Select Transactions

Uniform Certified Public Accountant (CPA) Examination

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Select Transactions covers events that cut across the statements: accounting changes and errors, contingencies, revenue and contributions, income taxes, fair value, lessee accounting and subsequent events. Each one turns on a recognition rule, so learn the trigger first, then the measurement, then the entry and the note.

You should be able to: Check yourself: can you tell a change in estimate from a change in principle, decide accrue, disclose or ignore for a contingency, allocate a contract price, book the tax provision, pick the market that sets fair value, classify and measure a lease and sort subsequent events into adjust or disclose?

Every topic: the key point and the trap

Accounting changes and errors

A change in accounting principle is applied retrospectively: prior periods presented are adjusted and the cumulative effect on earlier years goes to opening retained earnings of the earliest period shown, unless impracticable (ASC 250).

Trap: Restating prior years for a change in estimate, or treating a switch from straight line to an accelerated method as a retrospective change in principle.

Contingencies and commitments

A loss contingency is accrued when a loss is probable and reasonably estimable (ASC 450-20). If a range has a best estimate, accrue it; if no amount in the range is better, accrue the minimum and disclose the range.

Trap: Accruing the midpoint of a range when no amount is a better estimate. Accrue the low end and disclose the possible additional loss.

Revenue and contributions

The five steps (ASC 606): identify the contract, identify the distinct performance obligations, set the transaction price, allocate it on relative standalone selling prices, and recognize revenue when or as each obligation is satisfied.

Trap: Recognizing a conditional pledge as revenue because the donor paid early. Until the barrier is met the cash is a refundable advance, a liability.

Income taxes

Uncertain tax positions use two steps: recognize a benefit only if the position is more likely than not to be sustained on its technical merits, then measure it as the largest amount more than 50% likely to be realized on settlement. The rest is a liability for unrecognized tax benefits (ASC 740-10).

Trap: Recording deferred tax on a permanent difference, or using today's rate when a different rate has already been enacted for the reversal years.

Fair value

Fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date: an exit price (ASC 820).

Trap: Deducting transaction costs from fair value. They only help pick the most advantageous market; transport costs are the ones deducted.

Leases for the lessee

A lessee's lease is a finance lease if any one test is met: ownership transfers; a purchase option is reasonably certain to be exercised; the term is a major part of the remaining economic life; the present value of payments plus any guaranteed residual equals or exceeds substantially all of fair value; or the asset is so specialized it has no alternative use to the lessor. Otherwise it is an operating lease (ASC 842).

Trap: Putting usage-based or sales-based rent into the lease liability. Only fixed payments and those tied to an index or rate are measured at commencement.

Subsequent events

Subsequent events occur after the balance sheet date but before the statements are issued (SEC filers) or available to be issued (other entities); non-SEC entities disclose the date through which they evaluated (ASC 855).

Trap: Adjusting the year-end figures for an event whose cause arose after the balance sheet date, such as a fire or a storm.

Key terms

Retrospective application: Presenting prior periods as if the new principle had always been used.

Prospective application: Applying a change only to the current and future periods.

Prior period adjustment: A correction of an error in earlier statements through opening retained earnings.

Probable: The future event is likely to occur.

Reasonably possible: More than remote but less than likely.

Assurance-type warranty: A promise that the product works as agreed; accrued as a cost, not a separate obligation.

Performance obligation: A promise to transfer a distinct good or service, or a series of them.

Standalone selling price: The price at which the entity would sell the item separately.

Conditional promise to give: A pledge with a barrier to overcome and a right of return or release.

Variance power: A recipient's unilateral power to redirect a gift to another beneficiary.

Temporary difference: A gap between book and tax basis that reverses and creates taxable or deductible amounts later.

Valuation allowance: A reduction of deferred tax assets not more likely than not to be realized.

Unrecognized tax benefit: The part of a tax position taken on a return that is not recognized in the statements.

Exit price: The price received to sell an asset or paid to transfer a liability.

Principal market: The market with the greatest volume and level of activity for the item.

Highest and best use: The use by market participants that maximizes an asset's value.

Level 3 input: An unobservable input based on the entity's own assumptions about market participants.

Right-of-use asset: The lessee's right to use the underlying asset over the lease term.

Incremental borrowing rate: The rate the lessee would pay to borrow on a collateralized basis over a similar term.

Residual value guarantee: A lessee's promise that the asset will be worth at least a stated amount at the end of the lease.

Recognized subsequent event: An event that confirms a condition existing at the balance sheet date; it is adjusted for.

Nonrecognized subsequent event: An event from a condition arising after the balance sheet date; disclosed only.

Available to be issued: Complete in form and format with all approvals obtained, for entities that are not SEC filers.

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