FINANCIAL-ACCOUNTING-AND-REPORTING Q&As

Certified Public Accountant (Financial Accounting & Reporting)

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QUESTION 1

Which of the following is a generally accepted accounting principle that illustrates the practice of conservatism during a particular reporting period?

A. Capitalization of research and development costs.

B. Accrual of a contingency deemed to be reasonably possible.

C. Reporting investments with appreciated market values at market value.

D. Reporting inventory at the lower of cost or market value.

Correct Answer: D

Choice "d" is correct. The rule of conservatism states that revenues and gains should be recognized when the earnings process is complete, but that expenses and losses should be expensed immediately. Reporting inventory at the lower of cost or market requires the recording of a loss on inventory when market is lower than cost in the period the loss is sustained, rather than when the inventory is sold, consistent with the rule of conservatism. Choice "a" is incorrect. Because the future benefits of RandD costs are questionable, these cost should be expensed immediately, consistent with the rule of conservatism and the matching principle. Choice "b" is incorrect. The rule of conservatism only requires the accrual of "probable" losses. The accrual of a reasonably possible loss is not required and the accrual of any contingent gain, whether probable, reasonably possible, or remote, is prohibited. Choice "c" is incorrect. The reporting of marketable securities with appreciated values at market value requires the recording of a gain on the asset before the gain is realized. This contradicts the rule of conservatism, but is allowed because fair value is a more relevant measure of the value of marketable securities.

QUESTION 2

During 1990, Fuqua Steel Co. had the following unusual financial events occur:

•

Bonds payable were retired five years before their scheduled maturity, resulting in a $260,000 gain. Fuqua has frequently retired bonds early when interest rates declined significantly.

•

A steel forming segment suffered $255,000 in losses due to hurricane damage. This was the fourth similar loss sustained in a 5-year period at that location.

•

A component of Fuqua\\'s operations, steel transportation, was sold at a net loss of $350,000.

This was Fuqua\\'s first divestiture of one of its operating segments.

Before income taxes, what amount should be disclosed as the gain (loss) from extraordinary items in

1990?

A. $0

B. $5,000

C. $(90,000)

D. $(350,000)

Correct Answer: A

Choice "a" is correct. $0. Note: The sale of the steel transportation component resulted in a loss from discontinued operations and is reported after "income from continuing operations." The steel forming segment\\'s hurricane damage (4th in 5 years) of $255,000 is only "unusual in nature" and does not occur infrequently, therefore, it is not an "extraordinary item," and should be reported separately as a component of "income from continuing operations." The retirement of debt, although unusual, is not infrequent for the company; therefore, the gain does not qualify for classification as an extraordinary item per APBO No. 30 (and SFAS No. 145).

QUESTION 3

On January 2, 1989, Union Co. purchased a machine for $264,000 and depreciated it by the straight-line method using an estimated useful life of eight years with no salvage value. On January 2, 1992, Union determined that the machine had a useful life of six years from the date of acquisition and will have a salvage value of $24,000. An accounting change was made in 1992 to reflect the additional data. The accumulated depreciation for this machine should have a balance at December 31, 1992, of:

A. $176,000

B. $160,000

C. $154,000

D. $146,000

Correct Answer: D

Choice "d" is correct, $146,000 accumulated depreciation balance at DeC. 31, 1992.

	depreciable cost		useful life		annual deprec		years elapsed		accumulated deprec
Original	$264	÷	8 yrs	=	$33	x	3yrs	=	$99 ('89-'91)
Accum deprec	(99)								
NBV 12/31/91	165								
Salvage	<24>								
Revised	141	÷	3 yrs	=	47	x	1 yr	=	47 (1992)
Balance, 12/31/92									$146

QUESTION 4

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.

QUESTION 5

The following items were among those that were reported on Lee Co.\\'s income statement for the year ended December 31, 1989:

Legal and audit fees	$170,000
Rent for office space	240,000
Interest on inventory floorplan	210,000
Loss on abandoned data processing equipment used in operations	35,000

The office space is used equally by Lee\\'s sales and accounting departments. What amount of the abovelisted items should be classified as general and administrative expenses in Lee\\'s multiple-step income statement?

A. $290,000

B. $325,000

C. $410,000

D. $500,000

Correct Answer: A

Legal and audit fees	$170,000
Rent for admin office (1/2 × $240,000)	120,000
Total general and administrative expenses	$290,000

Note: 1/2 of the office space of $240,000 was used by the sales department, which should be allocated to

"selling expenses" (not general and administrative).

Choice "a" is correct. $290,000.

QUESTION 6

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.

QUESTION 7

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 B represents the general accounting treatment

required for these transactions. These treatments are:

•

Cumulative effect approach - Include the cumulative effect of the adjustment resulting from the accounting change or error correction in the 1993 financial statements, and do not restate the 1992 financial statements.

•

Retroactive or retrospective restatement approach - Restate the 1992 financial statements and adjust 1992 beginning retained earnings if the error or change affects a period prior to 1992.

•

Prospective approach - Report 1993 and future financial statements on the new basis but do not restate 1992 financial statements.

Item to Be Answered Quo sells extended service contracts on its products. Because related services are performed over several years, in 1993 Quo changed from the cash method to the accrual method of recognizing income from these service contracts.

List B (Select one)

A. Cumulative effect approach.

B. Retroactive or retrospective restatement approach.

C. Prospective approach.

Correct Answer: B

Choice "B" is correct. If comparative FS are issued, restate prior year\\'s FS. If comparative FS are not issued, restate prior year-end\\'s retained earnings account by "adjusting" (net of tax) the opening balance of the current retained earnings statement. Note that when an error is corrected, retroactive restatement is used, and when there is a change in accounting principle, retrospective restatement is done. However, this is only a difference in terminology.

QUESTION 8

Grum Corp., a publicly-owned corporation, is subject to the requirements for segment reporting. In its income statement for the year ended December 31, 1991, Grum reported revenues of $50,000,000, operating expenses of $47,000,000, and net income of $3,000,000. Operating expenses include payroll costs of $ 15,000,000. Grum\\'s combined identifiable assets of all industry segments at December 31, 1991, were $40,000,000. Cott Co.\\'s four business segments have revenues and identifiable assets expressed as percentages of Cott\\'s total revenues and total assets as follows: Which of these business segments are deemed to be reportable segments?

	Revenues	Assets
Ebon	64%	66%
Fair	14%	18%
Gel	14%	4%
Hak	8%	12%
	100%	100%

A. Ebon only.

B. Ebon and Fair only.

C. Ebon, Fair, and Gel only.

D. Ebon, Fair, Gel, and Hak.

Correct Answer: D

Rule: A segment must be at least 10% of:

1.

Combined revenues (whether intersegment or unaffiliated customers), or

2.

Operating income (of all segments not having an operating loss), or

3.

Identifiable assets.

Choice "d" is correct. Ebon, Fair, Gel, and Hak, since all four companies meet at least one of the criteria.

QUESTION 9

Belle Co. determined after four years that the estimated useful life of its labeling machine should be 10 years rather than 12 years. The machine originally cost $46,000 and had an estimated salvage value of $1,000. Belle uses straight-line depreciation. What amount should Belle report as depreciation expense for the current year?

A. $3,200

B. $3,750

C. $4,500

D. $5,000

Correct Answer: D

Choice "d" is correct. A change in estimated useful life is a change in accounting estimate, and is therefore accounted for prospectively. The revised useful life should be used as of the beginning of the year of the change and should be applied to the current book value of the fixed asset. The first step in determining the depreciation expense in the year of the change in estimate is to determine the book value of the labeling machine at the time of the change:

Original cost $46,000

-Accumulated depreciation 15,000 = [(46,000 - 1,000) / 12] *4 Current book value $31,000 This book value is then depreciated over the remaining life of the fixed asset based on the new estimated life. In this problem, the new estimated life is 10 years, four of which have already passed, so the asset must be depreciated over the remaining 6 years: ($31,000 - 1,000) / 6 = $5,000 Choice "a" is incorrect. This answer is incorrectly calculated by adding the salvage value to the current book value, and by using the entire 10 year revised estimated life. Salvage value should always be subtracted and the asset should only be depreciated over the remaining life of the asset. Choice "b" is incorrect. This is the annual depreciation before the change in estimated life ($46,000 -$1,000) / 12 = $3,750]. The depreciation after the change in estimate should be calculated as described above. Choice "c" is incorrect. This would have been the annual straight-line depreciation if the original useful life of the asset had been 10 years rather than 12 years. The change in estimated life is applied prospectively, as described above, not retrospectively.

QUESTION 10

Which of the following facts concerning fixed assets should be included in the summary of significant accounting policies?

Depreciation method	Composition
No	Yes
Yes	Yes
Yes	No
No	No

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: C

Choice "c" is correct. Yes - No.

Yes - "Depreciation methods" should be disclosed in the "summary of significant accounting policies."

No - Composition of fixed assets (or any other account) should not be disclosed in the "summary of significant accounting policies."

QUESTION 11

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

Quo changed from LIFO to FIFO to account for its finished goods inventory.

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: A

Choice "a" is correct. Change from LIFO to FIFO is a change in accounting principle.

QUESTION 12

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 13

Arpco, Inc., a for-profit provider of healthcare services, recently purchased two smaller companies and is researching accounting issues arising from the two business combinations. Which of the following accounting pronouncements are the most authoritative?

A. AICA Statements of Position.

B. AICPA Industry and Audit Guides.

C. FASB Statements of Financial Accounting Concepts.

D. FASB Statements of Financial Accounting Standards.

Correct Answer: D

Choice "d" is correct. Since Arpco is a for-profit provider of healthcare services, it is covered under normal GAAP. Thus, the most authoritative pronouncements are the FASB Statements of Financial Accounting Standards (SFAS). Choice "a" is incorrect. AICPA Statements of Position are not the most authoritative pronouncement for almost anything (other than for some issues that only they cover). They are normally "merely" the opinion of the AICPA. Choice "b" is incorrect. AICPA Industry and Audit Guides are not the most authoritative pronouncement for almost anything (other than for some issues that only they cover). Choice "c" is incorrect. FASB Statements of Financial Accounting Concepts are not authoritative pronouncements except where they have been incorporated by reference into an SFAS. They are the basis on which SFAS can be constructed.

QUESTION 14

A transaction that is unusual in nature and infrequent in occurrence should be reported separately as a component of income:

A. After cumulative effect of accounting changes and before discontinued operations of a segment of a business.

B. After cumulative effect of accounting changes and after discontinued operations of a segment of a business.

C. Before cumulative effect of accounting changes and before discontinued operations of a segment of a business.

D. After discontinued operations of a segment of a business.

Correct Answer: D

Choice "d" is correct. An extraordinary item (a transaction that is both "unusual in nature" and "infrequent in occurrence") should be reported separately as a component of income after discontinued operations of a segment of a business.

The cumulative effect of a change in accounting principle is shown on the retained earnings statement.

This is why memorizing the mnemonic "idea" is so important.

QUESTION 15

The effect of a material transaction that is infrequent in occurrence but not unusual in nature should be presented separately as a component of income from continuing operations when the transaction results in

a:

A.

Option A

B.

Option B

C.

Option C

D.

Option D

	Gain	Loss
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

Correct Answer: A

Choice "a" is correct, Yes - Yes. A material transaction that is "infrequent in occurrence" but not "unusual in nature" should be presented separately as a component of "income from continuing operations" when the transaction results in a gain or loss.