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QUESTION 1

Thorpe Co.'s income statement for the year ended December 31, 1990, reported net income of \$74,100. The auditor raised questions about the following amounts that had been included in net income:

Unrealized loss on decline in market value of available-for-sale investments in stock	\$(5,400)
Gain on early retirement of bonds payable (net of \$11,000 tax effect)	22,000
Adjustment to profits of prior years for errors in depreciation (net of \$3,750 tax effect)	(7,500)
Loss from fire (net of \$7,000 tax effect)	(14,000)

The loss from the fire was an infrequent but not unusual occurrence in Thorpe's line of business. Thorpe's December 31, 1990, income statement should report net income of:

- A. \$65,000
- B. \$66,100
- C. \$81,600
- D. \$87,000

Correct Answer: D

Net income before adjustments

Net income before adjustments	\$74,100
Add: Unrealized loss in market value of available-for-sale investments in stock which should not have affected net income	5,400
Add: Correction of error of prior period which should not have affected net income	7,500
Net income after adjustments	<u>\$87,000</u>

Rule: Unrealized losses (or gains) resulting from changes in market value of available-for-sale investments should be reported as a component of other comprehensive income in shareholders' equity.

Unrealized gains and losses on investments held for trading would be included in net income.

Correction of errors of prior periods should be reported as an adjustment to beginning retained earnings, not as an item of net income.

Choice "d" is correct. \$87,000.

QUESTION 2

Hyde Corp. has three manufacturing divisions, each of which has been determined to be a reportable segment. In 1989, Clay division had sales of \$3,000,000, which was 25% of Hyde's total sales, and had operating costs of \$1,900,000, as reported to the CFO. In 1989, Hyde incurred operating costs of \$500,000 that were not directly traceable to any of the divisions. In addition, Hyde incurred corporate interest expense of \$300,000 in 1989. In reporting segment information, what amount should be shown as Clay's operating profit for 1989?

- A. \$875,000
- B. \$900,000
- C. \$975,000
- D. \$1,100,000

Correct Answer: D

Choice "d" is correct. \$1,100,000 operating profit for clay.

Rule: Operating profit by segments is based on the measure of profit reported to the "chief operating decision maker."

Allocations for general operating costs and interest, etc., should not be made solely for purposes of segment disclosures.

Sales	\$3,000,000
Less operating costs	<u>(1,900,000)</u>
Sub total	<u>\$1,100,000</u>

QUESTION 3

Opto Co. is a publicly-traded, consolidated enterprise reporting segment information. Which of the following items is a required enterprise-wide disclosure regarding external customers?

- A. The fact that transactions with a particular external customer constitute more than 10% of the total enterprise revenues.
- B. The identity of any external customer providing 10% or more of a particular operating segment's revenue.
- C. The identity of any external customer considered to be "major" by management.
- D. Information on major customers is not required in segment reporting.

Correct Answer: A

Choice "a" is correct. In order to conform to GAAP, financial statements for public business enterprises must report segment information about a company's major customers if that customer provides 10% or more of the combined revenue, internal and external, of all operating segments.

Choice "b" is incorrect. Revenue is 10% of ALL operating segments not "a particular" segment.

Choice "c" is incorrect. Disclosure is not at management's discretion.

Choice "d" is incorrect. Disclosure is required.

QUESTION 4

Dean Co. acquired 100% of Morey Corp. prior to 1989. During 1989, the individual companies included in their financial statements the following:

	<u>Dean</u>	<u>Morey</u>
Officers' salaries	\$ 75,000	\$ 50,000
Officers' expenses	20,000	10,000
Loans to officers	125,000	50,000
Intercompany Sales	150,000	--

What amount should be reported as related party disclosures in the notes to Dean's 1989 consolidated financial statements?

- A. \$150,000
- B. \$155,000
- C. \$175,000
- D. \$330,000

Correct Answer: C

Choice "c" is correct. The only related party transaction that would require disclosure (assuming that all amounts are material to the financial statements) would be the loans to officers since they are outside of the ordinary course of business. Choices "a", "b", and "d" are incorrect. Officers' salaries, officers' expenses and intercompany sales (between entities included in a consolidated set of financial statements) are all transactions in the ordinary course of business and generally would not require disclosure.

QUESTION 5

YIV, Inc. is a multidivisional corporation, which has both intersegment sales and sales to unaffiliated customers. YIV should report segment financial information for each division meeting which of the following criteria?

- A. Segment operating profit or loss is 10% or more of consolidated profit or loss.
- B. Segment operating profit or loss is 10% or more of combined operating profit or loss of all company segments.
- C. Segment revenue is 10% or more of combined revenue of all the company segments.
- D. Segment revenue is 10% or more of consolidated revenue.

Correct Answer: C

Choice "c" is correct. Segment revenue is 10% or more of combined revenue of all the company segments. Rule: To be significant enough to report on, a segment must be at least 10% of:

1.

Combined revenues (whether intersegment or affiliated customers) or

2.

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

3.

Identifiable assets.

Choice "a" is incorrect. Rule is 10% of "operating profit," not "consolidated profit."

Choice "b" is incorrect. Segments with "operating losses" are not combined with those having "operating profits" in determining a segment. Choice "d" is incorrect. "Consolidated revenue" would not include

"intersegment revenue." Rule is "combined revenue," not "consolidated revenue."

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