FINANCIAL-ACCOUNTING-AND-REPORTING Q&As

Certified Public Accountant (Financial Accounting & Reporting)

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QUESTION 1

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

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 2

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

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 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 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

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 4

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

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 5

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

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 and 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.