ADDIS ABABA UNIVERSITY

College of Business and Economics

Accounting and Finance

Model Exit Exam

Attempt the following 25 multiple choice questions and press submit when you complete all items.

51. Using the maturity-matching principle, which of the following types of assets should be financed with long-term financing?

A. Fixed assets only.

B. Fixed assets and temporary current assets.

C. Fixed assets and permanent current assets.

D. Temporary and permanent current assets

Answer=c

The maturity-matching principle is a financial management strategy that suggests matching the maturity of assets with the maturity of liabilities. In other words, it recommends financing long-term assets with long-term financing and short-term assets with short-term financing.

Let's analyze each option:

A. Fixed assets only: This option suggests financing only fixed assets with long-term financing. However, it doesn't address the financing needs for current assets, which could lead to a mismatch between short-term assets and long-term liabilities.

B. Fixed assets and temporary current assets: This option suggests financing both fixed assets and temporary current assets with long-term financing. While it considers the financing of fixed assets correctly, using long-term financing for temporary current assets may result in higher costs and could be inefficient.

C. Fixed assets and permanent current assets: This option aligns with the maturity-matching principle by recommending the financing of both fixed assets and permanent current assets with long-term financing. Permanent current assets are those that a company holds on a continuous basis, and using long-term financing for these aligns with the principle of matching maturities.

D. Temporary and permanent current assets: This option suggests financing both temporary and permanent current assets with long-term financing. Financing temporary current assets with long-term financing may not be optimal, as these assets are typically held for a short period. It could lead to unnecessary interest costs and a mismatch in maturities.

Therefore, option C (Fixed assets and permanent current assets) is the correct choice because it aligns with the maturity-matching principle by recommending the use of long-term financing for both fixed assets and permanent current assets.

52. ABC Company is considering replacing a machine. The following data are available as presented in the table below.

Which of the data provided in the table is a sunk cost and what is the difference between keeping the old machine and replacing the old machine?

	Old Machine	**Replacement Machine**
Original COST	90000	70000
Useful life in years	20	10
Current age in years	10	-
Book value	50000	-
Disposal value now	16000	-
Disposal value in 5 years	-	-
Annual cash operating cost	14000	8000

A. Birr 50,000 sunk cost and 74,000 in favour of keeping the old machine

B. Birr 70,000 sunk cost and Birr 74,000 in favour of replacing the old machine

C. Birr 50,000 and Birr 24,000 in favour of keeping the old machine

D. Birr 70,000 and Birr 24,000 in favour of replacing the old machine

Answer=c

Workout: Replacement Decision Analysis

Scenario: ABC Company is considering replacing an old machine.

Data:

Feature	**Old Machine**	**Replacement Machine**
Original Cost	Birr 90,000	Birr 70,000
Useful Life	20 years	10 years
Current Age	10 years	-
Book Value	Birr 50,000	-
Disposal Value Now	Birr 16,000	-
Disposal Value in 5 years	-	-
Annual Cash Operating Cost	Birr 14,000	Birr 8,000

- **Objective: Determine if it's financially better to keep the old machine or replace it.**

Step 1: Identify the sunk cost.

- A sunk cost is a cost already incurred that cannot be recovered, regardless of the decision.
- In this case, the Birr 50,000 book value of the old machine is the sunk cost.

Step 2: Calculate the future costs and benefits for each option.

Keeping the old machine:

- Annual operating cost for remaining 10 years: 10 years * Birr 14,000/year = Birr 140,000
- Disposal value after 10 years: Birr 16,000

Replacing the old machine:

- Initial cost: Birr 70,000
- Annual operating cost for 10 years: 10 years * Birr 8,000/year = Birr 80,000
- Disposal value of the new machine after 10 years: Assume negligible for this workout.

Step 3: Compare the options.

- **Calculate the total benefit of keeping the old machine:**

  Disposal value + savings in initial cost

  = Birr 16,000 + (Birr 70,000 - Birr 140,000) = Birr 26,000

- **Remember to deduct the sunk cost for a fair comparison:**

  Total benefit - sunk cost

  = Birr 26,000 - Birr 50,000 = Birr -24,000

Conclusion:

- Keeping the old machine would result in a negative difference of Birr 24,000.
- This indicates that replacing the machine would be more financially beneficial in the long run, despite the initial investment cost.

Note: This workout assumes the disposal value of the new machine after 10 years is negligible. In a real-life scenario, this value should be included in the analysis for a more accurate comparison.

Key Takeaways:

- Sunk costs are irrelevant when making future decisions.

- Consider all future costs and benefits when comparing options.
- Choose the option that maximizes long-term financial benefit.

OR

You're correct! Option C. Birr 50,000 sunk cost and Birr 24,000 in favour of keeping the old machine is the accurate answer. Let's break down the reasoning:

Sunk cost: In this scenario, the Birr 50,000 book value of the old machine is the sunk cost. This amount has already been incurred and cannot be recovered regardless of the decision to keep or replace the machine.

Calculating the difference: Now, we need to compare the future costs and benefits of both options:

- **Keeping the old machine:**
    - Annual cash operating cost for remaining 10 years: 10 years * Birr 14,000/year = Birr 140,000
    - Disposal value after 10 years: Birr 16,000
- **Replacing the old machine:**
    - Initial cost of the new machine: Birr 70,000
    - Annual cash operating cost for 10 years: 10 years * Birr 8,000/year = Birr 80,000
    - Disposal value of the new machine after 10 years (not provided in the table, assume negligible for calculation purposes)

Difference in favour of keeping the old machine:

(Disposal value of old machine + savings in initial cost) - (Additional operating cost)

(Birr 16,000 + Birr 70,000) - (Birr 140,000 - Birr 80,000) = Birr 86,000 - Birr 60,000 = Birr 26,000

However, remember that we should deduct the sunk cost for a fair comparison:

Total benefit of keeping the old machine - Sunk cost Birr 26,000 - Birr 50,000 = Birr -24,000

Therefore, keeping the old machine would result in a negative difference of Birr 24,000, indicating that replacing the machine would be more financially beneficial in the long run.

Important note:

- Remember that the disposal value of the new machine after 10 years was not provided and assumed negligible for calculation purposes. In a real-life scenario, this value should be included in the analysis for a more accurate comparison**.**

53. Which of the following statements about cost of capital is incorrect?

A. A company's target capital structure affects its weighted average cost of capital.

B. Weighted average cost of capital calculations should be based on the after-tax costs of all the individual capital components

C. If a company's tax rate increases, then, all else equal, its weighted average cost of capital will increase.

D. Flotation costs can increase the weighted average cost of capital.

Answer=c

The correct answer is C. "If a company's tax rate increases, then, all else equal, its weighted average cost of capital will increase."

Explanation:

A. A company's target capital structure affects its weighted average cost of capital. - This statement is correct. The weighted average cost of capital (WACC) takes into account the proportion of debt and equity in a company's capital structure. Changes in the target capital structure can impact the overall WACC.

B. Weighted average cost of capital calculations should be based on the after-tax costs of all the individual capital components. - This statement is correct. WACC is calculated using the after-tax costs of debt

and the cost of equity. The after-tax cost of debt is considered because interest payments are tax-deductible.

C. If a company's tax rate increases, then, all else equal, its weighted average cost of capital will increase. - This statement is incorrect. An increase in the tax rate would actually lead to a decrease in the after-tax cost of debt, which, in turn, would lower the overall WACC. Therefore, an increase in the tax rate would not increase the WACC, assuming all else remains equal.

D. Flotation costs can increase the weighted average cost of capital. - This statement is correct. Flotation costs, which are incurred when issuing new securities, can increase the overall cost of capital. These costs should be considered in the WACC calculation because they impact the net proceeds received from issuing new securities.

In summary, option C is incorrect because an increase in the tax rate generally results in a decrease in the after-tax cost of debt, leading to a lower weighted average cost of capital.

54. Rice Industries owns a manufacturing plant in a foreign country. Political unrest in the country indicates that Rice should investigate for possible impairment. Below is information related to the plant's assets (Birr in millions):

• Book value Birr 190

• Undiscounted sum of future estimated cash flows 210

•Present value of future cash flows195

•Fair value less cost to sell (determined by appraisal) 180 The amount of impairment loss that Rice should recognize is:

A. There is no impairment.

B. Birr 10 million

C. Birr 20 million

D. Birr 15 million

Answer=A

The correct answer is A. "There is no impairment."

Explanation:

Impairment of assets occurs when the carrying amount of an asset exceeds its recoverable amount, which is the higher of its fair value less costs to sell and its value in use. In this case, let's compare the carrying amount (book value) with the various indicators of recoverable amount:

1. Book value: Birr 190 million
2. Undiscounted sum of future estimated cash flows: Birr 210 million
3. Present value of future cash flows: Birr 195 million
4. Fair value less cost to sell (appraisal): Birr 180 million

Since the book value (Birr 190 million) is less than both the undiscounted sum of future estimated cash flows (Birr 210 million) and the present value of future cash flows (Birr 195 million), and it is also not greater than the fair value less cost to sell (Birr 180 million), there is no impairment.

Therefore, option A is the correct answer. Rice Industries does not need to recognize an impairment loss as the carrying amount is not higher than the recoverable amount based on the provided information.

55. A 15-year annuity pays Birr 2,200 per month, and payments are made at the end of each month. If the interest rate is 10 percent compounded monthly for the first seven years, and 6 percent compounded monthly thereafter, what is the present value of the annuity

A. Birr 299,930

B. Birr 83,375

C. Birr 167,409

D. Birr 215,895

Answer=D

56. Assume that a client has encountered a Birr 500,000 fraud and that the Auditor's percentage of responsibility established at 10%, while the company itself was responsible for the other 90%. Under

which approach to liability is the Auditor most likely to avoid liability entirely?

A. Absolute negligence.

B. Comparative negligence.

C. Contributory negligence.

D. Joint Negligence.

Answer=c

The correct answer is C. "Contributory negligence."

Explanation:

Under contributory negligence, liability is allocated based on the degree of negligence of each party involved. In this scenario, the auditor's percentage of responsibility is established at 10%, and the company itself is responsible for the remaining 90%. Contributory negligence allows for a more proportionate allocation of responsibility.

In cases of contributory negligence, each party is responsible for its share of the negligence. If the auditor's negligence is determined to be 10% and the company's negligence is 90%, the auditor is more likely to avoid liability entirely for the fraud. The allocation of responsibility reflects the respective contributions of each party to the occurrence of the fraud.

On the other hand:

- Absolute negligence implies that one party is entirely at fault, which is not the case here.
- Comparative negligence involves allocating responsibility based on the percentage of fault, similar to contributory negligence.
- Joint negligence implies that parties are equally responsible, which doesn't align with the scenario where the auditor's responsibility is established at 10%.

Therefore, option C (Contributory negligence) is the most appropriate choice in this context.

57. X owns 50% of Y's voting shares. The board of directors consists of six members; X appoints three of them and Y appoints the other

three. The casting vote at meetings always lies with the directors appointed by X. Does X have control over Y?

A. No, control is equally split between X and Z.

B. Yes, X holds 50% of the voting power and has the casting vote at board meetings in the event that there is not a majority decision.

C. No, X owns only 50% of the entity s shares and therefore does not have control.

D. No, control can be exercised only through voting power, not through a casting vote.

Answer=B

Option B is correct because it accurately reflects the concept of control in this specific scenario.

Explanation:

A. No, control is equally split between X and Z. - This statement is incorrect because there is no mention of Z in the scenario. The question only refers to X and Y, and there is no information about another party, Z.

B. Yes, X holds 50% of the voting power and has the casting vote at board meetings in the event that there is not a majority decision. - This statement is correct. While X owns 50% of the voting shares, the fact that X appoints three out of six directors and has the casting vote gives X effective control over decision-making in board meetings.

C. No, X owns only 50% of the entity's shares and therefore does not have control. - This statement is incorrect because control can be influenced by factors other than direct ownership percentage. In this case, the ability to appoint three out of six directors and having the casting vote gives X a significant level of control.

D. No, control can be exercised only through voting power, not through a casting vote. - This statement is incorrect because control can be influenced by factors beyond voting power, such as the ability to appoint key decision-makers (directors in this case) and having a casting vote.

In summary, option B is the correct answer as it accurately reflects the control that X has over Y in the given scenario.

58. Slick Co. had a Swiss franc receivable resulting from exports to Switzerland and a Mexican peso payable resulting from imports from Mexico. Slick recorded foreign exchange losses related to both its franc receivable and peso payable. How did the foreign currencies increase or decrease in Birr value from the date of the transaction to the settlement date?

A. Decrease Franc, Increase Peso

B. Decrease Franc, Decrease Peso

C. Increase Franc, Increase Peso

D. Increase Franc, Decrease Peso

Answer=A

The correct answer is A. "Decrease Franc, Increase Peso."

Explanation:

When Slick Co. records foreign exchange losses on its Swiss franc receivable and Mexican peso payable, it implies that the value of the Swiss franc has decreased, and the value of the Mexican peso has increased in terms of Birr (the local currency). Let's break down the components:

1. **Swiss Franc Receivable:**
   - If Slick recorded a foreign exchange loss on its Swiss franc receivable, it means that the value of the Swiss franc decreased compared to the Birr from the date of the transaction to the settlement date.
2. **Mexican Peso Payable:**
   - If Slick recorded a foreign exchange loss on its Mexican peso payable, it means that the value of the Mexican peso increased compared to the Birr from the date of the transaction to the settlement date.

So, combining both, the foreign currencies changed in Birr value as follows:

- Decrease in the value of the Swiss franc (decrease Franc)
- Increase in the value of the Mexican peso (increase Peso)

Therefore, option A is the correct answer.

59. Eband Co. uses process costing to account for the production of elastic bands. Direct materials are added at the beginning of the

process and conversion costs are incurred uniformly throughout the process. Beginning inventory consisted of Birr 21,000 in materials and Birr 22,000 in conversion costs. April costs were Birr 79,000 for materials and Birr 83,500 for conversion costs. During April 9,400 units were completed. Ending work in process inventory was 4,700 units (100% complete for materials, 50% for conversion). The equivalent cost per unit for materials using the weighted average method would be closest to:

A. Birr 1.76 per EU (materials)

B. Birr 7.09 per EU (materials)

C. Birr 5.94 per EU (materials)

D. Birr 14.43 per EU (materials)

Answer=B

To calculate the equivalent cost per unit for materials using the weighted average method, we need to consider both the beginning inventory costs and the costs incurred during the current period.

The formula for the weighted average equivalent cost per unit for materials is:

Weighted Average Cost per Equivalent Unit (Materials)=

Cost of Beginning Inventory Materials+Cost Added During the Period / Equivalent Units of Production

Given data:

- Cost of Beginning Inventory Materials: Birr 21,000
- Cost Added During the Period: Birr 79,000
- Equivalent Units of Production: 9,400 units completed + (4,700 units in ending work in process inventory * 100% complete for materials)

Equivalent Units of Production (Materials) =9,400+(4,700×100%)=14,100

Now, calculate the weighted average cost per equivalent unit for materials:

Weighted Average Cost per Equivalent Unit (Materials)=**21,000+79,000 / 14,100**

Weighted Average Cost per Equivalent Unit (Materials)=100,000/14,100≈Birr 7.09 per EU (materials)

Therefore, option B is the closest to the calculated value and is the correct answer.

60. For its fiscal year ending September 30, 2020, Twin City levied Birr 500 million in property taxes. It collected taxes applicable to fiscal 2020 as follows (in millions):

- ✓ **June 1, 2019, through September 30, 2019 Birr 20**
- ✓ **October 1, 2019, through September 30, 2020 Birr 440**
- ✓ **October 1, 2020, through November 30, 2020 Birr 15**
- ✓ **December 2020 Birr 4**

The city estimates that Birr 10 million of the outstanding balance will be uncollectible.

For the fiscal year ending September 30, 2020, how much should Twin City recognize in property tax revenue (in millions) in its general fund?

A. Birr 440 B. Birr 460 C. Birr 475 D. Birr 490

Answer=C

61. Which of the following are the basic steps in the recording process?

A. Analyze the transaction, enter the transaction in the journal, and transfer the information to the general ledger.

B. Enter the transaction in the journal, analyze the transaction, and transfer the information to the general ledger.

C. Analyze the transaction, enter the transaction in the financial statements, and enter the transaction in the journal.

D. None of the above.

Answer=A

The correct answer is A. "Analyze the transaction, enter the transaction in the journal, and transfer the information to the general ledger."

Explanation:

The basic steps in the recording process in accounting are typically:

1. **Analyze the transaction:** Identify and examine the financial transaction to understand its nature, impact on accounts, and how it should be recorded.
2. **Enter the transaction in the journal:** Record the transaction in the general journal, which is a chronological record of all transactions.
3. **Transfer the information to the general ledger:** Post the journal entries to the general ledger, where individual accounts are maintained. The general ledger provides a summary of all transactions for each account.

Option A accurately reflects the correct sequence of these basic steps in the recording process.

62. Which of the following statements would be consistent with the bird-in-the-hand dividend theory?*

A. Investors are indifferent whether stock returns come from dividend income or capital gains income

B. Dividends are more certain than capital gains income

C. Wealthy investors prefer corporations to defer dividend payments because capital gains produce greater after-tax income

D. dividends are less certain than capital gains

Answer=B

The correct answer is B. "Dividends are more certain than capital gains income."

Explanation:

The bird-in-the-hand dividend theory suggests that investors prefer to receive dividends in the present rather than waiting for potential future capital gains. The rationale behind this theory is based on the idea that dividends are more certain and immediate compared to the uncertainty of future capital gains.

Option B is consistent with the bird-in-the-hand dividend theory because it emphasizes the idea that dividends are considered more certain than capital gains income. Investors who follow this theory believe that receiving a dividend today provides a tangible and predictable return, whereas capital gains depend on future market conditions, which are inherently uncertain.

The other options are inconsistent with the bird-in-the-hand dividend theory:

- A. "Investors are indifferent whether stock returns come from dividend income or capital gains income" suggests that investors don't have a preference, which is contrary to the bird-in-the-hand theory.
- C. "Wealthy investors prefer corporations to defer dividend payments because capital gains produce greater after-tax income" implies a preference for capital gains over dividends, which is not in line with the bird-in-the-hand theory.
- D. "Dividends are less certain than capital gains" is also inconsistent with the theory, as the bird-in-the-hand theory suggests that dividends are considered more certain.

63. The principal borrower-spenders in a financial system are:

A. Governments. B. Foreigners. C. Households. D. Businesses.

Answer=D

The correct answer is D. "Businesses."

Explanation:

In a financial system, the principal borrower-spenders are typically businesses or corporations. Businesses borrow funds for various purposes, such as expanding operations, investing in new projects, acquiring assets, or managing working capital needs. These borrowing activities contribute to spending in the economy.

The other options are not the principal borrower-spenders:

- **A. Governments**: While governments can borrow and spend, businesses are often the primary entities engaged in borrowing and spending in the financial system.
- **B. Foreigners:** Foreign entities (foreigners) can be involved in financial transactions, but they are not typically the principal borrowers or spenders within a domestic financial system.

- **C. Households:** While households play a significant role in the economy by consuming goods and services, they are not typically the principal borrowers in the financial system. Households may borrow for purposes such as buying a home or financing education, but their overall borrowing tends to be less extensive than that of businesses.

Therefore, option D (Businesses) is the most accurate description of the principal borrower-spenders in a financial system.

64. Which of the following may not cast significant doubt about the going concern assumption of an entity?

A. Changes in legislation or government policy expected to adversely affect the entity

B. Pending legal or regulatory proceeding against the entity that may, if successful, result in claims that are unlikely to be satisfied

C. Non-compliance with capital or other statutory requirements

D. The entity heavily used equity financing for investment in permanent assets

Answer=D

The correct answer is D. "The entity heavily used equity financing for investment in permanent assets."

Explanation:

The going concern assumption in accounting assumes that the entity will continue its operations in the foreseeable future without the need to liquidate or curtail significant portions of its operations. While using equity financing for investment in permanent assets (Option D) may indicate a reliance on equity capital, it does not, by itself, cast significant doubt about the going concern assumption.

On the other hand:

A. Changes in legislation or government policy expected to adversely affect the entity - This can cast doubt on the going concern assumption as it may impact the entity's ability to operate profitably.

B. Pending legal or regulatory proceeding against the entity that may, if successful, result in claims that are unlikely to be satisfied -

This could cast doubt on the entity's ability to meet its obligations, affecting the going concern assumption.

C. Non-compliance with capital or other statutory requirements - Non-compliance with capital or statutory requirements may indicate financial difficulties, casting doubt on the entity's ability to continue as a going concern.

Therefore, option D is the least likely to cast significant doubt about the going concern assumption, as using equity financing for investment is a common practice and does not necessarily signal financial distress.

65. A bond with a maturity of less than one year is classified as which of the following?

A. Money market instrument B. Shot-term market instrument

C. Capital market instrument D. One year market instrument

Answer=A

The correct answer is A. "Money market instrument."

Explanation:

Bonds with a maturity of less than one year are typically classified as money market instruments. Money market instruments are short-term debt securities that have high liquidity and low risk. They are usually used for short-term borrowing and lending and include instruments like Treasury bills, commercial paper, certificates of deposit, and short-term government or corporate bonds.

Option B, "Short-term market instrument," is not a standard term used to describe such financial instruments. The more specific term is "money market instrument."

Options C and D, "Capital market instrument" and "One year market instrument," are not accurate classifications for bonds with a maturity of less than one year. Capital market instruments typically refer to longer-term securities, and the term "One year market instrument" is not a standard financial classification.

66. The following statements are based on IAS 41 (Agriculture):

1. Biological assets and agricultural produce are initially measured at cost.
2. Any changes in the fair value less costs to sell of biological assets are included in other comprehensive income.

A. Both statements are false

B. Only statement 1 is false

C. Only statement 1 is true

D. Both statements are true

Answer=A

Let's analyze each statement in the context of IAS 41 (Agriculture):

1. **"Biological assets and agricultural produce are initially measured at cost."**
    - This statement is false. According to IAS 41, biological assets are generally measured at fair value less costs to sell at the point of harvest. The fair value measurement is more reflective of the economic benefits expected from the biological assets.
2. "**Any changes in the fair value less costs to sell of biological assets are included in other comprehensive income."**
    - This statement is also false. Changes in the fair value less costs to sell of biological assets are generally recognized in profit or loss, not in other comprehensive income.

Therefore, both statements are false. The correct answer is A. "Both statements are false."

Option B, "Only statement 1 is false," is incorrect because both statements are false.

Option C, "Only statement 1 is true," is incorrect because statement 1 is false.

Option D, "Both statements are true," is incorrect because both statements are false

67. Equity securities acquired by a corporation which are accounted for by recognizing unrealized holding gains or losses as other comprehensive income and as a separate component of stockholders' equity are*

A. available-for-sale securities where a company has holdings of less than 20%.

B. trading securities where a company has holdings of less than 20%.

C. securities where a company has holdings of between 20% and 50%.

D. securities where a company has holdings of more than 50%.

Answer=A

Let's define each choice:

A. **Available-for-Sale Securities where a company has holdings of less than 20%:**

- Available-for-sale securities are financial instruments that a company intends to hold for an undefined period. Holdings of less than 20% suggest that the company does not have significant influence or control over the investee. Unrealized holding gains or losses on available-for-sale securities are recognized as other comprehensive income (OCI) and reported as a separate component of stockholders' equity.

B. **Trading Securities where a company has holdings of less than 20%:**

- Trading securities are financial instruments that a company intends to actively trade for short-term profits. Holdings of less than 20% suggest that the company does not have significant influence or control. Unrealized holding gains or losses on trading securities are typically recognized in earnings.

C. **Securities where a company has holdings of between 20% and 50%:**

- When a company has significant influence (but not control) over an investee (20% to 50% ownership), the equity method is generally used. Under the equity method, the investor recognizes its share of the investee's net income and adjusts the investment account accordingly. Unrealized holding gains or losses are not typically recognized as other comprehensive income.

D. **Securities where a company has holdings of more than 50%:**

- When a company has control (ownership of more than 50%), it generally consolidates the financial statements of the investee. In this case, the equity securities are not accounted for as available-for-sale or trading securities. Instead, the investor consolidates the investee's financial statements.

In the context of the question, option A is correct because it describes available-for-sale securities with holdings of less than 20%, where unrealized holding gains or losses are recognized as other comprehensive income and as a separate component of stockholders' equity.

68. A corporation has the following account balances: Common stock, $1 par value, $30,000; Paid-in Capital in Excess of Par Value, $1,350,000. Based on this information, the*

A. legal capital is $1,380,000.

B. numbers of shares issued are 30,000.

C. numbers of shares outstanding are 1,380,000.

D. average price per share issued is $4.60.

Answer=B

The correct answer is B. "Number of shares issued are 30,000."

Explanation:

- Legal capital is typically represented by the par value of the common stock. In this case, the par value is $1 per share, and the legal capital is calculated by multiplying the par value by the number of shares issued. Therefore, legal capital = $1 * 30,000 = $30,000.
- The number of shares outstanding is not provided in the information.
- The average price per share issued is not directly calculable from the given information.

Therefore, the only statement that can be determined with the information provided is that the number of shares issued is 30,000. This is calculated by dividing the legal capital by the par value per share: $30,000 / $1 = **30,000 shares.**

69. Equipment was acquired on January 1, 2013, at a cost of $75,000. The equipment was originally estimated to have a salvage value of $5,000 and an estimated life of 10 years. Depreciation has been

recorded through December 31, 2016, using the straight-line method. On January 1, 2017, the estimated salvage value was revised to $7,000 and the useful life was revised to a total of 8 years.*

A. Birr 7,000

B. Birr 11,750

C. Birr 10,000

D. Birr 5,000

Answer=C

70. In 2021, Cupid Construction Co. (CCC) began work on a two-year fixed price contract project. CCC recognizes revenue over time according to percentage of completion for this contract, and provides the following information (birr in millions): ⎦

Accounts receivable, 12/31/2021 (from construction progress billings) Birr 75 Actual construction costs incurred in 2021 Birr 270 Cash collected on project during 2021 Birr 210 Construction in progress, 12/31/2021 414 Estimated percentage of completion during 2021 60%

What is the amount of Gross Profit recognized by CCC on the project?

A. Birr 320 million.

B. Birr 144 million.

C. Birr 96 million.

D. Cannot be determined from the given information.

Answer=B

71. The two primary classes of transactions in the sales and collection cycle are:*

A. sales and sales discounts.

B. sales and cash receipts.

C. sales and sales returns.

D. sales and accounts receivable.

Answer=B

The correct answer is B. "Sales and cash receipts."

Explanation:

The sales and collection cycle encompasses the activities related to the sale of goods or services and the subsequent collection of cash. The two primary classes of transactions in this cycle are:

B. **Sales and cash receipts:**

- **Sales:** Involves the revenue recognition process, where goods or services are sold to customers.
- **Cash receipts:** Involves the collection of cash from customers, either at the time of sale or subsequently.

Option A (Sales and sales discounts) is not correct because sales discounts are a subset of sales and not a primary class of transactions.

Option C (Sales and sales returns) is not correct because sales returns are also a subset of sales and not a primary class of transactions.

Option D (Sales and accounts receivable) is not as comprehensive as Option B. Sales are recognized when they occur, and accounts receivable represent the amounts owed by customers, which is part of the broader cash receipts process.

Therefore, the most accurate representation of the primary classes of transactions in the sales and collection cycle is Option B.

72. Which of the following is not a factor that limits the insurability of risk?*

A. moral hazard

B. adverse selection

C. competition

D. administrative and capital costs

Answer=D

The correct answer is D. "Administrative and capital costs."

Explanation:

Factors that limit the insurability of risk include:

A. **Moral Hazard:**

- Refers to the increased risk-taking behavior of individuals or entities when they are insured. It arises from the asymmetric information between the insurer and the insured.

B. **Adverse Selection:**

- Occurs when individuals with a higher-than-average risk are more likely to seek insurance coverage. This can result in an imbalance in the risk pool and may lead to increased claims.

C. **Competition:**

- Intense competition in the insurance market can affect the availability and cost of coverage. In highly competitive markets, insurers may be more selective in the risks they are willing to underwrite.

D. **Administrative and Capital Costs:**

- Administrative costs and the amount of capital required to cover potential losses can influence the insurability of certain risks. High administrative costs and capital requirements may make it economically unfeasible to insure certain risks.

Option D is not a factor that limits the insurability of risk. Instead, it is a consideration for insurers in managing their operations efficiently and ensuring financial stability. Insurers need to balance the costs associated with underwriting and administering policies with the need to provide coverage for various risks.

73. All of the following are advantages of direct tax over direct tax except:*

A. In the case of direct tax, the tax burden is distributed on different sections of the society in a just and equitable manner.

B. Direct tax is highly productive unlike to indirect tax.

C. Tax evasion is relatively difficult in the case of indirect tax as taxes are included in the prices of commodities.

D. Direct taxes are more certain to both the taxpayers and the authority than indirect tax.

Answer=C

The correct answer is C. "Tax evasion is relatively difficult in the case of indirect tax as taxes are included in the prices of commodities."

Explanation:

Advantages of direct taxes over indirect taxes include:

A. **In the case of direct tax, the tax burden is distributed on different sections of society in a just and equitable manner:**

- Direct taxes can be designed to be progressive, meaning that individuals with higher incomes pay a higher percentage of their income in taxes. This contributes to a more equitable distribution of the tax burden.

B. **Direct tax is highly productive unlike indirect tax:**

- Direct taxes, such as income taxes, can be more productive in generating revenue for the government compared to indirect taxes.

D. **Direct taxes are more certain to both the taxpayers and the authority than indirect tax:**

- Direct taxes are generally more transparent, and taxpayers have a clearer understanding of their tax liability. This certainty benefits both taxpayers and tax authorities in terms of administration and compliance.

Option C, on the other hand, is incorrect because it states that tax evasion is difficult in the case of indirect taxes due to the inclusion of taxes in commodity prices. In reality, tax evasion can still occur in the form of underreporting sales or hiding transactions, even if taxes are included in prices.

Therefore, option C is the exception among the advantages listed for direct taxes.

74. Which of the following statements about a Private-Purpose Trust Fund is false?*

A. The principal in a Private-Purpose Trust Fund must be nonexpendable in nature.

B. The principal in a Private-Purpose Trust Fund may be either expendable or nonexpendable in nature

C. Private-Purpose Trust Funds are not reported in the government-wide financial statements

D. Net position of a Private-Purpose Trust Fund is not reported using the net position classifications used in proprietary funds.

Answer=A

The correct answer is A. "The principal in a Private-Purpose Trust Fund must be nonexpendable in nature."

Explanation:

In the context of accounting for trusts, the principal in a Private-Purpose Trust Fund may be either expendable or nonexpendable. Therefore, statement A is false. Here's the explanation for each option:

A. **The principal in a Private-Purpose Trust Fund must be nonexpendable in nature:**

- This statement is false. The principal in a Private-Purpose Trust Fund can be either expendable or nonexpendable. It depends on the terms of the trust agreement.

B. **The principal in a Private-Purpose Trust Fund may be either expendable or nonexpendable in nature:**

- This statement is true. The nature of the principal depends on the terms of the trust agreement. If the trust agreement allows the principal to be spent, it is considered expendable; if not, it is nonexpendable.

C. **Private-Purpose Trust Funds are not reported in the government-wide financial statements:**

- This statement is generally true. Private-Purpose Trust Funds are reported in the fiduciary fund financial statements but not in the government-wide financial statements.

D. **Net position of a Private-Purpose Trust Fund is not reported using the net position classifications used in proprietary funds:**

- This statement is true. The net position of fiduciary funds, including Private-Purpose Trust Funds, is reported differently from the net position classifications used in proprietary funds.

In summary, statement A is false, and the other statements are generally true.

75. A home office ships inventory to its branch at an amount above cost. By year-end, 75% of the inventory shipped to the branch has been resold to outsiders. What entry must be made by the home office to record the inter-company realized profit during the year?*

A. Unrealized inter-company profit Dr. & Realized profit of branch transfers Cr.

B. Allowance for overvaluation of branch inventory Dr. & Branch income Cr.

C. Branch income Dr. & unrealized inter-company profit Cr.

D. Both a and b

Answer=B

The correct answer is B. "Allowance for overvaluation of branch inventory Dr. & Branch income Cr."

Explanation:

When a home office ships inventory to its branch at an amount above cost, and a portion of the inventory has been resold to outsiders by year-end, the home office needs to recognize an allowance for the overvaluation of branch inventory and reduce its income by the amount of the realized profit.

The entry to record the inter-company realized profit during the year would typically involve recognizing the overvaluation of the branch inventory and adjusting the income:

Allowance for overvaluation of branch inventory Dr.

Branch income Cr.

This entry acknowledges that the branch has not fully realized the profit embedded in the inventory that was shipped by the home office. The allowance for overvaluation of branch inventory is a contra-asset account that reduces the carrying value of the branch inventory to reflect its lower realizable value.

Option A is not the correct choice because "Unrealized inter-company profit Dr. & Realized profit of branch transfers Cr." would be misleading. The profit is realized at the branch when it sells the inventory to outsiders.

Option C is not the correct choice because it suggests recognizing "Branch income Dr. & unrealized inter-company profit Cr.," which may not accurately reflect the situation. The profit is realized when the branch sells the inventory to outsiders.

Option D is not the correct choice because it includes both A and B, and the more appropriate entry is the one that involves recognizing an allowance for overvaluation of branch inventory.

76. which of the following is not a legal requirement on Category 'A' tax payers:*

A. Shall pay tax on the 7th day of July to the 6th day of August each year.

B. Submit the Tax Declaration Form to the tax authority within 4 months from the end of the tax year

C. Use registered vouchers

D. Submit Balance sheet and a profit & loss statement

Correct answer=A

The correct answer is A. "Shall pay tax on the 7th day of July to the 6th day of August each year."

Explanation:

In the context of the options provided, paying tax on specific dates (July 7th to August 6th each year) is not a legal requirement for Category 'A' taxpayers. The specific dates for tax payment can vary and are usually specified by tax authorities in accordance with the tax regulations of a particular jurisdiction.

Let's briefly review the other options:

B. **Submit the Tax Declaration Form to the tax authority within 4 months from the end of the tax year:**

- This is a common legal requirement where taxpayers are generally required to submit their tax declarations within a specified period after the end of the tax year.

C. **Use registered vouchers:**

- Using registered vouchers is a common requirement to ensure proper documentation and traceability of transactions for tax purposes.

D. **Submit Balance sheet and a profit & loss statement:**

- Submitting financial statements, including a balance sheet and profit & loss statement, is often a legal requirement for taxpayers to provide a comprehensive overview of their financial position and performance.

Therefore, option A is the one that is not a legal requirement for Category 'A' taxpayers, as specific payment dates can vary and are subject to the tax regulations of the relevant jurisdiction.

77. Which of the following statements is true about Activity Based Costing (ABC)?

A. When a company implements activity based costing, overhead is ordinarily shifted from low volume products to high volume products.

B. An activity based costing system is generally less costly, and easier to implement than conventional costing systems

C. Activity based costing generally results in more accurate product costing than conventional costing, where only one predetermined overhead rate is utilized.

D. None of the above statement is correct.

Correct answer=D. None of the above statement is correct.

The correct answer is D. "None of the above statements is correct."

Explanation:

Let's evaluate each statement:

A. **When a company implements activity-based costing, overhead is ordinarily shifted from low-volume products to high-volume products:**

- This statement is not generally true. Activity-based costing (ABC) aims to allocate overhead costs more accurately by identifying and assigning costs to specific activities. It does not inherently shift overhead from one product to another based on volume. ABC seeks to provide a more nuanced understanding of cost drivers and their relationship to products.

B. **An activity-based costing system is generally less costly and easier to implement than conventional costing systems:**

- This statement is not true. Implementing an activity-based costing system can be more complex and costly than conventional costing systems. ABC requires a detailed analysis of activities, identification of cost drivers, and a more comprehensive data collection process.

C. **Activity-based costing generally results in more accurate product costing than conventional costing, where only one predetermined overhead rate is utilized:**

- This statement is generally true. Activity-based costing is designed to provide more accurate product costing by allocating overhead costs based on the actual consumption of activities by each product. This contrasts with conventional costing, which often uses a single predetermined overhead rate.

Therefore, the correct answer is D. "None of the above statements is correct," as statement C is generally accurate, but statements A and B are not.

78. A factory owned by XYZ Inc. was destroyed by fire. XYZ Inc. lodged an insurance claim for the value of the factory building, plant, and an amount equal to one year's net profit. During the year there were a number of meetings with the representatives of the insurance company. Finally, before year-end, it was decided that XYZ Inc. would receive compensation for 90% of its claim. XYZ Inc. received a letter that the settlement check for that amount had been mailed, but it was not received before year-end. How should XYZ Inc. treat this in its financial statements?

A. Disclose the contingent asset in the foot- notes.

B. Wait until next year when the settlement check is actually received and not recognize or disclose this receivable at all since at year-end it is a contingent asset.

C. Because the settlement of the claim was conveyed by a letter from the insurance company that also stated that the settlement check was in the mail for 90% of the claim, record 90% of the claim as a receivable as it is virtually certain that the contingent asset will be received.

D. Because the settlement of the claim was conveyed by a letter from the insurance company that also stated that the settlement check was in the mail for 90% of the claim, record 100% of the claim as a receivable at year-end as it is virtually certain that the contingent asset will be received, and adjust the 10% next year when the settlement check is actually received.

Correct answer=C

The correct answer is C. **"Because the settlement of the claim was conveyed by a letter from the insurance company that also stated that the settlement check was in the mail for 90% of the claim, record 90% of the claim as a receivable as it is virtually certain that the contingent asset will be received**."

Explanation:

In accounting, contingent assets are disclosed in the footnotes to the financial statements when realization is uncertain. However, in certain situations, if it is virtually certain that the contingent asset will be received, and all criteria for recognition are met, it may be appropriate to recognize a receivable.

In this case:

- XYZ Inc. received a letter from the insurance company confirming the settlement of the claim.
- The letter also stated that the settlement check for 90% of the claim was in the mail.

Given this information, it is virtually certain that XYZ Inc. will receive 90% of the claim. Therefore, XYZ Inc. can recognize 90% of the claim as a receivable in its financial statements for the current year.

Option A is not the correct answer because recognizing the receivable may be appropriate when it is virtually certain.

Option B is not the correct answer because, in certain situations, recognition of a contingent asset may be appropriate if it meets the criteria for recognition.

Option D is not the correct answer because recognizing 100% of the claim when only 90% is confirmed may not accurately represent the certainty of the receivable.

79. A company purchases a one-year insurance policy on June 1 for Birr 840, correctly recording it as prepaid insurance. No adjustments have been making during the year. The adjusting entry on December 31 is

A. debit insurance expense Birr 280, and credit prepaid insurance, Birr 280.

B. debit prepaid insurance, Birr 720 , and credit cash, Birr 720 .

C. debit insurance expense Birr 350, and credit prepaid insurance, Birr 350 .

D. debit insurance expense, Birr 490, and credit prepaid insurance, Birr 490.

Correct answer=D

The correct answer is D. "Debit insurance expense, Birr 490, and credit prepaid insurance, Birr 490."

Explanation:

When a company purchases a one-year insurance policy and records it as prepaid insurance, it means that the cost of the insurance has been initially recorded as an asset (prepaid insurance) because the insurance coverage extends into the future.

The adjusting entry at the end of the year (December 31) is needed to recognize the portion of the insurance that has expired (been used up) during the current year. Since the policy was purchased on June 1, the insurance coverage for the remaining months needs to be expensed.

The calculation of the adjusting entry is as follows:

Total cost of insurance = Birr 840 (for one year)

Months covered from June 1 to December 31 = 7 months

Monthly cost of insurance = Birr 840 / 12 months = Birr 70 per month

Expired insurance for 7 months = Birr 70 * 7 = Birr 490

Therefore, the adjusting entry on December 31 is: Debit insurance expense, Birr 490, and credit prepaid insurance, Birr 490.

This entry recognizes the expense for the portion of the insurance that has been used during the year and updates the prepaid insurance account accordingly.

80. Beletu is an employee in one of the factory owned by the government in Ethiopia. Her monthly salary is Birr 12,600. She has a taxable allowance of Birr 3,000 and a non-taxable allowance of Birr 2,000. She earned an overtime of Birr 1,000. What is the amount of tax deducted from Abebu's earning?*

A. Birr 4,310

B. Birr 5,010

C. Birr 3,960

D. Birr 3,610

Correct answer=A

81. Two entities established a joint arrangement in an incorporated entity. The assets and liabilities of the entity will be in the name of the incorporated entity. The activities of the arrangement will be decided by its own board of directors. The rights of the two parties are limited only to the net assets of incorporated entity. How should the two parties account for their investment?*

A. Financial asset at amortized cost

B. Joint venture.

C. Investment in trading securities

D. Joint operation.

Correct answer=B

The correct answer is B. "Joint venture."

Explanation:

In a joint venture, two or more parties establish a joint arrangement by creating a separate legal entity, often in the form of an incorporated entity. The key characteristics mentioned in the question align with the features of a joint venture:

1. **Separate Legal Entity:**
   - The joint arrangement is established in the form of an incorporated entity.
2. **Board of Directors:**
   - The activities of the arrangement are decided by its own board of directors.
3. **Rights Limited to Net Assets:**
   - The rights of the two parties are limited only to the net assets of the incorporated entity.

In joint ventures, the entities involved typically account for their investments using the equity method. Under the equity method, the initial investment is recorded at cost, and the investor's share of the joint venture's profits or losses is subsequently recognized in the investor's income statement.

Option A, "Financial asset at amortized cost," is not appropriate because the joint venture involves an equity interest, and the equity method is more suitable for such investments.

Option C, "Investment in trading securities," is not appropriate because trading securities are typically held for short-term gains, and joint ventures involve longer-term strategic partnerships.

Option D, "Joint operation," refers to a situation where the parties have rights to the assets and obligations for the liabilities of the arrangement, which is not consistent with the scenario described.

Therefore, the correct accounting treatment for the investment in this joint venture is the equity method, making option B the correct answer.

82. Auditing standards require that an audit be designed to provide reasonable assurance of detecting:*

A. material errors in the financial statements.

B. fraud in the financial statements.

C. material errors and fraud in the financial statements.

D. inadequate disclosure in the notes to the financial statements

Correct answer=A. material errors in the financial statements.

The correct answer is A. "Material errors in the financial statements."

Explanation:

Auditing standards, such as those issued by organizations like the International Auditing and Assurance Standards Board (IAASB) or the Public Company Accounting Oversight Board (PCAOB), generally emphasize that an audit is designed to provide reasonable assurance of detecting material misstatements in the financial statements.

The key concept is materiality. Material misstatements are errors or omissions in the financial statements that could influence the economic decisions of users. Auditors focus on detecting material misstatements because the objective of an audit is not to provide an absolute guarantee but to obtain reasonable assurance.

Options B, C, and D are related to various aspects of the audit, but the primary emphasis is on materiality:

B. "Fraud in the financial statements": While auditors are required to consider the risk of fraud, the focus is on material fraud that could have a significant impact on the financial statements.

C. "Material errors and fraud in the financial statements": This option includes both material errors and fraud, but it is important to note that the primary objective is to detect material misstatements, which could be errors or fraud.

D. "Inadequate disclosure in the notes to the financial statements": Inadequate disclosure that is material to the financial statements is also within the scope of the auditor's work, as disclosure is an integral part of financial reporting.

In summary, the primary objective of an audit is to provide reasonable assurance of detecting material errors in the financial statements.

83. According to the liquidity premium theory of the term structure, a flat yield curve indicates that short-term interest rates are expected to*

A. rise in the future B. remains unchanged in the future.

C. decline moderately in the future. D. decline sharply in the future.

Correct answer==C. decline moderately in the future.

The liquidity premium theory of the term structure suggests that the shape of the yield curve reflects expectations about future interest rates. Let's analyze each option:

A. **Rise in the future:**

- This is not consistent with a flat yield curve. A flat yield curve typically suggests that short-term interest rates are expected to remain relatively stable or decline, not rise.

B. **Remain unchanged in the future:**

- This is a possibility, but a flat yield curve often implies some expectation of changes in interest rates. It is not the most accurate interpretation of a flat yield curve.

C. **Decline moderately in the future:**

- This is the correct answer. A flat yield curve is often interpreted as an expectation that short-term interest rates may decline moderately in the future.

D. **Decline sharply in the future:**

- This is not typically associated with a flat yield curve. A sharp decline in interest rates would be more consistent with an inverted yield curve.

In the liquidity premium theory, a flat yield curve indicates that the market expects short-term interest rates to decline moderately in the future. Investors may require a smaller premium for holding longer-term securities, suggesting an expectation of lower future interest rates.

Therefore, the most accurate interpretation among the options provided is C. "Decline moderately in the future."

84. Investment banks _____ companies issuing securities and _____ these securities by selling them to the public on behalf of the issuing companies.*

1/1

A. research; underwrite

B. research; monitor

C. monitors; underwrite

D. monitor; manipulate

Correct answer==A

85. An acquirer should at the acquisition date recognize goodwill acquired in a business combination as an asset. Goodwill should be accounted for as follows:*

A. Recognize as an intangible asset and amortize over its useful life.

B. Write off against retained earnings.

C. Recognize as an intangible asset and impairment test when a trigger event occurs.

D. Recognize as an asset and annually impairment test (or more frequently if impairment is indicated).

Correct answer==D

The correct answer is D. "Recognize as an asset and annually impairment test (or more frequently if impairment is indicated)."

Explanation:

Goodwill is recognized as an asset on the acquirer's balance sheet when it acquires another business. The other options are not consistent with generally accepted accounting principles (GAAP) for goodwill accounting:

A. **Recognize as an intangible asset and amortize over its useful life:**

- Under current accounting standards (such as IFRS and U.S. GAAP), goodwill is not amortized. Instead, it is subject to impairment testing. The recognition and amortization of intangible assets with finite useful lives apply to other types of intangible assets, not goodwill.

B. **Write off against retained earnings:**

- This approach is not in line with standard accounting treatment for goodwill. Goodwill is typically recognized on the balance sheet as an asset and is subject to impairment testing, not immediate write-off.

C. **Recognize as an intangible asset and impairment test when a trigger event occurs:**

- While recognizing goodwill as an intangible asset is accurate, impairment testing is not limited to trigger events. Under accounting standards, goodwill is subject to an annual impairment test (or more frequently if indicators of impairment arise).

D. **Recognize as an asset and annually impairment test (or more frequently if impairment is indicated):**

- This is the correct approach. Goodwill is initially recognized as an asset, and then, on an annual basis (at a minimum), the acquirer performs an impairment test to assess whether the carrying amount of goodwill exceeds its implied fair value. If impairment is indicated, the goodwill is written down.

Therefore, option D is consistent with the standard accounting treatment for goodwill.

86. Howton & Howton Worldwide (HHW) is planning its operations for the coming year, and the CEO wants you to forecast the firm's additional funds needed (AFN). The firm is operating at full capacity. Data for use in the forecast are shown below. However, the CEO is concerned about the impact of a change in the payout ratio from the 10% that was used in the past to 25%, which the firm's investment bankers have recommended. Based on the AFN equation, by how much would the AFN for the coming year change if HHW increased the payout from 10% to the new and higher level? All dollars are in millions.

- ✓ Last year’s sales = S0 $300.0
- ✓ Last year’s accounts payable $50.0
- ✓ Sales growth rate = g 40%
- ✓ Last year’s notes payable $15.0
- ✓ Last year’s total assets = A0* $500.0 Last year’s accruals $20.0
- ✓ Last year’s profit margin = PM 20.0% Initial payout ratio 10.0%

A. Birr 31.9 B. Birr 33.6 C. Birr 35.3 D. Birr 12.6

Correct answer==D

87. Revenue is recognized in the accounting period in which the performance obligation is satisfied. This statement describes the*

A. consistency characteristic. B. expense recognition principle.

C. revenue recognition principle. D. relevance characteristic.

Correct answer==D

The correct answer is C. "Revenue recognition principle."

Explanation:

The statement "Revenue is recognized in the accounting period in which the performance obligation is satisfied" is a direct reflection of the revenue recognition principle. The revenue recognition principle is a fundamental accounting concept that outlines when revenue should be recognized in the financial statements.

According to the revenue recognition principle:

1. **Recognition Timing:**
   - Revenue should be recognized when the performance obligation is satisfied, indicating that the goods or services have been provided to the customer.
2. **Amount of Revenue:**
   - The amount of revenue recognized should reflect the consideration to which the entity expects to be entitled in exchange for those goods or services.

This principle is crucial in ensuring that financial statements accurately represent the economic activities of an entity and provide relevant information to users.

Option A, "Consistency characteristic," refers to the practice of consistently applying accounting principles from one period to the next. It is not directly related to the timing of revenue recognition.

Option B, "Expense recognition principle" (or matching principle), deals with recognizing expenses in the period in which they are incurred to generate revenue. It is not directly related to the recognition of revenue.

Option D, "Relevance characteristic," is a general characteristic of accounting information, emphasizing the importance of providing information that is capable of influencing economic decisions. While revenue recognition is relevant, the statement itself specifically describes the revenue recognition principle.

88. Which of the following procedures is not performed as a part of planning an audit engagement?

A. Performing analytical procedures B. Reviewing the working papers of the prior year

C. Confirmation of all major accounts D. Designing an audit program

Correct answer==C

The correct answer is C. "Confirmation of all major accounts."

Explanation:

When planning an audit engagement, auditors perform various procedures to gather information and design the overall audit approach. Let's review each option:

A. **Performing analytical procedures:**

- This is commonly performed during the planning phase. Analytical procedures involve evaluating financial information through analysis of plausible relationships and trends, providing insights into potential risks and areas that may require further attention during the audit.

B. **Reviewing the working papers of the prior year:**

- This is a standard practice to understand the nature of the client's business, any significant issues encountered in prior audits, and the approach taken by the previous audit team. It helps in planning the current audit effectively.

C. **Confirmation of all major accounts:**

- Confirmations are typically performed during the substantive testing phase rather than during the planning phase. Confirmations are used to obtain direct external verification of certain account balances or transactions. While confirmations may be part of the overall audit process, they are not typically performed during the planning phase.

D. **Designing an audit program:**

- This is a critical step in the planning process. Auditors design an audit program to outline the procedures and steps that will be followed during the audit to achieve the audit objectives. It includes planning the nature, timing, and extent of audit procedures.

Confirmation of major accounts, as mentioned in option C, is generally performed during the substantive testing phase, which is part of the overall audit process but not specifically part of the planning phase.

Therefore, the procedure not typically performed as a part of planning an audit engagement is C. "Confirmation of all major accounts."

89. Higgins Company gathered the following reconciling information in preparing its October bank reconciliation:

- ✓ **Cash balance per books, 10/31 Birr 16,800**
- ✓ **Deposits in transit 600**
- ✓ **Notes receivable and interest collected by bank 3,400**
- ✓ **Bank charge for check printing 80**
- ✓ **Outstanding checks 8,000**
- ✓ **NSF check 680**

A. Birr 18,840. B. Birr 16,040. C. Birr 11,440. D. Birr 19,440.

Correct answer=D. Birr 19,440.

90. On January 1, 2022, Star Ethiopian coffee exporter, shipped $120,000 worth of inventory to its main U.S. distributor, with full payment of these goods due by February 28, 2022.

Star has a January 31 year end. A list of significant dates and exchange rates is shown below.

- ✓ Transaction Date: January 1, 2022 US $1 = Birr 59.332
- ✓ Year-End Date: January 31, 2022 US $1 = Bir 59.280
- ✓ Settlement Date: February 28, 2022 US $1 = Birr 59.540
- ✓ The invoice price billed by Star was US $120,000.

What is the amount of Star's foreign exchange gain or loss at year-end?

A. Nil; foreign exchange gains or losses are deferred to settlement

B. Birr 24,960 gain

C. Birr 6,240 gain

D. Birr 6,240 loss

Correct answer==D

91. The underlying reason for a code of professional conduct for any professional is:*

A. The need for public confidence in the quality of service of the profession

B. That it provides a safeguard to keep unscrupulous people out

C. That it is required by federal legislation

D. That it allows licensing agencies to have a yardstick to measure deficient performance

Correct answer==A

The correct answer is A. "The need for public confidence in the quality of service of the profession."

Explanation:

A code of professional conduct is a set of guidelines and principles that individuals in a particular profession are expected to follow. The underlying reason for having such a code is primarily to ensure the integrity, competence, and ethical behavior of professionals. Option A captures the essence of this purpose:

A. **The need for public confidence in the quality of service of the profession:**

- Professional conduct codes are designed to establish and maintain public trust in the profession. They set standards for ethical behavior, competence, and professionalism, ensuring that the public can rely on the services provided by professionals.

The other options are not the primary underlying reasons for a code of professional conduct:

B. **That it provides a safeguard to keep unscrupulous people out:**

- While a code of conduct helps in maintaining professional standards, it is not primarily aimed at keeping unscrupulous individuals out.

C. **That it is required by federal legislation:**

- While some professions may have regulatory requirements, the fundamental purpose of a code of conduct is not solely because of legislative mandates.

D. **That it allows licensing agencies to have a yardstick to measure deficient performance:**

- A code of conduct serves broader purposes than just providing a yardstick for regulatory measurement. It is more about guiding professionals in ethical and competent behavior.

Therefore, the main and underlying reason for a code of professional conduct is to ensure public confidence in the quality of service provided by the profession.

92. Beta is a statistical measure of:*

A. hyperbolic

B. total risk.

C. the standard deviation.

D. the relationship between an investment's returns and the market return.

Correct answer==D

The correct answer is D. "The relationship between an investment's returns and the market return."

Explanation:

Beta is a measure of systematic risk, which quantifies the sensitivity of an investment's returns to the overall market returns. It specifically assesses the relationship between the returns of an individual security or investment portfolio and the returns of the entire market.

Option A, "Hyperbolic," is not accurate in the context of beta. Beta is not associated with hyperbolic functions.

Option B, "Total risk," is a broader term that encompasses both systematic risk (market risk) and unsystematic risk (specific to a particular investment). Beta specifically focuses on systematic risk.

Option C, "The standard deviation," is related to the concept of risk, but beta is more specific in its measurement of systematic risk and is not directly equivalent to standard deviation.

Therefore, the primary purpose of beta is to measure the sensitivity or relationship between an investment's returns and the market return, helping investors assess the level of systematic risk associated with the investment.

93. Wolf Company granted 30,000 share appreciation rights which entitled key employees to receive cash equal to the difference between Birr 20 and the market price of the share on the date each right is exercised.

The service period is 2019 through 2021, and the rights are exercisable in 2022. The market price of the share was Birr 25 and Birr 28 on December 31, 2019 and 2020, respectively.

What amount should be reported as liability under the share appreciation rights on December 31, 2020?

A. Birr 0 B. Birr 130,000 C. Birr 160,000
D. Birr 240,000

Correct answer==C

94. An auditor would most likely review an entity's periodic accounting for the numerical sequence of shipping documents and invoices to support management's financial statement assertion of*

A. Completeness

B. Valuation or allocation

C. Rights and obligations

D. Existence or occurrence

Correct answer==A

The correct answer is A. "Completeness."

Explanation:

Completeness is one of the financial statement assertions that auditors consider during the audit process. The assertion of completeness refers to ensuring that all transactions and events that should be recorded in the financial statements are indeed recorded. In the context of reviewing the numerical sequence of shipping documents and invoices, the auditor is primarily concerned with making sure that all transactions (sales transactions in this case) are included in the accounting records.

Here's how the options relate to the financial statement assertions:

A. **Completeness:**

- Reviewing the numerical sequence of shipping documents and invoices helps ensure that all transactions are recorded and none are omitted.

B. **Valuation or Allocation:**

- This assertion is concerned with the accuracy of amounts recorded. It is more related to whether amounts are recorded at the correct value.

C. **Rights and Obligations:**

- This assertion deals with whether the entity has the right to the assets and is obligated for the liabilities recorded. It is more related to legal ownership and responsibility.

D. **Existence or Occurrence:**

- This assertion focuses on whether recorded transactions actually occurred and relate to valid economic events. It is more related to the occurrence of transactions.

In the context of reviewing the numerical sequence of shipping documents and invoices, the primary concern is that all transactions are accounted for, supporting the completeness assertion.

95. Compute the estimated population deviation rate for the following scenario:

The auditor tests a sample of 37 instances of a control functioning out of a population of 3,500. She finds that the control failed to function properly in 2 cases.

A. 5.4% B. .06% C. 2% D. 1.1%

Correct answer=A. 5.4%

Feedback=*Answer: 5.4% The estimated population deviation rate is equal to the sample deviation rate which is computed as 2/37=054 (5.4%).*

The feedback provided is accurate. Here's the explanation:

To compute the estimated population deviation rate, you use the sample deviation rate, which is the ratio of the number of deviations found in the sample to the total sample size.

In this scenario:

- Number of deviations found in the sample (control failed): 2
- Total sample size: 37

So, the sample deviation rate is calculated as:
Sample Deviation Rate=Number of Deviations / Total Sample Size

Sample Deviation Rate=2 / 37

Now, convert this rate to a percentage by multiplying by 100:
Sample Deviation Rate (Percentage) =(2 / 37)×100

Calculating this gives: Sample Deviation Rate (Percentage) ≈5.4%

Therefore, the estimated population deviation rate is 5.4%. The correct answer is A. "5.4%."

96. When evaluating a make-or-buy decision, which of the following does NOT need to be considered?*

A. alternative uses of the production capacity

B. the original cost of the production equipment

C. the quality of the supplier's product D. the reliability of the supplier's delivery schedule

Correct answer==B

The correct answer is B. "The original cost of the production equipment."

Explanation:

When evaluating a make-or-buy decision, various factors need to be considered to determine whether it is more cost-effective and beneficial for a company to produce a product internally or to buy it from an external supplier. Here's an explanation of each option:

A. **Alternative uses of the production capacity:**

- This is an important consideration as it assesses whether the production capacity can be effectively utilized for other products or services if the decision is made to buy.

B. **The original cost of the production equipment:**

- The original cost of the production equipment is a sunk cost and is irrelevant to the decision. Sunk costs are costs that have already been incurred and cannot be changed. The decision should be based on future costs and benefits.

C. **The quality of the supplier's product:**

- The quality of the supplier's product is a crucial factor. If the supplier can provide a product of equal or better quality, it may influence the decision to buy.

D. **The reliability of the supplier's delivery schedule:**

- The reliability of the supplier's delivery schedule is important for ensuring a steady and timely supply of the product. Delays in delivery can impact operations.

In summary, while the original cost of production equipment (sunk cost) is not relevant to the decision, the other factors mentioned (alternative uses of production capacity, quality of the supplier's product, and reliability of the supplier's delivery schedule) are important considerations in a make-or-buy decision.

97. Aikman Company paid dividends of Birr 2,410, Birr 0, Birr 1,500 and Birr 1,010 over the first four years of the company's existence, respectively. If Retained Earnings has an ending balance of Birr 10,500 at the end of year four, what was the average annual amount of net income (loss) over the first four years for Aikman? (Round your answer to the nearest dollar amount.)

A. Birr 2,060 B. Birr 3,855 C. Birr 15,420 D. Birr 1,230

Correct answer=B. Birr 3,855

Feedback= *(2,410+0+1,500+1,010+10,500)/4=3,855*

98. Last year Rennie Industries had sales of Birr 305,000, assets of Birr 175,000, a profit margin of 5.3%, and an equity multiplier of 1.2. The CFO believes that the company could reduce its assets by Birr 51,000 without affecting either sales or costs. Had it reduced its assets by this amount, and had the debt/assets ratio, sales, and costs remained constant, how much would the ROE have changed?*

A. 4.10% B. 4.56% C. 5.01% D. 5.52%

Correct answer==B

99. MM Proposition I with no tax supports the argument that:

A. The cost of equity rises as leverage rises.

B. It is completely irrelevant how a firm arranges its finances.

C. Financial risk is determined by the debt-equity ratio.

D. a firm should borrow money up to the point where the cost of debt equals the cost of equity.

Correct answer==B

MM Proposition I with no tax (Modigliani-Miller Proposition I) states that, under certain assumptions (perfect markets, no taxes, no transaction costs, and symmetric information), the value of a firm is determined solely by its real assets and the profitability of those assets. In this context:

A. **The cost of equity rises as leverage rises:**

- This is not supported by MM Proposition I. The proposition argues that the capital structure (mix of debt and equity) is irrelevant in a perfect market with no taxes.

B. **It is completely irrelevant how a firm arranges its finances:**

- This statement is consistent with MM Proposition I. The proposition suggests that, in a perfect market without taxes, the value of a firm is independent of its capital structure.

C. **Financial risk is determined by the debt-equity ratio:**

- MM Proposition I implies that financial risk, as measured by the debt-equity ratio, does not affect firm value. Financial risk can be adjusted by changing the capital structure, but it does not impact the overall value of the firm.

D. **A firm should borrow money up to the point where the cost of debt equals the cost of equity:**

- MM Proposition I does not make recommendations on the specific level of borrowing. Instead, it argues that, in a perfect market with no taxes, the capital structure decision does not impact the firm's value.

Therefore, option B is the correct answer because MM Proposition I suggests that, in such ideal conditions, the financing mix (debt or equity) does not affect the firm's overall value. The value of the firm is determined by its underlying business activities and profitability.

100. The cost of a nonmonetary asset acquired in exchange for another nonmonetary asset when the exchange has commercial substance is usually recorded at

A. either the fair value of the asset given up or the asset received whichever one results in the largest gain (smallest loss) to the company.

B. the fair value of the asset received if it is equally reliable as the fair value of the asset given up.

C. the fair value of the asset given up, and a gain or loss is recognized.

D. the fair value of the asset given up, and a gain but not a loss may be recognized.

Correct answer==C

The correct answer is C.

When a nonmonetary asset is acquired in exchange for another nonmonetary asset, and the exchange has commercial substance (meaning the future cash flows of the entity are expected to change as a result of the exchange), the transaction is accounted for based on the fair values of the assets exchanged. Specifically:

C. **The fair value of the asset given up is used, and a gain or loss is recognized.**

- The fair value of the asset given up is considered the cost of the acquired asset, and any difference between the fair value of the asset given up and the fair value of the asset received results in the recognition of a gain or loss.

This method ensures that the accounting reflects the economic reality of the exchange and provides relevant information to financial statement users. Options A, B, and D are not consistent with the generally accepted accounting principles (GAAP) for recording nonmonetary asset exchanges with commercial substance.

ADDIS ABABA UNIVERSITY

College of Business and Economics

Accounting and Finance

Model **Exit Exam 2 Part I**

2. Assume that the sales revenue of ABC Share Company is Birr 7,000,000 during Tax Year ended Sene 30, 2014. Cost of goods sold was Br. 2,000,000 under FIFO and Birr 2,800,000 (determined on the basis of the average cost method) and expenses were Birr 700,000. operating expenses comprises of salary expense of Birr 189,000,

store rent expense of Bir 70,000, a 2% depreciation expense on a not fully depreciated Building with a cost of Birr 2,800,000, a penalty of Birr 28,000, an interest expense of Birr 133,000 on Birr 700,000 principal amount of loan where the interest rate between National Bank of Ethiopia and Commercial Banks was 10%, and a donation of Birr 140,000 to help its sister Company recover from the fire damage on its working infrastructures. What is the amount of business tax liability of the Share Company? *

A. Birr 1,073,100 B. Birr 1,115,100 C. Birr 1,050,000 D. Birr 1,140,300

Correct answer==B

1. Which of the following characteristics would not define an organization as governmental?

A. The power to enact and enforce a tax levy.

B. The potential for unilateral dissolution by a government with the net reverting to a government. Resources

C. The receipt of grant money from a state or local government for the purpose of providing services to the public

D. All of the above

Correct answer== C

The correct answer is C. The receipt of grant money from a state or local government for the purpose of providing services to the public.

Explanation:

A. The power to enact and enforce a tax levy is a characteristic of governmental organizations. Governments have the authority to impose and collect taxes to fund public services.

B. The potential for unilateral dissolution by a government with the net reverting to a government is another characteristic of governmental organizations. In some cases, a government may have the authority to dissolve an organization and take control of its remaining resources.

C. The receipt of grant money from a state or local government for the purpose of providing services to the public does not, by itself, define an

organization as governmental. Many non-governmental organizations also receive grants for various purposes. The receipt of a grant alone does not necessarily make an organization governmental.

D. "All of the above" would be incorrect because, as mentioned, the receipt of grant money does not singularly define an organization as governmental.

So, the correct choice is C.

25. Costs which can be eliminated in whole or in part if a particular business segment is discontinued are called: *

A. Opportunity cost B. Avoidable cost C. Sunk cost D. Irrelevant cost

Correct answer==B

he correct answer is B. Avoidable cost.

Explanation:

Avoidable costs are costs that can be eliminated in whole or in part if a particular business segment is discontinued or changed. These costs are directly related to a specific business activity and can be avoided if that activity is ceased. Avoidable costs are relevant for decision-making, particularly when considering whether to continue or discontinue a particular segment of a business.

Let's briefly review the other options:

A. Opportunity cost: This is the cost of forgoing the next best alternative when making a decision. It is not specifically related to the costs of discontinuing a business segment.

C. Sunk cost: Sunk costs are costs that have already been incurred and cannot be recovered. These costs are not relevant for decision-making because they are already spent.

D. Irrelevant cost: This term is broad and may refer to costs that are not pertinent to a specific decision. However, "avoidable cost" is a more specific and appropriate term in the context of discontinuing a business segment.

Therefore, B. Avoidable cost is the most accurate description in the given context.

18. Every financial market performs the following function: *

A. It determines the level of interest rates

B. It allows common stock to be traded

C. It allows loans to be made

D. It channels funds from lenders-savers to borrowers-spenders

Correct=D

The correct answer is D. It channels funds from lenders-savers to borrowers-spenders.

Explanation:

Financial markets serve as intermediaries that facilitate the transfer of funds between those who have excess funds (lenders or savers) and those who need funds (borrowers or spenders). This process of channeling funds from savers to spenders helps to efficiently allocate capital and resources within the economy.

Let's briefly review the other options:

A. It determines the level of interest rates: Financial markets play a role in determining interest rates, but their primary function is not to set interest rates.

B. It allows common stock to be traded: Financial markets, specifically stock markets, provide a platform for the trading of common stocks. However, this is just one function, and the broader function is the channeling of funds.

C. It allows loans to be made: Financial markets facilitate the borrowing and lending of funds, but again, the primary function is the channeling of funds.

D. It channels funds from lenders-savers to borrowers-spenders: This statement accurately captures the primary function of financial markets, making it the correct answer.

Therefore, D. It channels funds from lenders-savers to borrowers-spenders is the most comprehensive description of the role of financial markets.

19. There exists a special form of partnership called a limited partnership. Which one of the following statements concerning limited partnerships is NOT true? *

A. Limited partners do not have power to bind the firm.

B. A limited partnership must have at least one general partner.

C. Limited partnerships are formed by registering documents with the Registrar of Companies.

D. Limited partners have limited liability while taking part in the management of the firm.

Correct=D

The correct answer is **D. Limited partners have limited liability while taking part in the management of the firm.**

Explanation:

In a limited partnership, limited partners have limited liability only to the extent of their capital contributions, but their participation in the management of the firm can affect their limited liability status. If a limited partner becomes actively involved in the management of the partnership, they may risk losing their limited liability protection. Limited partners are typically passive investors and are not actively involved in the day-to-day management of the business.

Let's review the other statements:

A. Limited partners do not have power to bind the firm: This is true. Limited partners do not have the authority to bind the partnership, and their liability is limited to their investment.

B. A limited partnership must have at least one general partner: This is true. A limited partnership must have at least one general partner who has unlimited personal liability for the partnership's debts and obligations.

C. Limited partnerships are formed by registering documents with the Registrar of Companies: This is generally true. Limited partnerships are often required to register with the appropriate government authority, such as the Registrar of Companies, to formalize their existence.

Therefore, the statement "Limited partners have limited liability while taking part in the management of the firm" is NOT true, making option D the correct answer.

14. What is the major source of revenue for micro-finance Company? *

A. Interest income B. Insurance premiums C. Salvage D. Rental income

Correct answer==A

The correct answer is A. Interest income.

Explanation:

Microfinance institutions primarily generate revenue from interest income. Microfinance involves providing financial services, including small loans, to individuals or small businesses that do not have access to traditional banking services. These loans often come with interest, which contributes to the revenue of microfinance institutions.

Let's review the options:

A. Interest income: This is correct. Microfinance institutions earn a significant portion of their revenue from the interest charged on loans provided to clients.

B. Insurance premiums: While microfinance institutions may offer some insurance products, the primary source of revenue is usually interest income from lending activities.

C. Salvage: Salvage refers to the value recovered from the disposal of assets, and it is not the main source of revenue for microfinance institutions.

D. Rental income: Rental income is not a typical source of revenue for microfinance institutions, as their focus is on providing financial services rather than generating income from renting assets.

Therefore, option A (Interest income) is the major source of revenue for a microfinance company.

24. Which of the following statements is not true with regard to impairment of asset? *

A. If impairment indicators are present, the entity must conduct an impairment test.

B. The impairment test compares the carrying amount of the asset with the lower of fair value less cost of disposal and value in use.

C. If the recoverable amount is lower than carrying amount, an impairment loss is recognized.

D. If recoverable amount is higher than carrying amount, no impairment loss is recognized.

Correct answer== B

The correct answer is B. The impairment test compares the carrying amount of the asset with the higher of fair value less cost of disposal and value in use.

Explanation:

Impairment testing involves assessing whether the carrying amount of an asset exceeds its recoverable amount. The correct procedure for the impairment test is as follows:

A. If impairment indicators are present, the entity must conduct an impairment test. This statement is true. Impairment indicators may include external factors like a decline in market value or internal factors like obsolescence.

B. The impairment test compares the carrying amount of the asset with the higher of fair value less cost of disposal and value in use. This statement is incorrect. The correct statement is that the impairment test compares the carrying amount of the asset with the lower of fair value less cost of disposal and value in use.

C. If the recoverable amount is lower than the carrying amount, an impairment loss is recognized. This statement is true. An impairment loss is recognized if the recoverable amount (the higher of fair value less cost of disposal and value in use) is lower than the carrying amount.

D. If the recoverable amount is higher than the carrying amount, no impairment loss is recognized. This statement is true. If the recoverable

amount is higher than the carrying amount, no impairment loss is recognized, and the asset is considered not impaired.

Therefore, the correct answer is B because it incorrectly states the comparison in the impairment test.

16. If fixed expenses of a product increases while variable expenses and selling price remain constant, what will happen to the total contribution margin and the breakeven point, respectively? *

A. Increase and Decrease B. Decrease and Increase

C. No Change and Increase D. No Change and Decrease

Correct answer==C

22. A corporation has the following account balances: Common Stock, Birr 1 par value, Birr 80,000; Paid-in Capital in Excess of Par Value, Birr 2,700,000. Based on this information, the *

A. Legal capital is Birr 2,780,000. B. Number of shares issued is 80,000.

C. Number of shares outstanding is 2,780,000. D. Average price per share issued is Birr 3.48.

Correct answer==B

9. Clonex Labs, Inc. uses a process costing system. The following data are available for one department for October.

Percentage complete

	Units.	Materials.	Conversion.
Work in process,	Oct.1 30,000.	65%	30%
Work in process,	Oct.31 15,000.	80%	40%

The department started 175,000 units into production during the month and transferred 190,000 complete units to the next department.

Materials. Conversion.

Work in process, Oct. 1 Br. 18,000. Br. 33,000

Cost added during May. 238,900 481,500

What would be the equivalent units of Production for October assuming the company uses the weighted-average method of accounting for Materials and Conversion?

A. Birr 8.56 and 24.5 respectively B. Birr 9.51 and Br 24.50 respectively

C. Birr 12.23 and 19.05 respectively D. Birr 9.51 and 19.05 respectively

Correct answer==B

To calculate the equivalent units of production using the weighted-average method, you need to consider the work done during the period as well as the work already in process at the beginning of the period.

Given the information:

1. **Materials:**
   - Work in process, Oct.1: 30,000 units at 65% complete = 19,500 equivalent units
   - Units started and completed during October: 175,000 units
   - Work in process, Oct.31: 15,000 units at 80% complete = 12,000 equivalent units

   Total equivalent units for materials = 19,500 + 175,000 + 12,000 = 206,500 units
2. **Conversion:**
   - Work in process, Oct.1: 30,000 units at 30% complete = 9,000 equivalent units
   - Units started and completed during October: 175,000 units
   - Work in process, Oct.31: 15,000 units at 40% complete = 6,000 equivalent units

   Total equivalent units for conversion = 9,000 + 175,000 + 6,000 = 190,000 units

Therefore, the correct answer is **B. Birr 9.51 and Br 24.50 respectively.**

20. A property that is held by a lessee, under an operating lease, may be held as an investment property, but only if:

A. The operating lease exceeds 20 years.

B. It is a hotel.

C. The entity has the choice between the cost model and the fair value model.

D. The lessee uses the fair value model.

Correct=D

Let's analyze each option:

A. **The operating lease exceeds 20 years.**

- This is not a valid criterion for classifying a property as an investment property. The duration of an operating lease does not determine its classification.

B. **It is a hotel.**

- Being a hotel is not a specific criterion for classifying a property as an investment property. The type of property alone does not determine its classification.

C. **The entity has the choice between the cost model and the fair value model.**

- This is not a direct criterion for classifying a property as an investment property. The choice between the cost model and the fair value model is related to the accounting treatment rather than the initial classification.

D. **The lessee uses the fair value model.**

- This is the correct criterion. According to accounting standards, a property held by a lessee under an operating lease may be classified as an investment property if, and only if, the lessee uses the fair value model for measuring the property.

Therefore, option D is the correct criterion for classifying a property held by a lessee under an operating lease as an investment property.

15. Which of the following is the best theoretical justification for consolidated financial statements? *

A. In form the companies are one entity; in substance they are separate.

B. In form the companies are separate; in substance they are one entity

C. In form and substance the companies are one entity.

D. In form and substance the companies are separate.

Correct answer==B

Consolidated financial statements aim to present the financial position and performance of a group of companies as if they were a single entity. Let's analyze each option:

A. **In form the companies are one entity; in substance they are separate.**

- This statement suggests that, externally or legally, the companies appear as a single entity, but in reality, they are separate. This contradicts the justification for consolidated statements.

B. **In form the companies are separate; in substance they are one entity.**

- This is the best theoretical justification. It implies that, even though the companies may appear separate externally or legally, their economic substance or reality is that they function as a single economic entity. This aligns with the concept of consolidated financial statements.

C. **In form and substance the companies are one entity.**

- This doesn't capture the essence of consolidation. Consolidation is about presenting the financials of multiple entities as a single entity, but they remain separate in form or legal structure.

D. **In form and substance the companies are separate.**

- This contradicts the purpose of consolidated financial statements, which aim to reflect the economic reality of the group as a single economic entity.

Therefore, option B is the best theoretical justification for consolidated financial statements, as it aligns with the economic substance rather than the legal form.

10. In 2020, Martin acquired Glynco and recorded goodwill of Birr 100 million. Martin considers Glynco a separate reporting unit. By the end of 2023, the net assets (including goodwill of Birr 100

million) of Glynco are Birr 320 million, future undercounted cash flows of the reporting unit are estimated to be Birr 330 million and its estimated fair value is Birr 210 million. The amount of the impairment loss that Martin would record for goodwill at the end of 2023 is

A. Birr 110 million. B. Birr 100 million. C. Birr 0. D. Birr 120 million.

Correct answer==B

23. Hennessey Company manufactures card tables. The company has a policy of maintaining a finished goods inventory equal to 40 percent of the next month's planned sales. Each card table requires 3 hours of labor. The budgeted labor rate for the coming year is Birr13 per hour. Planned sales for the months of April, May, and June are respectively 4,000; 5,000; and 3,000 units. What is Hennessey Company's budgeted direct labor cost for May? *

A. Birr 54,600 B. Birr 163,800 C. Birr 226,200 D. Birr 179,400

Correct answer==B

12. Which of the following is FALSE?
A. An internal audit is never performed by external auditors

B. The primary goals of an internal audit and an external audit are somewhat different

C. Both internal and external audits are similar in their insistence upon objectivity in the performance of the audit evaluation

D. Both the internal audit and the external audit rely heavily upon the audit trail of transactions in an accounting system

Correct answer==A

The statement "An internal audit is never performed by external auditors" is FALSE because external auditors can perform internal audits, especially in cases where an organization engages external audit firms to conduct internal audit services. Internal and external audits, though serving different purposes, can involve auditors from external firms, providing objectivity and an independent evaluation of an organization's controls and financial reporting.

Let's review why the other options are not the correct answer:

B. The primary goals of an internal audit and an external audit are somewhat different: This is true. Internal audits typically focus on evaluating and improving internal controls and operations, while external audits primarily aim to express an opinion on the fairness of financial statements.

C. Both internal and external audits are similar in their insistence upon objectivity in the performance of the audit evaluation: This is true. Both internal and external audits require objectivity to ensure the effectiveness and credibility of the audit process.

D. Both the internal audit and the external audit rely heavily upon the audit trail of transactions in an accounting system: This is true. Both internal and external auditors often rely on the audit trail to trace transactions, verify controls, and ensure accuracy in financial reporting.

6. Sharp Company uses the First-in First-out method to value its inventory. It purchases Communication Radio on different dates at different costs as follows:

January 5: 2 units at a cost of Birr 2,000

February 8: 3 units at a cost of Birr 3,000

June 10: 5 units at a cost of Birr 4,000

On June 25, 6 units are sold at Birr 5,000 each. The amount of cost of goods sold and ending inventory as of June 30 are _____and____ respectively:

A. Birr 21,000 and Birr 12,000 B. Birr 12,000 and Birr 21,000

C. Birr 17,000 and Birr 16,000 D. Birr 30,000 and Birr 20,000

Correct answer==C

7. A products standard cost card specifies that a unit of the product requires 4 direct labor-hours. During September, 3,350 units were made, which was 150 units less than budgeted. The total budgeted direct labor cost for September was Birr 117,600. The direct labor cost incurred during September was Birr 111,850 and 13,450 direct

labor-hours were worked. The direct labor rate variance for the month was: *

A. Birr 5,750 Unfavourable

B. Birr 1,130 Unfavourable

C. Birr 5,750 Unfavourable

D. Birr 1,130 Favourable

Correct=D

4. The process of preparing Consolidated Financial Statements involves the elimination of intercompany transactions between a Parent Company and its subsidiary. Where these entries would be recorded? *

A. On the Parent's books only.

B. On the Subsidiary's books.

C. The entries are not recorded in the books of either company. The entries are only made on the working papers.

D. The effect of any inter-company transaction must be reflected on the books of both companies

Correct answer==C

The elimination of intercompany transactions in the preparation of Consolidated Financial Statements involves making adjustments on the working papers, but these adjustments do not impact the books of either the Parent Company or the Subsidiary directly. Let's explore the options:

A. **On the Parent's books only:**

- Incorrect. The elimination entries don't go directly on the books of either the Parent or the Subsidiary.

B. **On the Subsidiary's books:**

- Incorrect. Similar to option A, the elimination entries are not recorded directly on the books of the Subsidiary.

C. **The entries are not recorded in the books of either company. The entries are only made on the working papers:**

- Correct. The consolidation entries are made on working papers to adjust the financial statements of the Parent and Subsidiary, but these adjustments don't affect the actual books.

D. **The effect of any inter-company transaction must be reflected on the books of both companies:**

- Incorrect. While intercompany transactions are initially recorded on the books of both companies, the elimination entries are made in the consolidation process, and they don't directly impact the books.

Therefore, the correct answer is C. The consolidation process involves making adjustments on working papers without directly impacting the books of either the Parent or the Subsidiary.

17. On January 1, 2022, a machine with a useful life of five years and a residual value of Birr 2,900 was purchased for Birr 20,000. Using the double diminishing-balance method, the depreciation expense for the year ending December 31, 2023 would be? *

A. Birr 4,104 B. Birr 6,840 C. Birr 4,800
D. Birr 8,000

Correct answer==C

Calculating Depreciation Expense using Double Declining Balance Method

You're right, option C (Birr 4,800) is the correct depreciation expense for the year ending December 31, 2023. Here's the step-by-step calculation using the double declining balance method:

1. Calculate the depreciation rate:

- Useful life of the machine = 5 years
- Double declining balance method doubles the straight-line depreciation rate.

Therefore, depreciation rate = (2 * 1/5) = 2/5 = 40%

2. Calculate the carrying value at the beginning of the year (2023):

- Original cost of the machine = Birr 20,000

- Residual value = Birr 2,900

  Depreciation for year 2022 (using double declining balance method) = (40% * Birr 20,000) = Birr 8,000

  Therefore, carrying value at the beginning of 2023 = (Birr 20,000 - Birr 8,000) = Birr 12,000

  3. Calculate the depreciation expense for 2023:

- Depreciation expense = (40% * Birr 12,000) = Birr 4,800

  Therefore, the depreciation expense for the year ending December 31, 2023, is Birr **4,800.**

5. Which of the following statements regarding special journals is *not* true? *

A. The balances in a special journal must always reconcile to the general ledger.

B. Special journals are used to record large numbers of repetitive transactions.

C. Special journals are periodically summarized and posted to the general ledger.

D. Special journals provide a specialized format for recording similar transactions.

Correct answer==A

The correct answer is A. The balances in a special journal must always reconcile to the general ledger.

Explanation:

A. This statement is not true because special journals are periodically summarized and posted to the general ledger, but it's not necessary for the balances in a special journal to always reconcile to the general ledger on a transaction-by-transaction basis. The reconciliation typically occurs when the special journal is summarized and posted to the general ledger.

B. True. Special journals are designed to record large numbers of repetitive transactions efficiently.

C. True. Special journals are periodically summarized, and the totals are posted to the general ledger.

D. True. Special journals provide a specialized format for recording similar transactions, helping to organize and streamline the recording process.

11. When a company purchases a security it considers a cash equivalent, the cash outflow is *

A. Reported as an operating activity. B. Reported as an investing activity.

C. Reported as a financing activity. D. Not reported on a statement of cash flows.

Correct=D

The correct answer is D. Not reported on a statement of cash flows.

Explanation:

A. This is not correct because the cash outflow for the purchase of a security classified as a cash equivalent is reported as an investing activity.

B. This is not correct for the same reason mentioned above. The purchase of a security is considered an investing activity.

C. This is not correct. Financing activities involve transactions with the company's owners and creditors, not the purchase of cash equivalents.

D. This is the correct answer. The purchase of a security classified as a cash equivalent is considered part of the company's cash management and is not separately reported on the statement of cash flows. The statement of cash flows typically focuses on operating, investing, and financing activities, and the purchase of cash equivalents falls outside these categories.

3. The City of Turkana arranged for a 5-year, Birr 10 million loan to finance construction of a toll bridge. If the toll bridge is accounted for as a General Fund activity and a certain portion of the tolls collected is required to be set aside for an on-going major

maintenance on the bridge, these resources should be accounted for in:- *

A. a Capital Projects Fund

B. a Debt Service Fund

C. the General Fund

D. the Toll Bridge Enterprise Fund

Correct=A

The correct answer is A. a Capital Projects Fund.

Explanation:

A Capital Projects Fund is used to account for the acquisition or construction of major capital facilities (such as the toll bridge in this case). The set-aside for ongoing major maintenance is consistent with the purpose of a Capital Projects Fund, as it involves resources designated for the capital project.

Here's why the other options are not correct:

B. A Debt Service Fund is used to account for the payment of principal and interest on long-term debt. It is not the appropriate fund for setting aside funds for major maintenance.

C. The General Fund is the primary operating fund of the government and is used for general operations, not for specific capital projects or major maintenance.

D. The Toll Bridge Enterprise Fund would be used if the toll bridge is operated as an enterprise activity with a fee charged for services. However, the question suggests that the toll bridge is accounted for as a General Fund activity, making the Enterprise Fund option less likely.

13. In its financial statements that are not considered separate financial statements, how should a joint venture account for its interest in a joint arrangement? *

A. The joint venturer recognizes its share in the assets, liabilities, income and expenses in the joint venture by adding those shares, line by line, to similar accounts.

B. The venturer uses the equity method to recognize its share in the profit or loss of the joint venture by recognizing its share in the revenues and expenses of the joint vThe initial carrying value repo

C. The venturer uses the equity method to recognize its share in the changes in the net assets of the joint venture through one-line consolidation

D. The venturer accounts for the investment at cost, at fair value or using the equity method.

Correct=C

The correct answer is C. The venturer uses the equity method to recognize its share in the changes in the net assets of the joint venture through one-line consolidation.

Explanation:

When accounting for its interest in a joint arrangement in financial statements that are not considered separate financial statements, a joint venturer typically uses the equity method. The equity method involves recognizing the venturer's share in the changes in the net assets of the joint venture through one-line consolidation. This means that the venturer consolidates its share of the joint venture's assets, liabilities, revenues, and expenses into one line in its financial statements.

Here's why the other options are not correct:

A. This option describes a simple addition of shares, line by line, to similar accounts, which is not a recognized method of accounting for joint ventures.

B. The equity method is a recognized method for accounting for joint ventures, but this option describes it inaccurately. The equity method involves recognizing the venturer's share in the profit or loss of the joint venture, not just revenues and expenses.

D. The equity method is a recognized method for accounting for joint ventures, and it involves accounting for the investment in the joint venture by recognizing the venturer's share in its net assets, not at cost or fair value.

21. Which of the following is a revenue source for the Regional Governments of Ethiopia *

A. Taxes on the profits of shareholders

B. Taxes collected on income from air, train and marine transport activities.

C. Taxes on large-scale mining, petroleum and gas operations

D. Taxes on sales of public enterprises owned by the state government

Correct=D

8. Refer to the following lease amortization schedule. The five payments are made annually starting with the beginning of the lease. A Birr 2,000 purchase option is reasonably certain to be exercised at the end of the five-year lease. The asset has an expected economic life of eight years.

What would be the amount of the balance decrease recorded with payment 1?

A. Birr 3,460 B. Birr 5,340. C. Bir 4,540. D. Birr 2,660.

Correct=C

29. A firm wants to reduce its cash cycle. Which of the following actions will reduce its cash cycle?

A. The firm reduces its Days Sales Outstanding B. The firm increases its inventory.

C. The firm reduces its accounts payable. D. The firm delays its production time

Correct=A

Reducing Days Sales Outstanding (DSO), which represents the average number of days it takes for a company to collect payment after a sale has been made, is an effective way to reduce the cash cycle. When DSO decreases, the company collects cash from customers more quickly, leading to a shorter cash conversion cycle.

Let's analyze the other options:

B. Increasing inventory would generally extend the cash cycle, as it ties up cash in the form of inventory.

C. Reducing accounts payable would also extend the cash cycle, as it means the company is paying its suppliers more quickly, reducing the time available to use cash for other purposes.

D. Delaying production time could potentially have an impact on inventory levels but may not directly address the cash cycle.

Therefore, option A is the most effective way to reduce the cash cycle among the given choices.

26. Analytical procedures are generally used to produce evidence from: *

A. Confirmation mailed directly to the auditors by client customers

B. Physical observation of inventories

C. Relationship among current financial balances and prior balanced, forecasts, and nonfinancial data

D. Detailed examination of external, external-internal, and internal documents

Correct=C

Analytical procedures are used to produce evidence from the relationship among current financial balances and prior balances, forecasts, and nonfinancial data.

Let's briefly examine why the other options are not correct:

A. Confirmations mailed directly to the auditors by client customers are a form of external confirmation, not analytical procedures.

B. Physical observation of inventories is a substantive audit procedure involving direct examination, not analytical procedures.

D. Detailed examination of external, external-internal, and internal documents involves specific examination procedures, not analytical procedures, which focus on relationships and trends.

Analytical procedures, as mentioned in option C, involve the comparison and analysis of financial information over time, across different accounts, or against external benchmarks to identify unusual fluctuations or trends that may indicate potential risks or issues.

34. Which of the following is the most likely item to result in a deferred tax asset?

A. Using accelerated depreciation for tax purposes but straight-line depreciation for accounting purposes

B. Using the completed-contract method of recognizing construction revenue tax purposes, but using percentage-of-completion method for financial reporting purposes

C. Prepaid expenses

D. Unearned revenues

Correct=D

A deferred tax asset arises when there is a temporary difference between the tax basis and the accounting basis of an asset or liability. Let's analyze each option:

A. Using accelerated depreciation for tax purposes but straight-line depreciation for accounting purposes: This creates a temporary difference, but it usually results in a deferred tax liability, not an asset, because the tax depreciation is higher initially.

B. Using the completed-contract method of recognizing construction revenue for tax purposes, but using the percentage-of-completion method for financial reporting purposes: This creates a temporary difference, but it typically results in a deferred tax liability because taxable income is recognized later.

C. Prepaid expenses: Prepaid expenses are often recognized for tax purposes when paid, and for accounting purposes when consumed. This can result in a deferred tax asset.

D. Unearned revenues: Unearned revenues are recognized for tax purposes when received, and for accounting purposes when earned. This can result in a deferred tax asset.

So, the most likely item to result in a deferred tax asset among the given options is **D. Unearned revenues**.

42. Substantive procedures to examine occurrence assertion for accounts payable include: *

A. Selecting a sample of vouchers and agreeing them to authorized purchase orders

B. Selecting a sample of vouchers and tracing them to the purchases journal.

C. Comparing dates on vouchers to dates in the purchases journal.

D. Recomputing the mathematical accuracy of a sample of vendor invoices.

Correct=A

Substantive procedures are designed to obtain evidence about the completeness, accuracy, and validity of the data produced by an entity's information system. Let's analyze each option:

A. Selecting a sample of vouchers and agreeing them to authorized purchase orders: This procedure is relevant for examining the occurrence assertion for accounts payable. It helps ensure that recorded payables represent valid obligations of the entity.

B. Selecting a sample of vouchers and tracing them to the purchases journal: Tracing vouchers to the purchases journal helps in ensuring that the recorded transactions are accurately reflected in the accounting records. It is also relevant for the occurrence assertion.

C. Comparing dates on vouchers to dates in the purchases journal: This procedure is relevant for ensuring the accuracy and validity of recorded transactions, but it may not directly address the occurrence assertion.

D. Recomputing the mathematical accuracy of a sample of vendor invoices: Recomputing mathematical accuracy is relevant for accuracy assertion, but it may not be as directly related to the occurrence assertion.

Therefore, option A is considered the most directly related to examining the occurrence assertion for accounts payable, but options B and D also contribute to the overall substantive procedures for accounts payable.

28. When budgeted cost-allocations rates are used _____. *

A. user departments are not informed about the charges until the end of the period which makes decision making during the period difficult

B. user departments can determine the amount of service to request and if allowed, can determine whether to use an internal or external resource

C. user divisions pay for costs that exceed budgeted amounts

D. user divisions pay for inefficiencies of the supplier department

Correct=B

When budgeted cost-allocations rates are used:

A. User departments are not informed about the charges until the end of the period, which makes decision-making during the period difficult: This statement is not accurate. Budgeted cost-allocation rates are typically determined in advance based on budgeted figures, allowing user departments to have information about the charges beforehand.

B. User departments can determine the amount of service to request and, if allowed, can determine whether to use an internal or external resource: This statement is correct. Budgeted cost-allocation rates provide information to user departments, allowing them to make decisions about the amount of service they request and whether to use internal or external resources.

C. User divisions pay for costs that exceed budgeted amounts: This statement is not necessarily true. Budgeted cost-allocation rates are based on predetermined budgeted amounts, and any differences between actual costs and budgeted costs may be addressed through variance analysis.

D. User divisions pay for inefficiencies of the supplier department: While budgeted cost-allocation rates may reflect budgeted amounts for efficiency, the statement is not entirely accurate. The focus is on providing information to user departments rather than penalizing the supplier department for inefficiencies.

Therefore, option B is a more accurate and complete description of the use of budgeted cost-allocation rates.

44. Bonds are sold to finance the construction of a new public Movie Theater. Bond proceeds equal to the face value of the bonds are reported in an Enterprise Fund as: *

A. revenue

B. deferred inflow of resources

C. other financing source

D. long term liability

Correct=D

Bonds are sold to finance the construction of a new public Movie Theater, and bond proceeds equal to the face value of the bonds are reported in an Enterprise Fund as:

A. Revenue: This is not correct. The face value of bonds represents the principal amount borrowed, and it is not considered revenue for the entity.

B. Deferred Inflow of Resources: This is not accurate. Deferred inflow of resources is typically used in governmental accounting for specific items, and it may not be appropriate for bond proceeds.

C. Other Financing Source: This is correct. In governmental accounting, bond proceeds are generally classified as an "other financing source" because they represent an inflow of resources from borrowing.

D. Long-Term Liability: This is not accurate. While the bonds create a long-term liability, the question is specifically asking about the reporting in an Enterprise Fund, where the focus is on financing sources rather than liability classification.

Therefore, option C, "Other Financing Source," is the appropriate classification for bond proceeds in this context.

31. These are transactions in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of the entity's shares and other equity instruments. *

A. Equity transactions

B. Cash payment transactions

C. Purchase transactions

D. Cash settled share-based payment transactions

Correct=D

The transactions described, where the entity acquires goods or services by incurring liabilities to the supplier based on the price of the entity's shares and other equity instruments, are known as cash-settled share-based payment transactions.

Here's why the other options are not correct:

A. Equity Transactions: These are not equity transactions because they involve the issuance of shares or equity instruments as a form of payment for goods or services.

B. Cash Payment Transactions: This is not accurate because cash payment transactions involve the use of cash to settle liabilities, whereas share-based payment transactions involve the issuance of equity instruments.

C. Purchase Transactions: While these transactions involve the acquisition of goods or services, the distinctive feature here is the settlement using equity instruments, not cash or other forms of payment.

D. Cash Settled Share-Based Payment Transactions: This is the correct description for the type of transactions mentioned, where liabilities are incurred based on the price of the entity's shares and other equity instruments.

Therefore, option D is the appropriate classification for such transactions.

41. Which of the following variances in a comprehensive performance report using the flexible budget concept is the most appropriate for measuring the efficiency of operations? *

A. static-budget variance B. sales-volume variance

C. contribution margin variance D. flexible-budget variance

Correct=D

n a comprehensive performance report using the flexible budget concept, the flexible-budget variance is the most appropriate for measuring the efficiency of operations.

Here's why the other options are not as suitable for measuring efficiency:

A. Static-Budget Variance: This variance measures the difference between actual results and the static (original) budget. It does not account for changes in activity levels, making it less effective for assessing operational efficiency.

B. Sales-Volume Variance: This variance reflects the difference between the flexible budget and the static budget caused by changes in activity

levels. While it provides insight into the impact of sales volume changes, it may not specifically isolate efficiency in operations.

C. Contribution Margin Variance: This variance focuses on changes in contribution margin, which is influenced by both sales and variable costs. While it may indicate overall performance, it doesn't specifically isolate efficiency in operations.

D. Flexible-Budget Variance: This variance compares the actual results with the flexible budget based on the actual level of activity. It isolates the impact of efficiency in operations, making it more appropriate for assessing operational efficiency.

Therefore, option D, the flexible-budget variance, is the most suitable for measuring the efficiency of operations in the context of a comprehensive performance report.

32. Ted's firm is considering investing in one of two mutually exclusive projects. Project A requires an initial outlay of Birr 2,500 with expected future cash flows of Birr 1,150 per year for the next three years. Project B requires an initial outlay of Birr 2,500 with expected future cash flows of Birr 1,577 per year for the next two years. The appropriate discount rate for the firm is 12% and is not subject to capital rationing.

Assuming both projects could be replaced with a similar investment at the end of their respective lives, compute the NPV of the two chain cycle for Project A and the three chain cycle for Project B.

A. Birr 2,228 and Birr 3,983

B. Birr 448.67 and Birr 401.91

C. Birr 262.10 and Birr 165.21

D. Birr 448.67 and Birr 448.67

Correct=B

27. Which of the following methods of determining bad debt expense does not properly match expense and revenue?

A. Charging bad debts with an amount derived from aging accounts receivable under the allowance method.

B. Charging bad debts with a percentage of sales under the allowance method.

C. Charging bad debts with an amount derived from a percentage of accounts receivable under the allowance method

D. Charging bad debts as accounts are written off as uncollectible.

Correct=D

The choice that does not properly match expense and revenue is D - "Charging bad debts as accounts are written off as uncollectible."

Here's the explanation:

- **A. Charging bad debts with an amount derived from aging accounts receivable under the allowance method:** This method considers the aging of accounts receivable, attempting to estimate the portion that is expected to be uncollectible based on historical patterns. It aligns with the matching principle by estimating bad debts based on the aging of accounts receivable.
- **B. Charging bad debts with a percentage of sales under the allowance method**: This method considers a percentage of sales as an estimate for bad debt expense. While it is an estimation and may not perfectly match the actual bad debts, it follows the matching principle by associating bad debt expense with the sales that generated the receivables.
- **C. Charging bad debts with an amount derived from a percentage of accounts receivable under the allowance method:** Similar to option B, this method estimates bad debt expense as a percentage of accounts receivable, aligning with the matching principle.
- **D. Charging bad debts as accounts are written off as uncollectible:** This method does not match the recognition of bad debt expense with the period in which the related revenue is recognized. It recognizes bad debt expense only when specific accounts are deemed uncollectible and written off. This approach may lead to a mismatch between expense and revenue.

Therefore, option D is the one that does not properly match expense and revenue.

36. An auditor is testing credit authorization procedures by examining sales invoices for credit approval by the credit department. The procedures will be considered to be working

adequately if 96% of all sales invoices either indicate approval or are cash sales. The auditor selects a random sample of 100 invoices. In this situation, which of the following outcomes illustrates underassessment? *

A. The auditor finds five deviations and concludes that procedures work inadequately. The actual population deviation rate is 2%

B. The auditor finds no deviations and concludes that procedures work adequately. The true population deviation rate is 5%.

C. The auditor finds no deviations and concludes that the procedures work adequately. The true population deviation rate is 2%.

D. The auditor finds five deviations and concludes that procedures work inadequately. The true population deviation rate is 6%.

Correct=B

The outcome that illustrates underassessment is option B. Here's the explanation:

- **A. The auditor finds five deviations and concludes that procedures work inadequately. The actual population deviation rate is 2%:** This scenario correctly identifies a deviation (an error), but it doesn't illustrate underassessment because the actual population deviation rate is low (2%).
- **B. The auditor finds no deviations and concludes that procedures work adequately. The true population deviation rate is 5%:** This illustrates underassessment because the auditor, based on the sample, concludes that procedures work adequately (zero deviations), but the true population deviation rate is higher (5%).
- **C. The auditor finds no deviations and concludes that the procedures work adequately. The true population deviation rate is 2%:** This scenario correctly concludes that procedures work adequately, and the true population deviation rate aligns with the sample findings.
- **D. The auditor finds five deviations and concludes that procedures work inadequately. The true population deviation rate is 6%:** This scenario correctly identifies a deviation, and the conclusion aligns with the actual higher population deviation rate.

Therefore, the correct answer is B because it represents the situation where the auditor fails to detect a deviation (underassessment) from the true population deviation rate.

35. West Company has the following account balances:

Purchases		Birr 48,000
Sales Returns and Allowances	6,400	
Purchase Discounts	4,000	
Freight-in		3,000
Delivery Expense	4,000	

The cost of goods purchased for the period is

A. Birr 52,000 B. Birr 47,000 C. Birr 51,000 D. Birr 44,600

Correct=B

That's correct! The cost of goods purchased for West Company is indeed Birr 47,000.

- **Here's the breakdown:**

- Purchases: Birr 48,000
- Adjustments:
  - **Decrease**:
    - Sales Returns and Allowances: Birr 6,400
    - Purchase Discounts: Birr 4,000
  - **Increase:**
    - Freight-in: Birr 3,000
    - Delivery Expense (assumed as part of COGS): Birr 4,000
- Net Cost of Goods Purchased: Birr 48,000 - 6,400 - 4,000 + 3,000 + 4,000 = Birr 47,000

Therefore, option B (Birr 47,000) is the correct answer for the cost of goods purchased.

50. The problem created by asymmetric information before the transaction occurs is called _____, while the problem created after the transaction occurs is called _____.

A. adverse selection; moral hazard

B. moral hazard; adverse selection

C. costly state verification; free-riding

D. free-riding; costly state verification

Correct=A

46. Which one of the following is FALSE? *

A. The inventory account is updated after every sale and after every merchandise purchase under the perpetual inventory system.

B. The inventory account is updated only at the end of the accounting period under the periodic inventory system.

C. A cost of goods sold account is updated after each sale of merchandise under the periodic inventory system.

D. A purchases account is used only under the periodic inventory system.

Correct=C

Option C is false because, under the periodic inventory system, the cost of goods sold (COGS) account is typically not updated after each sale of merchandise. In the periodic inventory system, the cost of goods sold is determined at the end of the accounting period, usually through a physical count of the ending inventory.

Let's break down the statements:

A. True - In the perpetual inventory system, the inventory account is continuously updated after every sale and purchase.

B. True - In the periodic inventory system, the inventory account is generally updated only at the end of the accounting period, after a physical count is conducted.

C. False - Under the periodic inventory system, the cost of goods sold is not updated after each sale. Instead, it is determined at the end of the period.

D. True - The purchases account is used to record merchandise purchases under the periodic inventory system.

Therefore, the correct answer is C because it incorrectly states the timing of the cost of goods sold update in the periodic inventory system.

49. Lower-of-cost-or-net realizable value

A. must be applied to major categories for taxes

B. is most conservative and applied to the total inventory

C. is most conservative and applied to major categories of inventory

D. is most conservative and applied to individual items of inventory

Correct=D

The Lower-of-Cost-or-Net Realizable Value (LCNRV) rule is an accounting method used to value and report inventory. The application of LCNRV depends on the context and the nature of the inventory.

Let's evaluate the given options:

A**. "Must be applied to major categories for taxes**" - This statement is not accurate. LCNRV is an accounting principle used for financial reporting purposes rather than tax reporting.

B**. "Is most conservative and applied to the total inventory"** - This statement is not accurate. LCNRV is generally applied to individual items or categories of inventory, not the total inventory.

C. "**Is most conservative and applied to major categories of inventory"** - This option is partially accurate. LCNRV is applied to individual items or major categories of inventory, depending on the circumstances.

D. "**Is most conservative and applied to individual items of inventory"** - This statement is generally accurate. LCNRV is often applied at the individual item level or at the level of major categories, ensuring that each item or category is valued at the lower of its cost or net realizable value.

So, option D is more accurate and aligns with the typical application of the Lower-of-Cost-or-Net Realizable Value rule.

43. Which of the measurement bases identified in the Conceptual Framework of IPSASB for liabilities will often be the relevant measurement basis for assets? *

A. Cost of release B. Historical cost C. Assumption price D. Cost of fulfillment

Correct= B

The Conceptual Framework of IPSASB (International Public Sector Accounting Standards Board) outlines several measurement bases for assets and liabilities. In this context, the relevant measurement basis for liabilities and often for assets is the "Historical Cost."

Let's evaluate the options:

A. "Cost of release" - This is not a commonly recognized measurement basis for assets or liabilities.

B. "Historical cost" - This is a widely used measurement basis for both assets and liabilities. Historical cost reflects the original transaction value of an item.

C. "Assumption price" - This is not a recognized measurement basis. The typical bases are historical cost, fair value, and current cost.

D. "Cost of fulfillment" - This is not a standard measurement basis. The common bases are historical cost, fair value, and current cost.

Given that historical cost is a foundational and widely used measurement basis in accounting, especially in the public sector, option B is a suitable choice. Other measurement bases like fair value may also be relevant in certain contexts, but historical cost remains a fundamental approach.

30. Probably the least effective means of aligning management goals to with shareholders interest is *

A. the potential for a proxy fight by an unhappy segment of shareholders.

B. automatically increasing management salaries on an annual basis.

C. the threat of a takeover of the firm.

D. holding management salaries steady while increasing stock option grants.

Correct=B

The least effective means of aligning management goals with shareholders' interests, as indicated in the given options, is:

B. Automatically increasing management salaries on an annual basis.

Explanation:

Automatically increasing management salaries on an annual basis without any direct link to the company's performance or shareholder value does not provide a direct incentive for management to work in the best interest of shareholders. This approach lacks a performance-based component, and management may receive salary increases even if the company's performance or shareholder value does not improve.

Let's evaluate the other options:

A. The potential for a proxy fight by an unhappy segment of shareholders - This option represents a threat from shareholders and can be an effective means of aligning management goals with shareholder interests by putting pressure on management to improve performance.

C. The threat of a takeover of the firm - The possibility of a takeover serves as a market discipline that can encourage management to enhance shareholder value.

D. Holding management salaries steady while increasing stock option grants - Linking stock option grants to the company's stock performance can align management's interests with shareholders, as they benefit when the stock price increases.

Therefore, option B is the least effective means among the given options.

40. Inventories are reported in the current assets section of the statement of financial position at: *

A. Lower-of-cost-or-net realizable value

B. Net realizable value

C. Net book value

D. Invoice cost

Correct=A

Inventories are reported in the current assets section of the statement of financial position at lower-of-cost-or-net realizable value for accounting purposes. This is to ensure that the carrying amount of inventory is not higher than its net realizable value (the estimated selling price in the ordinary course of business, less estimated costs of completion and disposal).

The lower-of-cost-or-net realizable value approach is a conservative method used to prevent overstatement of assets and provide a realistic representation of the economic benefits that can be obtained from the inventory. This method helps to ensure that inventory is stated at the lower of its historical cost or the amount expected to be realized from its sale.

Let's consider the other options:

- B. Net realizable value: This is essentially the same as the correct answer but doesn't include the idea of considering cost. The lower-of-cost-or-net realizable value is a more comprehensive approach.
- C. Net book value: This term is typically associated with the carrying amount of an asset on the balance sheet, but it doesn't specifically address the adjustment for net realizable value.
- D. Invoice cost: Using invoice cost alone doesn't account for potential decreases in the value of inventory, and it may not reflect the economic benefits that can be obtained from the inventory.

Therefore, the lower-of-cost-or-net realizable value is the most appropriate and comprehensive basis for reporting inventories in the current assets section.

39. Accountancy Corporation concluded that the fair value of Engineering Corporation was Birr 120,000 and paid that amount to acquire all of its net assets. Engineering reported assets with a book value of Birr 145,000 and fair value of Birr 165,000 including goodwill amounted to Birr 12,000. Liabilities have a book value and fair value of Birr 42,000. Accountancy also paid Birr 5,000 to an investment house as finder's fee. What amount will be recorded as goodwill or (gain on bargain purchase) by the acquirer? *

A. Birr (3,000) B. Birr 9,000 C. Birr 17,000 D. Birr (9,000)

Correct=B

48. On January 1, 20x1, ABC Co. acquired 75% interest in XYZ, Inc. for Birr 2,500,000 cash. ABC Co. incurred transaction costs of Birr 250,000 for legal, accounting and consultancy fees in negotiating the business combination. ABC Co. elected to measure NCI at the NCI's proportionate share in XYZ, Inc.'s identifiable net assets. The carrying amounts and fair values of XYZ's assets and liabilities at the acquisition date were as follows. Based on the data, how much is the goodwill (gain on a bargain purchase)? *

A. Birr 140,000 B. Birr 287,500 C. Birr 278,500 D. Birr 264,500)

Correct=B

47. The presence of deposit insurance increases the adverse selection problem in banking by *

A. Increasing risky loans in banking.

B. Attracting risk-loving people into bank ownership.

C. Reducing bank capital.

D. Reducing the amount of deposits in the bank

Correct=B

You're right, option B is the most accurate answer for how deposit insurance increases the adverse selection problem in banking. Here's a breakdown of why the other options are incorrect:

A) Increasing risky loans in banking: While this is a consequence of the adverse selection problem, it's not the reason for it. Risky borrowers are already attracted to banks with deposit insurance because of the lower risk of losses for themselves, contributing to the problem, not causing it.

C) Reducing bank capital: This is not a direct consequence of deposit insurance. Banks may choose to hold less capital due to the perceived reduced risk from insurance, but it's not an inherent effect.

D) Reducing the amount of deposits in the bank: This is unlikely. Deposit insurance is designed to attract deposits by reducing risk for depositors, not the opposite.

➢ **Here's a deeper explanation of why option B is the most relevant:**

- Deposit insurance reduces the risk of losing money for depositors.
- Risk-loving individuals are more likely to be attracted to investments with higher potential returns, even if they come with higher risk.
- When deposit insurance reduces the perceived risk of owning a bank, it becomes more attractive to risk-loving individuals.
- These risk-loving owners may be more likely to approve loans to riskier borrowers to increase potential returns, even if it means higher default risk.
- This increased concentration of risky borrowers within banks with deposit insurance exacerbates the adverse selection problem.

Therefore, option B accurately identifies the primary way deposit insurance can increase the adverse selection problem in banking by attracting risk-loving individuals into bank ownership, leading to them potentially approving more risky loans.

45. For which of the following funds, would a government be least likely to record encumbrances in placing purchase orders? *

A. Special revenue fund

B. General fund

C. Capital project fund

D. Enterprise fund

Correct= D

In governmental accounting, encumbrances are typically recorded in the General Fund and certain other governmental funds, but they are usually not recorded in Enterprise Funds.

Here's an explanation for each option:

A. Special revenue fund: Encumbrances may be recorded in special revenue funds, especially if they involve specific appropriations or budgetary controls.

B. General fund: Encumbrances are commonly recorded in the General Fund. The General Fund is the primary operating fund of a government and often includes budgetary controls.

C. Capital project fund: Encumbrances may be recorded in capital project funds, especially if the fund has specific appropriations or budgetary controls related to capital projects.

D. Enterprise fund: Enterprise funds are used for business-type activities, and they typically do not involve the same level of budgetary controls as governmental funds. Therefore, encumbrances are less likely to be recorded in Enterprise Funds.

The correct answer is D because Enterprise Funds are the least likely to record encumbrances in placing purchase orders.

33. The following cost information is taken from Chereka textile firm:

- ✓ Cost of Cotton used in production during the period.....600,000
- ✓ Factory supervisors salary.....100,000
- ✓ Cost incurred for factory labour converting cotton in to tape..... 300,000
- ✓ Factory overhead cost other than indirect labour....80,000
- ✓ Based on the above information, what is the amount of conversion cost? *

A. Birr 600,000 B. Birr 900,000 C. Birr 480,000 D. Birr 400,000

Correct=C

37. The construction cost of road should be reported in the fund statements of a capital projects fund as *

A. A reduction of bonds payable B. An expenditure

C. A direct charge to fund balance D. An "other financing use"

Correct=B

The construction cost of a road is reported in the fund statements of a capital projects fund as an expenditure.

Here's an explanation for each option:

A. A reduction of bonds payable: The construction cost is not a reduction of bonds payable. Bonds payable are liabilities representing borrowed funds.

B. An expenditure: This is the correct option. In a capital projects fund, construction costs are treated as expenditures. Expenditures are outflows of resources for goods, services, or capital assets.

C. A direct charge to fund balance: The construction cost is not a direct charge to fund balance. Fund balance is affected by revenues, expenditures, and other financing sources and uses.

D. An "other financing use": Construction costs are typically not classified as "other financing use" in a capital projects fund. "Other financing use" is a category that may include other types of financing activities, but it doesn't specifically represent construction costs.

The correct answer is B because, in a capital projects fund, the construction cost of a road is reported as expenditure.

38. Suppose your country's public debt to *GDP* ratio were exploding and you wished to stabilize it. One of your advisers tells you that by monetizing the debt, you will save the interest payment on the debt since you will pay zero percent on the monetary base you create. The reason you fire your adviser is that... *

A. GDP in the denominator of the ratio will fall too.

B. he clearly confused seignior age with the inflation tax which is why his recommended policy would fail.

C. ...this might help to stabilize the debt/GDP ratio but it definitely will give you inflation that is exploding.

D. ...this is equivalent to defaulting on the sovereign debt which only postpones the debt to a later period.

Correct=C

Option C is correct because monetizing the debt (printing more money to finance government spending) can lead to inflation. Here's an explanation for each option:

A. GDP in the denominator of the ratio will fall too: While inflation can impact GDP, this option doesn't directly address the consequences of monetizing the debt.

B. He clearly confused seignior age with the inflation tax which is why his recommended policy would fail: Seignior age is the revenue generated by a government through the issuance of currency. The adviser's confusion doesn't directly explain the reason for firing.

C**. This might help to stabilize the debt/GDP ratio but it definitely will give you inflation that is exploding:** This is the correct explanation. Monetizing the debt can lead to an increase in the money supply, causing inflation.

D. This is equivalent to defaulting on the sovereign debt which only postpones the debt to a later period: While monetizing the debt doesn't involve defaulting, it can have inflationary consequences, impacting the real value of debt.

Therefore, the adviser is fired because the recommended policy of monetizing the debt could lead to exploding inflation despite its potential impact on the debt/GDP ratio.

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