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QUESTION 1

What is the underlying concept that supports the immediate recognition of a contingent loss?

- A. Substance over form.
- B. Consistency.
- C. Matching.
- D. Conservatism.

Correct Answer: D

Choice "d" is correct. Conservatism is a prudent reaction to uncertainty to try to ensure that uncertainty and risks inherent in business situations are adequately considered. Recognition of a contingent loss is the recording of an amount representing uncertainty and risk in a business situation. SFAC 2, SFAS 5 para. 82 Choice "a" is incorrect. The substance over form concept presumes that the transaction form may not dictate the accounting treatment. Choice "b" is incorrect. Consistency is conformity from period to period with unchanging policies and procedures. SFAC 2 Choice "c" is incorrect. The matching principle dictates that expenses be matched with the related revenues generated or the time period in which the expense is incurred and known. SFAS #5 cites matching as the one concept supporting the immediate recognition of a contingent loss, but it is not the primary underlying concept. SFAS 5 para. 76

QUESTION 2

What are the Statements of Financial Accounting Concepts intended to establish?

- A. Generally accepted accounting principles in financial reporting by business enterprises.
- B. The meaning of "Present fairly in accordance with generally accepted accounting principles."
- C. The objectives and concepts for use in developing standards of financial accounting and reporting.
- D. The hierarchy of sources of generally accepted accounting principles.

Correct Answer: C

Choice "c" is correct. Statements of Financial Accounting Concepts are intended to establish the objectives and concepts that the Financial Accounting Standards Board will use in developing standards of financial accounting and reporting. SFAC 1 para. 3 Choice "a" is incorrect. The Statements of Financial Accounting Concepts do not specify financial accounting standards prescribing accounting procedures or practices. SFAC 1 para. 3 Choice "b" is incorrect. Auditing standards develop the meaning of "Present fairly in accordance with generally accepted accounting principles." Choice "d" is incorrect. The hierarchy of sources of generally accepted accounting principles is determined by GAAP.

QUESTION 3

A statement of cash flows for a development stage enterprise:

- A. Is the same as that of an established operating enterprise and, in addition, shows cumulative amounts from the enterprise's inception.



- B. Shows only cumulative amounts from the enterprise's inception.
- C. Is the same as that of an established operating enterprise, but does not show cumulative amounts from the enterprise's inception.
- D. Is not presented.

Correct Answer: A

Rule: Development stage enterprises should present financial statements in accordance with GAAP and make additional disclosures such as cumulative amounts from inception for: net losses, deficits, sales, expenses, and cash flows and supplementary data.

Choice "a" is correct, per the rule shown above.

Choice "b" is incorrect. Current amounts are shown as well as cumulative amounts.

Choice "c" is incorrect. Cumulative amounts from inception are shown.

Choice "d" is incorrect. A statement of cash flows is required.

QUESTION 4

Which of the following assumptions means that money is the common denominator of economic activity and provides an appropriate basis for accounting measurement and analysis?

- A. Going concern.
- B. Periodicity.
- C. Monetary unit.
- D. Economic entity.

Correct Answer: C

Choice "c" is correct. The monetary unit assumption means that money is the common denominator for economic activity and provides an appropriate basis for accounting measurements and analysis. Choice "a" is incorrect. The going concern assumption has nothing to do with money per se. The going concern assumption presumes that an entity will continue to operate in the foreseeable future. Choice "b" is incorrect. The periodicity has nothing to do with money per se. The periodicity assumption is that economic activity can be divided into meaningful time periods. Choice "d" is incorrect. The economic entity assumption has nothing to do with money per se. The economic entity assumption is that economic activity can be accounted for when considering an identifiable set of activities.

QUESTION 5

On January 2, 1993, Quo, Inc. hired Reed to be its controller. During the year, Reed, working closely with Quo's president and outside accountants, made changes in accounting policies, corrected several errors

dating from 1992 and before, and instituted new accounting policies.



Quo's 1993 financial statements will be presented in comparative form with its 1992 financial statements.

This question represents one of Quo's transactions. List A represents possible clarifications of these transactions as: a change in accounting principle, a change in accounting estimate, a correction of an error in previously presented financial statements, or neither an accounting change nor an accounting error.

Item to Be Answered

The equipment that Quo manufactures is sold with a five-year warranty. Because of a production breakthrough, Quo reduced its computation of warranty costs from 3% of sales to 1% of sales.

List A (Select one)

- A. Change in accounting principal.
- B. Change in accounting estimate.
- C. Correction of an error in previously presented financial statements.
- D. Neither an accounting change nor an accounting error.

Correct Answer: B

Choice "b" is correct. Change in the computation of warranty costs from 3% of sales to 1% of sales is a change in accounting estimate.

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