# FINANCIAL-ACCOUNTING-AND-REPORTING Q&As

Certified Public Accountant (Financial Accounting & Reporting)

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**QUESTION 1**

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

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

**QUESTION 2**

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

A. $176,000

B. $160,000

C. $154,000

D. $146,000

Correct Answer: D

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

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

**QUESTION 3**

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

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 4**

On January 2, 1993, Quo, Inc. hired Reed to be its controller. During the year, Reed, working closely with

Quo\\'s president and outside accountants, made changes in accounting policies, corrected several errors

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

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

This question represents one of Quo\\'s transactions. List 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

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 5**

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

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."