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CPA

Certified Public Accountant (Financial Accounting and Reporting)

Version 1.0

Exam K

QUESTION 1
According to the FASB conceptual framework, the objectives of financial reporting for business enterprises are based on:

A. Generally accepted accounting principles.
B. Reporting on management's stewardship.
C. The need for conservatism.
D. The needs of the users of the information.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. The FASB conceptual framework states that the objectives of financial reporting stem from the informational needs of the external users of the information. SFAC 1 para. 28 Choice "a" is incorrect. Generally accepted accounting principles (GAAP) are derived from and based on the objectives of financial reporting, not the other way around.
Choice "b" is incorrect. Information concerning management's stewardship is only one aspect of the information financial statements are intended to provide. SFAC 1 para. 50
Choice "c" is incorrect. Conservatism is an underlying concept for financial accounting but is not the basis for the objectives. SFAC 2 para. 91-97

QUESTION 2
According to the FASB conceptual framework, the usefulness of providing information in financial statements is subject to the constraint of:

A. Consistency. B.
Cost-benefit.
C. Reliability.
D. Representational faithfulness.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. The pervasive constraint on providing information in financial statements is that the cost should be outweighed by the benefit to be derived from providing the information. SFAC 1 para. 23, SFAC 2 para. 133
Choice "a" is incorrect. Consistency is an underlying concept for financial statements (and a secondary quality of accounting information), but it is not a constraint on providing information. SFAC 2 para. 120 Choice "c" is incorrect. Reliability is a primary quality of accounting information and an underlying concept for financial statements, but it is not a constraint on providing information. SFAC 2 para. 58 Choice "d" is incorrect. Representational faithfulness is an underlying concept for financial statements (as an element of reliability), but it is not a constraint on providing information. SFAC 2 para.

QUESTION 3
According to the FASB conceptual framework, which of the following attributes would not be used to measure inventory?

A. Historical cost.
B. Replacement cost.
C. Net realizable value.
D. Present value of future cash flows.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. The present value of future cash flows is used to measure long-term receivables or payables, not inventory, because inventory is a short-term asset, which has more immediate cash flows. SFAC 5 para. 67 Choice "a" is incorrect. Historical cost can be used to measure inventory because it is a relevant and reliable measurement attribute of current assets such as inventory.
Choice "b" is incorrect. Replacement (or current) cost can be used to measure inventory because it is a relevant and reliable measurement attribute of current assets such as inventory. Choice "c" is incorrect. Net realizable value can be used to measure inventory because it is a relevant and reliable measurement attribute of current assets such as inventory.

QUESTION 4
According to the FASB conceptual framework, which of the following situations violates the concept of reliability?

A. Data on segments having the same expected risks and growth rates are reported to analysts estimating future profits.
B. Financial statements are issued nine months late.
C. Management reports to stockholders regularly refer to new projects undertaken, but the financial statements never report project results.
D. Financial statements include property with a carrying amount increased to management's estimate of market value.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Management's estimate of market value lacks verifiability, which is a component of reliability. SFAC 2 para. 89 Choice "a" is incorrect. Communicating data on segments to analysts does not violate the concept of reliability.
Choice "b" is incorrect. Issuing financial statements nine months late violates timeliness, which is a component of relevance, not reliability. SFAC 2 para. 56 Choice "c" is incorrect. Neglecting to report results of new projects violates full disclosure, not reliability.

QUESTION 5
In the hierarchy of generally accepted accounting principles, APB Opinions have the same authority as AICPA:

A. Statements of Position.
B. Industry Audit and Accounting Guides.
C. Issues Papers.
D. Accounting Research Bulletins.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. AICPA Accounting Research Bulletins, FASB Standards, FASB Interpretations, FASB Staff Positions, FASB Statement 133 Implementation Issues, and APB Opinions and Interpretations are the most authoritative sources of generally accepted accounting principles.
Choice "a" is incorrect. AICPA Statements of Position, AICPA Accounting and Auditing Guides, and FASB Technical Bulletins are secondary sources of generally accepted accounting principles.
Choice "b" is incorrect. AICPA Statements of Position, AICPA Accounting and Auditing Guides, and FASB Technical Bulletins are secondary sources of generally accepted accounting principles.
Choice "c" is incorrect. AICPA Issues Papers and Practice Bulletins, FASB Concepts Statements, and other authoritative pronouncements are tertiary sources for generally accepted accounting principles.

QUESTION 6 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
Section: (none)
Explanation

Explanation/Reference:
Explanation:
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 7
According to the FASB conceptual framework, the process of reporting an item in the financial statements of an entity is:

A. Allocation.
B. Matching.
C. Realization.
D. Recognition.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Recognition is the process of recording an item in the financial statements of an entity. SFAC 5 para. 6
Choice "a" is incorrect. Allocation is the accounting process of assigning or distributing an amount according to a plan or a formula. SFAC 6 para. 142
Choice "b" is incorrect. Matching of costs and revenues is simultaneous or combined recognition of the revenues and expenses that result directly and jointly from the same transactions or other events. SFAC 6 para. 146
Choice "c" is incorrect. Realization is the process of converting noncash resources and rights into money. SFAC 6 para. 143

QUESTION 8

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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 9
During a period when an enterprise is under the direction of a particular management, its financial statements will directly provide information about:

A. Both enterprise performance and management performance.
B. Management performance but not directly provide information about enterprise performance.
C. Enterprise performance but not directly provide information about management performance.
D. Neither enterprise performance nor management performance.

Correct Answer: C
Section: (none)
Explanation
Explanation/Reference:
Explanation:

Choice "c" is correct. Financial reporting, and especially financial statements, usually cannot and do not separate management performance from enterprise performance. Financial reporting provides information about an enterprise during a period when it was under the direction of a particular management but does not directly provide information about that management's performance. SFAC 1 para. 53

QUESTION 10
According to the FASB conceptual framework, which of the following statements conforms to the realization concept?

A. Equipment depreciation was assigned to a production department and then to product unit costs.
B. Depreciated equipment was sold in exchange for a note receivable.
C. Cash was collected on accounts receivable.
D. Product unit costs were assigned to cost of goods sold when the units were sold.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Revenues and gains are realized when assets are exchanged for cash or claims to cash. SFAC 5 para. 83.
Choice "a" is incorrect. Assigning depreciation in a production department is an example of allocating overhead. There is no realization associated with the assignment.
Choice "c" is incorrect. The realization concept is integral to accounting for revenues and expenses and is not connected to collection of receivables.
Choice "d" is incorrect. Assignment of overhead costs to products and thus to cost of goods sold is an example of matching. There is no realization associated with this assignment.

QUESTION 11
In Yew Co.'s 1992 annual report, Yew described its social awareness expenditures during the year as follows:

"The Company contributed $250,000 in cash to youth and educational programs. The Company also gave $140,000 to health and human-service organizations, of which $80,000 was contributed by employees through payroll deductions. In addition, consistent with the Company's commitment to the environment, the Company spent $100,000 to redesign product packaging." What amount of the above should be included in Yew's income statement as charitable contributions expense?

A. $310,000
B. $390,000
C. $410,000
D. $490,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Charitable contributions include amounts the company gave to recognized charities. This includes:

Youth and education programs	$ 250,000
Health ($140,000 - $80,000)	60,000
Total	$ 310,000

Note: Of the $140,000, employees gave $80,000, and the company $60,000. Redesigning packaging is not a contribution to a charity.
Choice "b" is incorrect. The company gave only $60,000 of the $140,000. Employees gave $80,000. Choice "c" is incorrect.
Redesigning packaging is not a contribution to a charity.

Choice "d" is incorrect. The company gave only $60,000 of the $140,000. Employees gave $80,000. Redesigning packaging is not a contribution to a charity.

QUESTION 12

According to the FASB conceptual framework, which of the following relates to both relevance and reliability?

A. Comparability.
B. Feedback value.
C. Verifiability.
D. Timeliness.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Comparability and consistency are secondary qualities of both relevance and reliability. SFAC 2 para. 111-122 Choice "b" is incorrect. Feedback value is a key characteristic of relevance only.
Choice "c" is incorrect. Verifiability is a key characteristic of reliability only.
Choice "d" is incorrect. Timeliness is a key characteristic of relevance only.

QUESTION 13 Which of the following is true regarding the comparison of managerial to financial accounting?

A. Managerial accounting is generally more precise.
B. Managerial accounting has a past focus and financial accounting has a future focus.
C. The emphasis on managerial accounting is relevance and the emphasis on financial accounting is timeliness.
D. Managerial accounting need not follow generally accepted accounting principles (GAAP) while financial accounting must follow them.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Public companies must follow GAAP for (external) financial reporting purposes. GAAP need not be followed for (internal) managerial accounting purposes. Choice "a" is incorrect. Financial accounting is generally more precise.
Choice "b" is incorrect. Managerial accounting has a future focus, while financial accounting focuses on reporting past results.
Choice "c" is incorrect. The emphasis of financial accounting is providing useful information to financial statement users (including the characteristic of relevance), while the emphasis of managerial accounting is providing timely information to management decision makers.

QUESTION 14

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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 R&D 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 15
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 16 According to the FASB conceptual framework, the quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called:

A. Feedback value.
B. Predictive value.
C. Representational faithfulness.
D. Reliability.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. The quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called predictive value. Forecasting is predicting.
Choice "a" is incorrect. The quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called predictive value, not feedback value. Feedback value enables decision makers to confirm prior expectations or to adjust or correct the decisions made previously.
Choice "c" is incorrect. The quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called predictive value, not representational faithfulness. Representational faithfulness is the agreement between financial reporting and the resources or events represented.
Choice "d" is incorrect. The quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called predictive value, not reliability. Reliability is the combination of neutrality, representational faithfulness, and verifiability.

QUESTION 17 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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 18
Which of the following statements best describes an operating procedure for issuing a new Financial Accounting Standards Board (FASB) statement?

A. The emerging issues task force must approve a discussion memorandum before it is disseminated to the public.
B. The exposure draft is modified per public opinion before issuing the discussion memorandum.
C. A new statement is issued only after a majority vote by the members of the FASB.
D. A new FASB statement can be rescinded by a majority vote of the AICPA membership.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. A new statement from the FASB is issued only after a majority vote of the members of the FASB.

Choice "a" is incorrect. There is no necessity for the EITF to approve a discussion memorandum
(presumably the question means a discussion memorandum of the FASB statement itself and not an EITF statement) before it is disseminated to the public.

Choice "b" is incorrect. There is no necessity for an exposure draft to be modified per public opinion before issuing the discussion memorandum (a question can be raised here as to "what" discussion memorandum"). Exposure drafts are quite/most often modified before they are issued as FASB statements, but they do not have to be. Whether they are or are not modified is a function of whether the FASB thinks they should be modified, partly due to the public comments that have been received.

Choice "d" is incorrect. There is no way to rescind a new FASB statement, although, in reality, a FASB statement can be rescinded by the issuance of a new statement on the same subject. However, even if there was a way to rescind a new FASB statement, it would not be by a majority vote of the AICPA membership, but by a majority vote of the members of the FASB. Reporting Net Income

QUESTION 19
Income tax-basis financial statements differ from those prepared under GAAP in that income tax-basis financial statements:

A. Do not include nontaxable revenues and nondeductible expenses in determining income.
B. Include detailed information about current and deferred income tax liabilities.
C. Contain no disclosures about capital and operating lease transactions.
D. Recognize certain revenues and expenses in different reporting periods.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Income tax-basis financial statements recognize events when taxable income or deductible expenses are recognized on the entity's tax return. Non-taxable income and non-deductible expenses are shown on the financial statement and included in the determination of income (and become M-1 adjustments to arrive at taxable income).

Please Note: This question appeared in the releases for 1999 in FARE; however, it may also apply to OCBOA financial statements discussed in the Auditing textbook. The question did not apply well to any FARE CSO line item, so we included it here so that you could read the Explanation: and learn from it.

QUESTION 20
An extraordinary gain should be reported as a direct increase to which of the following?

A. Net income.
B. Comprehensive income.
C. Income from continuing operations, net of tax.
D. Income from discontinued operations, net of tax.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Extraordinary items are reported as a component of net income, after income from continuing operations and discontinued operations.
Choice "b" is incorrect. An extraordinary gain (or loss) only indirectly affects comprehensive income as a component of net income.
Choice "c" is incorrect. Extraordinary items are reported net of tax after income from continuing operations and discontinued operations.
Choice "d" is incorrect. Extraordinary items are reported net of tax after income from continuing operations and discontinued operations.

QUESTION 21
On December 2, 20X1, Flint Corp.'s board of directors voted to discontinue operations of its frozen food division and to sell the division's assets on the open market as soon as possible. The division reported net operating losses of $20,000 in December and $30,000 in January. On February 26, 20X2, sale of the division's assets resulted in a gain of $90,000. Assuming that the frozen foods division qualifies as a component of the business and ignoring income taxes, what amount of gain/loss from discontinued operations should Flint recognize in its income statement for 20X2?

A. $0
B. $40,000C. $60,000
D. $90,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The $60,000 gain from discontinued operations would be reported in Flint's 20X2 income statement. The operating loss for January would offset the gain from disposal in February, and the net amount would be reported as a gain (in this case) from discontinued operations.
The operating losses for December would have been reported in Flint's 20X1 income statement.
Choice "a" is incorrect per the above. It would be correct if all of the gains and losses were included in 20X1 instead of 20X2. However, gains and losses from discontinued operations are included in the year they occur.
Choice "b" is incorrect. It includes the operating loss for December, 20X1 in with the 20X2 amounts.
Choice "d" is incorrect. It ignores the January operating loss. Operating losses are included in gain/loss from discontinued operations, along with impairment losses and gains/losses on disposal.

QUESTION 22
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. $200,000C. $350,000
D. $500,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:
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 23
How should the effect of a change in accounting principle that is inseparable from the effect of a change in accounting estimate be reported?

A. As a component of income from continuing operations.
B. By restating the financial statements of all prior periods presented.
C. As a correction of an error.
D. By footnote disclosure only.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. When the effect of a change in accounting principle is inseparable from the effect of a change in accounting estimate, the reporting treatment for the overall effect is as a change in estimate.
Thus, the effect is reported prospectively as a component of income from continuing operations. Under SFAS No. 154, this type of change is now called a change in accounting estimate affected by a change in accounting principle. Choice "b" is incorrect. Restatement of all prior periods is the retroactive accounting treatment that is applied to the correction of an error and the retrospective accounting treatment given to changes in accounting principle. However, a change in accounting principle that is inseparable from the effect of a change in accounting estimate is now treated as a change in accounting estimate.
Choice "c" is incorrect. Correction of an error is given retroactive treatment as a prior period adjustment to retained earnings with restatement of prior periods. This is not the treatment appropriate for the effect of a change in accounting principle that is inseparable from the effect of a change in accounting estimate.
Choice "d" is incorrect. While footnote disclosure is always appropriate for an accounting change, such disclosure alone is never the appropriate accounting treatment.

QUESTION 24
In September 1996, Koff Co.'s operating plant was destroyed by an earthquake. Earthquakes are rare in the area in which the plant was located. The portion of the resultant loss not covered by insurance was $700,000. Koff's income tax rate for 1996 was 40%. In its 1996 income statement, what amount should Koff report as extraordinary loss?

A. $0
B. $280,000C. $420,000
D. $700,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. For a loss to be reported as an extraordinary loss, the event causing the loss must be both unusual in nature and infrequent in occurrence. The earthquake in this case does meet these criteria so the loss is reported net of income tax effect as an extraordinary loss of $420,000 (60% of the total $700,000 loss). APB 30.11, .19-.26 Choice "a" is incorrect. Review the criteria for reporting an extraordinary loss.
Choice "b" is incorrect. This is the tax effect of the loss. Review your calculations.
Choice "d" is incorrect. It is not appropriate to report the full loss as an extraordinary loss.

QUESTION 25
In April 30, 20X4, Deer Corp. approved a plan to dispose of a component of its business. For the period January 1 through April 30, 20X4, the component had revenues of $500,000 and expenses of $800,000.
The assets of the component were sold on October 15, 20X4 at a loss. In its income statement for the year ended December 31, 20X4, how should Deer report the component's operations from January 1 to April 30, 20X4?

A. $500,000 and $800,000 should be included with revenues and expenses, respectively, as part of continuing operations.
B. $300,000 should be reported as part of the loss on disposal of a component and included as part of continuing operations.
C. $300,000 should be reported as an extraordinary loss.
D. $300,000 should be reported as a loss from operations of a component and included in loss from discontinued operations.

Correct Answer: D

Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Once the decision has been made to dispose of a component of a business and that component meets the criteria to be classified as held for sale, the operating results of the component for the period reported on, and any gain or loss from the disposal, should be reported separately from continuing operations, net of tax. In this question, the component was classified as held for sale and was sold in the same year.

Thus, in 20X4, the results of operations, the $300,000 ($500,000-$800,000) loss, are reported as a loss from discontinued operations. The loss on disposal would be reported as part of that loss from discontinued operations also.

Choice "a" is incorrect. The results of operations prior to the decision date, and also after the decision date, are reported separately from the results of continuing operations as a part of discontinued operations.
Choice "b" is incorrect. The results of operations prior to the decision date, and also after the decision date, are reported separately from the results of continuing operations as a loss from operations of a component and included in loss from discontinued operations.
Choice "c" is incorrect. The results of discontinued operations are not reported as an extraordinary item.

QUESTION 26
In open market transactions, Gold Corp. simultaneously sold its long-term investment in Iron Corp. bonds and purchased its own outstanding bonds. The broker remitted the net cash from the two transactions. Gold's gain on the purchase of its own bonds exceeded its loss on the sale of the Iron bonds. Assume the transaction to purchase its own outstanding bonds is unusual in nature and has occurred infrequently. Gold should report the:

A. Net effect of the two transactions as an extraordinary gain.
B. Net effect of the two transactions in income before extraordinary items.
C. Effect of its own bond transaction gain in income before extraordinary items, and report the Iron bond transaction as an extraordinary loss.D. Effect of its own bond transaction as an extraordinary gain, and report the Iron bond transaction loss in income before extraordinary items.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct, these are two separate transactions because Gold Corp. (1) sold Iron Corp. bonds (an investment) for a loss, and, (2) bought back its own (Gold) Corp. bonds (a debt) for a gain. This is not a "refinancing" (where one would sell new bond debt to buy back old bond debt outstanding).
The gain from the purchase of its own bonds is an "extraordinary gain" because it is both unusual in nature and infrequently occurring (per APB Opinion No. 30 and SFAS No. 145). The Iron Corp. transaction is a loss in "income before extraordinary items."
Choices "a" and "b" are incorrect. The two transactions are separate and cannot be netted.
Choice "c" is incorrect. Just the opposite. The sale of the investment is a loss in "income before extraordinary items," while the purchase of its bond debt is an "extraordinary gain" according to the provisions of APB Opinion No. 30.

QUESTION 27
Lore Co. changed from the cash basis of accounting to the accrual basis of accounting during 1994. The cumulative effect of this change should be reported in Lore's 1994 financial statements as a:

A. Prior period adjustment resulting from the correction of an error.
B. Prior period adjustment resulting from the change in accounting principle.
C. Component of income before extraordinary item.
D. Component of income after extraordinary item.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. The cash basis for financial reporting is not a generally accepted accounting basis of accounting (GAAP); therefore, it is an error. Correction of an error from a prior period is a reported as prior period adjustment to retained earnings.
Choice "b" is incorrect. Cash basis reporting is not an accounting principle under accrual accounting principles. Thus, the change from cash basis is not reported as a change in accounting principle. In addition, changes in accounting principle are not prior period adjustments; instead, they are treated retrospectively.

Choices "c" and "d" are incorrect. Correction of prior period errors has no effect on the current year's income statement.

QUESTION 28

A material loss should be presented separately as a component of income from continuing operations when it is:

A. An extraordinary item.
B. A cumulative effect type change in accounting principle.
C. Unusual in nature and infrequent in occurrence.
D. Not unusual in nature but infrequent in occurrence.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Gains or losses that are unusual in nature or occur infrequently but not both, are presented as a component of income from continuing operations.
Choice "a" is incorrect. Extraordinary items are shown net of tax in a separate section of the income statement after income from continuing operations.
Choice "b" is incorrect. Cumulative effects of changes in accounting principle are now shown net of tax as an adjustment to the opening balance of retained earnings in the retained earnings statement. This treatment is called retrospective application. There really are no longer any cumulative effect types of changes in accounting principle. The cumulative effect is merely how the amount of the change is measured. Choice "c" is incorrect. This is the definition of an extraordinary item.

QUESTION 29

During 1994, Orca Corp. decided to change from the FIFO method of inventory valuation to the weightedaverage method. Inventory balances under each method were as follows:

	FIFO	*Weighted-average*
January 1, 1994	$71,000	$77,000
December 31, 1994	79,000	83,000

Orca's income tax rate is 30%.
Orca should report the cumulative effect of this accounting change as a(n):

A. Adjustment to beginning retained earnings.
B. Component of income from continuing operations.
C. Extraordinary item.
D. Component of income after extraordinary items.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. The cumulative effect of a change in accounting principle is shown as an adjustment to beginning retained earnings.
Choice "b" is incorrect. The cumulative effect of a change in accounting principle is now presented as a separate category on the retained earnings statement and is not a component of net income.
Choice "c" is incorrect. Extraordinary items are unusual and infrequent in nature. Extraordinary items have nothing to do with changes in accounting principle. Choice "d" is incorrect. A change in accounting principle affects retained earnings, not the income statement, under SFAS No. 154.

QUESTION 30

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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 31 How should the effect of a change in accounting estimate be accounted for?

A. By restating amounts reported in financial statements of prior periods.
B. By reporting pro forma amounts for prior periods.
C. As a prior period adjustment to beginning retained earnings.
D. In the period of change and future periods if the change affects both.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct, a "change in accounting estimate" affects only the current and subsequent (future) periods, if the change affects both. It does not affect "prior periods," nor "retained earnings."
Choice "a" is incorrect. Restating prior years' financial statements is required when comparative financial statements are shown for prior period adjustments of "corrections of errors," "changes in entities," and changes in accounting principle.
Choices "b" and "c" are incorrect. A "change in accounting estimate" does not affect prior periods.

QUESTION 32
Foy Corp. failed to accrue warranty costs of $50,000 in its December 31, 1992, financial statements. In addition, a $30,000 change from straight-line to accelerated depreciation was made at the beginning of 1993. Both the $50,000 and the $30,000 are net of related income taxes. What amount should Foy report as prior period adjustments in 1993?

A. $0
B. $30,000C. $50,000
D. $80,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. $50,000.
The cumulative effect of a change in accounting principle is now shown on the retained earnings statement as an adjustment to the beginning balance of retained earnings, assuming that the cumulative effect can be calculated.
An exception is made however, for a change in depreciation method, since a change in depreciation method is no longer considered to be a change in accounting principle. A change in depreciation method is now considered to be both a change in method and a change in estimate. These changes should now be accounted for as a change in estimate and handled prospectively. The new depreciation method should be used as of the beginning of the year of change and should start with the current book value of the underlying asset. No retroactive or retrospective calculations should be made, and no adjustment should be made to retained earnings.
The correction of the failure to accrue warranty costs is treated as a correction of an error and thus as a prior period adjustment. Choices "a", "b", and "d" are incorrect, per the above Explanation: .

QUESTION 33
The following question is based on the following:
Vane Co.'s trial balance of income statement accounts for the year ended December 31, 2002, included the following:

	Debit	Credit
Sales		$575,000
Cost of sales	$240,000	
Administrative expenses	70,000	
Loss on sale of equipment	10,000	
Sales commissions	50,000	
Interest revenue		25,000
Freight out	15,000	
Loss on early retirement of long-term debt (unusual & infrequent item)	20,000	
Uncollectible accounts expense	15,000	
Totals	$420,000	$600,000
Other information		
Finished goods inventory:		
January 1, 2002	$400,000	
December 31, 2002	$360,000	

Vane's income tax rate is 30%.
In Vane's 2002 multiple-step income statement, what amount should Vane report as income from continuing operations?

A. $126,000
B. $129,500
C. $140,000
D. $147,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct, $140,000.

Net of credits over debits ($600-420)	$180,000
add: extraordinary item - loss on early retirement of long-term debt	20,000
Income from continuing operations	200,000
"Net of tax" rate (100%-30% tax)	70%
Income after income taxes from continuing operations	$140,000

QUESTION 34
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:

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

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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.

QUESTION 35
An extraordinary item should be reported separately on the income statement as a component of income:

	Net of income taxes	Before discontinued operations of a segment of a business
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct, Yes - No. An extraordinary item should be reported separately on the income statement as a component of income: Yes
- net of income taxes.
No - after (not before) "discontinued operations of a segment of a business."

QUESTION 36
On January 2, 20X5, to better reflect the variable use of its only machine, Holly, Inc. elected to change its method of depreciation from the straight-line method to the units of production method. The original cost of the machine on January 2, 20X3, was $50,000, and its estimated life was 10 years. Holly estimates that the machine's total life is 50,000 machine hours. Machine hours usage was 8,500 during 20X4 and 3,500 during 20X3.
Holly's income tax rate is 30%. Holly should report the accounting change in its 20X5 financial statements as a(n):

A. Cumulative effect of a change in accounting principle of $2,000 in its income statement.
B. Adjustment to beginning retained earnings of $2,000.
C. Cumulative effect of a change in accounting principle of $1,400 in its income statement.
D. None of the above.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:
Choice "d" is correct. A change in the method of depreciation is now considered to be both a change in method and a change in estimate. These changes should be accounted for as changes in estimate and handled prospectively. The new depreciation method should be used as of the beginning of the year of change and should start with the current book value of the underlying asset. No retroactive or retrospective calculations should be made, and no adjustment should be made to retained earnings.

The cumulative effect treatment on the income statement was the treatment of most changes in accounting principle prior to SFAS No. 154. The adjustment to beginning retained earnings is the treatment now given to changes in accounting principle by SFAS No. 154. However a change in depreciation method is no longer accounted for as a change in accounting principle. Choices "a", "b", and "c" are incorrect, per the above Explanation: .

QUESTION 37
On November 1, 20X2, Smith Co. contracted to dispose of an industry segment. Throughout 20X2 the segment had operating losses. These losses were expected to continue until the segment's disposition.
If a loss is projected on final disposition, how much of the operating losses should be included in the loss from discontinued operations reported in Smith's 20X2 income statement?

I. Operating losses for the period January 1 to October 31, 20X2.
II. Operating losses for the period November 1 to December 31, 20X2.
III. Estimated operating losses for the period January 1 to February 28, 20X3.

A. II only.
B. II and III only.
C. I and III only.
D. I and II only.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. The operating losses to be included in Smith's 20X2 income statement would be the total 20X2 operating losses, regardless of whether those losses occurred before or after the date the decision to dispose of the component was made, and not any 20X3 operating losses. Projected operating losses are not anticipated and accrued.
Choice "a" is incorrect. The operating losses to be included in Smith's 20X2 income statement would be the total 20X2 operating losses, regardless of whether those losses occurred before or after the date the decision to dispose of the component was made, and not any 20X3 operating losses.
Choice "b" is incorrect. The operating losses to be included in Smith's 20X2 income statement would be the total 20X2 operating losses, regardless of whether those losses occurred before or after the date the decision to dispose of the component was made, and not any 20X3 operating losses.
Choice "c" is incorrect. The operating losses to be included in Smith's 20X2 income statement would be the total 20X2 operating losses, regardless of whether those losses occurred before or after the date the decision to dispose of the component was made, and not any 20X3 operating losses.

QUESTION 38
If a company is not presenting comparative financial statements, the correction of an error in the financial statements of a prior period should be reported, net of applicable income taxes, in the current:

A. Retained earnings statement after net income but before dividends.
B. Retained earnings statement as an adjustment of the opening balance.
C. Income statement after income from continuing operations and before extraordinary items.
D. Income statement after income from continuing operations and after extraordinary items.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. The correction of an error in the financial statements of a prior period should be reported, net of tax, in the current statement of retained earnings as an adjustment of the opening balance. Choice "a" is incorrect. The adjustment is before net income, not after net income.
Choices "c" and "d" are incorrect. Corrections of errors of prior periods go to retained earnings and do not affect the income statement.

QUESTION 39 The cumulative effect of a change in accounting estimate should be shown separately:

A. On the income statement above income from continuing operations.
B. On the income statement after income from continuing operations and before extraordinary items.
C. On the retained earnings statement as an adjustment to the beginning balance.
D. It should not be recorded separately on any financial statement.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. A change in estimate is handled prospectively. No cumulative effect adjustment is made and no separate line item presentation is made on any financial statement. If a material change is being made, appropriate footnote disclosure is necessary.
Choices "a", "b", and "c" are incorrect, per the above Explanation: .

QUESTION 40
The following costs were incurred by Griff Co., a manufacturer, during 1992:

Accounting and legal fees	$ 25,000
Freight-in	175,000
Freight-out	160,000
Officers salaries	150,000
Insurance	85,000
Sales representatives salaries	215,000

What amount of these costs should be reported as general and administrative expenses for 1992?

A. $260,000
B. $550,000
C. $635,000
D. $810,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. General and administrative expenses include:

Accounting and legal	$ 25,000
Officers salaries	150,000
Insurance	85,000
Total	$260,000

Freight-in is part of cost of sales; freight-out is a selling expense; and sales salaries are selling expenses.
Choice "b" is incorrect. Freight-in is part of cost of inventory; freight-out is a selling expense; and sales salaries are selling expenses. Choice "c" is incorrect. Freight-in is part of cost of inventory; freight-out is a selling expense; and sales salaries are selling expenses.
Choice "d" is incorrect. Freight-in is part of cost of inventory; freight-out is a selling expense; and sales salaries are selling expenses.

QUESTION 41
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 42
During 1992, Krey Co. increased the estimated quantity of copper recoverable from its mine. Krey uses the units of production depletion method. As a result of the change, which of the following should be reported in Krey's 1992 financial statements?

	Cumulative effect of a change in accounting principle	*Pro forma effects of retroactive application of new depletion base*
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:
Choice "c" is correct, No - No. This is a change in "accounting estimate," which affects only the current and subsequent periods (not prior periods and not retained earnings). "Cumulative effect of a change in accounting principle" is only used for changes in "accounting principle."

QUESTION 43 On August 31, 1992, Harvey Co. decided to change from the FIFO periodic inventory system to the weighted average periodic inventory system. Harvey is on a calendar year basis. The cumulative effect of the change is determined:

A. As of January 1, 1992.
B. As of August 31, 1992.
C. During the eight months ending August 31, 1992, by a weighted average of the purchases.

D. During 1992 by a weighted average of the purchases.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct, as of January 1, 1992, the beginning of the year.
Rule: The cumulative effect of a change in accounting principle equals the difference between retained earnings at the beginning of period of the change and what retained earnings would have been if the change was applied to all affected prior periods, assuming comparative financial statements are not presented. If comparative statements are presented, then beginning retained earnings of the earliest year presented is adjusted for the cumulative effect of the change. We are assuming, based on the answer options given, that Harvey is not presenting comparative financial statements.
Choice "b" is incorrect. The cumulative effect of the change is not determined as of the date the decision is made. Choices "c" and "d" are incorrect. The cumulative effect of the change is not determined by a weighted average.

QUESTION 44
In 1992, hail damaged several of Toncan Co.'s vans. Hailstorms had frequently inflicted similar damage to Toncan's vans. Over the years, Toncan had saved money by not buying hail insurance and either paying for repairs, or selling damaged vans and then replacing them. In 1992, the damaged vans were sold for less than their carrying amount. How should the hail damage cost be reported in Toncan's 1992 financial statements?

A. The actual 1992 hail damage loss as an extraordinary loss, net of income taxes.
B. The actual 1992 hail damage loss in continuing operations, with no separate disclosure.
C. The expected average hail damage loss in continuing operations, with no separate disclosure.
D. The expected average hail damage loss in continuing operations, with separate disclosure.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Actual hail damage must be reported. Since the hailstorms are frequent, the damage is not considered an extraordinary gain/loss. Thus, the damages would be shown in continuing operations. No separate disclosure is necessary since hail damage is a common occurrence.
Choice "a" is incorrect. Hailstorms are not unusual and infrequent so the loss could not be classified as extraordinary. APB 30 para. 20
Choice "c" is incorrect. Actual hail damage must be reported. Estimated hail damage may be probable but is not estimable; so it should not be included in income calculations. Choice "d" is incorrect. Estimated hail damage may be probable but is not estimable; so it should not be included in income calculations.

QUESTION 45
A segment of Ace Inc. was discontinued during 1992. Ace's loss from discontinued operations should not:

A. Include employee relocation costs associated with the decision to dispose.
B. Exclude operating losses from the date the decision to dispose of the segment was made until the end of 1992.
C. Include additional pension costs associated with the decision to dispose.
D. Include operating losses of the current period up to the date the decision to dispose of the segment was made.

Correct Answer: B
Section: (none)
Explanation
Explanation/Reference:
Explanation:

Choice "b" is correct. Ace's loss on discontinued operations should not exclude operating losses from the date the decision to dispose of the segment was made until the end of 1992. All 1992 operating losses should be included. Choice "a" is incorrect. Employee relocation costs associated with the decision to dispose should be included in the loss from discontinued operations.
Choice "c" is incorrect. Additional pension costs associated with the decision to dispose should be included in the loss from discontinued operations.
Choice "d" is incorrect. Ace's loss on discontinued operations should include operating losses of the current period up to the date the decision to dispose of the segment was made and also after that date. All 1992 operating losses should be included.

QUESTION 46

On December 31, 20X2, the Board of Directors of Maxy Manufacturing, Inc. committed to a plan to discontinue the operations of its Alpha division. Maxy estimated that Alpha's 20X3 operating loss would be $500,000 and that the fair value of Alpha's facilities was $300,000 less than their carrying amounts.

Alpha's 20X2 operating loss was $1,400,000, and the division was actually sold for $400,000 less than its carrying amount in 20X3. Maxy's effective tax rate is 30%. In its 20X2 income statement, what amount should Maxy report as loss from discontinued operations?

A. $980,000
B. $1,190,000C. $1,400,000
D. $1,700,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Since the fair value of Alpha's facilities was $300,000 less than its carrying value, there has been an impairment loss, and that loss should be recognized in 20X2. That $300,000 impairment loss plus the $1,400,000 20X2 operating loss would be recognized in 20X2 net of tax. The total loss would be $1,700,000 × 70% (100% - 30%) or $1,190,000.
Choice "a" is incorrect. It includes the 20X2 operating loss of $1,400,000 but not the $300,000 impairment loss but does report the 20X2 operating loss net of tax.
Choice "c" is incorrect. It includes the 20X2 operating loss of $1,400,000, but not the $300,000 impairment loss, and reports the 20X2 operating loss gross of tax and not net of tax. Choice "d" is incorrect. It reports the 20X2 loss from discontinued operations gross of tax and not net of tax.

QUESTION 47
On December 31, 20X2, the Board of Directors of Maxy Manufacturing, Inc. committed to a plan to discontinue the operations of its Alpha division. Maxy estimated that Alpha's 20X3 operating loss would be $500,000 and that the fair value of Alpha's facilities was $300,000 less than their carrying amounts.
The estimate for 20X3 turned out to be correct. Alpha's 20X2 operating loss was $1,400,000, and the division was actually sold for $400,000 less than its carrying amount. Maxy's effective tax rate is 30%. In its 20X3 income statement, what amount should Maxy report as loss from discontinued operations?

A. $350,000
B. $500,000
C. $420,000
D. $600,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The 20X3 loss from discontinued operations would include both the 20X3 operating loss of $500,000 (which turned out to be a correct estimate) and the "additional" loss (on disposal) of $100,000, net of tax, for a total of $600,000 x .70 or $420,000.
Choice "a" is incorrect. It includes the 20X3 operating loss of $500,000 but not the $300,000 impairment loss but does report the 20X3 operating loss net of tax.
Choice "b" is incorrect. It includes the 20X3 operating loss of $500,000, but not the $100,000 loss on disposal, and reports the 20X3 operating loss gross of tax and not net of tax.
Choice "d" is incorrect. It reports the 20X3 loss from discontinued operations gross of tax and not net of tax. The 20X3 loss from discontinued operations should include both the 20X3 operating loss of $500,000 and the loss on disposal of $100,000, net of tax, for a total of $600,000 x .70 or $420,000.

QUESTION 48
In which of the following situations should a company report a prior-period adjustment?
A. A change in the estimated useful lives of fixed assets purchased in prior years.
B. The correction of a mathematical error in the calculation of prior years' depreciation.
C. A switch from the straight-line to double-declining balance method of depreciation.
D. The scrapping of an asset prior to the end of its expected useful life.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Prior period adjustments consist of: corrections of errors in the financial statements of prior periods, retroactive restatements required by new GAAP pronouncements, and changes from a non-GAAP method of accounting to a GAAP method of accounting (which are corrections of errors).
Choice "a" is incorrect. This change is a change in accounting estimate.
Choice "c" is incorrect. This change is a change for one GAAP method of depreciation to another GAAP method of depreciation. Under SFAS No. 154, it is treated as a change in accounting estimate effected by a change in accounting principle and is handled prospectively, and not as a prior-period adjustment. Choice "d" is incorrect. This is a business activity ordinary in nature.

QUESTION 49
Mellow Co. depreciated a $12,000 asset over five years, using the straight-line method with no salvage value. At the beginning of the fifth year, it was determined that the asset will last another four years. What amount should Mellow report as depreciation expense for year 5?

A. $600
B. $900
C. $1,500
D. $2,400

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Over the first 4 years, the asset would be depreciated down to $2,400. Once it was determined that the asset would last for another 4 years, $600 would be depreciated each year of that 4 year period. This change is a change in accounting estimate (the estimate being the life of the asset).
Changes is accounting estimate are accounted for in the current year and future years if the change affects both.
Choice "b" is incorrect. This answer is the annual difference between the depreciation expense IF depreciation expense had been retroactively restated ($24,000 / 8 = $1,500) and the correct depreciation expense. Retroactive restatement is not appropriate for changes in accounting estimate.
Choice "c" is incorrect. This answer is the depreciation expense IF depreciation had been retroactively restated ($24,000 / 8 = $1,500). Retroactive restatement is not appropriate for changes in accounting estimate.
Choice "d" is incorrect. This answer is the undepreciated amount at the beginning of the fifth year or the amount of the annual depreciation expense for each of the first 4 years. Either way, it certainly is not going to be the depreciation expense for that year because the remaining cost will depreciated over the remaining period.

QUESTION 50
Envoy Co. manufactures and sells household products. Envoy experienced losses associated with its small appliance group. Operations and cash flows for this group can be clearly distinguished from the rest of Envoy's operations. Envoy plans to sell the small appliance group with its operations. What is the earliest point at which Envoy should report the small appliance group as a discontinued operation?

A. When Envoy classifies it as held for sale.
B. When Envoy receives an offer for the segment.
C. When Envoy first sells any of the assets of the segment.
D. When Envoy sells the majority of the assets of the segment.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. The earliest period that a component of an entity can be reported in discontinued operations is when the component meets the following "held for sale" criteria:

1. Management commits to a plan to sell the component.
2. The component is available for immediate sale in its present condition.
3. An active program to locate a buyer has been initiated.
4. The sale of the component is probable and the sale is expected to be completed within one year.
5. The sale of the component is being actively marketed.
6. It is unlikely that significant change to the plan to sell will be made or that the plan will be withdrawn.Choices "b", "c", and "d" are incorrect, per the Explanation: above.

QUESTION 51
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 52
Rock Co.'s financial statements had the following balances at December 31:

Extraordinary gain	$50,000
Foreign currency translation gain, net of tax	100,000
Net income	400,000
Unrealized gain on available-for-sale equity securities, net of tax	20,000

What amount should Rock report as comprehensive income for the year ended December 31?

A. $400,000
B. $420,000
C. $520,000
D. $570,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Comprehensive Income includes all items included in "Net Income" plus "Other Comprehensive Income" items. Since the $50,000 extraordinary gain is already included in Net Income, Comprehensive Income is:

Net Income	$400,000
"PUFE" adjustments:	
Foreign currency translation adj.	100,000
Unrealized gain on available-for-sale securities	20,000
	$520,000

QUESTION 53
According to the FASB conceptual framework, comprehensive income includes which of the following?

	Loss on discontinued operations	*Investments by owners*
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Comprehensive income is the change in equity of a business during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity except those resulting from investments by owners and distributions to owners. SFAC 6 para 70.

QUESTION 54 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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 55 What is the purpose of information presented in notes to the financial statements?

A. To provide disclosures required by generally accepted accounting principles.
B. To correct improper presentation in the financial statements.
C. To provide recognition of amounts not included in the totals of the financial statements.
D. To present management's responses to auditor comments.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Information presented in notes to the financial statements have the purpose of providing disclosures required by generally accepted accounting principles. SFAC 5 para. 7

QUESTION 56

Which of the following should be disclosed in a summary of significant accounting policies?

A. Basis of profit recognition on long-term construction contracts.
B. Future minimum lease payments in the aggregate and for each of the five succeeding fiscal years.
C. Depreciation expense.
D. Composition of sales by segment.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. The summary of significant accounting policies should disclose policies. The only policy in this question is the "basis" of profit recognition on long-term construction contracts. The other disclosures are accounting details and would be disclosed in other footnotes, but not in the summary of significant accounting policies.
Choice "b" is incorrect. The future minimum lease payments should be disclosed, but not in the summary of significant accounting policies.
Choice "c" is incorrect. Depreciation expense should certainly be disclosed, but not in the summary of significant accounting policies.
Choice "d" is incorrect. The composition of sales by segment should be disclosed, but not in the summary of significant accounting policies.

QUESTION 57
Which of the following must be included in a company's summary of significant accounting policies in the notes to the financial statements?

A. Description of current year equity transactions.
B. Summary of long-term debt outstanding.
C. Schedule of fixed assets.
D. Revenue recognition policies.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. The summary of significant accounting policies should include "policies." The only policy in the choices listed is the revenue recognition policies.
Choice "a" is incorrect. A description of current year equity transactions is not a policy. It should be disclosed somewhere in the footnotes but not in the summary of significant accounting policies.
Choice "b" is incorrect. A summary of long-term debt outstanding is not a policy. It should be disclosed somewhere in the footnotes but not in the summary of significant accounting policies. Choice "c" is incorrect. A schedule of fixed assets is not a policy. It should be disclosed somewhere in the footnotes but not in the summary of significant accounting policies.

QUESTION 58
Which of the following is correct concerning financial statement disclosure of accounting policies?

A. Disclosures should be limited to principles and methods peculiar to the industry in which the company operates.
B. Disclosure of accounting policies is an integral part of the financial statements.
C. The format and location of accounting policy disclosures are fixed by generally accepted accounting principles.
D. Disclosures should duplicate details disclosed elsewhere in the financial statements.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Disclosure of accounting policies (and all other disclosure also) is an integral part of the financial statements.
Choice "a" is incorrect. For disclosure of accounting policies, disclosure should not be limited to principles and methods peculiar to the industry in which the company operates. All material accounting policies should be disclosed.
Choice "c" is incorrect. For disclosure of accounting policies, the format and location of accounting policies are not fixed by GAAP. Accounting policy disclosures are normally Note 1, but that is a (reasonable and very general) practice and not a "rule." It does make sense to disclose the "why" before the "what."
Choice "d" is incorrect. Disclosure of accounting policies should not duplicate details disclosed elsewhere in the financial statements. Interim
Financial Reporting

QUESTION 59 Conceptually, interim financial statements can be described
as emphasizing:

A. Timeliness over reliability.
B. Reliability over relevance.
C. Relevance over comparability.
D. Comparability over neutrality.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Interim financial statements emphasize timeliness (an element of relevance) by providing financial information based on actual performance to date and estimates prior to year end.
Information must be available when it is needed to be useful. Reliability is impeded by the extensive use of estimates; however, the lag until verifiability is obtained detracts from usefulness. SFAC 2 para. 56 Choice "b" is incorrect. Relevance (particularly timeliness) of information in interim financial statements is emphasized more than reliability. Reliability is impeded by the extensive use of estimates in interim data.
Choice "c" is incorrect. Since comparability is a secondary quality of information, there should be no need to trade off comparability for relevance (a primary quality).
Choice "d" is incorrect. Neutrality is an element of reliability (a primary quality of information. There should be NO need for a trade-off for comparability over neutrality.

QUESTION 60
APB Opinion No. 28, Interim Financial Reporting, concluded that interim financial reporting should be viewed primarily in which of the following ways?

A. As useful only if activity is spread evenly throughout the year.
B. As if the interim period were an annual accounting period.
C. As reporting for an integral part of an annual period.
D. As reporting under a comprehensive basis of accounting other than GAAP.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Interim financial reporting should be viewed as reporting for an integral part of an annual period. Choices "a", "b", and "d" are incorrect, per the above rule.

QUESTION 61
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. $30,000C. $50,000
D. $60,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 62
Due to a decline in market price in the second quarter, Petal Co. incurred an inventory loss. The market price is expected to return to previous levels by the end of the year. At the end of the year the decline had not reversed. When should the loss be reported in Petal's interim income statements?

A. Ratably over the second, third, and forth [sic] quarters.
B. Ratably over the third and fourth quarters.
C. In the second quarter only.
D. In the fourth quarter only.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. When the loss is probable and estimable, the expected loss must be recorded in full. This loss becomes such at the end of the fourth quarter. Therefore, the inventory must be valued on the year-end at the lower of cost or market, recognizing the loss at that time.
Choice "a" is incorrect. Expected losses must be recorded in full when the loss is probable and estimable and not ratably over several quarters.
Choice "b" is incorrect. Expected losses must be recorded in full when the loss is probable and estimable and not ratably over several quarters. Choice "c" is incorrect. Since the loss is not probable at the end of the second quarter, no amount should be recognized at that time.

QUESTION 63 In general, an enterprise preparing interim financial statements should: A. Defer recognition of seasonal revenue.

B. Disregard permanent decreases in the market value of its inventory.
C. Allocate revenues and expenses evenly over the quarters, regardless of when they actually occurred.
D. Use the same accounting principles followed in preparing its latest annual financial statements.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Generally accepted accounting principles that were used in the most recent annual report of an enterprise should be applied to interim financial statements of the current year, unless a change in accounting principle is adopted in the current year.
Choices "a", "b", and "c" are incorrect, per above.

QUESTION 64
During the first quarter of the calendar year, Worth Co. had income before taxes of $100,000, and its effective income tax rate was 15%. Worth's effective annual income tax rate for the previous year was 30%. Worth expects that its effective annual income tax rate for the current year will be 25%. The statutory tax rate for the current year is 35%. In its first quarter interim income statement, what amount of income tax expense should Worth report?

A. $15,000
B. $25,000
C. $30,000
D. $35,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. When preparing interim financial statements, income tax expense is estimated each quarter using the effective tax rate expected to apply to the entire year.
Choice "a" is incorrect. Worth should use the effective annual tax rate, not the effective tax rate for the quarter only.
Choice "c" is incorrect. Worth should use the effective annual tax rate expected to apply to the current year, not the prior year's effective tax rate. Choice "d" is incorrect. Worth should use the effective annual tax rate, not the statutory tax rate.

QUESTION 65
Terra Co.'s total revenues from its three operating segments were as follows:

Segment	Sales to unaffiliated customers	Intersegment sales	Total revenues
Lion	$ 70,000	$ 30,000	$ 100,000
Monk	22,000	4,000	26,000
Nevi	8,000	16,000	24,000
Combined	$100,000	$ 50,000	$ 150,000
Elimination	-	(50,000)	(50,000)
Consolidated	$100,000	$ -	$ 100,000

Which operating segment(s) is (are) deemed to be reportable segments?

A. None.
B. Lion only.
C. Lion and Monk only.
D. Lion, Monk, and Nevi.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. A reportable operating segment is one having 10% of all revenue, including revenue from unaffiliated sales and from intersegment sales:

Lion's revenue percentage is 66.7% [$100,000/150,000].
Monk's revenue percentage is 17.3% [$26,000/150,000].
Nevi's revenue percentage is 16% [$24,000/150,000].

Thus, all three segments meet the 10% of total revenues test and are reportable as operating segments. SFAS 14 para. 10 and 15 as amended by SFAS 131 Choice "a" is incorrect. All segments with revenue percentages exceeding 10% of total revenues are reportable operating segments.
Choice "b" is incorrect. Lion is not the only segment with revenue percentages exceeding 10% of total revenues. Choice "c" is incorrect. Nevi has a revenue percentage exceeding 10% of total revenues.

QUESTION 66 What information should a public company present about revenues from its reporting segments?

A. Disclose separately the amount of sales to unaffiliated customers and the amount of intracompany sales.
B. Disclose as a combined amount sales to unaffiliated customers and intracompany sales between geographic areas.
C. Disclose separately the amount of sales to unaffiliated customers but not the amount of intracompany sales between geographic areas.
D. No disclosure of revenues from foreign operations need be reported.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Unaffiliated customers sales and intracompany sales must be disclosed separately.

QUESTION 67
Taft Corp. discloses supplemental industry segment information. The following information is available for 1992:

Segment	Sales	Traceable operating expenses
A	$ 20,000	$ 12,000
B	16,000	10,000
C	12,000	7,000
	$ 48,000	$ 29,000

Additional 1992 expenses, not included above, are as follows:

Indirect operating expenses $7,200
General corporate expenses 4,800

Segment C's 1992 operating profit was:

A. $5,000
B. $3,200
C. $2,600
D. $2,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. $5,000 operating profit for Segment C.
Rule: Operating profit by segments is based on the measure of profit reported to the "Chief Operating Decision Maker."
Interest expense, income taxes, and general corporate expenses are not allocated to the divisions solely for the purposes of segment disclosures; they may be allocated if that is how the segments report to the "Chief Operating Decision Maker."

Segment C's sales	$12,000
Less traceable operating expenses	(7,000)
Segment C operating profit	$ 5,000

QUESTION 68
In financial reporting of segment data, which of the following items is always used in determining a segment's operating income?

A. Income tax expense.
B. Sales to other segments.
C. General corporate expense.
D. Gain or loss on discontinued operations.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Sales to other segments would be used in determining a segment's operating income.
Rule: Equity in net income of another company, general corporate expenses, interest, income tax expense, and gains or losses on discontinued operations are all not included in segment profit unless they are included in the determination of segment profit reported to the "Chief Operating Decision Maker."

QUESTION 69
Opto Co. is a publicly-traded, consolidated enterprise reporting segment information. Which of the following items is a required enterprise-wide disclosure regarding external customers?

A. The fact that transactions with a particular external customer constitute more than 10% of the total enterprise revenues.
B. The identity of any external customer providing 10% or more of a particular operating segment's revenue.
C. The identity of any external customer considered to be "major" by management.
D. Information on major customers is not required in segment reporting.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. In order to conform to GAAP, financial statements for public business enterprises must report segment information about a company's major customers if that customer provides 10% or more of the combined revenue, internal and external, of all operating segments.
Choice "b" is incorrect. Revenue is 10% of ALL operating segments not "a particular" segment.
Choice "c" is incorrect. Disclosure is not at management's discretion. Choice "d" is incorrect.
Disclosure is required.

QUESTION 70
Which of the following qualifies as an operating segment?

A. Corporate headquarters, which oversees $1 billion in sales for the entire company.
B. North American segment, whose assets are 12% of the company's assets of all segments, and management reports to the chief operating officer.
C. South American segment, whose results of operations are reported directly to the chief operating officer, and has 5% of the company's assets, 9% of revenues, and 8% of the profits.
D. Eastern Europe segment, which reports its results directly to the manager of the European division, and has 20% of the company's assets, 12% of revenues, and 11% of profits.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Assets of the North American segment exceed 10% combined assets of all operating segments.
Choice "a" is incorrect. Corporate headquarters in not considered a segment.
Choice "c" is incorrect. The South American segment does not meet any of the 10% minimums (Revenue, P&L or Assets). Choice "d" is incorrect. Eastern Europe segment does not report to the chief operating officer.

QUESTION 71
Which of the following should be disclosed for each reportable operating segment of an enterprise?

Profit or loss	*Total assets*
Yes	Yes
Yes	No
No	Yes
No	No

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. For each reportable segment of an enterprise, both profit or loss and total assets should be disclosed. In disclosure questions, if you are not sure, disclose the most rather than the least.
Choice "b" is incorrect. For each reportable segment of an enterprise, both profit or loss and total assets should be disclosed. Choice "c" is incorrect. For each reportable segment of an enterprise, both profit or loss and total assets should be disclosed.
Choice "d" is incorrect. For each reportable segment of an enterprise, both profit or loss and total assets should be disclosed.

QUESTION 72
Which of the following factors determines whether an identified segment of an enterprise should be reported in the enterprise's financial statements under SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information?

I. The segment's assets constitute more than 10% of the combined assets of all operating segments.
II. The segment's liabilities constitute more than 10% of the combined liabilities of all operating segments.

A. I only.
B. II only.
C. Both I and II.
D. Neither I nor II.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. For segment reporting, if an identified segment's assets constitute more than 10% of the combined assets of all operating segments, the segment should be reported. The same rule does not apply for the segment's liabilities. The candidate does have to remember the 10% and also the 10% of "what."
Choice "b" is incorrect. For segment reporting, if an identified segment's assets constitute more than 10% of the combined assets of all operating segments, the segment should be reported. The same rule does not apply for the segment's liabilities.
Choice "c" is incorrect. For segment reporting, if an identified segment's assets constitute more than 10% of the combined assets of all operating segments, the segment should be reported. The same rule does not apply for the segment's liabilities, so the correct answer cannot be "Both."

Choice "d" is incorrect. For segment reporting, if an identified segment's assets constitute more than 10% of the combined assets of all operating segments, the segment should be reported. The correct answer cannot be "Neither."

QUESTION 73 Which of the following types of entities are required to report on business segments?

A. Nonpublic business enterprises.
B. Publicly-traded enterprises.
C. Not-for-profit enterprises.
D. Joint ventures.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Only publicly-traded enterprises are required to report on business segments.
Choices "a", "c", and "d" are incorrect, per the Explanation: above.

QUESTION 74
In financial reporting of segment data, which of the following must be considered in determining if an industry segment is a reportable segment?

	Sales to unaffiliated customers	*Intersegment sales*
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. A segment is considered reportable if its reported revenue, including sales to unaffiliated customers and intersegment sales, is 10% or more of the combined revenue (unaffiliated and intersegment) of all operating segments.
Choices "b", "c", and "d" are incorrect, per the above Explanation.

QUESTION 75
A development stage enterprise should use the same generally accepted accounting principles that apply to established operating enterprises for:

	Revenue recognition	Deferral of expenses
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Development stage enterprises must use all the same principles as established enterprises including those of revenue recognition and deferral of expenses. The primary difference is that development stage enterprises must provide additional disclosures not required of established operating enterprises. SFAS #7, para. 10

QUESTION 76
Tanker Oil Co., a development stage enterprise, incurred the following costs during its first year of operations:

Legal fees for incorporation and other related matters	55,000
Underwriters' fees for initial stock offering	40,000
Exploration costs and purchases of mineral rights	60,000

Tanker had no revenue during its first year of operation. What amount may Tanker capitalize as organizational costs?

A. $115,000
B. $95,000
C. $55,000
D. $0

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

	Capitalize as organizational costs
Legal fees for incorporation and other related matters should be expensed as start-up costs	-
Underwriting fees for initial stock offering should be recorded as a reduction of contributed capital	-
Exploration costs should be expensed as research & development	-
Purchases of mineral rights should be capitalized as fixed assets	-
Capitalize as organizational costs	0

Choice "d" is correct. $0.
All organizational costs (start-up costs) should be expensed when incurred (per SOP 98-5).
Fair Value Measurements

QUESTION 77 Which of the following statements regarding fair value is/are correct?

I. The fair value of an asset or liability is specific to the entity making the fair value measurement.
II. Fair value is the price to acquire an asset or assume a liability.
III. Fair value includes transportation costs, but not transaction costs.
IV. The price in the principal market for an asset or liability will be the fair value measurement.

A. I & II
B. I & IV
C. II & III
D. III & IV

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Statements III and IV are correct. Statement I is incorrect because fair value is a market-specific measure, not an entity-specific measure. Statement II is incorrect because fair value is an exit price (the price to sell an asset or transfer a liability), not an entrance price.
Choices "a", "b" and "c" are incorrect, per the above Explanation: .

QUESTION 78
Which of the following is not a valuation technique that can be used to measure the fair value of an asset or liability?

A. The market approach.
B. The impairment approach.
C. The income approach.
D. The cost approach.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. The impairment approach is not used to measure the fair value of an asset or liability. Instead, when an entity is determining whether an asset has been impaired, the entity will use the market approach, the income approach or the cost approach to determine the fair value of the asset.
Choice "a" is incorrect. The market approach is an accepted method of fair value measurement in which price and other market information from identical or comparable assets or liabilities is used to measure fair value.
Choice "c" is incorrect. The income approach is an accepted method of fair value measurement in which future cash flows or earnings are discounted to determine fair value.
Choice "d" is incorrect. The cost approach is an accepted method of fair value measurement in which current replacement cost is used to determine the fair value of an asset.

QUESTION 79
Which of the following statements is incorrect regarding the inputs that can be used to measure fair value?

I. Level I inputs are the most reliable fair value measurements and Level III inputs are the least reliable.
II. Level I measurements are quoted prices in active markets for identical or similar assets or liabilities.
III. A fair value measurement based on management assumptions only (no market data) would not be acceptable per GAAP.
IV. The level in the fair value hierarchy of a fair value measurement is determined by the level of the highest level significant input.

A. I only.
B. I, II, IV.
C. II, III, IV.
D. I, II, III, IV.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Statement I is correct and statements II, III, and IV are incorrect. Statement II is incorrect because Level I measurements are quoted prices in active markets for identical assets or liabilities only. Quoted prices in active markets for similar assets or liabilities are Level II inputs.
Statement III is incorrect because a fair value measurement based on management assumptions only is a
Level III measurement and is acceptable when there are no Level I or Level II inputs or when undo cost or effort is required to obtain Level I or Level II inputs. Statement IV is incorrect because the level in the fair value hierarchy of a fair value measurement is determined by the level of the lowest level significant input.

QUESTION 80
There are multiple active markets for a financial asset with different observable market prices:

Market	Quoted Price	Transaction Costs
A	$76	$5
B	$74	$2

There is no principal market for the financial asset. What is the fair value of the asset?

A. $71
B. $72
C. $74
D. $76

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. When there is no principal market, the price in the most advantageous market is the fair value measurement. Although transaction costs are not included in the fair value measurement, they are used to determine the most advantageous market, as follows:

Market A: Net Price = Quoted Price - Transaction Costs = $76 - 5 = $71
Market B: Net Price = Quoted Price - Transaction Costs = $74 - 2 = $72

Because the net price in Market B is higher than the net price in Market A, Market B is the most advantageous market and the quoted price in Market B ($74) is the fair value of the asset.
Choice "a" is incorrect. This is the net price in Market A. Fair value does not include transaction costs.
Choice "b" is incorrect. This is the net price in Market B. This net price indicates that Market B is the most advantageous market, but the net price is not the fair value because fair value does not include transaction costs.
Choice "d" is incorrect. If Market A were the principal market for the asset, then this would be the fair value of the asset. However, because there is no principal market, the price in the most advantageous market (Market B) is the price of the asset.

QUESTION 81
A change from the cost approach to the market approach of measuring fair value is considered to be what type of accounting change?

A. Change in accounting estimate.
B. Change in accounting principle.
C. Change in valuation technique.
D. Error correction.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. A change in the valuation technique used to measure fair value is a change in accounting estimate.
Choice "b" is incorrect. Per SFAS No. 157, a change in valuation technique is a change in accounting estimate, not a change in accounting principal.
Choice "c" is incorrect. Although a change from the cost approach to the market approach is a change in valuation technique, a change in valuation technique is not defined as a type of accounting change, but instead falls into the category of changes in accounting estimate.
Choice "d" is incorrect. Both the market approach and the cost approach are acceptable methods of measuring fair value per SFAS No. 157; therefore, switching between these methods is not the correction of an error. Additionally, an error correction is not a type of accounting change.

QUESTION 82
According to the FASB conceptual framework, the objectives of financial reporting for business enterprises are based on:

A. The need for conservatism.
B. Reporting on management's stewardship.
C. Generally accepted accounting principles.
D. The needs of the users of the information.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. The FASB conceptual framework states that the objectives of financial reporting stem from the informational needs of the external users of the information. SFAC 1 para. 28
Choice "a" is incorrect. Conservatism is an underlying concept for financial accounting but is not the basis for the objectives. SFAC 2 para. 91-97
Choice "b" is incorrect. Information concerning management's stewardship is only one aspect of the information financial statements are intended to provide. SFAC 1 para. 50 Choice "c" is incorrect. Generally accepted accounting principles (GAAP) are derived from and based on the objectives of financial reporting, not the other way around.

QUESTION 83
According to the FASB conceptual framework, predictive value is an ingredient of:

	Relevance	Reliability
A.	No	No
B.	Yes	Yes
C.	No	Yes
D.	Yes	No

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Yes - No. Predictive value is an ingredient of relevance but not of reliability.

Memorize:
Bud's relevance to "PFT."
Bud's reliability to "VRN."

QUESTION 84
According to the FASB's conceptual framework, the process of reporting an item in the financial statements of an entity is:

A. Recognition.
B. Realization.
C. Allocation.
D. Matching.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Recognition.
According to the FASB's conceptual framework, the process of reporting an item in the financial statements of an entity is recognition.

QUESTION 85
Under FASB Statement of Financial Accounting Concepts #5, which of the following items would cause earnings to differ from comprehensive income for an enterprise in an industry not having specialized accounting principles?

A. Unrealized loss on investments in noncurrent marketable equity securities available for sale.
B. Unrealized loss on investments in current marketable equity securities held for trading.
C. Loss on exchange of nonmonetary assets without commercial substance.
D. Loss on exchange of nonmonetary assets with commercial substance.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:
Choice "a" is correct. Unrealized loss on investments in marketable equity securities available for sale would cause earnings to differ from comprehensive income for an enterprise in an industry not having specialized accounting principles.
Rule: FAC 5 defines "earnings" for a period to exclude certain cumulative accounting adjustments and other non-owner changes in equity (such as changes in market value of marketable securities available for sale) that are included in comprehensive income for a period.

QUESTION 86
FASB's conceptual framework explains both financial and physical capital maintenance concepts. Which capital maintenance concept is applied to currently reported net income, and which is applied to comprehensive income?

	Currently reported net income	*Comprehensive income*
A.	Financial capital	Physical capital
B.	Physical capital	Physical capital
C.	Financial capital	Financial capital
D.	Physical capital	Financial capital

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Financial capital - Financial capital.
Financial capital maintenance is considered to be an element of both "currently reported net income" and "comprehensive income." This was a rare instance in which this type of information was asked on the exam.

QUESTION 87
According to the FASB conceptual framework, which of the following is an essential characteristic of an asset?

A. The claims to an asset's benefits are legally enforceable.
B. An asset is tangible.
C. An asset is obtained at a cost.
D. An asset provides future benefits.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. An asset provides future benefits.
Rule: According to the FASB conceptual framework, assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

QUESTION 88 According to the FASB conceptual framework, an entity's revenue may result from:

A. A decrease in an asset from primary operations.
B. An increase in an asset from incidental transactions.

C. An increase in a liability from incidental transactions.
D. A decrease in a liability from primary operations.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Rule: Revenues are inflows or other enhancements of assets and/or settlements (decreases) in liabilities resulting from the entity's ongoing major operations, not from "incidental" operations. Choice "d" is correct. An entity's revenue may result from a decrease in a liability from primary operations.

QUESTION 89
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 90
Brock Corp. reports operating expenses in two categories: (1) selling and (2) general and administrative. The adjusted trial balance at December 31, 1989 included the following expense and loss accounts:

Accounting and legal fees	$120,000
Advertising	150,000
Freight out	80,000
Interest	70,000
Loss on sale of long-term investment	30,000
Officers' salaries	225,000
Rent for office space	220,000
Sales salaries and commissions	140,000

One-half of the rented premises is occupied by the sales department. Brock's total selling expenses for 1989 are:

A. $480,000

B. $400,000 C. $370,000
D. $360,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Advertising	$150,000
Freight out	80,000
Office space	110,000 (1/2 × $220,000)
Sales salaries and commissions	140,000
Total selling expenses	$480,000

Note: Only one-half of rent for office space was used for sales office. Choice "a" is correct. $480,000.

QUESTION 91
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 92
In Baer Food Co.'s 1990 single-step income statement, the section titled "Revenues" consisted of the following:

Net sales revenue		$187,000
Results from discontinued operations:		
Loss from operations of component		
(net of $1,200 tax effect)	$(2,400)	
Gain on disposal of component		
(net of $7,200 tax effect)	14,400	12,000
Interest revenue		10,200
Gain on sale of equipment		4,700
Total revenues		$213,900

In the revenues section of its 1990 income statement, Baer Food should have reported total revenues of:

A. $216,300
B. $215,400
C. $203,700
D. $201,900

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. $201,900.

Revenues (in a single step income statement) include:

Net sales revenue (of goods & services)	$187,000
Interest revenue (and dividends earned)	10,200
Gain on sale of equipment	4,700
Total revenues	201,900

The various amounts from discontinued operations should be included in discontinued operations, not in revenues.

QUESTION 93
FASB Interpretations of Statements of Financial Accounting Standards have the same authority as the FASB:

A. Statements of Financial Accounting Concepts.
B. Emerging Issues Task Force Consensus.
C. Technical Bulletins.
D. Statements of Financial Accounting Standards.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. FASB interpretations of the "statements of financial accounting standards" (SFAS) have the same authority as the FASB statements of financial accounting standards (SFAS), which by themselves determine GAAP.
Choice "a" is incorrect. Statements of financial accounting concepts (FAC's) have much less authority (fifth floor) and do not by themselves determine GAAP as is the case with SFASs and interpretations of SFASs.

Choice "b" is incorrect. Emerging issues task force (EITF) consensus is in the nature of a "third floor" authority. The EITF was established in 1984 to aid the FASB in identifying and implementing emerging issues before they become widespread and ultimately require action by the FASB. After discussing the issues and the relevant accounting pronouncements, the group can sometimes reach a consensus on an issue, in which case no action by the FASB is usually needed.
Choice "c" is incorrect. Technical bulletins of the FASB (second floor) do not by themselves determine GAAP.

QUESTION 94
On January 1, 1991, Brecon Co. installed cabinets to display its merchandise in customers' stores. Brecon expects to use these cabinets for five years. Brecon's 1991 multi-step income statement should include:

A. One-fifth of the cabinet costs in cost of goods sold.
B. One-fifth of the cabinet costs in selling, general, and administrative expenses.
C. All of the cabinet costs in cost of goods sold.
D. All of the cabinet costs in selling, general, and administrative expenses.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. One-fifth of the cabinet costs (depreciation expense) should be included in selling, general, and administrative expenses for 1991.
Choice "a" is incorrect. Merchandise display cabinets in stores relate to selling activities, not to the purchase cost of goods sold.
Choices "c" and "d" are incorrect. Merchandise display cabinets are fixed assets whose cost should be allocated systematically over their five-year useful life.

QUESTION 95 Which of the following accounting pronouncements is the most authoritative?

A. FASB Statement of Financial Accounting Concepts.
B. FASB Technical Bulletin.
C. AICPA Accounting Principles Board Opinion.
D. AICPA Statement of Position.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The AICPA accounting principal board opinion (APBO) is a first floor (category A) of established accounting principle pronouncements.
Choice "a" is incorrect. FASB statement of financial accounting concepts (SFAC or FACs) is a fifth floor (other accounting literature) category.
Choice "b" is incorrect. FASB technical bulletins are a second floor (category B) accounting pronouncement.
Choice "d" is incorrect. AICPA statement of position is a second floor (category B) accounting pronouncement.

QUESTION 96 Which of the following should be disclosed in a summary of significant accounting policies?

I. Management's intention to maintain or vary the dividend payout ratio.
II. Criteria for determining which investments are treated as cash equivalents.
III. Composition of the sales order backlog by segment.

A. I only.
B. I and III.
C. II only.
D. II and III.

Correct Answer: C

Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. II only.
The criteria for determining which investments are treated as "cash equivalents" is a method of accounting policies that needs to be disclosed in the summary of significant accounting policies.
Choice "a" is incorrect. Management's intention to maintain or vary the "dividend payout ratio" is not an "accounting policy." Choices "b" and "d" are incorrect. Composition of the sales order backlog by segment is not an "accounting policy."

QUESTION 97 The summary of significant accounting policies should disclose the:

A. Maturity dates of noncurrent debts.
B. Terms for convertible debt to be exchanged for common stock.
C. Concentration of credit risk of all financial instruments by geographical region.
D. Criteria for determining which investments are treated as cash equivalents.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. The criteria for determining which investments are treated as cash equivalents would be part of the summary of significant accounting policies.
Choice "a" is incorrect. The maturity dates of noncurrent debts are required disclosures, but are not a part of the summary of significant accounting policies.
Choice "b" is incorrect. The terms for convertible debt to be exchanged for common stock are not accounting policies; they would be disclosed separately.
Choice "c" is incorrect. The concentration of credit risk of all financial instruments by geographic region may be a required segment disclosure, especially for financial institutions. However, it would not be a part of the summary of significant accounting policies.

QUESTION 98
The following costs were incurred by Griff Co., a manufacturer, during 1992:

Accounting and legal fees	$25,000
Freight-in	175,000
Freight-out	160,000
Officers salaries	150,000
Insurance	85,000
Sales representatives salaries	215,000

What amount of these costs should be reported as general and administrative expenses for 1992?

A. $260,000
B. $550,000
C. $635,000
D. $810,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. $260,000.

General and administrative

Accounting and legal fees	$ 25,000
Officers salaries	150,000
Insurance	85,000
Total "general and admin" expenses	$260,000 **A**

"Freight-in" is part of "cost of goods sold." "Freight-out" is a "selling" expense.
Sales representative salaries is a selling expense.

QUESTION 99
Which of the following information should be included in Melay, Inc.'s 1992 summary of significant accounting policies?

A. Property, plant, and equipment is recorded at cost with depreciation computed principally by the straight-line method.
B. During 1992, the Delay component was sold.
C. Business segment 1992 sales are Alay $1M, Belay $2M, and Celay $3M.
D. Future common share dividends are expected to approximate 60% of earnings.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Computing depreciation principally by the straight-line method is a GAAP method of depreciation that should be described in the "summary of significant accounting policies."
Choice "b" is incorrect. Disclosing the sale of a component of a business is required (and is covered in the lecture on "discontinued operations" in the F1 class) but is not a "significant accounting policy." Choice "c" is incorrect. Disclosing "sales" of segments is required, but is not a "significant accounting policy."
Choice "d" is incorrect. "Estimates of future common share dividends" are not appropriate disclosures for the financial statements. They might be appropriate for the "presidents letter to shareholders."

QUESTION 100 Several sources of GAAP consulted by an auditor are in conflict as to the application of an accounting principle. Which of the following should the auditor consider the most authoritative?

A. FASB Technical Bulletins.
B. AICPA Accounting Interpretations.
C. FASB Statements of Financial Accounting Concepts.
D. AICPA Technical Practice Aids.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. The most authoritative pronouncements (first floor) are FASB Statements, FASB Staff Positions, FASB Statement 133 Implementation Issues, FASB Interpretations, AICPA APB opinions, and AICPA Accounting Research Bulletins. When these pronouncements do not provide appropriate guidance, the next level of pronouncements (second floor) are AICPA Industry Audit and Accounting Guides, AICPA Statements of Position, and FASB Technical Bulletins.
Choice "b" is incorrect. AICPA Accounting Interpretations are not as authoritative as FASB Technical Bulletins, since they are on the fourth floor.
Choices "c" and "d" are incorrect. FASB Concepts Statements and AICPA Technical Practice Aids are among the least authoritative of accounting literature (fifth floor).

QUESTION 101
Coffey Corp.'s trial balance of Income Statement Accounts for the year ended December 31, 1988 as follows:

	Debit	Credit
Net sales		$1,600,000
Cost of goods sold	$ 960,000	
Selling expenses	235,000	
Administrative expenses	150,000	
Interest expense	25,000	
Gain on debt extinguishment		10,000
Totals	$1,370,000	$1,610,000

Coffey's income tax rate is 30%. The gain on debt extinguishment is considered a usual and recurring part of Coffey's operations. Coffey prepares a multiple-step income statement for 1988. Income from operations before income tax is:

A. $190,000
B. $200,000
C. $230,000
D. $240,000

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. $240,000
The gain on debt extinguishment does not meet the unusual and infrequent criteria of APB 30 to be treated as an extraordinary item (per SFAS No. 145, extinguishments of debt are no longer automatically extraordinary), so it is included as part of income from continuing operations.

QUESTION 102
Coffey Corp.'s trial balance of Income Statement Accounts for the year ended December 31, 1988 as follows:

	Debit	Credit
Net sales		$1,600,000
Cost of goods sold	$960,000	
Selling expenses	235,000	
Administrative expenses	150,000	
Interest expense	25,000	
Hurricane damage	40,000	
Gain on debt extinguishment		10,000
Totals	$1,410,000	$1,610,000

Coffey's income tax rate is 30%. The gain on debt extinguishment is considered a usual and recurring part of Coffey's operations. The hurricane is considered an unusual and infrequent event. Coffey prepares a multiple-step income statement for 1988.

Net income is:

A. $140,000
B. $161,000
C. $168,000
D. $200,000

Correct Answer: A

Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. $140,000.
Net income is the "bottom line" amount after all has been considered on the income statement. Without showing all the line items as required for the income statement, the "bottom line" amount of $140,000 is derived as follows:

Income from continuing operations	$240,000
Less: Income taxes (30%)	(72,000)
Extraordinary item - Hurricane damage (net of tax)	(28,000)
Net Income	$140,000

QUESTION 103
Gown, Inc. sold a warehouse and used the proceeds to acquire a new warehouse. The excess of the proceeds over the carrying amount of the warehouse sold should be reported as a(an):

A. Extraordinary gain, net of income taxes.
B. Part of continuing operations.
C. Gain from discontinued operations, net of income taxes.
D. Reduction of the cost of the new warehouse.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Part of continuing operations.
Rule: When a fixed asset is sold, gain or loss is recognized as part of income from continuing operations. The amount of the gain or loss is equal to the difference between the proceeds from the sale and the carrying amount (FMV) of the fixed asset sold.
Choice "a" is incorrect. The gain is not extraordinary and is shown gross - not net of tax.
Choice "c" is incorrect. The gain is part of continuing operations - not discontinued operations.
Choice "d" is incorrect. The gain is not reported as a reduction of the cost of the new warehouse.

QUESTION 104 Adam Corp. had the following infrequent transactions during 1989:

• A $190,000 gain on reacquisition and retirement of bonds. This material event is also considered unusual for Adam Corp.
• A $260,000 gain on the disposal of a component of a business. Adam continues similar operations at another location.
• A $90,000 loss on the abandonment of equipment.

In its 1989 income statement, what amount should Adam report as total infrequent net gains that are not considered extraordinary?

A. $100,000
B. $170,000
C. $360,000
D. $450,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Infrequent net gains not considered extraordinary include:

Gain on disposal of a component of a business	$260,000
Loss on abandonment of equipment	(90,000)
Total	$170,000

Choice "b" is correct. $170,000.

QUESTION 105
Thorpe Co.'s income statement for the year ended December 31, 1990, reported net income of $74,100. The auditor raised questions about the following amounts that had been included in net income:

Unrealized loss on decline in market value of available-for-sale investments in stock	$(5,400)
Gain on early retirement of bonds payable (net of $11,000 tax effect)	22,000
Adjustment to profits of prior years for errors in depreciation (net of $3,750 tax effect)	(7,500)
Loss from fire (net of $7,000 tax effect)	(14,000)

The loss from the fire was an infrequent but not unusual occurrence in Thorpe's line of business.
Thorpe's December 31, 1990, income statement should report net income of:

A. $65,000
B. $66,100
C. $81,600
D. $87,000

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Net income before adjustments

Net income before adjustments	$74,100
Add: Unrealized loss in market value of available-for-sale investments in stock which should not have affected net income	5,400
Add: Correction of error of prior period which should not have affected net income	7,500
Net income after adjustments	$87,000

Rule: Unrealized losses (or gains) resulting from changes in market value of available-for-sale investments should be reported as a component of other comprehensive income in shareholders' equity. Unrealized gains and losses on investments held for trading would be included in net income.
Correction of errors of prior periods should be reported as an adjustment to beginning retained earnings, not as an item of net income. Choice "d" is correct. $87,000.

QUESTION 106 A transaction that is unusual, but not infrequent, should be reported separately as a(an):

A. Extraordinary item, net of applicable income taxes.
B. Extraordinary item, but not net of applicable income taxes.
C. Component of income from continuing operations, net of applicable income taxes.
D. Component of income from continuing operations, but not net of applicable income taxes.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:
Choice "d" is correct. A transaction that is unusual, but not "infrequent" should be reported separately as a component of continuing operations, (gross) but not net of applicable income taxes.
Choices "a" and "b" are incorrect. An extraordinary item has to be both "unusual" and "infrequent." Choice "c" is incorrect, per "d" above.

QUESTION 107 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 of gain (loss) should be reported separately as a component of income from continuing operations in 1990?

A. $260,000
B. $5,000
C. $(255,000)
D. $(350,000)

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. $5,000.
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 108 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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 109
In 1990, Teller Co. incurred losses arising from its guilty plea in its first antitrust action, and from a substantial increase in production costs caused when a major supplier's workers went on strike. Which of these losses should be reported as an extraordinary item?

	Antitrust action	Production costs
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Yes - No.
Rule: Losses arising from a company's first (and probably "last") "anti-trust" action are unusual and extraordinary and should be reported as an extraordinary item. Losses resulting from additional costs caused by a strike at a major supplier or even at one's own company are not extraordinary and should be disclosed as a separate component of "income from continuing operations."

QUESTION 110
Ocean Corp.'s comprehensive insurance policy allows its assets to be replaced at current value. The policy has a $50,000 deductible clause. One of Ocean's waterfront warehouses was destroyed in a winter storm. Such storms occur approximately every four years. Ocean incurred $20,000 of costs in dismantling the warehouse and plans to replace it. The tax rate is 30%. The following data relate to the warehouse:

Current carrying amount $ 300,000
Replacement cost 1,100,000

What amount of gain should Ocean report as a separate component of income before extraordinary items?

A. $1,030,000
B. $780,000
C. $730,000
D. $0

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. $730,000 gain reported as a separate component of income before extraordinary items.

Replacement cost	$1,100,000
Less: Deductible clause	(50,000)
Subtotal - insurance proceeds	1,050,000
Less: Costs to dismantle old warehouse	(20,000)
Subtotal	1,030,000
Less: Current carrying amount	(300,000)
Gain on insurance settlement of casualty	$ 730,000

QUESTION 111
Which of the following should be reported as a prior period adjustment?

	Change in estimated lives of depreciable assets	*Change from unaccepted principle to accepted principle*
A.	Yes	Yes
B.	No	Yes
C.	Yes	No
D.	No	No

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. No - Yes
Change in estimated lives of depreciable assets is a "change in estimate." They affect only current and future periods (not "prior periods," not retained earnings).
Change from unaccepted principle to accepted principle is an example of an error of a prior period that should be reported as a "prior period adjustment."

QUESTION 112
On January 1, 20X1, Pell Corp. purchased a machine having an estimated useful life of 10 years and no salvage. The machine was depreciated by the double declining balance method for both financial statement and income tax reporting. On January 1, 20X6, Pell changed to the straight-line method for financial statement reporting but not for income tax reporting. Accumulated depreciation at December 31, 20X5, was $560,000. If the straight-line method had been used, the accumulated depreciation at December 31, 20X5, would have been $420,000. Pell's enacted income tax rate for 20X6 and thereafter is 30%. The amount shown in the 20X6 income statement for the cumulative effect of changing to the straight-line method should be:

A. $98,000 debit.
B. $98,000 credit.
C. $140,000 credit.
D. $0.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. A change in the method of depreciation is now considered to be both a change in method and a change in estimate. These changes should be accounted for as changes in estimate and handled prospectively. The new depreciation method should be used as of the beginning of the year of change and should start with the current book value of the underlying asset. No retroactive or retrospective calculations should be made, and no adjustment should be made to retained earnings.
And, certainly, the cumulative effect should not be reflected on the income statement any more. Choices
"a", "b", and "c" are incorrect, per the above Explanation: .

QUESTION 113
Is the cumulative effect of an inventory pricing change on prior years earnings reported on the financial statements for

	LIFO to weighted average?	Weighed average to LIFO?
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. The cumulative effect of a change in accounting principle is now reported as an adjustment to beginning retained earnings when it is considered practicable to calculate the cumulative effect. When making a change to LIFO, it is generally considered impracticable to calculate the cumulative effect of the change (in most cases, data on the historical LIFO layers in not available). In a change to LIFO, the beginning inventory dollar amount becomes the first LIFO layer. No cumulative effect adjustment is made. The change is accounted for prospectively.
A change from LIFO to weighted average, there is no such impracticability. The cumulative effect is computed and the change is handled retrospectively. Choices
"a", "c", and "d" are incorrect, per the above Explanation: .

QUESTION 114
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 115
During 20X5, Dale Corp. made the following accounting changes:

Method used in 20X4	Method used in 20X5	After-tax effect
Sum-of-the-years' digits depreciation	Straight-line depreciation	$30,000
Last-in, first-out for inventory valuation	First-in, first-out for inventory valuation	98,000

What amount should be shown in the 20X5 retained earnings statement as an adjustment to the beginning balance?

A. $0
B. $30,000
C. $98,000
D. $128,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. $98,000.
The cumulative effect of a change in accounting principle is now shown on the retained earnings statement as an adjustment to the beginning balance of retained earnings, assuming that the cumulative effect can be calculated. A change from LIFO to FIFO for inventory valuation (costing) is a change in accounting principle.
An exception is made however, for a change in depreciation method, since a change in depreciation method is no longer considered to be a change in accounting principle. A change in depreciation method is now considered to be both a change in principle and a change in estimate. These changes should now be accounted for as a change in estimate and handled prospectively. The new depreciation method should be used as of the beginning of the year of change and should start with the current book value of the underlying asset. No retroactive or retrospective calculations should be made, and no adjustment should be made to retained earnings. Choices "a", "b", and "d" are incorrect, per the above Explanation: .

QUESTION 116
Earnings per share data should be reported on the income statement for:

Extraordinary items	Income before extraordinary items
Yes	No
Yes	Yes
No	Yes
No	No

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Yes - Yes.
Both the "extraordinary items" and "income before extraordinary items" should be shown with an earnings per share number on the income statement.

QUESTION 117
The effect of a change in accounting principle that is inseparable from the effect of a change in accounting estimate should be reported:

A. By restating the financial statements of all prior periods presented.
B. As a correction of an error.
C. As a component of income from continuing operations, in the period of change and future periods if the change affects both.
D. As a separate disclosure after income from continuing operations, in the period of change and future periods if the change affects both.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. A change in accounting principle that is inseparable from a change in accounting estimate should now be reported as a change in estimate and thus as a component of income from continuing operations, in the period of change and future periods if the change affects both.
Distinguishing between a change in accounting principle and a change in accounting estimate is sometimes difficult. For example, a company may change from deferring and amortizing a cost to recording it as an expense when incurred because future benefits of the cost have become doubtful. The new accounting method is adopted, therefore, in partial or complete recognition of the change in estimated future benefits. The effect of the change in principle is inseparable from the effect of the change in estimate. Changes of this type are often related to the continuing process of obtaining additional information and revising estimates and are therefore considered as changes in estimates.
Choice "a" is incorrect. Restating the financial statements of all prior periods would be done in the case of prior period adjustments (corrections of errors), changes in accounting principle (retrospective application), and changes in accounting entity (retrospective application).
Choice "b" is incorrect. Correction of an error would be treated as a prior period adjustment.
Choice "d" is incorrect. Separate disclosure after income from continuing operations would be done in the case of extraordinary items or discontinued operations. However, this disclosure would not be made "in the period of change and future periods if the change affects both" but only in the period of the extraordinary item or discontinued operation.

QUESTION 118
In single period statements, which of the following should not be reflected as an adjustment to the opening balance of retained earnings?

A. Effect of a failure to provide for uncollectible accounts in the previous period.
B. Effect of a decrease in the estimated useful life of depreciable equipment.
C. Cumulative effect of a change from the percentage of completion to the completed contract method of accounting for long-term construction projects.
D. Cumulative effect of a change from LIFO to FIFO in valuing merchandise inventory.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. A change in the estimated useful life of a depreciable asset is a change in estimate handled prospectively. No adjustment to retained earnings is necessary.
Choice "a" is incorrect. The correction of a failure to provide for uncollectible accounts is considered to be a correction of an error. The opening balance of retained earnings would be adjusted to correct the error. Choice "c" is incorrect. This change is a change in accounting principle and is handled retrospectively.
With retrospective application, the opening balance of retained earnings would be adjusted to reflect the cumulative effect of the changes. Choice "d" is incorrect. This change is a change in accounting principle and is handled retrospectively.
With retrospective application, the opening balance of retained earnings would be adjusted to reflect the cumulative effect of the changes.

QUESTION 119
In 1990, Brighton Co. changed from the individual item approach to the aggregate approach in applying the lower of FIFO cost or market to inventories. The cumulative effect of this change should be reported in Brighton's financial statements as a:

A. Retrospective adjustment on the retained earnings statement, with separate disclosure.
B. Component of income from continuing operations, with separate disclosure.
C. Component of income from continuing operations, without separate disclosure.
D. Component of income after continuing operations, with separate disclosure.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. A change in the composition of the elements of cost such as changing from the individual item approach to the aggregate approach in applying the lower of FIFO cost or market to inventories (LCM is covered in F4) is an example of a change in accounting principle. The cumulative effect of the change in accounting principle should now be shown on the retained earnings statement as an adjustment to the beginning balance of retained earnings, in what is called retrospective application.
Choices "b", "c", and "d" are incorrect. The cumulative effect of a change in accounting principle is now reported on the retained earnings statement, not the income statement. Most of these types of changes (changes in accounting principle) used to be reported on the income statement. SFAS No. 154 changed that.

QUESTION 120
While preparing its 1991 financial statements, Dek Corp. discovered computational errors in its 1990 and 1989 depreciation expense. These errors resulted in overstatement of each year's income by $25,000, net of income taxes. The following amounts were reported in the previously issued financial statements:

	1990	*1989*
Retained earnings, 1/1	$700,000	$500,000
Net income	$150,000	$200,000
Retained earnings, 12/31	$850,000	$700,000

Dek's 1991 net income is correctly reported at $180,000. Which of the following amounts should be reported as prior period adjustments and net income in Dek's 1991 and 1990 comparative financial statements?

	Year	Prior Period Adjustment	Net Income
A.	1990	-	$150,000
	1991	($50,000)	$180,000
B.	1990	($50,000)	$150,000
	1991	-	$180,000
C.	1990	($25,000)	$125,000
	1991	-	$180,000
D.	1990	-	$125,000
	1991	-	$180,000

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. 1990 ($25,000) $125,000
1991 -- 180,000

Because these are comparative financial statements, prior period adjustments require retroactive treatment for the years presented. Because 1989 is not presented, the 1989 correction is shown as a prior period adjustment of $25,000 to retained earnings statement of 1990.

QUESTION 121
Tack, Inc. reported a retained earnings balance of $150,000 at December 31,1990. In June 1991, Tack discovered that merchandise costing $40,000 had not been included in inventory in its 1990 financial statements. Tack has a 30% tax rate. What amount should Tack report as adjusted beginning retained earnings in its statement of retained earnings at December 31, 1991?

A. $190,000
B. $178,000
C. $150,000
D. $122,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Retained earnings as previously reported 12-31-90		$150,000
Add: Adjustment for inventory not recorded	$40,000	
Less applicable tax (30% × 40,000)	(12,000)	28,000
As restated		$178,000 **B**

Choice "b" is correct. $178,000.

QUESTION 122
On January 2, 1991, Air, Inc. agreed to pay its former president $300,000 under a deferred compensation arrangement. Air should have recorded this expense in 1990 but did not do so. Air's reported income tax expense would have been $70,000 lower in 1990 had it properly accrued this deferred compensation in its December 31,1991, financial statements, Air should adjust the beginning balance of its retained earnings by a:

A. $230,000 credit.
B. $230,000 debit.
C. $300,000 credit.
D. $370,000 debit.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Less adjustments (shown "net of tax"):	
Deferred compensation	$ 300,000
Less: Applicable tax	(70,000)
Debit to subtract	$ 230,000 B

Choice "b" is correct. $230,000 debit.

QUESTION 123 On August 31, 1992, Harvey Co. decided to change from the FIFO periodic inventory system to the weighted average periodic inventory system. Harvey is on a calendar year basis. The cumulative effect of the change is determined:

A. As of January 1, 1992.
B. As of August 31, 1992.
C. During the eight months ending August 31, 1992, by a weighted average of the purchases.
D. During 1992 by a weighted average of the purchases.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Rule: The cumulative effect of a change in accounting principle equals the difference between retained earnings at the beginning of period of the change and what retained earnings would have been if the change was applied to all affected prior periods.
Choice "a" is correct. As of January 1, 1992, the beginning of the year. This assumes that the company is not presenting comparative financial statements. If comparative financial statements are presented, then the adjustment is made to the beginning retained earnings of the earliest year presented.
Choice "b" is incorrect. The cumulative effect of the change is not determined as of the date the decision is made.
Choices "c" and "d" are incorrect. The cumulative effect of the change is not determined by a weighted average. (A far out distractor.)

QUESTION 124
Conn Co. reported a retained earnings balance of $400,000 at December 31, 1991. In August 1992, Conn determined that insurance premiums of $60,000 for the three-year period beginning January 1, 1991, had been paid and fully expensed in 1991. Conn has a 30% income tax rate. What amount should Conn report as adjusted beginning retained earnings in its 1992 statement of retained earnings?

A. $420,000
B. $428,000
C. $440,000
D. $442,000
Correct Answer: B

Section: (none)
Explanation

Explanation/Reference:
Explanation:

Beginning balance - RE 12-31-91	$400,000
Add: Prior period adjustment - Net of tax:	
$60,000 3-year insurance policy 1-1-91 to 1-1-94	
Expensed in 1991. 2/3 prepaid at	
1-1-92. ($60,000 × 2/3 = $40,000 × 70% net of tax)	28,000
Adjusted balance – RE 1-1-92	$428,000
	B

Choice "b" is correct. $428,000 net of tax.

QUESTION 125
Which of the following is true regarding the presentation of "comprehensive income."

	Must be shown on the face of the income statement	*Related tax effects for components must be disclosed*
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. No - Yes.
Comprehensive income may be shown on the face of a combined "statement of income and comprehensive income" a separate section below net income, or in:

1. Separate "statement of comprehensive income," or as a
2. Component of the "statement of changes of owners' equity."

The income tax expense or benefit allocated to components must be disclosed, either on the face of the statement or in notes to the statement. Choices "a", "b", and "d" are incorrect, per the above rules.

QUESTION 126
Reclassification adjustments must be shown in the financial statement that discloses comprehensive income:
A. To show what portion of comprehensive income is from the realization of current assets.

B. To show the tax effect of items of comprehensive income.
C. To avoid double counting in comprehensive income items, which are currently displayed in net income.
D. To avoid including transactions with shareholders in items of comprehensive income.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Reclassification entries may be necessary to avoid double counting an item previously reported as comprehensive income (i.e., unrealized gain), which are now reported as part of net income (i.e., realized gain). Choice "a" is incorrect. The classification of assets as current or non-current has no bearing on reporting comprehensive income.
Choice "b" is incorrect. All items of comprehensive income must be shown net of the related tax effects, but it is not done with reclassification adjustments.
Choice "d" is incorrect. Transactions with shareholders such as paying dividends and issuing capital stock are not included in comprehensive income, thus, reclassification adjustments are not necessary to exclude them.

QUESTION 127
Dean Co. acquired 100% of Morey Corp. prior to 1989. During 1989, the individual companies included in their financial statements the following:

	Dean	Morey
Officers' salaries	$ 75,000	$ 50,000
Officers' expenses	20,000	10,000
Loans to officers	125,000	50,000
Intercompany Sales	150,000	--

What amount should be reported as related party disclosures in the notes to Dean's 1989 consolidated financial statements?

A. $150,000
B. $155,000
C. $175,000
D. $330,000

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. The only related party transaction that would require disclosure (assuming that all amounts are material to the financial statements) would be the loans to officers since they are outside of the ordinary course of business. Choices "a", "b", and "d" are incorrect. Officers' salaries, officers' expenses and intercompany sales (between entities included in a consolidated set of financial statements) are all transactions in the ordinary course of business and generally would not require disclosure.

QUESTION 128
Wilson Corp. experienced a $50,000 decline in the market value of its inventory in the first quarter of its fiscal year. Wilson had expected this decline to reverse in the third quarter, and in fact, the third quarter recovery exceeded the previous decline by $10,000. Wilson's inventory did not experience any other declines in market value during the fiscal year. What amounts of loss and/or gain should Wilson report in its interim financial statements for the first and third quarters?

	First quarter	Third quarter
A.	$0	$0
B.	$0	$10,000 gain
C.	$50,000 loss	$50,000 gain
D.	$50,000 loss	$60,000 gain

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Temporary market declines in inventory need not be recognized at interim when a turn-around can reasonably be expected to occur before the end of the fiscal year.

QUESTION 129 During the second quarter of 1988, Buzz Company sold a piece of equipment at a $12,000 gain. What portion of the gain should Buzz report in its income statement for the second quarter of 1988?

A. $12,000
B. $6,000
C. $4,000
D. $0

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. $12,000.
Rule: The entire amount of an "extraordinary gain or loss" or an "unusual or infrequently occurring item," e.g., a gain or loss from sale of fixed assets, should be reported during the period (quarter) incurred. Choices "b", "c", and "d" are incorrect. The full gain should be reported in the second quarter when it occurred.

QUESTION 130
For interim financial reporting, the computation of a company's second quarter provision for income taxes uses an effective tax rate expected to be applicable for the full fiscal year. The effective tax rate should reflect anticipated:

	Foreign tax rates	Available tax planning alternatives
A.	No	Yes
B.	No	No
C.	Yes	No
D.	Yes	Yes

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Yes - Yes.
The effective income tax rates for operations for the full year should reflect anticipated foreign tax rates and available tax planning alternatives. In addition, the effect of other anticipated tax credits, capital gains rates, and foreign tax credits should be included.

QUESTION 131
An inventory loss from a permanent market decline of $360,000 occurred in May 1989. Cox Co. appropriately recorded this loss in May 1989 after its March 31, 1989 quarterly report was issued. What amount of inventory loss should be reported in Cox's quarterly income statement for the three months ended June 30, 1989?

A. $0
B. $90,000
C. $180,000
D. $360,000

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. $360,000 inventory loss reported for the quarter ended 6-30-89.
Rule: Inventory losses from "permanent market declines" are recognized in the interim period, incurred and later, if they "turn-around," are recognized as gains in a subsequent interim period only to the extent of previously reported losses.
Rule: "Temporary" market declines need not be recognized at interim when a "turn-around" can reasonably be expected to occur before the end of the fiscal year. Facts: This $360,000 inventory decline is permanent and the entire loss would be recognized in the quarter interim period incurred (6-30-89).

QUESTION 132
Advertising costs may be accrued or deferred to provide an appropriate expense in each period for:

Interim financial reporting	Year-end financial reporting
Yes	No
Yes	Yes
No	No
No	Yes

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Yes - Yes.
Advertising costs may be accrued or deferred to provide an appropriate expense in each period for both "interim" and "year-end" financial reporting.

QUESTION 133
A planned volume variance in the first quarter, which is expected to be absorbed by the end of the fiscal period, ordinarily should be deferred at the end of the first quarter if it is:

	Favorable	Unfavorable
A.	Yes	No
B.	No	Yes
C.	No	No
D.	Yes	Yes

A. Option A
B. Option B
C. Option C
D. Option D

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. Yes - Yes.
Rule: Volume variances that are planned or expected to be absorbed by the end of the year should be deferred at interim whether favorable or unfavorable.

QUESTION 134 Kell Corp.'s $95,000 net income for the quarter ended September 30, 1990, included the following aftertax items:

• A $60,000 extraordinary gain, realized on April 30, 1990, was allocated equally to the second, third, and fourth quarters of 1990.
• A $16,000 cumulative-effect loss resulting from a change in inventory valuation method was recognized on August 2, 1990.

In addition, Kell paid $48,000 on February 1, 1990, for 1990 calendar-year property taxes. Of this amount, $12,000 was allocated to the third quarter of 1990. For the quarter ended September 30, 1990, Kell should report net income of:

A. $91,000
B. $103,000C. $111,000
D. $115,000

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. $91,000 net income for the third quarter ended 9-30-90.
Rules: The entire amount of an "extraordinary" item should be reported during the period incurred.
A "cumulative effect" type accounting change is not included in the net income of the period of change; instead, the beginning of the year retained earnings is restated. Expenses, which benefit more than one interim period, such as property taxes, are allocated among the periods benefited.

Third quarter income as originally calculated	$95,000
Less: 1/3 of second quarter extraordinary gain	(20,000)
Subtotal	$75,000
Plus: Cumulative effect of accounting change	16,000
Corrected third quarter net income	$91,000

QUESTION 135
On June 30, 1991, Mill Corp. incurred a $100,000 net loss from disposal of a component of a business. Also, on June 30, 1991, Mill paid $40,000 for property taxes assessed for the calendar year 1991. What amount of the foregoing items should be included in the determination of Mill's net income or loss for the six-month interim period ended June 30, 1991?

A. $140,000
B. $120,000
C. $90,000
D. $70,000

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. $120,000 expense included in the determination of net income or loss for the sixmonth interim period ended June 30, 1991.

Rules:

The net loss on disposal of a component is recorded in the interim period incurred	$100,000
Property taxes should be allocated over the periods ($40,000 ÷ 2)	20,000
Expenses for six-month interim period	$120,000

QUESTION 136
On March 15, 1992, Krol Co. paid property taxes of $90,000 on its office building for the calendar year 1992. On April 1, 1992, Krol paid $150,000 for unanticipated repairs to its office equipment. The repairs will benefit operations for the remainder of 1992. What is the total amount of these expenses that Krol should include in its quarterly income statement for the three months ended June 30, 1992?

A. $172,500
B. $97,500C. $72,500
D. $37,500

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Rule: Actual and estimated expenditures benefiting all interim periods equally should be expensed ratably throughout the year.

		Quarterly
Annual property taxes	$90,000 ÷ 4 =	$22,500
Repairs which will benefit operations for 3 quarters remaining in year	150,000 ÷ 3 =	50,000
		$72,500 C

Choice "c" is correct. $72,500 total expense for the three months ended June 30, 1992.

QUESTION 137
An inventory loss from a market price decline occurred in the first quarter, and the decline was not expected to reverse during the fiscal year. However, in the third quarter the inventory's market price recovery exceeded the market decline that occurred in the first quarter. For interim financial reporting, the dollar amount of net inventory should:

A. Decrease in the first quarter by the amount of the market price decline and increase in the third quarter by the amount of the decrease in the first quarter.
B. Decrease in the first quarter by the amount of the market price decline and increase in the third quarter by the amount of the market price recovery.
C. Decrease in the first quarter by the amount of the market price decline and not be affected in the third quarter.
D. Not be affected in either the first quarter or the third quarter.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Market price declines should be recognized in the interim period in which decline is judged permanent and later, if they "turn around," are recognized as gains in subsequent periods only to the extent of previously reported losses.
Choice "b" is incorrect. Recovery should not cause an increase in inventory value above original cost.
Choice "c" is incorrect. The recovery should be recognized to the extent of the first quarter write down. Choice "d" is incorrect.

QUESTION 138
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 139
Hyde Corp. has three manufacturing divisions, each of which has been determined to be a reportable segment. In 1989, Clay division had sales of $3,000,000, which was 25% of Hyde's total sales, and had operating costs of $1,900,000, as reported to the CFO. In 1989, Hyde incurred operating costs of $500,000 that were not directly traceable to any of the divisions. In addition, Hyde incurred corporate interest expense of $300,000 in 1989. In reporting segment information, what amount should be shown as Clay's operating profit for 1989?

A. $875,000 B.
$900,000
C. $975,000
D. $1,100,000

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. $1,100,000 operating profit for clay.
Rule: Operating profit by segments is based on the measure of profit reported to the "chief operating decision maker." Allocations for general operating costs and interest, etc., should not be made solely for purposes of segment disclosures.

Sales	$3,000,000
Less operating costs	(1,900,000)
Sub total	$1,100,000

QUESTION 140 YIV, Inc. is a multidivisional corporation, which has both intersegment sales and sales to unaffiliated customers. YIV should report segment financial information for each division meeting which of the following criteria?

A. Segment operating profit or loss is 10% or more of consolidated profit or loss.
B. Segment operating profit or loss is 10% or more of combined operating profit or loss of all company segments.
C. Segment revenue is 10% or more of combined revenue of all the company segments.
D. Segment revenue is 10% or more of consolidated revenue.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Segment revenue is 10% or more of combined revenue of all the company segments. Rule:
To be significant enough to report on, a segment must be at least 10% of:

1. Combined revenues (whether intersegment or affiliated customers) or 2.
Operating profit (of all segments not having an operating loss), or
3. Identifiable assets.

Choice "a" is incorrect. Rule is 10% of "operating profit," not "consolidated profit."
Choice "b" is incorrect. Segments with "operating losses" are not combined with those having "operating profits" in determining a segment.
Choice "d" is incorrect. "Consolidated revenue" would not include "intersegment revenue." Rule is "combined revenue," not "consolidated revenue."

QUESTION 141
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. In its 1991 financial statements, Grum should disclose major customer data if sales to any single customer amount to at least:

A. $300,000
B. $1,500,000C. $4,000,000
D. $5,000,000

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. $5,000,000 (10% x $50,000,000 revenue). If revenue from a single external customer is 10% or more of total revenue, then the company should disclose this fact, the total amount of revenue from the customer, and the segment or segments reporting the revenues. The identity of the customer need not be disclosed.

QUESTION 142

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:

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

Which of these business segments are deemed to be reportable segments?

A. Ebon only.
B. Ebon and Fair only.
C. Ebon, Fair, and Gel only.
D. Ebon, Fair, Gel, and Hak.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 143
Chester Corp. was a development stage enterprise from its inception on September 1, 1987 to December 31, 1988. The following information was taken from Chester's accounting records for the above period:

Net sales	$1,350,000
Cost of sales	1,000,000
Selling, general, and administrative expenses	400,000
Research and development costs	300,000
Interest expense	100,000

For the period September 1, 1987 to December 31, 1988, what amount should Chester report as net loss?

A. $ 50,000
B. $150,000C. $350,000
D. $450,000

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. $450,000 net loss for the period Sept. 1, 1987 to DeC. 31, 1988.

Rule: "Development stage enterprises" present their FS in accordance with GAAP and make additional disclosures such as: cumulative net losses, cumulative deficit, cumulative sales and expenses.

Net sales	$1,350,000
Cost of sales	(1,000,000)
Selling, general and administrative exp.	(400,000)
Research & development costs (100% expense)	(300,000)
Interest expense	(100,000)
Net loss (9/1/87 to 12/31/88)	(450,000)

QUESTION 144 Deficits accumulated during the development stage of a company should be:

A. Reported as organization costs.
B. Reported as a part of stockholders' equity.
C. Capitalized and written off in the first year of principal operations.
D. Capitalized and amortized over a five year period beginning when principal operations commence.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Deficits accumulated during the development stage of a company should be reported as a part of stockholders' equity.
Rule: Development stage enterprises should present FS in accordance with GAAP and make additional disclosures such as: cumulative net losses, cumulative deficit (as part of equity), cumulative sales & expenses (part of I/S), cumulative statement of cash flows and supplementary "shareholders equity." Choices "a", "c", and "d" are incorrect, per the rule above.

QUESTION 145 Financial reporting by a development stage enterprise differs from financial reporting for an established operating enterprise in regard to footnote disclosures:

A. Only.
B. And expense recognition principles only.
C. And revenue recognition principles only.
D. And revenue and expense recognition principles.

Correct Answer: A
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Financial reporting by a development stage enterprise differs from financial reporting for an established operating enterprise in regard to (more extensive) footnote disclosures only.
Choices "b", "c", and "d" are incorrect. Revenue and expense recognition principles are the same.
Rule: Development stage enterprises should present financial statements in accordance with GAAP and make additional disclosures such as: cumulative net losses, cumulative deficit (as part of equity), cumulative sales and expenses (as part of the income statement), cumulative statement of cash flows and supplementary "shareholders equity."

QUESTION 146 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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 147
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 manufactures heavy equipment to customer specifications on a contract basis. On the basis that it is preferable, accounting for these long-term contracts was switched from the completed-contract method to the percentage-ofcompletion method.

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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Switching from the completed-contract method of accounting to the percentage-ofcompletion method is a "change in accounting principle."

QUESTION 148
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 manufactures heavy equipment to customer specifications on a contract basis. On the basis that it is preferable, accounting for these long-term contracts was switched from the completed-contract method to the percentage-ofcompletion method.

List B (Select one)

A. Cumulative effect approach.
B. Retroactive or retrospective restatement approach.

C. Prospective approach.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "B" is correct. Changes in accounting principle are handled "retrospectively." Beginning retained earnings of the earliest year presented is adjusted for the cumulative effect of the change and all prior year financial statements are restated.

QUESTION 149
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
As a result of a production breakthrough, Quo determined that manufacturing equipment previously depreciated over 15 years should be depreciated over 20 years. 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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "b" is correct. Change in lives of fixed assets is a change in accounting estimate.

QUESTION 150
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
As a result of a production breakthrough, Quo determined that manufacturing equipment previously depreciated over 15 years should be depreciated over 20 years. List

B (Select one)

A. Cumulative effect approach.
B. Retroactive or retrospective restatement approach.
C. Prospective approach.

Correct Answer: C

Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "C" is correct. This affects only the prospective (current and subsequent) periods - not prior periods, not retained earnings.

QUESTION 151
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 152
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
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

B (Select one)

A. Cumulative effect approach.
B. Retroactive or retrospective restatement approach.
C. Prospective approach.

Correct Answer: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "C" is correct. This affects only the prospective (current and subsequent) periods - not prior periods, not retained earnings.

QUESTION 153
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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

QUESTION 154
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 changed from LIFO to FIFO to account for its finished goods inventory.

List B (Select one)
A. Cumulative effect approach.
B. Retroactive or retrospective restatement approach.
C. Prospective approach.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "B" is correct. A change in accounting principle should be shown in the retained earnings statement of the earliest year presented as an adjustment of the beginning balance. All prior year financial statements are recast.

QUESTION 155
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 FIFO to average cost to account for its raw materials and work in process inventories. 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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "a" is correct. Change in inventory pricing method from FIFO to average cost is a change in accounting principle.

QUESTION 156
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 changed from FIFO to average cost to account for its raw materials and work in process inventories. List

B (Select one)

A. Cumulative effect approach.
B. Retroactive or retrospective restatement approach.
C. Prospective approach.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "B" is correct. A change in accounting principle should be shown in the retained earnings statement of the earliest year presented as an adjustment of the beginning balance. All prior year financial statements are recast.

QUESTION 157
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 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

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: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Change from the cash method to the accrual method is a correction of an error in previously presented financial statements.

QUESTION 158
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
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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 159
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
During 1993, Quo determined that an insurance premium paid and entirely expensed in 1992 was for the period January 1, 1992, through January 1, 1994. 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: C
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "c" is correct. Expensing insurance premiums when paid (rather than allocating them to the periods benefited) is a correction of an error in previously presented financial statements.

QUESTION 160
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
During 1993, Quo determined that an insurance premium paid and entirely expensed in 1992 was for the period January 1, 1992, through January 1, 1994. List

B (Select one)

A. Cumulative effect approach.
B. Retroactive or retrospective restatement approach.
C. Prospective approach.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:

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.

QUESTION 161
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.
During 1993, Quo increased its investment in Worth, Inc. from a 10% interest, purchased in 1992, to 30%, and acquired a seat on Worth's board of directors. As a result of its increased investment, Quo changed its method of accounting for investment in Worth, Inc. from the cost method to the equity method.

List A

A. Change in accounting principle.
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: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. A change from the cost method (less than 20% ownership) to the equity method (20% or more ownership or a Board seat or other significant influence) of accounting for investment in an investee is neither an accounting change nor an accounting error. If it is not an accounting change, it cannot be a change in accounting principle or a change in accounting estimate since those two types of changes are both accounting changes.

There is a considerable amount of controversy on this particular answer. Some people think that this change is a change in accounting principle (something certainly changed, but was it the accounting principle?), and others think it is a change in accounting entity (which is not one of the available answers; anyway, did the accounting entity actually change or is it the same entity accounted for differently?). Under SFAS No. 154, a change in accounting principle is treated retrospectively and a change in accounting entity is treated retrospectively.

This kind of change (cost to equity) has never been specifically identified in any accounting literature as either a change in accounting principle or a change in accounting entity. The words "cost method" were never mentioned in APB 20 (other than the full cost method for oil & gas companies, which is an entirely different subject), nor was it mentioned in SFAS No. 154. It was, however, discussed in APB 18 (the pronouncement for the equity method) in Paragraph 19m (bold added): "An investment in common stock of an investee that was previously accounted for on other than the equity method may become qualified for use of the equity method by an increase in the level of ownership described in paragraph 17 (i.e., acquisition of additional voting stock by the investor, acquisition or retirement of voting stock by the investee, or other transactions). When an investment qualifies for use of the equity method, the investor should adopt the equity method of accounting. The investment, results of operations (current and prior
periods presented), and retained earnings of the investor should be adjusted retroactively in a manner consistent with the accounting for a step-by-step acquisition of a subsidiary."

What does all this mean? It means that, when there is a change in the percentage of ownership that changes accounting from the cost method to the equity method, the change is treated retroactively (just like changes in accounting entity used to be treated, although they are now treated retrospectively). It does not say that the change is a change in accounting principle or anything else. Nothing in SFAS No.154 changed this treatment. So all this still makes Choice "d" correct. This whole issue might easily be considered to be splitting hairs, at the very least. Some questions on the CPA exam are just that way. Most are not.

QUESTION 162
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.

During 1993, Quo increased its investment in Worth, Inc. from a 10% interest, purchased in 1992, to 30%, and acquired a seat on Worth's board of directors. As a result of its increased investment, Quo changed its method of accounting for investment in Worth, Inc. from the cost method to the equity method.

List B

A. Cumulative effect approach.
B. Retroactive or retrospective restatement approach.
C. Prospective approach.

Correct Answer: B
Section: (none)
Explanation

Explanation/Reference:
Explanation:
Choice "B" is correct. The equity method of accounting is applied retroactively when the investor has acquired 20% ownership. Prior to acquiring the ability to influence the investee, the cost method is proper. The retroactive restatement approach does not mean that this change is the correction of an error (which is now treated retroactively), a change in accounting principle (which is now treated retrospectively), or a change in accounting entity (which is now treated retrospectively). It just means that retroactive restatement is the proper treatment.

QUESTION 163
According to the FASB conceptual framework, what does the concept of reliability in financial reporting include?

A. Effectiveness.
B. Certainty.
C. Precision.

D. Neutrality.

Correct Answer: D
Section: (none)
Explanation

Explanation/Reference:
Explanation:

Choice "d" is correct. The concept of reliability in financial reporting includes; neutrality, representational faithfulness and verifiability. Choices "a", "b", and "c" are incorrect, per the above.