External Financial Reporting Decisions

10 Comprehensive Financial Accounting MCQs

Practice Set: Professional Series

QUESTION 1: REVENUE RECOGNITION (5-STEP PROCESS)

A construction company enters into a contract to build a warehouse for $1,000,000. The contract includes a $100,000 bonus if the project is completed within 6 months. The company has significant experience with similar projects and estimates a 70% probability of early completion and a 30% probability of delay. Using the 'most likely amount' method, what is the total transaction price the company should record?

A. $1,000,000

B. $1,070,000

C. $1,100,000

D. $770,000

Answer Key & Explanation

Correct Option: **C**

Rationale

Under ASC 606, when variable consideration has only two possible outcomes (bonus or no bonus), the 'most likely amount' method is often the best predictor. Since there is a 70% chance of completion, the most likely outcome is receiving the full bonus ($1,000,000 + $100,000).

Why other options are incorrect

A ignores the variable consideration. B uses the 'expected value' (weighted average) method, which is less appropriate for binary outcomes. D is a calculation error.

QUESTION 2: INVENTORY (LIFO LIQUIDATION)

A company using the LIFO method for inventory begins the year with 5,000 units at $10 each. During the year, it purchases 10,000 units at $20 each but sells 12,000 units. What is the impact of this LIFO liquidation on the Cost of Goods Sold (COGS) compared to if they had purchased enough units to avoid liquidation?

A. COGS will be $20,000 higher.

B. COGS will be $20,000 lower.

C. COGS will be $50,000 higher.

D. COGS will be $10,000 lower.

Answer Key & Explanation

Correct Option: **B**

Rationale

To avoid liquidation, the company would have needed to buy 2,000 more units at the current price ($20). Because they liquidated, they used 2,000 units from the old layer ($10). The difference is $10 per unit (2,000 units × $10 = $20,000). Since they used cheaper old costs, COGS is lower.

Why other options are incorrect

A suggests costs went up. C and D use incorrect unit calculations.

QUESTION 3: STATEMENT OF CASH FLOWS (INDIRECT METHOD)

When reconciling Net Income to Cash Flow from Operations, how should a $5,000 gain on the sale of equipment and a $2,000 increase in Inventory be treated?

A. Add $5,000; Subtract $2,000

B. Subtract $5,000; Add $2,000

C. Subtract $5,000; Subtract $2,000

D. Add $5,000; Add $2,000

Answer Key & Explanation

Correct Option: **C**

Rationale

Gains are non-cash credits to net income and must be subtracted to arrive at cash flow. An increase in an asset (Inventory) represents a 'use' of cash (cash is tied up in stock), so it must also be subtracted.

Why other options are incorrect

These reflect common 'sign' errors candidates make when adjusting for assets and non-cash gains.

QUESTION 4: INVESTMENTS (EQUITY METHOD)

Company A owns 30% of Company B and uses the equity method. During the year, Company B reports Net Income of $100,000 and pays total dividends of $40,000. What is the net increase in Company A’s 'Investment in Company B' account?

A. $30,000

B. $12,000

C. $18,000

D. $42,000

Answer Key & Explanation

Correct Option: **C**

Rationale

Under the equity method, the investment increases by the share of income ($100k × 30% = $30k) and decreases by the share of dividends received ($40k × 30% = $12k). Net increase = $30,000 - $12,000 = $18,000.

Why other options are incorrect

A ignores dividends. B only shows the dividend reduction. D adds the dividends instead of subtracting them.

QUESTION 5: LEASE ACCOUNTING (LESSEE)

A lessee signs a 5-year lease for an asset with a useful life of 10 years. There is no transfer of ownership or purchase option. The present value of lease payments is 60% of the asset's fair value. Under U.S. GAAP, how should this lease be classified?

A. Finance Lease

B. Operating Lease

C. Sales-type Lease

D. Short-term Lease

Answer Key & Explanation

Correct Option: **B**

Rationale

For a lease to be a Finance lease, it must meet one of five criteria: Transfer of ownership, Purchase option, Term is 'Major Part' (>=75%), PV is 'Substantially All' (>=90%), or Specialized asset. Since none are met, it is an Operating lease.

Why other options are incorrect

A is incorrect because the thresholds were not met. C is a lessor classification. D is only for leases under 12 months.

QUESTION 6: ACCOUNTS RECEIVABLE (FACTORING)

A company factors $100,000 of receivables 'with recourse.' The factor charges a 5% fee and retains 10% to cover sales returns. How should the company initially record the 'with recourse' obligation?

A. As a reduction in the fee expense.

B. As a liability representing the estimated fair value of the recourse obligation.

C. As a contra-asset to Accounts Receivable.

D. It is not recorded; it is only disclosed in the notes.

Answer Key & Explanation

Correct Option: **B**

Rationale

In a 'with recourse' sale, the seller remains liable for uncollectible accounts. GAAP requires the seller to recognize a liability for the fair value of this obligation at the time of sale.

Why other options are incorrect

A and C are incorrect accounting treatments. D is a violation of the matching principle.

QUESTION 7: COMPREHENSIVE INCOME (OCI)

Which of the following items is included in Accumulated Other Comprehensive Income (AOCI) on the Balance Sheet?

A. Treasury Stock

B. Unrealized gains on Trading Securities

C. Foreign currency translation adjustments

D. Retained Earnings

Answer Key & Explanation

Correct Option: **C**

Rationale

Foreign currency translation (using the functional currency approach) is a primary component of OCI and stays in AOCI until the subsidiary is sold.

Why other options are incorrect

A is a separate equity account. B goes to the Income Statement. D is for realized net income.

QUESTION 8: PP&E (IMPAIRMENT RECOVERY)

A company determines that a machine with a carrying value of $50,000 is impaired and writes it down to its fair value of $30,000. A year later, the fair value of the machine rises to $45,000. Under U.S. GAAP, the company should:

A. Recognize a gain of $15,000.

B. Recognize a gain of $5,000.

C. Not recognize any gain or recovery.

D. Restore the asset to $50,000.

Answer Key & Explanation

Correct Option: **C**

Rationale

Under U.S. GAAP, once a long-lived asset (PP&E) is written down for impairment, recovery of the loss is strictly prohibited. The new cost basis is the written-down value.

Why other options are incorrect

These reflect IFRS rules, which do allow for impairment reversals. This is a common CMA trap.

QUESTION 9: FINANCIAL STATEMENT NOTES

Which of the following is a mandatory disclosure in the Notes to the Financial Statements?

A. Detailed biographies of all middle-management employees.

B. Significant accounting policies, such as the basis of consolidation and inventory methods.

C. A list of all competitors and their market shares.

D. Internal projections for the next five years' sales.

Answer Key & Explanation

Correct Option: **B**

Rationale

The 'Summary of Significant Accounting Policies' (Note 1) is a required disclosure to help users understand the choices management made (e.g., LIFO vs FIFO).

Why other options are incorrect

A and C are not required and often proprietary. D is forward-looking and typically found in MD&A, not formal notes.

QUESTION 10: BUSINESS COMBINATIONS (GOODWILL)

Alpha Corp acquires 100% of Beta Inc. for a cash payment of $1,200,000. At the date of acquisition, Beta’s balance sheet shows total assets of $1,500,000 and total liabilities of $600,000. An appraisal reveals that Beta’s equipment is undervalued by $100,000 and it has an unrecorded patent with a fair value of $50,000. What amount of Goodwill should Alpha Corp record?

A. $300,000

B. $150,000

C. $250,000

D. $450,000

Answer Key & Explanation

Correct Option: **B**

Rationale

Goodwill = Consideration Transferred - FV of Net Identifiable Assets. BV of Net Assets = $1.5M - $0.6M = $900k. FV Adjustments = +$100k (Equipment) + $50k (Patent) = $150k. Total FV = $900k + $150k = $1,050,000. Goodwill = $1,200,000 - $1,050,000 = $150,000.

Why other options are incorrect

A uses Book Value. C misses the patent. D adds adjustments to the price instead of net assets.