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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 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

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

QUESTION 2

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

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 3

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 and II

B.

I and IV

C.

II and III

D.

III and IV

Correct Answer: D

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 4

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

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 5

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

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.

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