

1. Drillfast is a drilling corporation with operations at oil rigs around the world. For the 2014 annual report, which business segment should be reported as an operating segment?

- A. South American segment, which contributes 8% of total revenues, 5% of profits and accounts for 9% of assets. South American operating manager reports to the chief operating officer.
- B. African segment, which contributes 9% of the company's assets, 16% of total revenues, and 18% of profits. The African operating manager reports to the British operating manager.
- C. Australian segment, which contributes 10% of total revenues, 2% of assets, and 4% of profits. The Australian manager reports to the chief operating officer.
- D. Texas based corporate headquarters

ANSWER: C

The Australian segment has revenue that is greater than 10% of total revenue and local management reports to the chief operating officer. A segment is classified as an operating segment if either revenues, assets or profits are greater than 10% of the company totals and the segment reports to the chief operating decision maker.

2. Brayden Corporation issues bonds On May 1, year 1. The bonds are issued at 102 plus accrued interest, 100 of its 6%, \$1,000 bonds. The bonds are dated January 1, year 1. The bonds mature on January 1, year 5. Interest is payable semiannually on January 1 and July 1. Brayden paid the investment bank \$7,000 for the bond issue costs. Based on the information above, Brayden would realize net cash receipts from the bond issuance of

- A. \$ 97,000
- B. \$102,000
- C. \$99,000
- D. \$ 95,000

ANSWER: A

\$100,000 of bonds are issued at 102 plus accrued interest (4 months, from January 1 to May 1) less bond issue costs of \$7,000. The cash received for the bonds is 102% of \$100,000, or \$102,000. The cash received for the accrued interest is \$2,000 ($\$100,000 \times 6\% \times 4/12$). Therefore, cash receipts total \$97,000 ($\$102,000 + \$2,000 - \$7,000$).

3. Tristan, Inc. operates a business manufacturing bamboo cell phone cases. He purchased a wood engraving machine in January year 1 for \$30,000 and the estimated useful life was 10 years. The engraving machine was being depreciated using the straight-line method and has no salvage value. In year 5, Tristan, impressed with the machine, decides to extend the useful life to 12 years. What amount of depreciation expense should Tristan report in its financial statements for the year ending December 31, year 5?

- A. \$4,500
- B. \$2,250
- C. \$1,800
- D. \$3,000

ANSWER: B

In previous years, Tristan reported a depreciation expense using the straight-line method and no salvage value. This depreciation expense was \$3,000 ($\$30,000 \div 10$ years) per year. Therefore, accumulated depreciation at January 1, year 5, was \$12,000 ($\$3,000 \times 4$ years). The book value at January 1, year 5, is equal to \$18,000 ($\$30,000$ cost – \$12,000 accumulated depreciation), and the remaining life is 8 years (6 years remaining + 2 years extended life). Therefore, the depreciation expense for year 5 is equal to \$2,250 ($\$18,000 \div 8$ years).

4. In a statement of cash flows, receipts from the issuance of debt in order to purchase a manufacturing machine should be classified as cash inflows from

- A. Capital Investing activities.
- B. Operating activities.

- C. Financing activities.
- D. Investing activities.

ANSWER: C

Receiving cash from issuing stock or spending cash to repurchase shares are categorized as cash flows from financing activities.

5. On January 8, Connor entered into a finance lease with a vendor for equipment. The finance lease for seven years. The equipment had no guaranteed residual value. Under the lease terms, Connor had to pay \$400,000 annually on January 8.

At the inception of the lease, the present value of an annuity due for seven years was 4.15. What amount should Connor capitalize as leased equipment?

- A. \$400,000
- B. \$1,660,000
- C. \$2,060,000
- D. \$2,800,000

ANSWER: B

The equipment should be capitalized as the present value of the minimum lease payments. The present value of the minimum lease payments at January 8 is calculated as the present value of the annuity due factor times the payment, or \$1,660,000 ($4.15 \times \$400,000$).

Part 2: Sample FAR CPA Exam Questions

6. Which of the following is not an accrued expense?

- A. A company prepay for Internet services for one month in advance.
- B. The lawn maintenance company has completed sprinkler maintenance services yet has

not issued an invoice as of yet.

C. You receive delivery of a computer on May 5 and the invoice won't post until after June 1.

D. The office supply store delivers merchandise and your corporate account is billed. You have 90 days to make the payment.

ANSWER: D

An accrued expense is an expense that an entity has already incurred, but for which there is not yet any expenditure documentation in the accounting system. Since the office supply store billed the customer it would not be an accrued expense.

7. As of December 31, year 1, Hunter Company had 100,000 shares of common stock issued and outstanding. In year 2, Hunter issued a 10% stock dividend on July 1. At the end of year 2 there were 30,000 unexercised stock options to purchase shares of common stock at \$20 per share. During year 2, the average market price of Hunter's common stock was \$36 per share. Year 2 net income was \$860,000. For year 2, what are the diluted earnings per common share?

A. \$6.62

B. \$6.97

C. \$7.81

D. \$6.14

ANSWER: B

Common shares outstanding at the beginning of the year were 100,000. 10,000 shares were issued as a stock dividend. The treasury stock method is used to determine the number of incremental shares in computing diluted earnings per share.

Proceeds from exercise (30,000 shares × \$20) \$600,000

Shares issued upon exercise 30,000

Less: Treasury shares purchasable ($\$600,000/\36) 16,667

Incremental shares 13,333

The incremental shares of 13,333 are added to the 110,000 shares. Diluted Earnings Per Share = $\$860,000/123,333$ shares = \$6.97.

8. A corporation has prepared a 6 % bond with a date of January 1, 2014. However, the bond is delayed and actually sold on February 1. The bond will mature in 5 years and requires interest payments on July 1 and January 1 of each year. The bond was sold to investors at par.

What would the interest payable be credited as on

A. \$1500

B. \$0

C. \$150

D. \$900

ANSWER: C

To calculate the interest payable $30,000 \times 1/12 \times 6\% = \150 . The journal entries would be to debit cash \$30, 150 and credit bonds payable \$30,000 and credit interest payable \$150.

9. All of the items below are material items. However, which item should be presented in the income statement separately as an extraordinary item?

A. Foreign currency hedging losses.

B. Expropriation of oil field by Venezuelan government.

C. Almond crop failure in California.

D. Goodwill write-off.

ANSWER: B

Extraordinary items are income statement items that are unusual in nature and infrequent in occurrence. Expropriation would generally be considered unusual and infrequent.

10. Of the following types of funds, which one would account for fixed assets like a “for-profit” organization?

- A. Enterprise Fund.
- B. General Fund.
- C. Internal Service Fund.
- D. Investment Trust Fund.

ANSWER: A

An Enterprise Fund capitalizes its fixed assets within the fund. The fixed assets are used in the production of the goods or services provided and sold. For example, an airport charging user fees might be a non-profit but it would have similar accounting to a for-profit organization.

11. A lease contains a bargain purchase option. In determining the lessee’s capitalizable cost at the beginning of the lease term, the payment called for by the bargain purchase option would

- A. Be added to the residual value.
- B. Not be capitalized
- C. Be subtracted at its present value.
- D. Be added at its present value.

ANSWER: D

When a bargain-purchase option exists, the lessee must increase the present value of the minimum lease payments by the present value of the purchase option price.

Minimum lease payments include the rental payments plus the amount of the bargain purchase option if it exists. The amount to be capitalized is the present value of the minimum lease payments. The present value of the bargain purchase option would be added to the present value of the rental payments.

12. The initial amount recorded by a lessee as a liability in a finance lease should:

- A. Exceed the present value at the beginning of the lease term of minimum lease payments during the lease term.
- B. Exceed the total of the minimum lease payments during the lease term.
- C. Not exceed the fair value of the leased property at the inception of the lease.
- D. Equal the total of the minimum lease payments during the lease term.

ANSWER: C

The lessee shall record a finance lease as a debit to an asset account and a credit to a liability account for an amount equal to the present value of the total of the minimum lease payments as of the beginning of the lease term. However, if the amount so determined exceeds the fair value of the leased property at the inception of the lease, the amount recorded as the asset and obligation shall be the fair value of the leased property.