FINANCIAL-ACCOUNTING-AND-REPORTING Q&As

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QUESTION 1

Which of the following information should be included in Melay, Inc.\\'s 1992 summary of significant accounting policies?

A. Property, plant, and equipment is recorded at cost with depreciation computed principally by the straight-line method.

B. During 1992, the Delay component was sold.

C. Business segment 1992 sales are Alay $1M, Belay $2M, and Celay $3M.

D. Future common share dividends are expected to approximate 60% of earnings.

Correct Answer: A

Choice "a" is correct. Computing depreciation principally by the straight-line method is a GAAP method of depreciation that should be described in the "summary of significant accounting policies." Choice "b" is incorrect. Disclosing the sale of a component of a business is required (and is covered in the lecture on "discontinued operations" in the F1 class) but is not a "significant accounting policy." Choice "c" is incorrect. Disclosing "sales" of segments is required, but is not a "significant accounting policy." Choice "d" is incorrect. "Estimates of future common share dividends" are not appropriate disclosures for the financial statements. They might be appropriate for the "presidents letter to shareholders."

QUESTION 2

According to the FASB conceptual framework, comprehensive income includes which of the following?

	Loss on discontinued operations	Investments by owners
A.	Yes	Yes
B.	Yes	No
C.	No	Yes
D.	No	No

A. Option A

B. Option B

C. Option C

D. Option D

Correct Answer: B

Choice "b" is correct. Comprehensive income is the change in equity of a business during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity except those resulting from investments by owners and distributions to owners. SFAC 6 para 70.

QUESTION 3

Financial reporting by a development stage enterprise differs from financial reporting for an established operating enterprise in regard to footnote disclosures:

A. Only.

B. And expense recognition principles only.

C. And revenue recognition principles only.

D. And revenue and expense recognition principles.

Correct Answer: A

Choice "a" is correct. Financial reporting by a development stage enterprise differs from financial reporting

for an established operating enterprise in regard to (more extensive) footnote disclosures only.

Choices "b", "c", and "d" are incorrect. Revenue and expense recognition principles are the same.

Rule: Development stage enterprises should present financial statements in accordance with GAAP and

make additional disclosures such as: cumulative net losses, cumulative deficit (as part of equity),

cumulative sales and expenses (as part of the income statement), cumulative statement of cash flows and

supplementary "shareholders equity."

QUESTION 4

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: .

QUESTION 5

On June 30, 1991, Mill Corp. incurred a $100,000 net loss from disposal of a component of a business. Also, on June 30, 1991, Mill paid $40,000 for property taxes assessed for the calendar year 1991. What amount of the foregoing items should be included in the determination of Mill\\'s net income or loss for the six-month interim period ended June 30, 1991?

A. $140,000

B. $120,000

C. $90,000

D. $70,000

Correct Answer: B

Choice "b" is correct. $120,000 expense included in the determination of net income or loss for the sixmonth interim period ended June 30, 1991.

Rules:

The net loss on disposal of a component is recorded in the interim period incurred	$100,000
Property taxes should be allocated over the periods ($40,000 ÷ 2)	20,000
Expenses for six-month interim period	$120,000

QUESTION 6

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 7

Reclassification adjustments must be shown in the financial statement that discloses comprehensive income:

A. To show what portion of comprehensive income is from the realization of current assets.

B. To show the tax effect of items of comprehensive income.

C. To avoid double counting in comprehensive income items, which are currently displayed in net income.

D. To avoid including transactions with shareholders in items of comprehensive income.

Correct Answer: C

Choice "c" is correct. Reclassification entries may be necessary to avoid double counting an item previously reported as comprehensive income (i.e., unrealized gain), which are now reported as part of net income (i.e., realized gain). Choice "a" is incorrect. The classification of assets as current or non-current has no bearing on reporting comprehensive income. Choice "b" is incorrect. All items of comprehensive income must be shown net of the related tax effects, but it is not done with reclassification adjustments. Choice "d" is incorrect. Transactions with shareholders such as paying dividends and issuing capital stock are not included in comprehensive income, thus, reclassification adjustments are not necessary to exclude them.

QUESTION 8

The summary of significant accounting policies should disclose the:

A. Maturity dates of noncurrent debts.

B. Terms for convertible debt to be exchanged for common stock.

C. Concentration of credit risk of all financial instruments by geographical region.

D. Criteria for determining which investments are treated as cash equivalents.

Correct Answer: D

Choice "d" is correct. The criteria for determining which investments are treated as cash equivalents would be part of the summary of significant accounting policies. Choice "a" is incorrect. The maturity dates of noncurrent debts are required disclosures, but are not a part of the summary of significant accounting policies. Choice "b" is incorrect. The terms for convertible debt to be exchanged for common stock are not accounting policies; they would be disclosed separately. Choice "c" is incorrect. The concentration of credit risk of all financial instruments by geographic region may be a required segment disclosure, especially for financial institutions. However, it would not be a part of the summary of significant accounting policies.

QUESTION 9

Which of the following statements is incorrect regarding the inputs that can be used to measure fair 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.

B.

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 10

According to the FASB conceptual framework, the quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called:

A. Feedback value.

B. Predictive value.

C. Representational faithfulness.

D. Reliability.

Correct Answer: B

Choice "b" is correct. The quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called predictive value. Forecasting is predicting. Choice "a" is incorrect. The quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called predictive value, not feedback value. Feedback value enables decision makers to confirm prior expectations or to adjust or correct the decisions made previously. Choice "c" is incorrect. The quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called predictive value, not representational faithfulness. Representational faithfulness is the agreement between financial reporting and the resources or events represented. Choice "d" is incorrect. The quality of information that helps users increase the likelihood of correctly forecasting the outcome of past or present events is called predictive value, not reliability. Reliability is the combination of neutrality, representational faithfulness, and verifiability.

QUESTION 11

Belle Co. determined after four years that the estimated useful life of its labeling machine should be 10 years rather than 12 years. The machine originally cost $46,000 and had an estimated salvage value of $1,000. Belle uses straight-line depreciation. What amount should Belle report as depreciation expense for the current year?

A. $3,200

B. $3,750

C. $4,500

D. $5,000

Correct Answer: D

Choice "d" is correct. A change in estimated useful life is a change in accounting estimate, and is therefore accounted for prospectively. The revised useful life should be used as of the beginning of the year of the change and should be applied to the current book value of the fixed asset. The first step in determining the depreciation expense in the year of the change in estimate is to determine the book value of the labeling machine at the time of the change:

Original cost $46,000

-Accumulated depreciation 15,000 = [(46,000 - 1,000) / 12] *4 Current book value $31,000 This book value is then depreciated over the remaining life of the fixed asset based on the new estimated life. In this problem, the new estimated life is 10 years, four of which have already passed, so the asset must be depreciated over the remaining 6 years: ($31,000 - 1,000) / 6 = $5,000 Choice "a" is incorrect. This answer is incorrectly calculated by adding the salvage value to the current book value, and by using the entire 10 year revised estimated life. Salvage value should always be subtracted and the asset should only be depreciated over the remaining life of the asset. Choice "b" is incorrect. This is the annual depreciation before the change in estimated life ($46,000 -$1,000) / 12 = $3,750]. The depreciation after the change in estimate should be calculated as described above. Choice "c" is incorrect. This would have been the annual straight-line depreciation if the original useful life of the asset had been 10 years rather than 12 years. The change in estimated life is applied prospectively, as described above, not retrospectively.

QUESTION 12

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 13

An extraordinary gain should be reported as a direct increase to which of the following?

A. Net income.

B. Comprehensive income.

C. Income from continuing operations, net of tax.

D. Income from discontinued operations, net of tax.

Correct Answer: A

Choice "a" is correct. Extraordinary items are reported as a component of net income, after income from continuing operations and discontinued operations. Choice "b" is incorrect. An extraordinary gain (or loss) only indirectly affects comprehensive income as a component of net income. Choice "c" is incorrect. Extraordinary items are reported net of tax after income from continuing operations and discontinued operations. Choice "d" is incorrect. Extraordinary items are reported net of tax after income from continuing operations and discontinued operations.

QUESTION 14

On January 1, 1991, Brecon Co. installed cabinets to display its merchandise in customers\\' stores. Brecon expects to use these cabinets for five years. Brecon\\'s 1991 multi-step income statement should include:

A. One-fifth of the cabinet costs in cost of goods sold.

B. One-fifth of the cabinet costs in selling, general, and administrative expenses.

C. All of the cabinet costs in cost of goods sold.

D. All of the cabinet costs in selling, general, and administrative expenses.

Correct Answer: B

Choice "b" is correct. One-fifth of the cabinet costs (depreciation expense) should be included in selling, general, and administrative expenses for 1991. Choice "a" is incorrect. Merchandise display cabinets in stores relate to selling activities, not to the purchase cost of goods sold. Choices "c" and "d" are incorrect. Merchandise display cabinets are fixed assets whose cost should be allocated systematically over their five-year useful life.

QUESTION 15

If a company is not presenting comparative financial statements, the correction of an error in the financial statements of a prior period should be reported, net of applicable income taxes, in the current:

A. Retained earnings statement after net income but before dividends.

B. Retained earnings statement as an adjustment of the opening balance.

C. Income statement after income from continuing operations and before extraordinary items.

D. Income statement after income from continuing operations and after extraordinary items.

Correct Answer: B

Choice "b" is correct. The correction of an error in the financial statements of a prior period should be

reported, net of tax, in the current statement of retained earnings as an adjustment of the opening balance.

Choice "a" is incorrect. The adjustment is before net income, not after net income.

Choices "c" and "d" are incorrect. Corrections of errors of prior periods go to retained earnings and do not

affect the income statement.

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