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 B represents the general accounting treatment

required for these transactions. These treatments are:

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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.

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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.

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Prospective approach - Report 1993 and future financial statements on the new basis but do not restate 1992 financial statements.

Item to Be Answered

Quo changed from FIFO to average cost to account for its raw materials and work in process inventories.

List B (Select one)

A. Cumulative effect approach.

B. Retroactive or retrospective restatement approach.

C. Prospective approach.

Correct Answer: B

Choice "B" is correct. A change in accounting principle should be shown in the retained earnings statement of the earliest year presented as an adjustment of the beginning balance. All prior year financial statements are recast.

QUESTION 2

According to the FASB conceptual framework, which of the following attributes would not be used to measure inventory?

A. Historical cost.

B. Replacement cost.

C. Net realizable value.

D. Present value of future cash flows.

Correct Answer: D

Choice "d" is correct. The present value of future cash flows is used to measure long-term receivables or payables, not inventory, because inventory is a short-term asset, which has more immediate cash flows.

SFAC 5 para. 67 Choice "a" is incorrect. Historical cost can be used to measure inventory because it is a relevant and reliable measurement attribute of current assets such as inventory. Choice "b" is incorrect. Replacement (or current) cost can be used to measure inventory because it is a relevant and reliable measurement attribute of current assets such as inventory. Choice "c" is incorrect. Net realizable value can be used to measure inventory because it is a relevant and reliable measurement attribute of current assets such as inventory.

QUESTION 3

Due to a decline in market price in the second quarter, Petal Co. incurred an inventory loss. The market price is expected to return to previous levels by the end of the year. At the end of the year the decline had not reversed. When should the loss be reported in Petal\\'s interim income statements?

A. Ratably over the second, third, and forth [sic] quarters.

B. Ratably over the third and fourth quarters.

C. In the second quarter only.

D. In the fourth quarter only.

Correct Answer: D

Choice "d" is correct. When the loss is probable and estimable, the expected loss must be recorded in full.

This loss becomes such at the end of the fourth quarter. Therefore, the inventory must be valued on the

year-end at the lower of cost or market, recognizing the loss at that time.

Choice "a" is incorrect. Expected losses must be recorded in full when the loss is probable and estimable

and not ratably over several quarters. Choice "b" is incorrect. Expected losses must be recorded in full

when the loss is probable and estimable and not ratably over several quarters. Choice "c" is incorrect.

Since the loss is not probable at the end of the second quarter, no amount should be recognized at that

time.

QUESTION 4

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. Cott Co.\\'s four business segments have revenues and identifiable assets expressed as percentages of Cott\\'s total revenues and total assets as follows: Which of these business segments are deemed to be reportable segments?

	Revenues	Assets
Ebon	64%	66%
Fair	14%	18%
Gel	14%	4%
Hak	8%	12%
	100%	100%

A. Ebon only.

B. Ebon and Fair only.

C. Ebon, Fair, and Gel only.

D. Ebon, Fair, Gel, and Hak.

Correct Answer: D

Rule: A segment must be at least 10% of:

1.

Combined revenues (whether intersegment or unaffiliated customers), or

2.

Operating income (of all segments not having an operating loss), or

3.

Identifiable assets.

Choice "d" is correct. Ebon, Fair, Gel, and Hak, since all four companies meet at least one of the criteria.

QUESTION 5

At December 31, 1998, Off-Line Co. changed its method of accounting for demo costs from writing off the costs over two years to expensing the costs immediately. Off-Line made the change in recognition of an increasing number of demos placed with customers that did not result in sales. Off-Line had deferred demo costs of $500,000 at December 31, 1997, $300,000 of which were to be written off in 1998 and the remainder in 1999. Off-Line\\'s income tax rate is 30%. In its 1998 financial statements, what amount should Off-Line report as cumulative effect of change in accounting principle?

A. $0

B. $200,000

C. $350,000

D. $500,000

Correct Answer: A

Choice "a" is correct. When a change in accounting principle is considered inseparable from a change in estimate, the change is handled as a change in estimate - prospectively. No cumulative effect adjustment is made.

Choices "b", "c", and "d" are incorrect since no cumulative effect adjustment is made.