

**WILEY CPA EXAM REVIEW**

# *Focus Notes*

**Financial Accounting and Reporting**

**F O U R T H E D I T I O N**

Less Antman

• *concepts*

• *problem-solving*

• *terms*

• *rules and criteria*



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## ***Preface***

This publication is a comprehensive, yet simplified study program. It provides a review of all the basic skills and concepts tested on the CPA exam, and teaches important strategies to take the exam faster and more accurately. This tool allows you to take control of the CPA exam.

This simplified and focused approach to studying for the CPA exam can be used:

- As a handy and convenient reference manual
- To solve exam questions
- To reinforce material being studied

Included is all of the information necessary to obtain a passing score on the CPA exam in a concise and easy-to-use format. Due to the wide variety of information covered on the exam, a number of techniques are included:

- Acronyms and mnemonics to help candidates learn and remember a variety of rules and checklists
  - Formulas and equations that simplify complex calculations required on the exam
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- Simplified outlines of key concepts without the details that encumber or distract from learning the essential elements
  - Techniques that can be applied to problem solving or essay writing, such as preparing a multiple-step income statement, determining who will prevail in a legal conflict, or developing an audit program
  - Pro forma statements, reports, and schedules that make it easy to prepare these items by simply filling in the blanks
  - Proven techniques to help you become a smarter, sharper, and more accurate test taker

This publication may also be useful to university students enrolled in Intermediate, Advanced and Cost Accounting, Auditing, Business Law, and Federal Income Tax classes.

Good Luck on the Exam,  
Less Antman, CPA

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### ***About the Author***

Less Antman, CPA has been preparing individuals for the CPA exam since 1979. For many years, he taught CPA review classes on a full-time basis for various programs, including *Mark's CPA Review Course and Kaplan CPA Review*. He currently operates his own CPA review program in the state of California, under the name *Antman CPA Review*, located in Arcadia, California. He has taught more than 5,000 totally live CPA review classes, more than any other CPA review instructor in the United States, and his written materials have been used in several different instructor-based CPA review programs.

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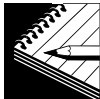


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# Objectives of Financial Reporting

Financial statements are designed to meet the objectives of financial reporting:

Balance Sheet	Direct Information	Financial Position
Statement of Earnings and Comprehensive Income	Direct Information	Entity Performance
Statement of Cash Flows	Direct Information	Entity Cash Flows
Financial Statements Taken As a Whole	Indirect Information	Management & Performance





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## Elements of Financial Statements

$$\text{Assets} - \text{Liabilities} = \text{Equity}$$

↓

$$\text{Equity} = \text{Contributions by owners} - \text{Distributions to owners} = \text{Comprehensive Income}$$

↓

$$\text{Comprehensive Income} = \text{Revenues} - \text{Expenses} + \text{Gains} - \text{Losses}$$

$$\text{Comprehensive Income} = \text{Net income} \pm \text{Adjustments to stockholders' equity}$$



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## Basic Rules & Concepts

Consistency

Realization

Conservatism

Recognition

Allocation

Matching

Full disclosure

*You'll get more credit (CR) if you **CRAM** your essays **FULL** of these rules and concepts*



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## Revenue Recognition

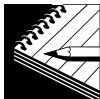
Accrual method	Collection reasonably assured Degree of uncollectibility estimable
Installment sale	Collection not reasonably assured
Cost recovery	Collection not reasonably assured No basis for determining whether or not collectible

## Installment Sales Method

Installment receivable balance	Cash collections
× Gross profit percentage	× Gross profit percentage
= Deferred gross profit (balance sheet)	= Realized gross profit (income statement)

## Cost Recovery Method

All collections applied to cost before any profit or interest income is recognized



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# Converting from Cash Basis to Accrual Basis

## Revenues

Cash (amount received)	XX	
Increase in accounts receivable (given)	XX	
Decrease in accounts receivable (given)		XX
<b>Revenues (plug)</b>		XX

## Cost of Sales

Cost of sales (plug)	XX	
Increase in inventory (given)	XX	
Decrease in accounts payable (given)	XX	
Decrease in inventory (given)		XX
Increase in accounts payable (given)		XX
Cash (payments for merchandise)		XX



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## Expenses

Expense (plug)	XX	
Increase in prepaid expenses (given)	XX	
Decrease in accrued expenses (given)	XX	
Decrease in prepaid expenses (given)		XX
Increase in accrued expenses (given)		XX
Cash (amount paid for expense)		XX

## Balance Sheet

### Current Assets

Cash  
Trading securities  
Current securities available for sale  
Accounts receivable  
Inventories  
Prepaid expenses  
Current deferred tax asset

### Current Liabilities

Short-term debt  
Accounts payable  
Accrued expenses  
Current income taxes payable  
Current deferred tax liability  
Current portion of long-term debt  
Unearned revenues



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**Long-Term Investments**

Noncurrent securities available for sale  
Securities held to maturity  
Investments at cost or equity

**Property, Plant, & Equipment****Intangibles****Other Assets**

Deposits  
Deferred charges  
Noncurrent deferred tax asset

**Long-Term Debt**

Long-term notes payable  
Bonds payable  
Noncurrent deferred tax liability

**Stockholders' Equity**

Preferred stock  
Common stock  
Additional paid-in capital  
Retained earnings  
Accumulated other comprehensive income





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# Current Assets & Liabilities

## Assets

Economic resource  
Future benefit  
Control of company  
Past event or transaction

## Liabilities

Economic obligation  
Future sacrifice  
Beyond control of company  
Past event or transaction

## Current Assets

Converted into cash or used up  
Longer of:  
    One year  
    One accounting cycle

## Current Liabilities

Paid or settled  
Longer of:  
    One year  
    One accounting cycle

**OR** Requires use of current assets



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## **Special Disclosures**

### **Significant Accounting Policies**

Inventory method

Depreciation method

Criteria for classifying investments

Method of accounting for long-term construction contracts

### **Related-Party Transactions**

Exceptions:

Salary

Expense reimbursements

Ordinary transactions



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# Reporting the Results of Operations

## Preparing an Income Statement

### Multiple step

Revenues  
– Cost of sales  
= Gross profit  
– Operating expenses  
    Selling expenses  
    G & A expenses  
= Operating income  
+ Other income  
+ Gains  
– Other expenses  
– Losses  
= Income before taxes  
– Income tax expense  
= Income from continuing operations

### Single step

Revenues  
+ Other income  
+ Gains  
= Total revenues  
– Costs and expenses  
    Cost of sales  
    Selling expenses  
    G & A expenses  
    Other expenses  
    Losses  
    Income tax expense  
= Income from continuing operations

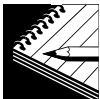


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## ***Computing Net Income***

- Income from continuing operations (either approach)
- ± **Discontinued operations**
- ± **Extraordinary items**
- = **Net income**

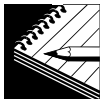
(Cumulative changes section was eliminated by SFAS 154)



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### ***Errors Affecting Income***

<u>Error (ending balance)</u>	<u>Current stmt</u>	<u>Prior stmt</u>
Asset overstated	Overstated	No effect
Asset understated	Understated	No effect
Liability overstated	Understated	No effect
Liability understated	Overstated	No effect
<u>Error (beginning balance – ending balance is correct)</u>		
Asset overstated	Understated	Overstated
Asset understated	Overstated	Understated
Liability overstated	Overstated	Understated
Liability understated	Understated	Overstated



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***Errors Affecting Income (continued)*****Error (beginning balance – ending balance is not correct)**

Asset overstated	No effect	Overstated
Asset understated	No effect	Understated
Liability overstated	No effect	Understated
Liability understated	No effect	Overstated



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## **Extraordinary Items**

Classification as extraordinary – 2 requirements (both must apply)

- Unusual in nature
- Infrequent of occurrence

One or neither applies – component of income from continuing operations

### ***Extraordinary***

Negative goodwill on consolidation resulted from purchase (always)

Acts of nature (usually)

### ***Not Extraordinary***

Gains or losses on sales of investments or prop, plant, & equip

Gains or losses due to changes in foreign currency exchange rates

Write-offs of inventory or receivables

Effects of major strikes or changes in value of investments



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## **Change in Accounting Principle**

Use **retrospective application** of new principle:

- 1) Calculate revised balance of asset or liability as of beginning of period as if new principle had always been in use.
- 2) Compare balance to amount reported under old method
- 3) Multiply difference by 100% minus tax rate
- 4) Result is treated on books as prior period adjustment to beginning retained earnings .
- 5) All previous periods being presented in comparative statements restated to new principle.
- 6) Beginning balance of earliest presented statement of retained earnings adjusted for all effects going back before that date.





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## Change in Accounting Principle (continued)

Journal entry:

Asset or liability	xxx	
Retained earnings		xxx
Current or deferred tax liability (asset)		xxx

Or

Retained earnings	xxx	
Current or deferred tax liability (asset)	xxx	
Asset or liability		xxx



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## ***Special Changes***

Changes in accounting principle are handled using the **prospective** method under limited circumstances. No calculation is made of prior period effects and the new principle is simply applied starting at the beginning of the current year when the following changes in principle occur:

- Changes in the method of depreciation, amortization, or depletion
- Changes whose effect on prior periods is impractical to determine (e.g. changes to LIFO when records don't allow computation of earlier LIFO cost bases)

(Note: the method of handling changes in accounting principle described here under SFAS 154 replaces earlier approaches, which applied the **cumulative method** to most changes in accounting principle. SFAS 154 abolished the use of the cumulative method.)



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## **Change in Estimate**

- No retrospective application
- Change applied as of beginning of current period
- Applied in current and future periods

