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Question 1

Question Type: **MultipleChoice**

Goddard has used the FIFO method of inventory valuation since it began operations in 1987. Goddard decided to change to the weighted-average method for determining inventory costs at the beginning of 1990. The following schedule shows year-end inventory balances under the FIFO and weighted-average methods:

Year	*FIFO*	*Weighted-average*
1987	$45,000	$54,000
1988	78,000	71,000
1989	83,000	78,000

What amount, before income taxes, should be reported in the 1990 retained earnings statement as the cumulative effect of the change in accounting principle?

Options:

A- $5,000 decrease.

B- $3,000 decrease.

C- $2,000 increase.

D- $0.

Answer:

A

Explanation:

Choice 'a' is correct. $5,000 decrease.

The cumulative effect of change in accounting principle is determined as of the beginning of the year of change if comparative financial statements are not presented. In this case, the year of change is 1990, so the cumulative effect is the difference in inventory as of the end of 1989. [Note that inventory is a balance sheet item, so the change is based on the balances at the end of the last year the prior method was used. Had this question shown annual income statement amounts of cost of goods sold, we would have had to look at all the past years in the aggregate.] This will allow us to arrive at the adjustment to obtain the amount of retained earnings that would have been reported at the beginning of the period of change if the new accounting principle had been used for all prior periods.

	1989
FIFO (current method)	$83,000
Weighted average - new method	(78,000)
Decrease in 1990 retained earnings	$ 5,000

Question 2

Question Type: MultipleChoice

Is the cumulative effect of an inventory pricing change on prior years earnings reported on the financial statements for

	LIFO to weighted average?	*Weighed average to LIFO?*
A.	Yes	Yes
B.	Yes	No
C.	No	No
D.	No	Yes

Options:

A- Option A

B- Option B

C- Option C

D- Option D

Answer:

B

Explanation:

Choice 'b' is correct. The cumulative effect of a change in accounting principle is now reported as an adjustment to beginning retained earnings when it is considered practicable to calculate the cumulative effect. When making a change to LIFO, it is generally considered impracticable to calculate the cumulative effect of the change (in most cases, data on the historical LIFO layers in not available). In a change to LIFO, the beginning inventory dollar amount becomes the first LIFO layer. No cumulative effect adjustment is made. The change is accounted for prospectively.

A change from LIFO to weighted average, there is no such impracticability. The cumulative effect is computed and the change is handled retrospectively.

Choices 'a', 'c', and 'd' are incorrect, per the above Explanation: .

Question 3

Question Type: MultipleChoice

On January 1, 20X1, Pell Corp. purchased a machine having an estimated useful life of 10 years and no salvage. The machine was depreciated by the double declining balance method for both financial statement and income tax reporting. On January 1, 20X6, Pell changed to the straight-line method for financial statement reporting but not for income tax reporting. Accumulated depreciation at December 31, 20X5, was $560,000. If the straight-line method had been used, the accumulated depreciation at December 31, 20X5, would have been $420,000. Pell's enacted income tax rate for 20X6 and thereafter is 30%. The amount shown in the 20X6 income statement for the cumulative effect of changing to the straight-line method should be:

Options:

A- $98,000 debit.

B- $98,000 credit.

C- $140,000 credit.

D- $0.

Answer:

D

Explanation:

Choice 'd' is correct. A change in the method of depreciation is now considered to be both a change in method and a change in estimate. These changes should be accounted for as changes in estimate and handled prospectively. The new depreciation method should be used as of the beginning of the year of change and should start with the current book value of the underlying asset. No retroactive or retrospective calculations should be made, and no adjustment should be made to retained earnings.

And, certainly, the cumulative effect should not be reflected on the income statement any more.

Choices 'a', 'b', and 'c' are incorrect, per the above Explanation: .

Question 4

Question Type: MultipleChoice

Which of the following should be reported as a prior period adjustment?

	Change in estimated lives of depreciable assets	*Change from unaccepted principle to accepted principle*
A.	Yes	Yes
B.	No	Yes
C.	Yes	No
D.	No	No

Options:

A- Option A

B- Option B

C- Option C

D- Option D

Answer:

B

Explanation:

Choice 'b' is correct. No - Yes

Change in estimated lives of depreciable assets is a 'change in estimate.' They affect only current and future periods (not 'prior periods,' not retained earnings).

Change from unaccepted principle to accepted principle is an example of an error of a prior period that should be reported as a 'prior period adjustment.'

Question 5

Question Type: MultipleChoice

Ocean Corp.'s comprehensive insurance policy allows its assets to be replaced at current value. The policy has a $50,000 deductible clause. One of Ocean's waterfront warehouses was destroyed in a winter storm. Such storms occur approximately every four years. Ocean incurred $20,000 of costs in dismantling the warehouse and plans to replace it. The tax rate is 30%. The following data relate to the warehouse:

Current carrying amount $ 300,000

Replacement cost 1,100,000

What amount of gain should Ocean report as a separate component of income before extraordinary items?

Options:

A- $1,030,000

B- $780,000

C- $730,000

D- $0

Answer:

C

Explanation:

Choice 'c' is correct. $730,000 gain reported as a separate component of income before extraordinary items.

Replacement cost	$1,100,000
Less: Deductible clause	(50,000)
Subtotal - insurance proceeds	1,050,000
Less: Costs to dismantle old warehouse	(20,000)
Subtotal	1,030,000
Less: Current carrying amount	(300,000)
Gain on insurance settlement of casualty	$ 730,000

Question 6

Question Type: MultipleChoice

In 1990, Teller Co. incurred losses arising from its guilty plea in its first antitrust action, and from a substantial increase in production costs caused when a major supplier's workers went on strike. Which of these losses should be reported as an extraordinary item?

	Antitrust action	*Production costs*
A.	No	No
B.	No	Yes
C.	Yes	No
D.	Yes	Yes

Options:

A- Option A

B- Option B

C- Option C

D- Option D

Answer:

C

Explanation:

Choice 'c' is correct. Yes - No.

Rule: Losses arising from a company's first (and probably 'last') 'anti-trust' action are unusual and extraordinary and should be reported as an extraordinary item. Losses resulting from additional costs caused by a strike at a major supplier or even at one's own company are not extraordinary and should be disclosed as a separate component of 'income from continuing operations.'

Question 7

Question Type: **MultipleChoice**

During 1990, Fuqua Steel Co. had the following unusual financial events occur:

* Bonds payable were retired five years before their scheduled maturity, resulting in a $260,000 gain. Fuqua has frequently retired bonds early when interest rates declined significantly.

* A steel forming segment suffered $255,000 in losses due to hurricane damage. This was the fourth similar loss sustained in a 5-year period at that location.

* A component of Fuqua's operations, steel transportation, was sold at a net loss of $350,000.

This was Fuqua's first divestiture of one of its operating segments.

Before income taxes, what amount should be disclosed as the gain (loss) from extraordinary items in 1990?

Options:

A- $0

B- $5,000

C- $(90,000)

D- $(350,000)

Answer:

A

Explanation:

Choice 'a' is correct. $0.

Note: The sale of the steel transportation component resulted in a loss from discontinued operations and is reported after 'income from continuing operations.' The steel forming segment's hurricane damage (4th in 5 years) of $255,000 is only 'unusual in nature' and does not occur infrequently, therefore, it is not an 'extraordinary item,' and should be reported separately as a component of 'income from continuing operations.' The retirement of debt, although unusual, is not infrequent for the company; therefore, the gain does not qualify for classification as an extraordinary item per APBO No. 30 (and SFAS No. 145).

Question 8

Question Type: MultipleChoice

During 1990, Fuqua Steel Co. had the following unusual financial events occur:

* Bonds payable were retired five years before their scheduled maturity, resulting in a $260,000 gain. Fuqua has frequently retired bonds early when interest rates declined significantly.

* A steel forming segment suffered $255,000 in losses due to hurricane damage. This was the fourth similar loss sustained in a 5-year period at that location.

* A component of Fuqua's operations, steel transportation, was sold at a net loss of $350,000.

This was Fuqua's first divestiture of one of its operating segments.

Before income taxes, what amount of gain (loss) should be reported separately as a component of income from continuing operations in 1990?

Options:

A- $260,000

B- $5,000

C- $(255,000)

D- $(350,000)

Answer:

B

Explanation:

Choice 'b' is correct. $5,000.

The steel forming segment's hurricane damage (4th in 5 years) of $255,000 is only 'unusual in nature' and does not occur infrequently, therefore, it is not an 'extraordinary item,' and should be reported separately as a component of 'income from continuing operations.'

The retirement of debt, although unusual, is not infrequent for the company; therefore, the gain does not qualify for classification as an extraordinary item per APBO No. 30 (and SFAS No. 145).

Question 9

Question Type: **MultipleChoice**

A transaction that is unusual, but not infrequent, should be reported separately as a(an):

Options:

A- Extraordinary item, net of applicable income taxes.

B- Extraordinary item, but not net of applicable income taxes.

C- Component of income from continuing operations, net of applicable income taxes.

D- Component of income from continuing operations, but not net of applicable income taxes.

Answer:

D

Explanation:

Choice 'd' is correct. A transaction that is unusual, but not 'infrequent' should be reported separately as a component of continuing operations, (gross) but not net of applicable income taxes.

Choices 'a' and 'b' are incorrect. An extraordinary item has to be both 'unusual' and 'infrequent.'

Choice 'c' is incorrect, per 'd' above.

Question 10

Question Type: **MultipleChoice**

Thorpe Co.'s income statement for the year ended December 31, 1990, reported net income of $74,100. The auditor raised questions about the following amounts that had been included in net income:

Unrealized loss on decline in market value of available-for-sale investments in stock	$(5,400)
Gain on early retirement of bonds payable (net of $11,000 tax effect)	22,000
Adjustment to profits of prior years for errors in depreciation (net of $3,750 tax effect)	(7,500)
Loss from fire (net of $7,000 tax effect)	(14,000)

The loss from the fire was an infrequent but not unusual occurrence in Thorpe's line of business.

Thorpe's December 31, 1990, income statement should report net income of:

Options:

A- $65,000

B- $66,100

C- $81,600

D- $87,000

Answer:

D

Explanation:

Net income before adjustments

Net income before adjustments	$74,100
Add: Unrealized loss in market value of available-for-sale investments in stock which should not have affected net income	5,400
Add: Correction of error of prior period which should not have affected net income	7,500
Net income after adjustments	$87,000

Rule: Unrealized losses (or gains) resulting from changes in market value of available-for-sale investments should be reported as a component of other comprehensive income in shareholders' equity.

Unrealized gains and losses on investments held for trading would be included in net income.

Correction of errors of prior periods should be reported as an adjustment to beginning retained earnings, not as an item of net income.

Choice 'd' is correct. $87,000.

Question 11

Question Type: MultipleChoice

Adam Corp. had the following infrequent transactions during 1989:

* A $190,000 gain on reacquisition and retirement of bonds. This material event is also considered unusual for Adam Corp.

* A $260,000 gain on the disposal of a component of a business. Adam continues similar operations at another location.

* A $90,000 loss on the abandonment of equipment.

In its 1989 income statement, what amount should Adam report as total infrequent net gains that are not considered extraordinary?

Options:

A- $100,000

B- $170,000

C- $360,000

D- $450,000

Answer:

B

Explanation:

Infrequent net gains not considered extraordinary include:

Gain on disposal of a component of a business	$260,000
Loss on abandonment of equipment	(90,000)
Total	$170,000

Choice 'b' is correct. $170,000.

Question 12

Question Type: **MultipleChoice**

Gown, Inc. sold a warehouse and used the proceeds to acquire a new warehouse. The excess of the proceeds over the carrying amount of the warehouse sold should be reported as a(an):

Options:

A- Extraordinary gain, net of income taxes.

B- Part of continuing operations.

C- Gain from discontinued operations, net of income taxes.

D- Reduction of the cost of the new warehouse.

Answer:

B

Explanation:

Choice 'b' is correct. Part of continuing operations.

Rule: When a fixed asset is sold, gain or loss is recognized as part of income from continuing operations. The amount of the gain or loss is equal to the difference between the proceeds from the sale and the carrying amount (FMV) of the fixed asset sold.

Choice 'a' is incorrect. The gain is not extraordinary and is shown gross - not net of tax.

Choice 'c' is incorrect. The gain is part of continuing operations - not discontinued operations.

Choice 'd' is incorrect. The gain is not reported as a reduction of the cost of the new warehouse.