

Financial Accounting and Reporting-CPA Practice Exam (Sample)

Study Guide



Everything you need from our exam experts!

This is a sample study guide. To access the full version with hundreds of questions,

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Introduction

Preparing for a certification exam can feel overwhelming, but with the right tools, it becomes an opportunity to build confidence, sharpen your skills, and move one step closer to your goals. At Examzify, we believe that effective exam preparation isn't just about memorization, it's about understanding the material, identifying knowledge gaps, and building the test-taking strategies that lead to success.

This guide was designed to help you do exactly that.

Whether you're preparing for a licensing exam, professional certification, or entry-level qualification, this book offers structured practice to reinforce key concepts. You'll find a wide range of multiple-choice questions, each followed by clear explanations to help you understand not just the right answer, but why it's correct.

The content in this guide is based on real-world exam objectives and aligned with the types of questions and topics commonly found on official tests. It's ideal for learners who want to:

- Practice answering questions under realistic conditions,
- Improve accuracy and speed,
- Review explanations to strengthen weak areas, and
- Approach the exam with greater confidence.

We recommend using this book not as a stand-alone study tool, but alongside other resources like flashcards, textbooks, or hands-on training. For best results, we recommend working through each question, reflecting on the explanation provided, and revisiting the topics that challenge you most.

Remember: successful test preparation isn't about getting every question right the first time, it's about learning from your mistakes and improving over time. Stay focused, trust the process, and know that every page you turn brings you closer to success.

Let's begin.

How to Use This Guide

This guide is designed to help you study more effectively and approach your exam with confidence. Whether you're reviewing for the first time or doing a final refresh, here's how to get the most out of your Examzify study guide:

1. Start with a Diagnostic Review

Skim through the questions to get a sense of what you know and what you need to focus on. Don't worry about getting everything right, your goal is to identify knowledge gaps early.

2. Study in Short, Focused Sessions

Break your study time into manageable blocks (e.g. 30 - 45 minutes). Review a handful of questions, reflect on the explanations, and take breaks to retain information better.

3. Learn from the Explanations

After answering a question, always read the explanation, even if you got it right. It reinforces key points, corrects misunderstandings, and teaches subtle distinctions between similar answers.

4. Track Your Progress

Use bookmarks or notes (if reading digitally) to mark difficult questions. Revisit these regularly and track improvements over time.

5. Simulate the Real Exam

Once you're comfortable, try taking a full set of questions without pausing. Set a timer and simulate test-day conditions to build confidence and time management skills.

6. Repeat and Review

Don't just study once, repetition builds retention. Re-attempt questions after a few days and revisit explanations to reinforce learning.

7. Use Other Tools

Pair this guide with other Examzify tools like flashcards, and digital practice tests to strengthen your preparation across formats.

There's no single right way to study, but consistent, thoughtful effort always wins. Use this guide flexibly — adapt the tips above to fit your pace and learning style. You've got this!

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Questions

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- 1. Which of the following conditions would lead to recognizing all gains in a sale-leaseback transaction?**
 - A. PV PMTs is less than or equal to 10% of the FV of the asset**
 - B. PV PMTs is more than 90% of the FV of the asset**
 - C. PV PMTs is greater than 10% but less than 90% of the FV of the asset**
 - D. Gross asset value exceeds carrying value**
- 2. What does ARO stand for in financial accounting?**
 - A. Asset Retirement Obligation**
 - B. Asset Retirement Organization**
 - C. Asset Revaluation Option**
 - D. Asset Recovery Obligation**
- 3. What is the total liability Welsh Corporation should recognize for its defined benefit pension plan?**
 - A. \$116,000**
 - B. \$122,000**
 - C. \$117,000**
 - D. None of the above**
- 4. What is a call option?**
 - A. The right to sell an asset at a specified price**
 - B. The right to buy an asset from the option writer**
 - C. An obligation to purchase at market value**
 - D. A future contract for selling securities**
- 5. What is the implication of a deferred tax asset being recognized under GAAP?**
 - A. It indicates a permanent difference between book and tax income**
 - B. It suggests future economic benefits are expected to result**
 - C. It guarantees that taxes will be lower than reported**
 - D. It must be amortized over several periods**

6. Which term is used to describe a promise by a corporation to pay bondholders a specific sum at maturity?

- A. Loan contract**
- B. Bond indenture**
- C. Bond covenant**
- D. Bond agreement**

7. What impact do nondeductible meal and entertainment expenses have on taxable income?

- A. They increase taxable income**
- B. They decrease taxable income**
- C. They are ignored for tax purposes**
- D. They create a deferred tax liability**

8. Which of the following signifies that an entity is a legal business entity?

- A. It operates purely as a nonprofit organization**
- B. It has a majority owned subsidiary that generates profits**
- C. It is an employee benefit plan**
- D. It conducts activities on behalf of other companies**

9. What type of accounting treatment is applied to capital leases from the lessee's perspective?

- A. Recorded as operating expenses only**
- B. Both assets and liabilities recognized**
- C. Only expenses are recorded**
- D. Not recorded on the balance sheet**

10. What does the term 'future minimum lease payments in the aggregate' refer to in capital lease disclosures?

- A. The total expected income from leasing**
- B. The total cash outflows over the lease term**
- C. The total of expected lease payments**
- D. The total amount of potential liabilities**

Answers

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1. A
2. A
3. D
4. B
5. B
6. B
7. A
8. B
9. B
10. C

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Explanations

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1. Which of the following conditions would lead to recognizing all gains in a sale-leaseback transaction?

- A. PV PMTs is less than or equal to 10% of the FV of the asset**
- B. PV PMTs is more than 90% of the FV of the asset**
- C. PV PMTs is greater than 10% but less than 90% of the FV of the asset**
- D. Gross asset value exceeds carrying value**

In a sale-leaseback transaction, one of the critical factors for determining how gains are recognized involves evaluating the present value of the lease payments compared to the fair value of the asset. When the present value of the lease payments is less than or equal to 10% of the fair value of the asset, this indicates that the leaseback is effectively a long-term financing arrangement. As a result, this condition typically leads to recognizing all gains from the sale. In this context, if the present value of the payments is minimal relative to the fair value of the asset, it suggests that the seller-lessee retains significant rights associated with ownership. Consequently, the transaction is interpreted as not being a significant transfer of benefits from the asset, allowing for the full gain realization at the time of sale. Other conditions present different implications for gain recognition. For example, if the present value of the payments exceeds 90% of the fair value, it may indicate that a significant portion of the asset's value has been encumbered, leading to more limited gain recognition. Similarly, when the present value is between 10% and 90%, the gain recognition could be restricted due to the degree of continuing involvement with the asset. While the condition around gross asset value

2. What does ARO stand for in financial accounting?

- A. Asset Retirement Obligation**
- B. Asset Retirement Organization**
- C. Asset Revaluation Option**
- D. Asset Recovery Obligation**

ARO stands for Asset Retirement Obligation in financial accounting. This term refers to a liability recognized on the balance sheet that is associated with the legal obligation to retire an asset at the end of its useful life. Essentially, it pertains to the costs that an entity is required to incur to dismantle, remove, or restore an asset, such as decommissioning a facility, removing hazardous materials, or restoring a site to its original condition. The accounting treatment for AROs is grounded in the principles of accounting that require the recognition of liabilities when they are probable and can be reasonably estimated. Therefore, when a company recognizes an ARO, it records the liability and corresponding asset to reflect the future costs of retirement in its financial statements. This approach aligns with the matching principle of accounting, where expenses are matched to the revenues they help generate over time. Understanding AROs is crucial for entities involved in industries where large infrastructure or environmental considerations are present, as failing to account for these obligations accurately can lead to significant misstatements in financial reporting.

3. What is the total liability Welsh Corporation should recognize for its defined benefit pension plan?

- A. \$116,000
- B. \$122,000
- C. \$117,000
- D. None of the above**

To determine the total liability that Welsh Corporation should recognize for its defined benefit pension plan, it's essential to follow the appropriate accounting standards, specifically ASC Topic 715 on Compensation—Retirement Benefits. In assessing the pension liability, the company needs to consider several factors, including the projected benefit obligation (PBO), which estimates the pension benefits that employees are expected to earn based on their service and salary levels at retirement. Any overfunded or underfunded status also must be calculated by comparing the PBO to the fair value of the plan's assets. If the calculated figures for the projected benefit obligation exceed the fair value of the plan's assets, the difference represents the total liability that should be recognized in the financial statements. Conversely, if the plan is overfunded, the liability would reflect less than the PBO. Without knowing the specific figures for Welsh Corporation's projected benefit obligation and fair value of the pension plan assets, it's not feasible to identify a precise numerical answer. However, the context provided indicates that the recognized liability might not correspond to the common totals suggested by the choices given. Therefore, if none of the suggested amounts align with the calculated liability based on the required method, the correct choice would indeed be that none of the values presented

4. What is a call option?

- A. The right to sell an asset at a specified price
- B. The right to buy an asset from the option writer**
- C. An obligation to purchase at market value
- D. A future contract for selling securities

A call option is defined as a financial contract that gives the holder the right, but not the obligation, to purchase a specified quantity of an underlying asset at a predetermined price, known as the strike price, at or before a certain expiration date. This is a fundamental concept in options trading, where investors use call options to speculate on price increases of the underlying asset. When a trader buys a call option, they expect the price of the underlying asset to rise above the strike price. If the asset's market price exceeds the strike price, the holder can exercise the option to buy the asset at the lower strike price and potentially sell it at the higher market price for a profit. This strategic choice allows for leveraged exposure to price movements, making call options a valuable tool in investment and risk management. The other options reflect different concepts in finance. The right to sell an asset refers to a put option, which functions oppositely to a call option. An obligation to purchase at market value does not capture the nature of an option, which is about rights and not obligations. Lastly, a future contract for selling securities defines a separate type of agreement distinct from options trading, which specifically allows the exchange of an asset at a predetermined price rather than granting the right to

5. What is the implication of a deferred tax asset being recognized under GAAP?

- A. It indicates a permanent difference between book and tax income
- B. It suggests future economic benefits are expected to result**
- C. It guarantees that taxes will be lower than reported
- D. It must be amortized over several periods

Recognizing a deferred tax asset under GAAP indicates that future economic benefits are expected to result from temporary differences between accounting income and taxable income. A deferred tax asset arises when a company has overpaid taxes or has tax attributes that can reduce future taxable income. These assets are based on the expectation that the company will realize these benefits in the future when it files tax returns, effectively lowering future tax payments. In the context of GAAP, the recognition of a deferred tax asset conveys that the company anticipates it will be able to utilize these tax benefits in future periods, either through carrying forward losses or benefiting from certain expenses that are recognized for financial reporting purposes but not for tax purposes in the current period. This is directly tied to the principle that tax obligations should align with economic activity, allowing for more accurate future forecasting and planning for tax liabilities. Other options suggest incorrect implications: a permanent difference does not reflect the essence of a deferred tax asset, which is inherently related to temporary differences. The idea that it guarantees taxes will be lower than reported is misleading, as it doesn't assure a reduction but rather anticipates a reduction when the asset is utilized. Additionally, deferred tax assets do not need to be amortized; they are essentially realized as the company incurs

6. Which term is used to describe a promise by a corporation to pay bondholders a specific sum at maturity?

- A. Loan contract
- B. Bond indenture**
- C. Bond covenant
- D. Bond agreement

The term that describes a promise by a corporation to pay bondholders a specific sum at maturity is the bond indenture. A bond indenture is a formal agreement between the bond issuer (the corporation) and the bondholders, detailing the terms of the bond, including the principal amount to be paid at maturity, the interest rate, and the payment schedule. This document serves as a contract that outlines the rights and responsibilities of both parties involved in the bond transaction. It ensures that the bondholders have a clear understanding of what to expect in terms of repayment and any other covenants or restrictions that the issuer must adhere to during the life of the bond. While other terms like loan contract, bond covenant, and bond agreement are related to financial agreements, they do not specifically capture the essence of the promise tied to the payment of the principal amount at maturity in the way that a bond indenture does. For example, a bond covenant refers to specific agreements or conditions that the issuer must follow as part of the indenture, rather than the promise itself. Understanding these distinctions clarifies the importance of the bond indenture in the context of bonds and corporate finance.

7. What impact do nondeductible meal and entertainment expenses have on taxable income?

- A. They increase taxable income**
- B. They decrease taxable income**
- C. They are ignored for tax purposes**
- D. They create a deferred tax liability**

Nondeductible meal and entertainment expenses impacting taxable income reflects the nature of tax regulations. In this case, nondeductible expenses do not qualify for a tax deduction, which means they cannot be subtracted from total income when calculating taxable income. Since these expenses are not allowed as deductions, they effectively increase the amount of income that is subject to tax. This results in higher taxable income compared to if these expenses were deductible. It is important to note that while these expenses generate actual cash outflows for a business, their nondeductibility means that the financial statements and tax returns do not allow for these amounts to lower the taxable income. Therefore, the overall effect of including these nondeductible expenses is an increase in the taxable income level for the business, as they are treated as expenses for financial reporting purposes but not for tax calculation purposes.

8. Which of the following signifies that an entity is a legal business entity?

- A. It operates purely as a nonprofit organization**
- B. It has a majority owned subsidiary that generates profits**
- C. It is an employee benefit plan**
- D. It conducts activities on behalf of other companies**

A legal business entity is one that has been established under the laws of a jurisdiction and is recognized as a separate entity that can engage in business activities, such as entering into contracts, suing or being sued, and holding property. The correct choice highlights a situation in which an entity has a majority-owned subsidiary that generates profits, indicating it has the characteristics of a legal business entity. Having a majority-owned subsidiary suggests that the entity is structured for profit-making activities and signifies a level of business operation complexities and responsibilities that are associated with a corporate structure. This scenario is typical for corporations that operate through various subsidiaries to manage risks and expand their operations. The other options do not indicate legal business entity status as clearly. Operating purely as a nonprofit organization does not signify an entity's ability to engage in commercial business, even if it is legally established. Similarly, an employee benefit plan does not conduct business activities on its own or generate profits, and conducting activities on behalf of other companies may indicate agency relationships rather than the existence of a standalone legal entity. Therefore, the presence of a majority-owned subsidiary involved in profit generation is the strongest indicator indicating that the entity operates as a legal business entity.

9. What type of accounting treatment is applied to capital leases from the lessee's perspective?

- A. Recorded as operating expenses only**
- B. Both assets and liabilities recognized**
- C. Only expenses are recorded**
- D. Not recorded on the balance sheet**

When accounting for capital leases from the lessee's perspective, the correct treatment involves recognizing both assets and liabilities on the balance sheet. This is because a capital lease is effectively a form of financing, where the lessee obtains the right to use an asset in exchange for future lease payments. Under generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), a capital lease is treated similarly to purchasing an asset with debt. The asset is recorded as property, plant, and equipment on the balance sheet, reflecting the lessee's right to use the asset. Concurrently, a liability is established to represent the obligation to make future lease payments. This treatment provides a more accurate picture of the lessee's financial position, as it acknowledges both the resources they control (the leased asset) and their associated obligations (the lease liabilities). This approach contrasts with operating leases, where the lease payments are typically treated as an expense and not recorded on the balance sheet in the same manner. Thus, the recognition of both assets and liabilities for capital leases enhances transparency and provides stakeholders with additional insight into the lessee's financial commitments and asset utilization.

10. What does the term 'future minimum lease payments in the aggregate' refer to in capital lease disclosures?

- A. The total expected income from leasing**
- B. The total cash outflows over the lease term**
- C. The total of expected lease payments**
- D. The total amount of potential liabilities**

The term "future minimum lease payments in the aggregate" specifically refers to the total of expected lease payments that are required to be made over the lease term, without considering the timing of payments or any interest components. This concept is important in financial accounting because it helps both lessees and lessors understand their contractual obligations and the cash flow implications of those leases. When a company enters into a capital lease, it commits to making a series of payments to the lessor over the life of the lease. These payments are typically stipulated in the lease agreement and can include fixed amounts as well as variable amounts based on factors such as usage. By aggregating these payments, companies provide a clear picture of the overall commitment they have made with respect to the lease, which is crucial for financial statement users evaluating the company's long-term liabilities. Other concepts mentioned, like expected income from leasing or cash outflows, are not directly related to how minimum lease payments are calculated or disclosed. Understanding the distinction helps clarify financial reporting and provides insights into a company's future cash obligations related to its leasing arrangements.

Next Steps

Congratulations on reaching the final section of this guide. You've taken a meaningful step toward passing your certification exam and advancing your career.

As you continue preparing, remember that consistent practice, review, and self-reflection are key to success. Make time to revisit difficult topics, simulate exam conditions, and track your progress along the way.

If you need help, have suggestions, or want to share feedback, we'd love to hear from you. Reach out to our team at hello@examzify.com.

Or visit your dedicated course page for more study tools and resources:

<https://cpa-far.examzify.com>

We wish you the very best on your exam journey. You've got this!

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