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Question 1

Question Type: **MultipleChoice**

On August 31, 1992, Harvey Co. decided to change from the FIFO periodic inventory system to the weighted average periodic inventory system. Harvey is on a calendar year basis. The cumulative effect of the change is determined:

Options:

A- As of January 1, 1992.

B- As of August 31, 1992.

C- During the eight months ending August 31, 1992, by a weighted average of the purchases.

D- During 1992 by a weighted average of the purchases.

Answer:

A

Explanation:

Rule: The cumulative effect of a change in accounting principle equals the difference between retained earnings at the beginning of period of the change and what retained earnings would have been if the change was applied to all affected prior periods.

Choice 'a' is correct. As of January 1, 1992, the beginning of the year. This assumes that the company is not presenting comparative financial statements. If comparative financial statements are presented, then the adjustment is made to the beginning retained earnings of the earliest year presented.

Choice 'b' is incorrect. The cumulative effect of the change is not determined as of the date the decision is made.

Choices 'c' and 'd' are incorrect. The cumulative effect of the change is not determined by a weighted average. (A far out distractor.)

Question 2

Question Type: **MultipleChoice**

On January 2, 1991, Air, Inc. agreed to pay its former president $300,000 under a deferred compensation arrangement. Air should have recorded this expense in 1990 but did not do so. Air's reported income tax expense would have been $70,000 lower in 1990 had it properly accrued this deferred compensation in its December 31,1991, financial statements, Air should adjust the beginning balance of its retained earnings by a:

Options:

A- $230,000 credit.

B- $230,000 debit.

C- $300,000 credit.

D- $370,000 debit.

Answer:

B

Explanation:

Less adjustments (shown "net of tax"):		
Deferred compensation	$ 300,000	
Less: Applicable tax	(70,000)	
Debit to subtract	$ 230,000	B

Choice 'b' is correct. $230,000 debit.

Question 3

Question Type: MultipleChoice

Tack, Inc. reported a retained earnings balance of $150,000 at December 31,1990. In June 1991, Tack discovered that merchandise costing $40,000 had not been included in inventory in its 1990 financial statements. Tack has a 30% tax rate. What amount should Tack report as adjusted beginning retained earnings in its statement of retained earnings at December 31, 1991?

Options:

A- $190,000

B- $178,000

C- $150,000

D- $122,000

Answer:

B

Explanation:

Retained earnings as previously reported 12-31-90		$150,000
Add: Adjustment for inventory not recorded	$40,000	
Less applicable tax (30% × 40,000)	(12,000)	28,000
As restated		$178,000 **B**

Choice 'b' is correct. $178,000.

Question 4

Question Type: **MultipleChoice**

While preparing its 1991 financial statements, Dek Corp. discovered computational errors in its 1990 and 1989 depreciation expense. These errors resulted in overstatement of each year's income by $25,000, net of income taxes. The following amounts were reported in the previously issued financial statements:

	1990	*1989*
Retained earnings, 1/1	$700,000	$500,000
Net income	$150,000	$200,000
Retained earnings, 12/31	$850,000	$700,000

Dek's 1991 net income is correctly reported at $180,000. Which of the following amounts should be reported as prior period adjustments and net income in Dek's 1991 and 1990 comparative financial statements?

	Year	Prior Period Adjustment	Net Income
A.	1990	-	$150,000
	1991	($50,000)	$180,000
B.	1990	($50,000)	$150,000
	1991	-	$180,000
C.	1990	($25,000)	$125,000
	1991	-	$180,000
D.	1990	-	$125,000
	1991	-	$180,000

Options:

A- Option A

B- Option B

C- Option C

D- Option D

Answer:

C

Explanation:

Choice 'c' is correct. 1990 ($25,000) $125,000

1991 -- 180,000

Because these are comparative financial statements, prior period adjustments require retroactive treatment for the years presented. Because 1989 is not presented, the 1989 correction is shown as a prior period adjustment of $25,000 to retained earnings statement of 1990.

Question 5

Question Type: MultipleChoice

In 1990, Brighton Co. changed from the individual item approach to the aggregate approach in applying the lower of FIFO cost or market to inventories. The cumulative effect of this change should be reported in Brighton's financial statements as a:

Options:

A- Retrospective adjustment on the retained earnings statement, with separate disclosure.

B- Component of income from continuing operations, with separate disclosure.

C- Component of income from continuing operations, without separate disclosure.

D- Component of income after continuing operations, with separate disclosure.

Answer:

A

Explanation:

Choice 'a' is correct. A change in the composition of the elements of cost such as changing from the individual item approach to the aggregate approach in applying the lower of FIFO cost or market to inventories (LCM is covered in F4) is an example of a change in accounting principle. The cumulative effect of the change in accounting principle should now be shown on the retained earnings statement as an adjustment to the beginning balance of retained earnings, in what is called retrospective application.

Choices 'b', 'c', and 'd' are incorrect. The cumulative effect of a change in accounting principle is now reported on the retained earnings statement, not the income statement. Most of these types of changes (changes in accounting principle) used to be reported on the income statement. SFAS No. 154 changed that.

Question 6

Question Type: **MultipleChoice**

In single period statements, which of the following should not be reflected as an adjustment to the opening balance of retained earnings?

Options:

A- Effect of a failure to provide for uncollectible accounts in the previous period.

B- Effect of a decrease in the estimated useful life of depreciable equipment.

C- Cumulative effect of a change from the percentage of completion to the completed contract method of accounting for long-term construction projects.

D- Cumulative effect of a change from LIFO to FIFO in valuing merchandise inventory.

Answer:

B

Explanation:

Choice 'b' is correct. A change in the estimated useful life of a depreciable asset is a change in estimate handled prospectively. No adjustment to retained earnings is necessary.

Choice 'a' is incorrect. The correction of a failure to provide for uncollectible accounts is considered to be a correction of an error. The opening balance of retained earnings would be adjusted to correct the error.

Choice 'c' is incorrect. This change is a change in accounting principle and is handled retrospectively.

With retrospective application, the opening balance of retained earnings would be adjusted to reflect the cumulative effect of the changes.

Choice 'd' is incorrect. This change is a change in accounting principle and is handled retrospectively.

With retrospective application, the opening balance of retained earnings would be adjusted to reflect the cumulative effect of the changes.

Question 7

Question Type: **MultipleChoice**

The effect of a change in accounting principle that is inseparable from the effect of a change in accounting estimate should be reported:

Options:

A- By restating the financial statements of all prior periods presented.

B- As a correction of an error.

C- As a component of income from continuing operations, in the period of change and future periods if the change affects both.

D- As a separate disclosure after income from continuing operations, in the period of change and future periods if the change affects both.

Answer:

C

Explanation:

Choice 'c' is correct. A change in accounting principle that is inseparable from a change in accounting estimate should now be reported as a change in estimate and thus as a component of income from continuing operations, in the period of change and future periods if the change affects both.

Distinguishing between a change in accounting principle and a change in accounting estimate is sometimes difficult. For example, a company may change from deferring and amortizing a cost to recording it as an expense when incurred because future benefits of the cost have become doubtful. The new accounting method is adopted, therefore, in partial or complete recognition of the change in estimated future benefits. The effect of the change in principle is inseparable from the effect of the change in estimate. Changes of this type are often related to the continuing process of obtaining additional information and revising estimates and are therefore considered as changes in estimates.

Choice 'a' is incorrect. Restating the financial statements of all prior periods would be done in the case of prior period adjustments (corrections of errors), changes in accounting principle (retrospective application), and changes in accounting entity (retrospective application).

Choice 'b' is incorrect. Correction of an error would be treated as a prior period adjustment.

Choice 'd' is incorrect. Separate disclosure after income from continuing operations would be done in the case of extraordinary items or discontinued operations. However, this disclosure would not be made 'in the period of change and future periods if the change affects both' but only in the period of the extraordinary item or discontinued operation.

Question 8

Question Type: MultipleChoice

Earnings per share data should be reported on the income statement for:

Extraordinary items	*Income before extraordinary items*
Yes	No
Yes	Yes
No	Yes
No	No

Options:

A- Option A

B- Option B

C- Option C

D- Option D

Answer:

B

Explanation:

Choice 'b' is correct. Yes - Yes.

Both the 'extraordinary items' and 'income before extraordinary items' should be shown with an earnings per share number on the income statement.

Question 9

Question Type: MultipleChoice

During 20X5, Dale Corp. made the following accounting changes:

Method used in 20X4	Method used in 20X5	After-tax effect
Sum-of-the-years' digits depreciation	Straight-line depreciation	$30,000
Last-in, first-out for inventory valuation	First-in, first-out for inventory valuation	98,000

What amount should be shown in the 20X5 retained earnings statement as an adjustment to the beginning balance?

Options:

A- $0

B- $30,000

C- $98,000

D- $128,000

Answer:

C

Explanation:

Choice 'c' is correct. $98,000.

The cumulative effect of a change in accounting principle is now shown on the retained earnings statement as an adjustment to the beginning balance of retained earnings, assuming that the cumulative effect can be calculated. A change from LIFO to FIFO for inventory valuation (costing) is a change in accounting principle.

An exception is made however, for a change in depreciation method, since a change in depreciation method is no longer considered to be a change in accounting principle. A change in depreciation method is now considered to be both a change in principle and a change in estimate. These changes should now be accounted for as a change 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.

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