

FINANCIAL-ACCOUNTING-AND- REPORTING^{Q&As}

Certified Public Accountant (Financial Accounting & Reporting)

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QUESTION 1

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

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 in 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 be depreciated over the remaining period.

QUESTION 2

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?

	<i>Cumulative effect of a change in accounting principle</i>	<i>Pro forma effects of retroactive application of new depletion base</i>
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."

QUESTION 3

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 4

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

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 5

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. \$1,190,000
- C. \$1,400,000
- D. \$1,700,000

Correct Answer: B

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 $\times 70%$ (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.

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