FINANCIAL-ACCOUNTING-AND-REPORTING Q&As

Certified Public Accountant (Financial Accounting & Reporting)

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QUESTION 1

Goddard has used the FIFO method of inventory valuation since it began operations in 1987. Goddard decided to change to the weighted-average method for determining inventory costs at the beginning of 1990. The following schedule shows year-end inventory balances under the FIFO and weighted-average methods:

Year	FIFO	Weighted-average
1987	$45,000	$54,000
1988	78,000	71,000
1989	83,000	78,000

What amount, before income taxes, should be reported in the 1990 retained earnings statement as the

cumulative effect of the change in accounting principle?

A. $5,000 decrease.

B. $3,000 decrease.

C. $2,000 increase.

D. $0.

Correct Answer: A

Choice "a" is correct. $5,000 decrease. The cumulative effect of change in accounting principle is determined as of the beginning of the year of change if comparative financial statements are not presented. In this case, the year of change is 1990, so the cumulative effect is the difference in inventory as of the end of 1989. [Note that inventory is a balance sheet item, so the change is based on the balances at the end of the last year the prior method was used. Had this question shown annual income statement amounts of cost of goods sold, we would have had to look at all the past years in the aggregate.] This will allow us to arrive at the adjustment to obtain the amount of retained earnings that would have been reported at the beginning of the period of change if the new accounting principle had been used for all prior periods.

	1989
FIFO (current method)	$83,000
Weighted average - new method	(78,000)
Decrease in 1990 retained earnings	$ 5,000

QUESTION 2

At December 31, 1998, Off-Line Co. changed its method of accounting for demo costs from writing off the costs over two years to expensing the costs immediately. Off-Line made the change in recognition of an increasing number of demos placed with customers that did not result in sales. Off-Line had deferred demo costs of $500,000 at December 31, 1997, $300,000 of which were to be written off in 1998 and the remainder in 1999. Off-Line\\'s income tax rate is

30%. In its 1998 financial statements, what amount should Off-Line report as cumulative effect of change in accounting principle?

A. $0

B. $200,000

C. $350,000

D. $500,000

Correct Answer: A

Choice "a" is correct. When a change in accounting principle is considered inseparable from a change in

estimate, the change is handled as a change in estimate - prospectively. No cumulative effect adjustment

is made.

Choices "b", "c", and "d" are incorrect since no cumulative effect adjustment is made.

QUESTION 3

During the first quarter of 1993, Tech Co. had income before taxes of $200,000, and its effective income tax rate was 15%. Tech\\'s 1992 effective annual income tax rate was 30%, but Tech expects its 1993 effective annual income tax rate to be 25%. In its first quarter interim income statement, what amount of income tax expense should Tech report?

A. $0

B. $30,000

C. $50,000

D. $60,000

Correct Answer: C

Choice "c" is correct. Interim period tax expense is the estimated annual effective tax rate (25% in this case) applied to the year-to-date income before taxes minus the tax expense recognized in previous interim periods. Since this question involves the first quarter, there are no previous interim periods. 25% ?$200,000 = $50,000. FIN 18, para. 16 Choice "a" is incorrect. Income tax expense is reported in interim income statements. Choice "b" is incorrect. The 1993 annual estimated tax rate, not the first quarter effective tax rate, is used to calculate income tax expense for interim statements. Choice "d" is incorrect. The 1993 annual estimated tax rate, not the 1992 annual effective tax rate, is used to calculate income tax expense for interim statements.

QUESTION 4

Which of the following describes how comprehensive income should be reported?

A. Must be reported in a separate statement, as part of a complete set of financial statements.

B. Should not be reported in the financial statements but should only be disclosed in the footnotes.

C. May be reported in a separate statement, in a combined statement of income and comprehensive income, or within a statement of stockholders\\' equity.

D. May be reported in a combined statement of income and comprehensive income or disclosed within a statement of stockholders\\' equity; separate statements of comprehensive income are not permitted.

Correct Answer: C

Choice "c" is correct.

Comprehensive income must be presented in one of three formats:

1.

In a combined statement of income and comprehensive income;

2.

In a separate statement of comprehensive income that begins with net income; or

3.

In a statement of changes in equity.

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

Balance Sheet and Disclosures Overview

QUESTION 5

The following information pertains to Aria Corp. and its divisions for the year ended December 31, 1988:

Sales to unaffiliated customers	$2,000,000
Intersegment sales of products similar to those sold to unaffiliated customers	600,000
Interest earned on loans to other industry segments	40,000

Aria and all of its divisions are engaged solely in manufacturing operations. Aria has a reportable segment if that segment\\'s revenue exceeds:

A. $264,000

B. $260,000

C. $204,000

D. $200,000

Correct Answer: B

Choice "b" is correct. $260,000 represents a reportable segment (10% of total sales):

Including unaffiliated sales	$2,000,000
and intersegment sales	600,000
Total combined sales	2,600,000
	× 10%
	$ 260,000

Rule: To be significant enough to report on, a segment must be at least 10% of:

1.

Combined revenues (whether intersegment or unaffiliated customers), or

2.

Operating income, or

3.

Identifiable assets.

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