

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

Certified Public Accountant (Financial Accounting & Reporting)

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QUESTION 1

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

Infrequent net gains not considered extraordinary include:

Gain on disposal of a component of a business Loss on abandonment of equipment Total

\$260,000 <u>(90,000)</u> \$170,000

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

QUESTION 2

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 3

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

- A. After cumulative effect of accounting changes and before discontinued operations of a segment of a business.
- B. After cumulative effect of accounting changes and after discontinued operations of a segment of a business.
- C. Before cumulative effect of accounting changes and before discontinued operations of a segment of a business.
- D. After discontinued operations of a segment of a business.

Correct Answer: D

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

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

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

QUESTION 4

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

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)

Adjusted balance - RE 1-1-92 \$428,000

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

QUESTION 5

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

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 6

Terra Co.\\'s total revenues from its three operating segments were as follows: Which operating segment(s) is (are) deemed to be reportable segments?



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

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

Correct Answer: D

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 7

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. \$280,000

C. \$420,000

D. \$700,000

Correct Answer: C

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 8

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

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 9

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



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 10

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\//hich	of tha	following	statements i	e incorroc	t rogarding t	ha innute	that can	ho used to	magaira	fair value	2
VVIIICALI	(J) II IC	10,110,100,1110,1	SIGIETTETTS	5 1111/011/01/01	i i c ualullu i	115 1111111111	ווומו עמוו	NE 09E0 1	, ,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,,	iali 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.

В.

I, II, IV.

C.

II, III, IV.

D.

I, II, III, IV.

Correct Answer: C

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 11

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. \$1,500,000

C. \$4,000,000

D. \$5,000,000

Correct Answer: D

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 12

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

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 13

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



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 14

Taft Corp. discloses supplemental industry segment information. The following information is available for 1992: Additional 1992 expenses, not included above, are as follows:

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

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

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 Less traceable operating expenses Segment C operating profit \$12,000 (7,000) \$ 5,000

QUESTION 15



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

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: .

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