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Certified Public Accountant (Financial Accounting & Reporting)

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### QUESTION 1

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.

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### QUESTION 2

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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### QUESTION 3

APB Opinion No. 28, Interim Financial Reporting, concluded that interim financial reporting should be viewed primarily in which of the following ways?

- A. As useful only if activity is spread evenly throughout the year.



- B. As if the interim period were an annual accounting period.
- C. As reporting for an integral part of an annual period.
- D. As reporting under a comprehensive basis of accounting other than GAAP.

Correct Answer: C

Choice "c" is correct. Interim financial reporting should be viewed as reporting for an integral part of an annual period.

Choices "a", "b", and "d" are incorrect, per the above rule.

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#### QUESTION 4

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.

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#### QUESTION 5

Conceptually, interim financial statements can be described as emphasizing:

- A. Timeliness over reliability.
- B. Reliability over relevance.
- C. Relevance over comparability.
- D. Comparability over neutrality.



Correct Answer: A

Choice "a" is correct. Interim financial statements emphasize timeliness (an element of relevance) by providing financial information based on actual performance to date and estimates prior to year end. Information must be available when it is needed to be useful. Reliability is impeded by the extensive use of estimates; however, the lag until verifiability is obtained detracts from usefulness. SFAC 2 para. 56 Choice "b" is incorrect. Relevance (particularly timeliness) of information in interim financial statements is emphasized more than reliability. Reliability is impeded by the extensive use of estimates in interim data. Choice "c" is incorrect. Since comparability is a secondary quality of information, there should be no need to trade off comparability for relevance (a primary quality). Choice "d" is incorrect. Neutrality is an element of reliability (a primary quality of information). There should be NO need for a trade-off for comparability over neutrality.

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