414

On December 31, 1992, Dirk Corp. sold Smith Co. two airplanes and simultaneously leased them back. Additional information pertaining to the sale-leasebacks follows:

	Plane #1	*Plane #2*
Sales price	$600,000	$1,000,000
Carrying amount, 12/31/92	$100,000	$550,000
Remaining useful life, 12/31/92	10 years	35 years
Lease term	8 years	3 years
Annual lease payments	$100,000	$200,000

In its December 31, 1992, balance sheet, what amount should Dirk report as deferred gain on these transactions?

a. $950,000
b. $500,000
c. $450,000
d. $0

22. CPA-00694

Payne, Inc. implemented a defined-benefit pension plan for its employees on January 2, 1993. The following data are provided for 1993, as of December 31, 1993:

Accumulated benefit obligation	$103,000
Plan assets at fair value	78,000
Net periodic pension cost	90,000
Employer's contribution	70,000

What amount should Payne record as additional minimum pension liability at December 31, 1993?

a. $0
b. $5,000
c. $20,000
d. $45,000

23. CPA-01226

In preparing its cash flow statement for the year ended December 31, 1994, Reve Co. collected the following data:

Gain on sale of equipment	$ (6,000)
Proceeds from sale of equipment	10,000
Purchase of A.S., Inc. bonds (par value $200,000)	(180,000)
Amortization of bond discount	2,000
Dividends declared	(45,000)
Dividends paid	(38,000)
Proceeds from sale of Treasury stock (carrying amount $65,000)	75,000

In its December 31, 1994, statement of cash flows, what amount should Reve report as net cash provided by financing activities?

a. $20,000
b. $27,000
c. $30,000
d. $37,000

24. CPA-00373

In a business combination, how should long-term debt of the acquired company generally be reported under each of the following methods?

	Pooling of interest	*Purchase*
a.	Fair value	Carrying amount
b.	Fair value	Fair value
c.	Carrying amount	Fair value
d.	Carrying amount	Carrying amount

25. CPA-00890

Which funds would most appropriately use the current financial resources measurement focus and modified accrual basis of accounting in their fund financial statements:

	Governmental	*Proprietary*	*Fiduciary*
a.	Yes	No	Yes
b.	No	Yes	Yes
c.	Yes	No	No
d.	Yes	Yes	Yes

ANSWER SECTION

AUDITING AND ATTESTATION

1. CPA-03107

Choice "b" is correct. Since the material loss affects the audit report and there are creditors relying on the financial statements, the client properly should adjust the financial statements. Since they are refusing to do so, the auditor would most likely notify the board of directors of the situation in an attempt to encourage the adjustment.

Choice "a" is incorrect. The auditor would only notify the creditors if the board of directors was unable to facilitate the proper adjustment.

Choice "c" is incorrect. The auditor cannot issue revised financial statements; only the client can do that.

Choice "d" is incorrect. If the board of directors is unable to facilitate the proper adjustment, the auditor would no longer allow the audit report to be associated with the financial statements, but the auditor would not issue a revised report.

2. CPA-03209

Choice "d" is correct. Knowledge of the accounting principles and practices of the industry is required in order to perform a compilation or review engagement; however, there is no requirement that such knowledge be obtained prior to accepting such an engagement.

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

3. CPA-02897

Choice "d" is correct. The auditor should assess the risk that errors and fraud may cause the financial statements to contain a material misstatement. Based on that assessment, the auditor should design the audit to provide reasonable assurance of detecting material errors and fraud.

Choice "a" is incorrect. An auditor is responsible for designing the audit to provide reasonable assurance of detecting material misstatement. This responsibility is the same regardless of the cause of the misstatement. The presence of employee collusion or management override does not change the auditor's responsibility, although it might explain why a properly planned and executed audit did not result in the discovery of material fraud.

Choice "b" is incorrect. The audit should be designed to detect **material** errors and fraud, regardless of the cause.

Choice "c" is incorrect. The auditor is not "responsible for detecting errors and fraud," but is responsible for designing the audit to provide reasonable assurance of detecting material misstatement, whether due to errors or fraud. Note that the auditor's responsibility relates to the design and execution of the audit, and that even an audit performed in accordance with GAAS may miss a material misstatement.

4. CPA-02493

Choice "a" is correct. Confirmation of accounts receivable confirm the existence of a customer. A lower than expected response rate could be indicative of fictitious customer accounts.

Choice "b" is incorrect. In a computerized accounting environment, audit trails generally exist for only a short time.

Choice "c" is incorrect. The management representation letter should be signed and dated as of the last day of fieldwork.

Choice "d" is incorrect. Consultation with other accountants would not cause an auditor to believe material misstatements have occurred.

5. CPA-02873

Choice "a" is correct. The auditor decided to increase the level of the preliminary assessment of control risk because the 7% tolerable rate (maximum rate of deviations that an auditor would be willing to accept without altering his/her planned reliance on the control) was less than the 8% upper deviation rate.

Choice "b" is incorrect. The expected deviation rate was 2.5%, not 7%.

Choice "c" is incorrect. The upper deviation rate is always more than the percentage of errors in the sample since the sum of the percentage of the errors and the allowance for sampling risk equals the upper deviation rate.

Choice "d" is incorrect. The expected deviation rate is not used in evaluating the sample. It is the upper deviation rate that is compared to the tolerable rate in evaluating a sample.

6. CPA-02734

Choice "c" is correct. In making judgments about the extent of the effect of the internal auditor's work on the auditor's procedures, the auditor considers the materiality of financial statement amounts, the risk of material misstatement of the assertions related to these financial statement amounts, and the degree of subjectivity involved in the evaluation of the audit evidence gathered in support of the assertions. As the degree of subjectivity increases, the need for the auditor to perform tests of the assertions increases. Testing the existence of fixed asset additions involves very little subjectivity, and thus may reduce the auditor's testing in this area.

Choice "a" is incorrect. Testing the existence of contingencies involves much subjectivity, and should, therefore, be performed by the auditor.

Choice "b" is incorrect. Testing the valuation of intangible assets involves much subjectivity, and should, therefore, be performed by the auditor.

Choice "d" is incorrect. Testing the valuation of related party transactions involves much subjectivity, and should, therefore, be performed by the auditor.

REGULATION

7. CPA-01812

Choice "b" is correct. The estate's distributable net income (DNI) for the calendar year is $42,000.

Rule: Absent written provisions to the contrary, capital gains and losses are classified as principal and must remain with the estate or trust (i.e., allocated to corpus) to be taxed at the estate or trust level.

Rule: All other taxable income (i.e., gross income net of deductible expenses) generated by the fiduciary assets is generally classified as distributable net income (DNI). Distributable net income is adjusted total income (line 17 on the Form 1041) with modifications for tax-exempt interest (included in DNI and allocated as tax exempt) and capital gains and losses (excluded from DNI and allocated to corpus).

Gross income:	
Taxable interest	$65,000
Tax exempt interest	--
Deductible expenses:	
Administrative expenses	(14,000)
Charitable contributions from gross income	(9,000)
Distributable net income	$42,000

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

8. CPA-01511

Choice "d" is correct. In a management consulting services engagement, the CPA may do all three of the listed choices.

9. CPA-01289

Choice "b" is correct. Advertisements are generally not offers, but invitations to negotiate. An advertisement is an offer only if it is a promise to perform a very specific act conditioned upon acceptance. If Harris' ad had stated that Harris would sell 10 specifically identified cars for a specified price during the sale, Harris' advertisement would be an offer. Harris' actual advertisement is too vague to be an offer.

Choice "a" is incorrect. The advertisement here is too vague to be considered an offer since it does not specify which cars or what the special discount is.

Choice "c" is incorrect. The announcement did not revoke an offer because the original ad was too vague to be considered an offer since it does not specify which cars or what the special discount is.

Choice "d" is incorrect. The advertisement here is too vague to be considered an offer since it does not specify which cars or what the special discount is. Thus, there was no offer to be accepted or not accepted.

10. CPA-01656

Choice "a" is correct. After default, a secured creditor can peacefully repossess the goods or bring an action to reduce the claim to judgment and have the goods repossessed and sold judicially, or sell the goods and apply the proceeds toward the debt.

11. CPA-01352

Choice "d" is correct. If a person has fewer than 12 creditors, any one or more of them with claims that aggregate at least $12,300 more than the value of any collateral securing the claim may file the petition. Decoy Publications has a claim for $13,000 beyond its security. JOG Office Suppliers' claim is for $2,000, not enough by itself to justify filing and unnecessary if Decoy files. Similarly, Nanstar is owed only $1,200, not enough by itself to justify filing and unnecessary if Decoy files.

BUSINESS

12. CPA-03237

Choice "c" is correct. Absent an agreement to the contrary, if a member in the LLC sells his interest in an LLC without obtaining the other member's consent, the assignee is only entitled to receive the assignor's share of profits.

Choices "a", "b", and "d" are incorrect, because, absent an agreement to the contrary, although a member of an LLC is allowed to assign his interest in profits and losses, an assignee of a membership interest may not participate in the management of the LLC.

13. CPA-03722

Choice "d" is correct. Demand is elastic if a decrease in price (P) results in an increase in total revenue (TR); or if an increase in P results in a decrease in TR. On the other hand, if demand is inelastic a decrease in P will result in a decrease in TR; or an increase in P will result in an increase in TR.

First, the total revenues at both the new and the previous rate must be computed. In a similar manner to above problem 4, the (new or previous) rate* average games played (AGP) = the total revenue. As a result, TR at the previous rate (PR) is 800 for regular weekday (RW), 900 for senior citizen (SC), and 3315 for the weekend (WE). TR at the new rate (NR) is 770 for RW, 656 for SC, and 4460 for WE.

So, demand for RW and SC is elastic because the increase in P results in a decrease in total revenue. The demand for WE is inelastic because the increase in P results in an increase in TR (see 1st paragraph).

As a result, choices "a", "b", and "c" are incorrect.

Note: if TR remains constant after a change in P, the demand is unit elastic.

14. CPA-03761

Choice "c" is correct. The purchasing power parity theory holds that inflation will cause exchange rates to automatically adjust to ensure that an equal amount of a common currency will purchase similar goods in separate economies. The International Fischer effect considers the premium or discount on interest rates as an indicator of inflation.

Choice "a" is incorrect. The basic idea underlying the purchasing power parity theory is that the purchasing power of a common currency in different economies for similar products will remain the same and that inflation in any particular economy will cause exchange rates to adjust until parity is consistently achieved.

Choice "b" is incorrect. The purchasing power parity theory holds that inflationary forces on foreign and domestic currencies will cause the exchange rates to automatically adjust to ensure that a common currency will have identical or similar purchasing power in each economy for similar goods.

Choice "d" is incorrect. The purchasing power parity theory is presented as both an absolute theory of parity determination regardless of market imperfections and as a relative concept that considers market imperfections.

15. CPA-03347

Choice "c" is correct. $(13,265) overall discounted cash flow impact of working capital investment.

Period	Cash Flow		PV Interest Factor		PV of Cash Flow	
0	35,000	×	1,000	=	(35,000)	PV of cash outflow (increase in working capital) in year 1
5	35,000	×	(.621)	=	21,735	PV of cash inflow release of working capital) in year 5
					(13,265)	Overall discounted cash flow impact of working capital investment

16. CPA-04608

Choice "b" (I only is correct) is the correct answer because Statement I is the only correct statement. Access controls limit access to program documentation, data files, programs, and computer hardware.

Statement II is incorrect. Passwords should not consist of words that can be found in a common dictionary and should be of a minimum, not a maximum, length.

Statement III is incorrect. A backdoor is a means of access to a program or system that bypasses normal security mechanisms. Backdoors should be eliminated.

17. CPA-03484

Choice "b" is correct. $1,500,000 joint cost is allocated to the second main product by using the physical-volume method.

Joint costs	$2,520,000
Less net realizable value of byproduct (60,000 × $2)	(120,000)
Net joint costs to be allocated	$2,400,000

$$\frac{\text{150,000 pounds of second main product}}{\text{240,000 pounds of total (first + second) main products}} \times \$2{,}400{,}000 = \$1{,}500{,}000$$

Choices "a", "c", and "d" are incorrect based on the above explanation.

18. CPA-04601

Choice "c" is the correct answer, as it is the only incorrect statement. The duties of system analysts and application programmers can be, and often are, combined. The duties of system programmers and application programmers should not be combined.

Choice "a" is incorrect because the statement is true. The IT department is a support group that normally does not initiate or authorize transactions.

Choice "b" is incorrect because the statement is true. Segregation of duties normally revolves around granting and/or restricting access to production programs and/or production data.

Choice "d" is incorrect because the statement is true. Segregation of duties in an IT environment is defined as dividing responsibilities for different portions of a transaction among several different people.

FINANCIAL

19. CPA-00460

Rule: Loan origination fees shall be deferred and recognized over the life of the loan as an adjustment of interest income (similar to the treatment of bond discount amortization).

Choice "c" is correct. $2,005 income from this loan in 1995.

Face amount of loan	$200,000
Nonrefundable loan origination fee	(6,000)
Net amount loaned	194,000
Effective interest rate (yield)	12.4%
	24,056
Outstanding one month (12/1/95 - 12/31/95)	× 1/12
Interest income for 1995	$ 2,005

20. CPA-00267

Choice "b" is correct. Investments in marketable equity securities which the company does not intend to sell in the near term should be classified as available-for-sale. Unrealized gains and losses on available-for-sale securities should be reported as a separate component of other comprehensive income.

21. CPA-00414

Choice "b" is correct. Because no present value information is given, we must assume that the Plane 1 lease is "major." It qualifies as a capital lease because it meets the 75% test (8 year term out of 10 year life is 80%). In "major" sale-leasebacks, all gain is deferred. We must also assume that the Plane 2 lease is "minor" because it will be classified as an operating lease (it fails all "OWNS" tests we are able to perform based on the given information). In "minor" sale-leasebacks, there is no deferral.

Choice "a" is incorrect. The leaseback on Plane 2 is considered minor because the lease life is less than 75% of its useful life. Therefore all gain is recognized on Plane 2.

Choice "c" is incorrect. The leaseback on Plane 2 is considered minor because the lease life is less than 75% of useful life. Therefore all gain is recognized rather than deferred on Plane 2.

Choice "d" is incorrect. Plane 1 is a capital lease since the lease term is greater than 75% of its useful life. The gain must be deferred.

22. CPA-00694

Choice "b" is correct. The accumulated benefit obligation ($103,000) exceeds the plan assets at fair value ($78,000) by $25,000, the minimum pension liability that must be reported. The balance sheet already includes a pension cost liability of $20,000 (pension cost of $90,000 less employer contribution of $70,000). Thus, an additional pension liability of $5,000 ($25,000 less $20,000) must be reported.

Choice "a" is incorrect. An additional pension liability must be reported.

Choice "c" is incorrect. $20,000 is the existing pension cost liability which is a component of determining how much, if any, additional pension liability must be reported.

Choice "d" is incorrect. If the existing pension account had been a pension asset (from overfunding compared to pension expense recognized) of $20,000, then a $45,000 additional pension liability would be necessary so that the total of the two accounts (credit $45,000 and debit $20,000) would represent the minimum pension liability of $20,000.

23. CPA-01226

Cash provided by financing activities:

Dividends paid	(38,000)
Proceeds from sale of Treasury stock	75,000
Net cash provided by financing activities	37,000

Choice "d" is correct. $37,000. Financing activities include obtaining resources from owners and providing them with a return on, and a return of, their investment; borrowing money and repaying amounts borrowed. Dividends paid, not dividends declared, should be included as an outflow of cash from financing activities.

24. CPA-00373

Choice "c" is correct. In the pooling of interest method, all assets and liabilities are reported at their carrying value, since no acquisition is recognized. In the purchase method, all assets and liabilities are reported at their fair values (as if the net assets had been purchased separately).

25. CPA-00890

Choice "c" is correct. Governmental funds use the current financial resources measurement focus and modified accrual basis of accounting in their fund financial statements. Proprietary and Fiduciary Funds use the economic resources measurement focus and accrual basis of accounting.

Not "a", "b", or "d", per above.