Financial Reporting and Analysis 7th edition Revsine Test Bank

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Chap002 Accrual Accounting and Net income determination

True/False

[QUESTION]
1. Accrual accounting decouples measured earnings from operating cash inflows and outflows.
Answer: True
Learning Objective: 02-01
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Accrual versus cash basis of accounting

[QUESTION]
2. Cash-basis accounting provides the most useful measure of future operating performance.
Answer: False
Learning Objective: 02-01
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Accrual versus cash basis of accounting

[QUESTION]
3. Net asset valuation and net income determination are inextricably intertwined.
Answer: True
Learning Objective: 02-02
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Net assets and Net income interrelationship

[QUESTION]
4. While the earnings process is the result of many separate activities, it is generally acknowledged that there is usually one critical event or key stage considered to be absolutely essential to the ultimate increase in net asset value of the firm.
Answer: True
Learning Objective: 02-02
Difficulty: 2 Medium
AACSB: Reflective Thinking

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AICPA: FN Measurement
Blooms: Understand
Topic: Net assets and Net income interrelationship

[QUESTION]
5. The matching principle says that expenses are matched to the revenue recognized during the period, not that revenue is matched to the period's expenses.
Answer: True
Learning Objective: 02-03
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Accrual basis—Expense recognition

[QUESTION]
6. Period costs would include costs like advertising or insurance where the linkage between these costs and individual sales is difficult to establish.
Answer: True
Learning Objective: 02-04
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Income statement—Traceable or period costs

[QUESTION]
7. Traditional financial reporting presents forecasted cash flow information.
Answer: False
Learning Objective: 02-05
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Income statement—Multiple-step

[QUESTION]
8. Gains and losses from continuing operations that are not typical recurring costs are presented as a separate line in the income from continuing operations section of the income statement.
Answer: True
Learning Objective: 02-06
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember

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Topic: Income statement—Unusual or infrequent items

[QUESTION]
9. Each set of EPS numbers includes separately reported numbers for income from continuing operations and the items that appear below it on the income statement.
Answer: True
Learning Objective: 02-09
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: EPS—Earnings per share

[QUESTION]
10. The change in equity of an entity during a period from transactions and other events from non-owner sources is known as comprehensive income.
Answer: True
Learning Objective: 02-10
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Comprehensive income

[QUESTION]
11. Selected unrealized gains (or losses) sometimes bypass the income statement and are reported as direct adjustments to a stockholders' equity account.
Answer: True
Learning Objective: 02-10
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Comprehensive income

[QUESTION]
12. The basic accounting equation may be expressed as assets = liabilities – owners' equity.
Answer: False
Learning Objective: 02-13
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: T Account analysis
Topic: Transaction analysis and adjusting entries

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[QUESTION]
13. To get revenue and expense account balances to zero an adjusting entry is made.
Answer: False
Learning Objective: 02-13
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Transaction analysis and adjusting entries

[QUESTION]
14. For each transaction, the dollar total of the debits must equal the dollar total of the credits.
Answer: True
Learning Objective: 02-13
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: T Account analysis
Topic: Transaction analysis and adjusting entries

[QUESTION]
15. U. S. GAAP permits companies to report components of other comprehensive income (OCI) as part of the statement of changes in stockholders' equity.
Answer: False
Learning Objective: 02-10
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Comprehensive income

[QUESTION]
16. The point within the operating cycle when the company's net assets have increased is the point when revenue should be recognized.
Answer: True
Learning Objective: 02-02
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Accrual basis—Revenue recognition

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Multiple Choice

[QUESTION]
17. Which of the following statements **best** describes expenses?
a. They are recorded in the accounting period when they are "earned" and become "measurable."
b. They consist of amounts paid for consumable items and services rendered to the organization during the accounting period.
c. They are the expired costs or assets "used up" during the accounting period.
d. They consist of cash payments to employees during the period for services rendered.
Answer: c
Learning Objective: 02-03
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Accrual basis—Expense recognition

[QUESTION]
18. The expense matching principle states that
a. Expenses are recognized when paid.
b. All expenses are recognized when the corresponding revenue is recorded.
c. Some expenses are recognized when the corresponding revenue is recognized and some are spread over time.
d. Expenses are recognized when the invoice is received.
Answer: c
Learning Objective: 02-03
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Accrual basis—Expense recognition

REFERENCE: Ref. 02_01
The Canon Corporation sells ten copiers to the Title Company on October 15 for $40,000. Canon delivers the copiers to Title on October 20 and Title pays $16,000, agreeing to pay the balance on November 10.

[QUESTION]
REFER TO: Ref. 02_01
19. Under the cash basis, how much revenue should Canon recognize in October?

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a. $0
b. $16,000
c. $24,000
d. $40,000
Answer: b
Learning Objective: 02-01
Difficulty: 2 Medium
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply
Topic: Accrual versus cash basis of accounting

[QUESTION]
REFER TO: Ref. 02_01
20. Under the accrual basis, how much revenue should Canon recognize in November?
a. $0
b. $16,000
c. $24,000
d. $40,000
Answer: a
Learning Objective: 02-02
Difficulty: 2 Medium
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply
Topic: Accrual basis—Revenue recognition

[QUESTION]
REFER TO: Ref. 02_01
21. Using the accrual basis, which one of the following entries would properly record Canon's revenue recognition for October?

a.	**DR**	Cash	40,000	
	CR	Copier sales		40,000
b.	**DR**	Cash	16,000	
	CR	Copier sales		16,000
c.	**DR**	Cash	16,000	
	DR	Accounts receivable	24,000	
	CR	Copier sales		40,000
d.	**DR**	Accounts receivable	40,000	
	CR	Copier sales		40,000

Answer: c
Learning Objective: 02-02
Difficulty: 2 Medium
AACSB: Knowledge Application
AICPA: FN Measurement

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Blooms: Apply
Topic: Accrual basis—Revenue recognition

REFERENCE: Ref. 02_02
Hickory Furniture Company paid for the following costs during the month of May:

Inventory purchases	$40,000
Advertising costs	8,000
Delivery costs	2,000

Hickory sold $32,000 of the inventory and has agreed to pay warranty expenses for its customers. These are expected to be $1,600 and occur evenly over the next four months (i.e., starting in June).

[QUESTION]
REFER TO: Ref. 02_02
22. What is the amount of Hickory's cash-basis expenses for the month of May?
a. $33,600
b. $42,400
c. $50,000
d. $51,600
Answer: c
Feedback: Cash expenses = Inventory purchases $40,000, Advertising $8,000, Delivery Costs $2,000
Learning Objective: 02-01
Difficulty: 1 Easy
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply
Topic: Accrual versus cash basis of accounting

[QUESTION]
REFERENCE: Ref. 02_02
23. What is the amount of Hickory's May expenses when applying the matching principle?
a. $33,600
b. $42,400
c. $43,600
d. $50,000
Answer: c
Feedback: Accrual expenses = Cost of Goods Sold $32,000, Advertising $8,000, Delivery Costs $2,000, and Warranty Costs $1,600
Learning Objective: 02-03
Difficulty: 2 Medium
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply

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Topic: Accrual basis—Expense recognition

[QUESTION]
24. Which statement below best describes when to record an expense?
a. When the expense is paid.
b. When the resource paid for is consumed.
c. Always taken in one period only.
d. Never is recognized before revenue is recognized.
Answer: c
Learning Objective: 02-01
Difficulty: 3 Hard
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Accrual basis—Expense recognition

[QUESTION]
25. Which of the following causes basic EPS to differ from fully diluted EPS?
a. Convertible preferred stock.
b. Warrants.
c. Management stock options.
d. All of these answer choices are correct.
Answer: d
Learning Objective: 02-09
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: EPS—Earnings per share

[QUESTION]
26. Which of the following is **not** correct with respect to accrual accounting?
a. Accrual accounting can produce large discrepancies between the firm's reported profit performance and the amount of cash generated from operations.
b. The principles that govern revenue and expense recognition under accrual accounting are designed to alleviate the mismatching problems that exist under cash-basis accounting.

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c. Reported accrual accounting net income for a period always provides an accurate picture of underlying economic performance.

d. Accrual accounting does not decouple measured earnings from operating cash inflows and outflows.

Answer: d

Learning Objective: 02-01
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Accrual versus cash basis of accounting

[QUESTION]
REFERENCE: Ref. 02_02
27. What type of cost is the advertising expense?
a. Product cost
b. Traceable cost
c. Inventory cost
d. Period cost
Answer: d
Learning Objective: 02-04
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Income statement—Traceable or period costs

[QUESTION]
28. Revenue is recognized when
a. a contract is signed by both parties.
b. the seller completes performance required by an agreement.
c. the buyer completes payment required under an agreement.
d. the buyer accepts delivery and completes required payments.
Answer: b
Learning Objective: 02-02
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Accrual basis—Revenue recognition

[QUESTION]
29. Net income recognition always increases
a. assets.

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b. net assets.
c. liabilities.
d. net liabilities.
Answer: b
Feedback: Net income recognition can occur by reducing Deferred Revenue and increasing Service Revenue. In this case, there is no change in assets, but net assets have increased.
Learning Objective: 02-02
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Net assets and Net income interrelationship

[QUESTION]
30. The real accounting issue in net income recognition is the
a. quantity of income recognized.
b. type of income recognized.
c. timing of the recognition.
d. basis of net income recognition.
Answer: c
Learning Objective: 02-01
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Accrual versus cash basis of accounting

[QUESTION]
31. Which of the following is not a change in reporting entity?
a. When combined statements replace statements of individual entities.
b. When there is a change in the subsidiaries to be consolidated or combined.
c. When a business combination is accounted for under the acquisition method.
d. All of these answer choices are correct.
Answer: c
Learning Objective: 02-07
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Change in accounting entity

[QUESTION]
32. Which of the following does not properly state the reporting requirements when a change in reporting entity occurs?

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a. Comparative financial statements for prior years must be restated to reflect the new reporting entity as if it had been inexistence during all the years presented.
b. Comparative financial statements for the prior year only must be restated to reflect the new reporting entity.
c. The effect of the change on income before extraordinary items, net income and other comprehensive income must be restated.
d. Per share amounts must be disclosed for all periods presented.

Answer: b
Learning Objective: 02-07
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Change in accounting entity

[QUESTION]
33.
Accounting errors or irregularities can occur for which reasons?
a. simple oversight.
b. misapplication of GAAP.
c. management exploitation of the flexibility in GAAP.
d. all of these answer choices are correct.

Answer: d
Learning Objective: 02-08
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: BB Critical Thinking
AICPA: FN Risk Analysis
Blooms: Remember
Topic: Error Correction

[QUESTION]
34.
Which of the following parties are responsible for the detection of errors and accounting irregularities in a company's financial statements?
a. external auditors.
b. the SEC staff during their review process.
c. internal audit staff and audit committee of the board of directors.
d. all of these answer choices are correct.

Answer: d
Learning Objective: 02-08
Difficulty: 2 Medium

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AACSB: Reflective Thinking
AICPA: FN Risk Analysis
Blooms: Understand
Topic: Error Correction

[QUESTION]
35. Restatements occur for a number of reasons. Which of the following is the most common type of restatement?
a. those related to revenue recognition.
b. items related to core expense issues.
c. items related to non-core expense issues.
d. reclassification and disclosure issues.

Answer: b
Learning Objective: 02-08
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Error Correction

[QUESTION]
36. Misstatements of tax expense, improper restructuring charges, asset impairment charges and gains/losses related to acquisitions are which type of restatement?
a. those related to revenue recognition
b. items related to core expense issues
c. items related to non-core expense issues
d. reclassification and disclosure issues

Answer: c
Learning Objective: 02-08
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Error Correction

[QUESTION]
37. The matching principle requires that expenses be recognized
a. in the same period in which all the assets are used up.
b. in the same period in which the revenue generated by these expenses is recognized.
c. when the costs are paid by the entity.
d. in the same period in which the revenue generated by these expenses is received.
Answer: b
Learning Objective: 02-03

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Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Accrual basis—Expense recognition

[QUESTION]
38. Traceable costs are also called
a. period costs.
b. expired costs.
c. product costs.
d. administrative costs.
Answer: c
Learning Objective: 02-04
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Income statement—Traceable or period costs

[QUESTION]
39. The statement, "linkage between these costs and individual sales is difficult to establish," refers to
a. period costs.
b. expired costs.
c. product costs.
d. traceable costs.
Answer: a
Learning Objective: 02-04
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Income statement—Traceable or period costs

[QUESTION]
40. Income statements are classified into sections to
a. separate revenue recognized from deferred revenue.
b. distinguish between sustainable and transitory income.
c. separate real income from book income.
d. distinguish between book income and taxable income.
Answer: b
Learning Objective: 02-05
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement

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Blooms: Remember
Topic: Income statement—Multiple-step

[QUESTION]
41. Which item is **not** correct with respect to the treatment of sustainable and transitory items and a company's income statement?

a. Financial reporting assists statement users in forecasting future cash flows by providing an income statement format that segregates components of net income.

b. Income statements prepared in accordance with GAAP differentiate between income components that are believed to be sustainable and those that are transitory.

c. The income statement isolates a key figure called "income from sustainable operations."

d. Transitory items are disclosed separately on the income statement so that statement users can place less weight on these earnings components when forecasting future profitability.

Answer: c
Learning Objective: 02-05
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Income statement—Multiple-step

[QUESTION]
42. The rationale behind the rules for multiple-step income statements is to subdivide the income in a manner that facilitates
a. cash flows.
b. forecasting.
c. tax return preparation.
d. audits.
Answer: b
Learning Objective: 02-05
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Income statement—Multiple-step

[QUESTION]
43. The best measure of a firm's sustainable income is
a. income from continuing operations.

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b. income before income tax.
c. income before unusual items and change in accounting principle.
d. net income.
Answer: a
Learning Objective: 02-05
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Income statement—Multiple-step

[QUESTION]
44. On the income statement, income from discontinued operations is shown
a. as a separate section of income from continuing operations.
b. as an accounting principle change.
c. without any income tax effect.
d. net of taxes after income from continuing operations.
Answer: d
Learning Objective: 02-06
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Discontinued operations

[QUESTION]
45. When transitory earnings are present, which of the following correctly depicts the order used on the income statement?
a. Income from continuing operations, unusual items, income tax expense, discontinued operations, net income.
b. Income from continuing operations, discontinued operations, income tax expense, net income.
c. Income from continuing operations, income tax expense, discontinued operations, net income.
d. Income tax expense, income from continuing operations, unusual items, discontinued operations, net income.
Answer: c
Learning Objective: 02-05
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Income statement—Multiple-step
Topic: Income statement—Unusual or infrequent items

[QUESTION]

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46. Black & Decker decides to discontinue producing toasters in lieu of more versatile toaster ovens. In the process of discontinuing this line, the company disposes of the old production equipment and buys new equipment. The disposal of the old equipment would be reported in the income statement as
a. gain or loss on the sale of equipment as part of continuing operations.
b. gain or loss on the sale of production equipment as part of cost of goods manufactured and sold.
c. gain or loss on the disposal of discontinued business component.
d. income from operation of a discontinued business component.
Answer: a
Learning Objective: 02-06
Difficulty: 3 Hard
AACSB: Analytical Thinking
AICPA: FN Measurement
Blooms: Analyze
Topic: Income statement—Unusual or infrequent items

[QUESTION]
47. When reporting unusual or infrequent items in the income statement which of the following is **not** correct?

a. If a material event is either unusual in nature or an infrequent occurrence it is classified on the income statement as a special or unusual item in continuing operations.

b. If a material event is either unusual in nature or an infrequent occurrence—such as a one-time charge resulting from a major restructuring—it may be classified on the income statement as a special or unusual item in continuing operations or treated as an extraordinary item if it has been a number of years since the company's last major restructuring

c. Firms that use early debt retirement on a recurring basis as part of their ongoing risk management practices will report the associated gains and losses as part of income from continuing operations with separate line-item disclosure.

d. The write-off of obsolete inventory would be reported on the income statement as a special item in continuing operations.

Answer: b
Learning Objective: 02-05
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Income statement—Unusual or infrequent items

[QUESTION]

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48. A component of an entity may be a/an
a. reportable or operating segment.
b. subsidiary.
c. asset group.
d. reportable or operating segment, subsidiary, or asset group.
Answer: d
Learning Objective: 02-06
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Discontinued operations

[QUESTION]
49. Which of the following best describes the reporting for discontinued operations?

a. Discontinued operations will not generate future cash flows and thus the results of transactions related to operations the firm intends to discontinue, or has already discontinued, must be reported separately from other income items on the income statement.
b. Discontinued operations presentation is used only when a component of an entity has been sold.
c. There are 4 criteria that must be met to classify a disposal group as held for sale.
d. Discontinued operations may generate future cash flows and thus there will be results of transactions related to operations the firm intends to discontinue. If the firm does generate future transactions before disposing of the disposal group, it will report that revenue in continuing operations revenue.
Answer: a
Learning Objective: 02-06
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Discontinued operations

[QUESTION]
50. The discontinued operations section of the income statement is comprised of which one of the following?
a. Income from the operation of a discontinued business component and gain or loss from the disposal of the discontinued component.

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b. Income from the operation of a discontinued business component, net of tax, and gain or loss from the disposal of the discontinued component, net of tax.
c. Income from the operation of a discontinued business component, net of tax, and gain or loss from the disposal of the discontinued component.
d. Gain or loss from the disposal of the discontinued component, net of tax.
Answer: b
Learning Objective: 02-06
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Discontinued operations

[QUESTION]
51. Which of the following is **not** considered an unusual or infrequently occurring item on an income statement?
a. Corporate restructuring charges.
b. Gains and losses from sales of investments.
c. Operating income or loss from discontinued operations.
d. Foreign currency transaction gains and losses.
Answer: c
Learning Objective: 02-06
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Discontinued operations
Topic: Income statement—Unusual or infrequent items

[QUESTION]
52. For a disposal group to be considered held for sale, which of the following conditions are required to be met?
a. Management has committed to a plan to see the component.
b. The sale is probable and is expected to be completed within one year.
c. The component is available for immediate sale in its present condition subject only to usual and customary terms for such sales.
d. All of these conditions must be met.

Answer: d
Learning Objective: 02-06
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Discontinued operations

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[QUESTION]
53. Which one of the following events would be considered an unusual or infrequent event?
a. a tornado in Kansas.
b. an earthquake in New York.
c. a flood in St. Louis near the Mississippi River.
d. an earthquake in southern California.
Answer: b
Learning Objective: 02-06
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Income statement—Unusual or infrequent items

[QUESTION]
54. A special one-time charge resulting from corporate restructurings would be reported on the income statement as a/an
a. operating item before gross profit.
b. special item in continuing operations.
c. special item in continuing operations, shown net of tax.
d. special item in discontinued operations, shown net of tax.
Answer: b
Learning Objective: 02-06
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Income statement—Unusual or infrequent items

[QUESTION]
55. When reporting a change in an accounting principle, the general rule requires that the current year's income from continuing operations reflect
a. use of the newly adopted principle for the current year recognition.
b. use of the old principle for the current year recognition.
c. management's choice of either the old or newly adopted principle for the current year recognition.
d. FASB's designation of either the old or newly-adopted principle based on the item being changed.
Answer: a
Learning Objective: 02-07
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Change in accounting principle

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[QUESTION]
56. Accounting treatment for changes in accounting principle are best described as:

a. Changes in accounting principle that are only permitted when FASB issues a standard that revises GAAP.
b. Changes in accounting principle that are always accounted for using the retrospective approach which requires only a restatement of prior years' presented financial information.
c. Changes in accounting principle that may require both a restatement of prior years' financial information and the recording of a cumulative adjustment to retained earnings.
d. Tax effects are ignored when reporting changes in accounting principles.
Answer: c
Learning Objective: 02-07
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Change in accounting principle

[QUESTION]
57. A cumulative effect of a change in an accounting principle is measured as
a. the difference between prior periods' net income under the old method and what would have been reported if the new method had been used in the prior years.
b. the after-tax difference between prior periods' net income under the old method and what would have been reported if the new method had been used in the prior years.
c. the difference between prior periods' net income and current net income under the old method and what would have been reported if the new method had been used in the prior years and the current year.
d. the after-tax difference between prior periods' net income and current net income under the old method and what would have been reported if the new method had been used in the prior years and the current year.
Answer: b
Learning Objective: 02-07
Difficulty: 3 Hard
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Change in accounting principle

[QUESTION]

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58. When using the retrospective approach for a change in accounting principle, disclosure rules require that
a. prior years' income statements presented for comparative purposes be restated to reflect use of the new principle unless it is impractical to do so.
b. all prior years' income statements be restated to reflect use of the new principle, and include a pro forma net income figure of the previously reported income.
c. no prior years' income statements be restated, but a pro forma net income figure be provided to reflect use of the new principle for each year presented.
d. no prior years' income statements be restated, and no pro forma net income figures be provided.
Answer: a
Learning Objective: 02-07
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Change in accounting principle

[QUESTION]
59. Which of the following items is **not** a type of accounting change?
a. Change in accounting principles used; for example, a change from LIFO to FIFO.
b. Change in the majority owner of the company.
c. Change in accounting estimate; for example, a change in the useful life or salvage value of a depreciable asset.
d. Change to consolidated financial statements from individual financial statements.
Answer: b
Learning Objective: 02-07
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Changes—Select the type of accounting change

[QUESTION]
60. When a company changes from LIFO to another inventory method, the change is reported
a. prospectively because it is impractical to determine the effects of this change on prior years' net income.
b. as an error correction.
c. as a change in an accounting estimate.
d. using the retrospective approach.
Answer: d
Learning Objective: 02-07

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Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Change in accounting principle

[QUESTION]
61. When a company changes from straight-line depreciation to double-declining-balance depreciation, the change is reported
a. prospectively because it is impractical to determine the effects of this change on prior years' net income.
b. as an error correction.
c. as a change in an accounting estimate.
d. using the retrospective approach.
Answer: c
Learning Objective: 02-07
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Change in estimate effected by change in principle

[QUESTION]
62. When a company changes from any inventory method to LIFO, the change is reported
a. prospectively because it is usually impractical to determine the effects of this change on prior years' net income.
b. as an error correction.
c. as a change in an accounting estimate.
d. using the retrospective approach.
Answer: a
Learning Objective: 02-07
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Change in accounting principle

[QUESTION]
63. Royal, Inc. discovered that equipment purchased on January 1, 2018 for $300,000 will not last as long as originally estimated. The firm was depreciating the equipment at the rate of $40,000 per year with an estimated salvage value of $20,000. New estimates on January 1, 2021 indicate that the equipment will last a total of five years with no salvage value. How much should Royal, Inc. record as depreciation in 2021?
a. $40,000
b. $60,000

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c. $90,000
d. $120,000
Answer: c
Feedback: $300,000 – ($40,000 × 3) = $180,000 (remaining book value) ÷ 2 (remaining useful life) = $90,000
Learning Objective: 02-07
Difficulty: 3 Hard
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply
Topic: Change in accounting estimate

[QUESTION]
64. For what reasons does management have incentive to meet analysts' expectations?
a. To build credibility with capital markets.
b. To convey future earnings prospects to investors.
c. To increase stock price.
d. All of these answer choices are correct.
Answer: d
Learning Objective: 02-12
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Earnings management

[QUESTION]
65. Which statement below is **not** correct with respect to earnings management?
a. It is increasingly common because of the pressure to meet analysts' expectations.
b. More firms just beat rather than just miss the analyst expectations.
c. More than 80% of CEOs surveyed indicated that reporting a profit is an important benchmark.
d. More than 70% of CEOs surveyed indicated that beating consensus EPS is an important benchmark.
Answer: d
Learning Objective: 02-12
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember

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Topic: Earnings management

[QUESTION]
66. GAAP requires that each set of EPS numbers includes separately reported numbers for all of the following **except**
a. special or unusual items.
b. income from continuing operations.
c. discontinued operations.
d. net income.
Answer: a
Learning Objective: 02-09
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: EPS—Earnings per share

[QUESTION]
67. When analysts provide basic EPS for income from continuing operations that exclude the effects of special (i.e., nonrecurring) gains or losses and certain other non-cash charges, such earnings are frequently referred to as
a. normal earnings.
b. pro forma earnings.
c. sustainable earnings.
d. real earnings.
Answer: b
Learning Objective: 02-09
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: EPS—Earnings per share

[QUESTION]
68. The change in equity of an entity during a period from transactions and other events from non-owner sources is known as
a. net income.
b. net operating income.
c. comprehensive income.
d. net change in assets.
Answer: c
Learning Objective: 02-10
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
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Topic: Comprehensive income

[QUESTION]
69. Which one of the following is part of other comprehensive income (OCI)?
a. Unrealized gains resulting from translating foreign currency financial statements of majority-owned subsidiaries to U.S. dollar amounts.
b. Gains on sales of treasury stock.
c. Receipt of land donated by a governmental unit.
d. Sale of common stock above par.
Answer: a
Learning Objective: 02-10
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Comprehensive income

[QUESTION]
70. GAAP requires firms to report comprehensive income
a. at the end of the income statement.
b. as one separate statement of comprehensive income.
c. in the statement of changes in stockholders' equity.
d. in a statement that is displayed with the same prominence as other financial statements.
Answer: d
Learning Objective: 02-10
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Comprehensive income

[QUESTION]
71. Current U.S. GAAP permits firms to display the components of other comprehensive income in which of the following formats?
a. as a schedule appearing in the notes to the financial statements.
b. in a two-statement approach, one in which net income comprises one statement and a second, which presents a separate statement of comprehensive income.
c. as part of the statement of changes in stockholders' equity.
d. as a part of the statement of cash flows.
Answer: b
Learning Objective: 02-10
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember

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Topic: Comprehensive income

[QUESTION]
72. Other Comprehensive Income (OCI) is used both in U.S. GAAP and IFRS. Which of the following statements is correct?

a. As a general rule, U.S. GAAP allows more opportunities for managers to change balance sheet valuations of certain assets even when management has no intention to sell these assets.

b. Changes in the valuation of property, plant, and equipment create a Revaluation Surplus used in both IFRS and U.S. GAAP.

c. Both IFRS and U.S. GAAP require companies to report in other comprehensive income each period the valuation changes from changes in actuarial estimates affecting defined benefit pension plans.

d. U.S. GAAP requires a separate statement of OCI to immediately follow the income statement in the financial reporting statement.

Answer: c
Learning Objective: 02-11
Difficulty: 2 Medium
AACSB: Diversity
AICPA: BB Global
AICPA: FN Measurement
Blooms: Remember
Topic: Comprehensive income—IFRS

[QUESTION]
73. The basic accounting equation may be expressed as
a. assets = liabilities – owners' equity
b. liabilities = assets + owners' equity
c. owners' equity = assets – liabilities
d. assets = owners' equity – liabilities
Answer: c
Learning Objective: 02-13
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Transaction analysis and adjusting entries

[QUESTION]
74. Any increase in an asset may be offset by
a. a corresponding decrease in a liability.
b. a decrease in some other asset account.
c. a corresponding decrease in owner' equity.
d. an increase in another asset account.

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Answer: b
Learning Objective: 02-13
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Transaction analysis and adjusting entries

[QUESTION]
75. Which of the following statements is correct regarding revenue and expense accounts?
a. These are really owners' equity accounts.
b. These are really contributed capital accounts.
c. They have no impact on the balance sheet.
d. These are balance sheet accounts.
Answer: a
Learning Objective: 02-13
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Transaction analysis and adjusting entries

[QUESTION]
76. A debit
a. increases Accounts Payable.
b. increases Cost of Goods Sold.
c. decreases Accounts Receivable.
d. decreases Equipment.
Answer: b
Learning Objective: 02-13
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: T-account analysis

[QUESTION]
77. Adjusting entries must be made
a. to correct errors in the accounts.
b. to reconcile the accounts to the budget.
c. because auditing standards require them.
d. because certain types of events will otherwise not be recorded in the accounts.
Answer: d
Learning Objective: 02-13
Difficulty: 2 Medium

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AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Transaction analysis and adjusting entries

[QUESTION]
78. Accumulated depreciation is a/an
a. expense account.
b. liability account.
c. contra-asset account.
d. owners' equity account.
Answer: c
Learning Objective: 02-13
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Transaction analysis and adjusting entries

[QUESTION]
79. Entering the **DR** or **CR** amount in the appropriate left or right side of the affected T-account is called
a. posting.
b. cross-referencing.
c. journalizing.
d. recording.
Answer: a
Learning Objective: 02-13
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: T-account analysis

[QUESTION]
80. Which of the following situations may create an accounting error?
a. Simple oversight.
b. Parties disagree on accounting for a transaction resulting in a misapplication of GAAP.
c. Management exploits the flexibility in GAAP to inflate earnings.
d. All of these answer choices are correct.
Answer: d
Learning Objective: 02-08
Difficulty: 1 Easy
AACSB: Reflective

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AICPA: FN Measurement
Blooms: Remember
Topic: Error corrections

[QUESTION]
81. A debit does which of the following?
a. Increases the value in an asset account.
b. Increased the value in a contra-asset account.
c. Decreases the value in a liability account.
d. Increases the value in an asset account and also decreases the value in a liability account.
Answer: d
Learning Objective: 02-13
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Transaction analysis and adjusting entries
Topic: T-account analysis

[QUESTION]
82. Which of the following is a true statement?
a. Revenue decreases owners' equity and increases liabilities.
b. Expenses increase owners' equity and decrease liabilities.
c. Revenue increases owners' equity and expenses decrease owners' equity.
d. Revenue decreases owners' equity and expenses increase owners' equity.
Answer: c
Learning Objective: 02-13
Difficulty: 1 Easy
AACSB: Analytical Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: T-account analysis

[QUESTION]
83. To get revenue and expense account balances to zero requires a/an
a. adjusting entry.
b. closing entry.
c. operating entry.
d. reversing entry.
Answer: b
Learning Objective: 02-13
Difficulty: 1 Easy

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AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Transaction analysis and adjusting entries

[QUESTION]
84. T-account analysis can be used to gain insights into why accrual basis earnings and cash basis earnings differ and to
a. journalize future transactions.
b. reconstruct transactions that have occurred during a given reporting period.
c. post transactions that have occurred during a given reporting period.
d. determine the current market price of common stock.
Answer: b
Learning Objective: 02-13
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: T-account analysis

[QUESTION]
85. Working capital accounts include
a. all assets.
b. all assets and liabilities.
c. current assets and all liabilities.
d. current assets and current liabilities.
Answer: d
Learning Objective: 02-13
Difficulty: 1 Easy
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Topic: Transaction analysis and adjusting entries

[QUESTION]
86. Adjusting entries are used in all but which of the following situations?
a. Prepayments.
b. Deferred Revenue and Expenses.
c. Accrued Revenue and Expenses.
d. Prepayments, Deferred Revenue, Accrued Expenses, Accrued Revenue.
Answer: b
Learning Objective: 02-13
Difficulty: 2 Medium
AACSB: Reflective Thinking

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AICPA: FN Measurement
Blooms: Remember
Topic: Transaction analysis and adjusting entries

[QUESTION]
87. Recent changes in _____ accounting standards require companies to group items within OCI based on _____:
a. U.S. GAAP; whether they will be reclassified subsequently into net income or whether they will be subsequently reclassified into income when specific conditions are met.
b. IFRS; whether they will be reclassified subsequently into net income or whether they will be subsequently reclassified into income when specific conditions are met.
c. U.S. GAAP; their expected future categorization on the income statement into income from continuing operations and discontinued operations.
d. IFRS; their expected future categorization on the income statement into income from continuing operations and discontinued operations.
Answer: b
Learning Objective: 02-11
Difficulty: 3 Hard
AACSB: Diversity
AICPA: FN Measurement
AICPA: BB Global
Blooms: Remember
Topic: Comprehensive income—IFRS

[QUESTION]
88. When actuarial estimates related to defined benefit pension plans are adjusted
a. Both U.S. GAAP and IFRS require companies to report these valuation changes in OCI each period.
b. Only U.S. GAAP requires companies to report these valuation changes in OCI each period.
c. Only IFRS requires companies to report these valuation changes in OCI each period.
d. Neither U.S. GAAP nor IFRS requires companies to report these valuation changes in the financial statements.
Answer: a
Learning Objective: 02-10
Difficulty: 2 Medium
AACSB: Diversity
AICPA: FN Measurement
AICPA: BB Global
Blooms: Remember
Topic: Comprehensive income—IFRS

[QUESTION]
89. Earnings management can occur through a variety of manipulations including:

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a. Manipulating accrual estimates to impact expenses.
b. Misapplications of GAAP deemed immaterial on an account by account basis.
c. Big bath restructuring charges.
d. All of these answer choices are correct.
Answer: d
Learning Objective: 02-12
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Earnings management

[QUESTION]
90. Which of the following would **not** be considered a revenue recognition abuse?
a. Recording goods on consignment as part of inventory when there is a right of return.
b. Recording goods on layaway for a customer as a final sale.
c. Recording revenue on a large shipment to a customer whose ability to pay is not reasonably assured.
d. Recording revenue on goods ready for delivery to the customers, segregated in the company warehouse without a bill-and-hold arrangement in the contract.
Answer: a
Learning Objective: 02-12
Difficulty: 2 Medium
AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Topic: Earnings management

Essay and Computational Questions

[QUESTION]
91. In its accrual-basis income statement for the year ended December 31, 2018, Ralph Company reported revenue of $2,565,000. Additional information was as follows:

Accounts receivable 12/31/17	$418,500
Uncollectible accounts written off during 2018	17,200
Accounts receivable 12/31/18	391,700

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Required:
Under the cash basis of net income determination, how much should Ralph report as revenue for 2018?

Answer:

Accrual basis revenue	$2,565,000
+ Beginning accounts receivable balance	418,500
− Ending accounts receivable balance	(391,700)
− Write-offs of accounts receivable	(17,200)
Cash basis revenue (cash collections on accounts receivable)	**$2,574,600**

Feedback: Under the cash basis of net income determination, the company would not regard its accounts receivable as revenue. To find cash basis revenue, add the decrease in accounts receivable to the revenue figure and subtract the write-offs to determine cash collections on accounts receivable.
Learning Objective: 02-01
Learning Objective: 02-13
Difficulty: 3 Hard
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Analyze
Topic: Accrual versus cash basis of accounting
Topic: T-account analysis

[QUESTION]
92. John Hamilton, D.D.S. keeps his accounting records on the cash basis. During 2018 Dr. Hamilton collected $220,000 in fees from his patients. At December 31, 2017, Dr. Hamilton had accounts receivable of $30,000. At December 31, 2018 Dr. Hamilton had accounts receivable of $35,000 and had collected deferred fee revenue of $8,000.

Required:
On the accrual basis, what was Dr. Hamilton's patient service revenue for 2018?

Answer:

Cash basis revenue	$220,000
− Beginning accounts receivable (12/31/17)	(30,000)
+ Ending accounts receivable (12/31/18)	35,000
− Deferred fee revenue on 12/31/18	(8,000)
= Accrual basis revenue	**$217,000**

Feedback: To change Dr. Hamilton's revenue from cash basis to an accrual basis, add the recognized but uncollected accounts receivable and subtract the beginning accounts receivable collected in 2018 but recognized in 2017. Also, subtract fees collected in 2018 but not recognized until after 2018 (deferred fee revenue at 12/31/18).
Learning Objective: 02-01

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Learning Objective: 02-02
Learning Objective: 02-13
Difficulty: 3 Hard
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Analyze
Topic: Accrual versus cash basis of accounting
Topic: Accrual basis—Revenue recognition
Topic: T-account analysis

[QUESTION]
93. Under Bart Company's accounting system, all insurance premiums paid are debited to prepaid insurance. For interim reports, Bart makes monthly estimated charges to insurance expense with credits to prepaid insurance. Additional information for the year ended December 31, 2018 is as follows:

Prepaid insurance at December 31, 2017	$310,000
Charges to insurance expense during 2018, including a year-end adjustment of $50,000	975,000
Unexpired insurance premiums at December 31, 2018	265,000

Required:
What was the total amount of insurance premiums paid by Bart during 2018?

Answer:

Charges to insurance expense during 2018	$975,000
− Decrease in prepaid insurance ($310,000 − $265,000)	(45,000)
= Insurance premiums paid in 2018	**$930,000**

Feedback: The total amount of insurance premiums paid in 2018 is equal to the insurance expense for 2018 less the decline in the balance in prepaid insurance.
Learning Objective: 02-01
Learning Objective: 02-13
Difficulty: 3 Hard
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Analyze
Topic: Accrual versus cash basis of accounting
Topic: T-account analysis

[QUESTION]
94. Schlegel Department Store sells gift certificates—redeemable for store merchandise—that expire one year after their issuance. Schlegel has the following information pertaining to its gift certificates sales and redemptions:

Unredeemed certificates at 12/31/17	$90,000
2018 sales	400,000

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2018 redemptions of prior year sales	60,000
2018 redemptions of current year sales	325,000

Schlegel's experience indicates that 10% of gift certificates will not be redeemed. The company's policy is to record revenue on gift certificates when they are redeemed or expire.

Required:
In its 2018 income statement, what amount should Schlegel report as gift certificate revenue?

Answer:

2017 sales redeemed or expired in 2018	$90,000
2018 sales redeemed in 2018	325,000
2018 gift certificate revenue	**$415,000**

Feedback: Any 2017 certificates unredeemed at 1/1/18 will either be redeemed or expire in 2018 and thus should be included in 2018 net income along with the dollar amount of certificates sold and redeemed in 2018.
Learning Objective: 02-01
Learning Objective: 02-02
Learning Objective: 02-13
Difficulty: 2 Medium
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Analyze
Topic: Accrual versus cash basis of accounting
Topic: Accrual basis—Revenue recognition
Topic: Transaction analysis and adjusting entries

[QUESTION]
95. Lazer Industries, Inc. manufactures medical equipment parts and accessories. Assume all amounts are pre-tax and a 30% tax rate for 2018.

Net sales	$1,200,000
Interest expense	$150,000
Gain on sale of discontinued operations	$400,000
Cost of goods sold	$300,000
Selling, general and administrative expenses	$170,000
Gain on sale of investments	$30,000
Restructuring charges	$20,000

Required:
Prepare a multiple-step income statement for Lazer Industries, Inc. based on the available information for the year ended December 31, 2018. Indicate all negative numbers using parentheses, and include all subtotals, appropriately labeled, to present your income statement in good form.

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Answer:

Lazer Industries, Inc.
Income Statement
For the year ended December 31, 2018

Net sales	$1,200,000
Cost of goods sold	(300,000)
Gross profit	900,000
Selling, general and administrative expenses	(170,000)
Unusual or infrequently occurring items:	
Interest expense	(150,000)
Gain on sale of investments	30,000
Restructuring charges	(20,000)
Income from continuing operations before income tax	590,000
Income tax expense	(177,000)
Income from continuing operations	413,000
Discontinued operations:	
Gain on sale of discontinued operations, net of tax	280,000
Net income	$693,000

Learning Objective: 02-05
Difficulty: 3 Hard
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply
Topic: Income statement—Multiple-step

[QUESTION]
96. Berg, Inc. provides exotic wedding planning services. Berg's facilities are located in an elevated area with a dry climate. Assume all amounts are pre-tax and a 30% tax rate for 2018.

Interest expense	$30,000
Cost of goods sold	900,000
Flood damage to facilities	60,000
Revenue	2,100,000
Office salaries expense	150,000
Advertising expense	180,000
Rent expense	100,000
Restructuring charges	80,000

Required:
Based on the available information, provide a multiple-step income statement for Berg, Inc. for the year ended December 31, 2018. Indicate all negative numbers using parentheses, and include all subtotals, appropriately labeled, to present your income statement in good form.

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Answer:

Berg, Inc.
Income Statement
For the year ended December 31, 2018

Revenue	$2,100,000
Cost of goods sold	(900,000)
Gross profit	1,200,000)
Selling, general and administrative expenses:	
Office salaries expense	(150,000)
Advertising expense	(180,000)
Rent expense	(100,000)
Unusual or infrequently occurring items:	
Interest expense	(30,000)
Flood damage to facilities	(60,000)
Restructuring charges	(80,000)
Income from continuing operations before income tax	600,000
Income tax expense	(180,000)
Net income	$420,000

Learning Objective: 02-05
Difficulty: 2 Medium
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply
Topic: Income statement—Multiple-step

[QUESTION]
97. On August 1, 2018, Alpha Co. approved a plan to dispose of an unprofitable segment of its business. Alpha expected that the sale would occur on April 30, 2019, at an estimated gain of $250,000. The segment had actual and estimated operating profits (losses) as follows:

Realized loss from 1/1/18 to 7/31/18	($400,000)
Realized loss from 8/1/18 to 12/31/18	(250,000)
Expected loss from 1/1/19 to 4/30/19	(300,000)

Assume Alpha's tax rate is 30%.

Required:
In its 2018 income statement, what should Alpha report as profit or loss from discontinued operations (net of tax effects)?

Answer:

Realized loss from 1/1/18 to 7/31/18	($400,000)
Realized loss from 8/1/18 to 12/31/18	(250,000)
Total pre-tax loss	(650,000)
Tax benefit at 30%	195,000

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Loss from discontinued operations, net of tax effect	**($455,000)**

Feedback: Under GAAP, results of operations on an operating segment or component of an entity classified as held for sale are to be reported in discontinued operations in the periods in which they occur (net of tax effects). None of the expected profit from operating the segment or component of the entity in 2019 or the estimated gain on sale is recognized in 2018. These amounts will be recognized in 2019 as they occur.
Learning Objective: 02-06
Difficulty: 3 Hard
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply
Topic: Discontinued operations

[QUESTION]
98. On November 15, 2018, Jones Co. sold a segment of its business for $2,750,000. The net book value of the segment at the time of its disposal was $2,900,000. Jones had pretax income from operations of $1,750,000 for 2018 which included $360,000 recognized by the discontinued segment prior to its disposal. Assume Jones' tax rate is 30%.

Required:
Prepare a partial income statement for Jones Co. for 2018, beginning with pretax income from continuing operations.

Answer:

Income from continuing operations ($1,750,000 − $360,000)	$1,390,000
Income tax expense ($1,390,000 × .30)	417,000
Income from continuing operations	973,000
Discontinued operations:	
Income from discontinued operations (net of taxes of $108,000) from 1/1/18 through 11/15/18	252,000
Loss on disposal of discontinued operations (net of tax benefit of $45,000)	(105,000)
Net income	**$1,120,000**

Feedback: Sale price of segment − book value of segment = gain (loss) on disposal = $2,750,000 − $2,900,000 = $(150,000) pretax loss.
Learning Objective: 02-06
Difficulty: 3 Hard
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply

[QUESTION]
99. Delta Co. began operations on January 1, 2018. During 2018 and 2019, the company used the weighted-average method for its inventory costing. In 2020, the company

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changed its method of inventory costing to FIFO so that its financial statements would be more comparable to those of other firms in its industry. If the FIFO method had been used, Delta's cost of goods sold would have been $45,000 less in 2018 and $35,000 less in 2019. Delta's income statements, as originally presented, appear below. Delta's tax rate is 30%.

	2018	2019	2020
Sales	$1,000,000	$1,100,000	$1,210,000
Cost of goods sold	645,000	695,000	726,000
Gross profit	355,000	405,000	484,000
Selling, general and administrative expenses	250,000	255,000	265,000
Depreciation expense	55,000	55,000	55,000
Income before tax	50,000	95,000	164,000
Income tax expense	15,000	28,500	49,200
Net income	$35,000	$66,500	$114,800

Required:
Assume that for comparison purposes Delta presents 2018 and 2019 income statements in its 2020 annual report. Revise Delta's 2018 and 2019 income statements to appear as they should in the 2020 annual report.

Answer:

	2018	2019	2020
Sales	$1,000,000	$1,100,000	$1,210,000
Cost of goods sold	600,000	660,000	726,000
Gross profit	400,000	440,000	484,000
Selling, general and administrative expenses	250,000	255,000	265,000
Depreciation expense	55,000	55,000	55,000
Income before taxes	95,000	130,000	164,000
Income tax expense	28,500	39,000	49,200
Net income	$66,500	$91,000	$114,800

Feedback: Adjustment to inventory = cost of goods sold as originally reported under weighted-average – cost of goods sold under FIFO = ($645,000 + $695,000) − ($600,000 + $660,000) = $80,000 over the two-year period of 2018 and 2019. Since pretax income—as restated for the two years—is increased by $80,000, taxes on the increase @ 30% = $24,000 total for the two years.
Learning Objective: 02-07
Difficulty: 2 Medium
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply
Topic: Change in accounting principle

[QUESTION]

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100. An analyst gathered the following information about a company whose fiscal year end is December 31, 2018.
Net income for the year was $23.7 million.
Preferred stock dividends of $3 million were paid for the year.
Common stock dividends of $6 million were paid for the year.
There were 10 million shares of common stock outstanding on January 1, 2018.
The company issued 6 million new shares of common stock on July 1, 2018.
The capital structure does not include any potentially dilutive securities.

Required:
Calculate the company's basic earnings per share for 2018.

Answer:
Net income – Preferred stock dividend = $23.7 − $3.0 = $20.7 million.
Weighted Average number of common shares = (0.5 × 10) + (0.5 × 16) = 13 million shares.
EPS = $20.7 million net income ÷ 13 million shares = $**1.59 per share**.

Learning Objective: 02-08
Difficulty: 2 Medium
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Apply
Topic: EPS—Earnings per share

[QUESTION]
101. Primo Landscaping commenced its business on January 1, 2018. On December 31, 2018, Primo Landscaping did not record any adjusting entries with respect to the following transactions:

a. During the first year of its operations, Primo purchased supplies in the amount of $10,000 (debited to "Supplies expense"), and of this amount, $3,000 were unused as of December 31, 2018.
b. On March 15, 2018 Primo received $36,000 for landscape maintenance services to be rendered for 24 months (beginning July 1, 2018). This amount was credited to "Landscaping revenue."
c. The company's fuel bill for $1,300 for the month of December 2018 was not received until January 15, 2019.
d. The company borrowed $100,000 from First Bank on April 1, 2018 at an interest rate of 12% per year. The principal, along with all of the interest, is due on March 30, 2019.
e. On January 17, 2018 the company purchased a backhoe for $65,000. The backhoe is expected to last for 10,000 hours and have no salvage value. During 2018, Primo operated the backhoe for 500 hours.

Required:

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Complete the table below, showing the effect of the omission of each year-end adjusting entry on assets, liabilities, and net income. Use "OS" for overstated, "US" for understated, and "NE" for no effect.

Item Number	Effect of Omission	Assets	Liabilities	Net Income
a.	Direction of effect Dollar amount of effect			
b.	Direction of effect Dollar amount of effect			
c.	Direction of effect Dollar amount of effect			
d.	Direction of effect Dollar amount of effect			
e.	Direction of effect Dollar amount of effect			

Answer:

Item Number	Effect of Omission	Assets	Liabilities	Net Income
a.	Direction of effect Dollar amount of effect	US $3,000	NE	US $3,000
b.	Direction of effect Dollar amount of effect	NE	US $27,000	OS $27,000
c.	Direction of effect Dollar amount of effect	NE	US $1,300	OS $1,300
d.	Direction of effect Dollar amount of effect	NE	US $9,000	OS $9,000
e.	Direction of effect Dollar amount of effect	OS $3,250	NE	OS $3,250

Feedback: a. Asset not recorded = $3,000 supplies on hand at 12/31/2018. b. Deferred revenue not adjusted for = $1,500 per month for services to be rendered from 1/1/2019 to 6/30/2020. c. Fuel expense not recorded = $1,300. d. Interest expense for 9 months not accrued = $100,000 × 0.12 × 9/12 = $9,000. e. Depreciation expense not recorded = $65,000 ÷ 100,000 hours = $6.50/hour depreciation rate × 500 hours used in 2018 = $3,250.
Learning Objective: 02-13
Difficulty: 3 Hard
AACSB: Knowledge Application
AICPA: FN Measurement
Blooms: Analyze
Topic: Transaction analysis and adjusting entries

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