

Chapter 02

Accrual Accounting and Income Determination

True / False Questions

1. To measure earnings under accrual accounting, revenue is recognized only when received.
True False
2. Recognition of revenue under the cash basis occurs when the revenue is received.
True False
3. Under the cash basis, expenses are recognized when the costs expire or assets are used.
True False
4. Accrual accounting decouples measured earnings from operating cash inflows and outflows.
True False
5. Cash-basis accounting provides the most useful measure of future operating performance.
True False
6. Accrual accounting can produce large discrepancies between the firm's reported profit performance and the amount of cash generated from operations.
True False
7. The principles that govern revenue and expense recognition under accrual accounting are designed to alleviate the mismatching problems that exist under cash-basis accounting.
True False
8. Reported accrual accounting net income for a period always provides an accurate picture of underlying economic performance.
True False
9. Revenue is earned when the seller substantially completes performance required by an agreement.
True False
10. The activities comprising the operating cycle are generally consistent across firms.
True False

11. Since net income is earned as a result of complex, multiple-stage processes, the key issue in net income determination is the timing of net income recognition.

True False

12. According to generally accepted accounting principles, revenue should be recognized at the earliest time that both (1) the "critical event" has taken place, and (2) the proceeds have been collected.

True False

13. GAAP specifies three conditions that must be satisfied in order for revenue to be appropriately recognized.

True False

14. "Book value" refers to the amount at which an account is carried in the company's accounting records as opposed to "carrying amount" which refers to the amount at which an account is reported in the company's financial statements.

True False

15. Net asset valuation and net income determination are inextricably intertwined.

True False

16. A ship building company is likely to recognize revenue at the completion of production.

True False

17. 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.

True False

18. In order to recognize revenue, it must be possible to measure the amount of revenue that has been earned with a reasonable degree of assurance.

True False

19. The two conditions for revenue recognition are occasionally satisfied even before a sale of product occurs.

True False

20. The matching principle requires that expenses incurred in generating revenue are recognized in the same period the related revenue is recognized.

True False

21. 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.

True False

22. Costs expensed with the passage of time are called period costs.
- True False
23. Traceable costs are also called period costs.
- True False
24. Period costs would include costs like advertising or insurance where the linkage between these costs and individual sales is difficult to establish.
- True False
25. The process of reporting transitory income items net of tax on the income statement is known as intraperiod income tax allocation.
- True False
26. Traditional financial reporting presents forecasted cash flow information.
- True False
27. Financial reporting assists statement users in forecasting future cash flows by providing an income statement format that segregates components of net income.
- True False
28. Income statements prepared in accordance with GAAP differentiate between income components that are believed to be sustainable and those that are transitory.
- True False
29. The income statement isolates a key figure called "income from sustainable operations."
- True False
30. 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.
- True False
31. To be reported as an extraordinary item on the income statement, an event must be either unusual in nature or an infrequent occurrence.
- True False
32. 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.
- True False
33. 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.
- True False

34. 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.

True False

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

True False

36. Gains or losses from the sale of property, plant or equipment would be reported on the income statement as a special item in continuing operations.

True False

37. By definition, discontinued operations will not generate future cash flows thus 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.

True False

38. If a component of an entity is classified as "held for sale," its results of operations are to be reported as discontinued operations.

True False

39. A component of an entity may be a reportable segment or operating segment, a reporting unit, a subsidiary, or an asset group. An asset group represents the highest level for which identifiable cash flows are largely independent of the cash flows of other components of the entity.

True False

40. The disposal group notion under IFRS rules envisions a larger unit than the component of an entity notion under U.S. GAAP.

True False

41. The business environment in which an enterprise operates is of little consideration in determining whether an underlying event or transaction is unusual in nature and infrequent in occurrence.

True False

42. Management might, in a "down" earnings year, be tempted to treat nonrecurring gains as part of income from continuing operations and nonrecurring losses as extraordinary.

True False

43. When firms use different accounting principles to account for similar accounting events in adjacent periods, the period-to-period consistency of the reported numbers can be compromised.

True False

44. Changes in accounting principle and changes in the reporting entity are reported under the retrospective approach.
- True False
45. Changes in accounting principle and changes in accounting estimate are reported under the prospective approach.
- True False
46. The advantage of the retrospective approach to accounting for changes in accounting principle is that the financial statements in the year of the change and for prior years presented for comparative purposes are prepared on the same basis of accounting.
- True False
47. An entry to record a change in accounting principle will typically require an adjustment to the firm's retained earnings balance to reflect the cumulative effect of the change in accounting principle on all prior periods' reported net income.
- True False
48. When accounting estimates are changed, the income effect of the changed estimate is accounted for in the period of the change and in future periods if the change affects both.
- True False
49. GAAP states that if it is impractical to determine the cumulative effect of applying a change in accounting principle to prior periods—such as when a firm adopts the LIFO inventory accounting method—the new accounting principle is to be applied as if the change was made prospectively as of the earliest date practicable.
- True False
50. Changes in accounting principle arise only when there are changes mandated by a standards-setting body such as the FASB.
- True False
51. When a company acquires another company, the merger gives rise to a type of accounting change.
- True False
52. Basic earnings per share (EPS) is always computed by dividing net income by the weighted average number of common shares of stock outstanding.
- True False
53. While basic earnings per share (EPS) must be disclosed, management may opt to place it in the notes to the financial statements.
- True False

54. Diluted earnings per share reflects the EPS that would result if all potentially dilutive securities were converted into shares of common stock.
- True False
55. Diluted earnings per share is a required disclosure for all corporations that have outstanding preferred stock.
- True False
56. 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.
- True False
57. The change in equity of an entity during a period from transactions and other events from non-owner sources is known as comprehensive income.
- True False
58. Selected unrealized gains (or losses) sometimes bypass the income statement and are reported as direct adjustments to a stockholders' equity account.
- True False
59. The basic accounting equation may be expressed as $\text{assets} = \text{liabilities} - \text{owners' equity}$.
- True False
60. Debit means increase.
- True False
61. A contra account is an account that is subtracted from a related account.
- True False
62. Revenue increases owners' equity and expenses decrease owners' equity.
- True False
63. To get revenue and expense account balances to zero an adjusting entry is made.
- True False
64. For each transaction, the dollar total of the debits must equal the dollar total of the credits.
- True False
65. An adjusting entry is required whenever all economic events that have occurred are not already reflected in the accounts.
- True False

66. Adjusting entries always fall into one of two categories: adjustments for prepayments or adjustments for unearned revenue.
- True False
67. One difference between U.S. GAAP and IFRS is that IFRS requires companies to present a single statement of comprehensive income while U.S. GAAP allows companies to alternatively present separately a net income statement and a statement of comprehensive income.
- True False
68. U.S. GAAP permits companies to report components of other comprehensive income (OCI) as part of the statement of changes in stockholders' equity.
- True False
69. As a general rule, IFRS allows more opportunities for managers to change balance sheet valuations of certain assets even when management has no intention to sell these assets.
- True False
70. The shareholders' equity account, Revaluation Surplus, is likely to be found on the balance sheet of a company reporting under U.S. GAAP.
- True False
71. Both IFRS and U.S. GAAP require companies to report valuation changes to the company's expected liability to its retired employees due to changes in actuarial estimates in other comprehensive income each period.
- True False
72. U.S. GAAP requires some firms to periodically recategorize a portion of actuarial adjustment losses relating to pensions into periodic net income.
- True False
73. Under IFRS if a company opts to present separately a net income statement and a statement of comprehensive income, the net income statement must immediately follow the statement of comprehensive income.
- True False

Multiple Choice Questions

74. 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.

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; Title pays \$16,000, and agrees to pay the balance on November 10.

75. Under the cash basis, how much revenue should Canon recognize in October?

- A. \$0
- B. \$16,000
- C. \$24,000
- D. \$40,000

76. Under the accrual basis, how much revenue should Canon recognize in November?

- A. \$0
- B. \$16,000
- C. \$24,000
- D. \$40,000

77. 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 |

Hickory Furniture Company had the following costs paid 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).

78. 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

79. 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

80. What type of cost is the advertising expense?

- A. Product cost
- B. Traceable cost
- C. Inventory cost
- D. Period cost

81. Revenue is earned when

- A. a contract is signed by both parties.
- B. the seller substantially completes performance required by an agreement.
- C. the buyer completes payment required under an agreement.
- D. the buyer accepts delivery and completes required payments.

82. Net income recognition always increases

- A. assets.
- B. net assets.
- C. liabilities.
- D. net liabilities.

83. 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.
84. According to generally accepted accounting principles, revenue should be recognized at the earliest time when
- A. the "critical event" has taken place and the proceeds are collected.
 - B. the "critical event" has taken place and the amount of revenue collected is reasonably assured.
 - C. collection is reasonably assured and the "critical event" can be measured.
 - D. collection has taken place and the "critical event" can be measured.
85. The "critical event" for revenue recognition is
- A. defined by generally accepted accounting principles for every situation.
 - B. the same for every industry.
 - C. dependent upon the exact nature of the business and industry.
 - D. easily defined by the FASB.
86. To recognize revenue during the production phase, a specific customer must be identified, an exchange price agreed upon, remaining costs to complete are reliably estimated, a significant portion of the services contracted are performed, and
- A. a reasonable estimate of cash collection determined.
 - B. the seller has the right to terminate the exchange.
 - C. a firm delivery date established.
 - D. the product is immediately salable at quoted market prices.
87. Which one of the following businesses is likely to recognize revenue during the production phase?
- A. Mining company
 - B. Cruise ship builder
 - C. Citrus grower
 - D. Department store
88. To recognize revenue upon completion of production, the product must be immediately saleable at quoted market prices, no significant uncertainty exists regarding cost of distributing the product, and
- A. the seller has the right to terminate the exchange.
 - B. the units are homogeneous.
 - C. a firm delivery date must be established.
 - D. a specific customer must be identified.

89. To recognize revenue after the time of sale, there must be extreme uncertainty regarding the amount of cash to be collected or
- A. there must be substantial future services required whose costs cannot be reasonably estimated.
 - B. units are heterogeneous.
 - C. the product is immediately salable at quoted market prices.
 - D. a formal contract must be signed.
90. 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.
91. Traceable costs are also called
- A. period costs.
 - B. expired costs.
 - C. product costs.
 - D. administrative costs.
92. 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.
93. Income statements are classified into sections to
- A. separate earned income from unearned income.
 - B. distinguish between sustainable and transitory income.
 - C. separate real income from book income.
 - D. distinguish between book income and taxable income.
94. 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.

95. The best measure of a firm's sustainable income is
- A. income from continuing operations.
 - B. income before extraordinary items.
 - C. income before extraordinary item and change in accounting principle.
 - D. net income.
96. 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.
97. When transitory earnings are present, which of the following correctly depicts the order used on the income statement?
- A. Income from continuing operations, income tax expense, extraordinary loss, discontinued operations, net income.
 - B. Income from continuing operations, extraordinary loss, discontinued operations, income tax expense, net income.
 - C. Income from continuing operations, income tax expense, discontinued operations, extraordinary loss, net income.
 - D. Income tax expense, income from continuing operations, discontinued operations, extraordinary loss, net income.
98. 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 equipment and buys new. 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 extraordinary gains and losses.
 - C. gain or loss on the disposal of discontinued business component.
 - D. income from operation of a discontinued business component.
99. 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.

100 The discontinued operations section of the income statement is comprised of which one of the following?

- A. Income from the operation of discontinued business component and gain or loss from the disposal of the discontinued component.
- B. Income from the operation of 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 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.

101 To be reported as an extraordinary item on the income statement, an event must be

- A. both unusual in nature and an infrequent occurrence.
- B. either unusual in nature or an infrequent occurrence.
- C. unusual in nature.
- D. an infrequent occurrence.

102 If a material event is either unusual in nature or an infrequent occurrence it is classified on the income statement as a/an

- A. special item in continuing operations.
- B. special item in continuing operations shown net of tax.
- C. extraordinary item.
- D. extraordinary item shown net of tax.

103 Which one of the following events would be considered an extraordinary 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.

104 A special one-time charge resulting from corporate restructurings would be reported on the income statement as a/an

- A. extraordinary item shown net of tax.
- 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.

105 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.

106 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.

107 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.

108 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.

- 109 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.
- 110 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.
- 111 Royal, Inc. discovered that equipment purchased three years ago 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 indicate that the equipment will last a total of five years with no salvage value. How much should Royal, Inc. record as depreciation in year four?
- A. \$40,000
 - B. \$60,000
 - C. \$90,000
 - D. \$120,000
- 112 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. extraordinary items.
- 113 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.

114 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.

115 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.

116 GAAP requires firms to report comprehensive income

- A. at the end of the income statement.
- B. as a 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.

117 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 financial statement footnotes.
- 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 a part of the statement of changes in stockholders' equity.
- D. as a part of the statement of cash flows.

118 The basic accounting equation may be expressed as:

- A. $\text{assets} = \text{liabilities} - \text{owners' equity}$
- B. $\text{liabilities} = \text{assets} + \text{owners' equity}$
- C. $\text{owners' equity} = \text{assets} - \text{liabilities}$
- D. $\text{assets} = \text{owners' equity} - \text{liabilities}$

119 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.

120 Which of the following statements is correct regarding revenue and expense accounts?

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- 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.

121 A debit

.

- A. increases Accounts Payable.
- B. increases Cost of Goods Sold.
- C. decreases Accounts Receivable.
- D. decreases Equipment.

122 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.

123 Accumulated depreciation is a/an

.

- A. expense account.
- B. liability account.
- C. contra-asset account.
- D. owners' equity account.

124 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.

125 Which of the following is a true statement?

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- 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.

126 To get revenue and expense account balances to zero requires a/an

.

- A. adjusting entry.
- B. closing entry.
- C. operating entry.
- D. reversing entry.

127 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.

128 Working capital accounts include

.

- A. all assets.
- B. all assets and liabilities.
- C. current assets and all liabilities.
- D. current assets and current liabilities.

129 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, discontinued operations, extraordinary items.
- D. IFRS; their expected future categorization on the income statement into income from continuing operations, discontinued operations, extraordinary items.

130 When actuarial estimates related to defined benefit pension plans are adjusted

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- 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.

Essay Questions

131 In its accrual-basis income statement for the year ended December 31, 2014, Ralph Company reported revenue of \$2,565,000. Additional information was as follows:

Accounts receivable 12/31/13	\$418,500
Uncollectible accounts written off during 2014	17,200
Accounts receivable 12/31/14	391,700

Required:

Under the cash basis of net income determination, how much should Ralph report as revenue for 2014?

132 John Hamilton, D.D.S. keeps his accounting records on the cash basis. During 2014 Dr. Hamilton collected \$220,000 in fees from his patients. At December 31, 2013 Dr. Hamilton had accounts receivable of \$30,000. At December 31, 2014 Dr. Hamilton had accounts receivable of \$35,000 and had collected unearned fees of \$8,000.

Required:

On the accrual basis, what was Dr. Hamilton's patient service revenue for 2014?

- 133 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, 2014 is as follows:

Prepaid insurance at December 31, 2013	\$310,000
Charges to insurance expense during 2014, including a year-end adjustment of \$50,000	975,000
Unexpired insurance premiums at December 31, 2014	265,000

Required:

What was the total amount of insurance premiums paid by Bart during 2014?

- 134 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 12/31/13	\$90,000
2014 sales	400,000
2014 redemptions of prior year sales	60,000
2014 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 2014 income statement, what amount should Schlegel report as gift certificate revenue?

135 Lazer Industries, Inc. manufactures medical equipment parts and accessories. Assume all amounts are pre-tax and a 30% tax rate for 2014.

Sales	\$1,200,000
Interest expense	\$150,000
Returns from customers	\$100,000
Rent expense	\$450,000
Cost of goods sold	\$300,000
Other selling, general and administrative expenses	\$170,000
Extraordinary loss	\$230,000
Goodwill impairment	\$20,000

Required:

Provide a condensed income statement for Lazer Industries, Inc. based on the available information. Include all subtotals needed (appropriately labeled) to present your income statement in good form.

136 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 2014.

Interest expense	\$230,000
Rent expense	390,000
Flood damage to facilities	270,000
Revenue	2,100,000
Salaries expense	450,000
Advertising expense	170,000
Restructuring charges	55,000

Required:

Based on the available information, provide a condensed income statement for Berg, Inc. Include all subtotals needed (appropriately labeled) to present your income statement in good form.

- 137 On August 1, 2014, Alpha Co. approved a plan to dispose of an unprofitable segment of its business. Alpha expected that the sale would occur on April 30, 2015, at an estimated gain of \$250,000. The segment had actual and estimated operating profits (losses) as follows:

Realized loss from 1/1/14 to 7/31/14	(\$400,000)
Realized loss from 8/1/14 to 12/31/14	(250,000)
Expected loss from 1/1/15 to 4/30/15	(300,000)

Assume Alpha's tax rate is 30%.

Required:

In its 2014 income statement, what should Alpha report as profit or loss from discontinued operations (net of tax effects)?

- 138 On November 15, 2014, 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 operating income of \$1,750,000 for 2014 which included \$360,000 earned by the discontinued segment prior to its disposal. Assume Jones' tax rate is 30%.

Required:

Prepare a partial income statement for Jones Co. for 2014, beginning with pretax income from continuing operations.

- 139 Delta Co. began operations on January 1, 2012. During 2012 and 2013, the company used the weighted-average method for its inventory costing. In 2014, the company 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 2012 and \$35,000 less in 2013. Delta's income statements, as originally presented, appear below. Delta's tax rate is 30%.

	2012	2013	2014
Sales	\$1,000,000	\$1,100,000	\$1,210,000
Cost of goods sold	<u>645,000</u>	<u>695,000</u>	<u>726,000</u>
Gross profit	355,000	405,000	484,000
Selling, general and administrative expenses	250,000	255,000	265,000
Depreciation expense	<u>55,000</u>	<u>55,000</u>	<u>55,000</u>
Income before tax	50,000	95,000	164,000
Income tax expense	<u>15,000</u>	<u>28,500</u>	<u>49,200</u>
Net income	<u>\$35,000</u>	<u>\$66,500</u>	<u>\$114,800</u>

Required:

- Assume that for comparison purposes Delta presents 2012 and 2013 income statements in its 2014 annual report. Revise Delta's 2012 and 2013 income statements to appear as they should in the 2014 annual report.
- Prepare the journal entry required in 2014 to record Delta's change in accounting principle.

140 An analyst gathered the following information about a company whose fiscal year end is December 31.

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, 2014.

The company issued 6 million new shares of common stock on July 1, 2014.

The capital structure does not include any potentially dilutive securities.

Required:

Calculate the company's basic earnings per share for 2014.

141 Primo Landscaping commenced its business on January 1, 2014. On December 31, 2014, 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, 2014.
- b. On March 15, 2014 Primo received \$18,000 for landscape maintenance services to be rendered for 24 months (beginning July 1, 2014). This amount was credited to "Landscaping revenue."
- c. The company's fuel bill for \$1,500 for the month of December 2014 was not received until January 15, 2015.
- d. The company borrowed \$100,000 from First Bank on April 1, 2014 at an interest rate of 12% per year. The principal, along with all of the interest, is due on March 30, 2015.
- e. On January 17, 2014 the company purchased a backhoe for \$65,000. The backhoe is expected to last for 10,000 hours and have no salvage value. During 2014, Primo operated the backhoe for 500 hours.

Required:

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.

<u>Item Number</u>	<u>Effect of Omission</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Net Income</u>
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			

Chapter 02 Accrual Accounting and Income Determination **Answer Key**

True / False Questions

1. To measure earnings under accrual accounting, revenue is recognized only when received.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

2. Recognition of revenue under the cash basis occurs when the revenue is received.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

3. Under the cash basis, expenses are recognized when the costs expire or assets are used.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

4. Accrual accounting decouples measured earnings from operating cash inflows and outflows.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

5. Cash-basis accounting provides the most useful measure of future operating performance.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally

is a better measure of operating performance.

6. Accrual accounting can produce large discrepancies between the firm's reported profit performance and the amount of cash generated from operations.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

7. The principles that govern revenue and expense recognition under accrual accounting are designed to alleviate the mismatching problems that exist under cash-basis accounting.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

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

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

9. Revenue is earned when the seller substantially completes performance required by an agreement.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

10. The activities comprising the operating cycle are generally consistent across firms.

FALSE

AACSB: Reflective Thinking
AICPA: BB Critical Thinking
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

11. Since net income is earned as a result of complex, multiple-stage processes, the key issue in net income determination is the timing of net income recognition.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

12. According to generally accepted accounting principles, revenue should be recognized at the earliest time that both (1) the "critical event" has taken place, and (2) the proceeds have been collected.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

13. GAAP specifies three conditions that must be satisfied in order for revenue to be appropriately recognized.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

14. "Book value" refers to the amount at which an account is carried in the company's accounting records as opposed to "carrying amount" which refers to the amount at which an account is reported in the company's financial statements.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

15. Net asset valuation and net income determination are inextricably intertwined.

TRUE

AACSB: Analytic
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

16. A ship building company is likely to recognize revenue at the completion of production.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

17. 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.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

18. In order to recognize revenue, it must be possible to measure the amount of revenue that has been earned with a reasonable degree of assurance.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

19. The two conditions for revenue recognition are occasionally satisfied even before a sale of product occurs.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

20. The matching principle requires that expenses incurred in generating revenue are recognized in the same period the related revenue is recognized.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-03 The matching principle and how it is applied to recognize expenses under accrual accounting.

21. 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.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-03 The matching principle and how it is applied to recognize expenses under accrual accounting.

22. Costs expensed with the passage of time are called period costs.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-04 The difference between product and period costs.

23. Traceable costs are also called period costs.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-04 The difference between product and period costs.

24. Period costs would include costs like advertising or insurance where the linkage between these costs and individual sales is difficult to establish.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-04 The difference between product and period costs.

25. The process of reporting transitory income items net of tax on the income statement is known as intraperiod income tax allocation.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

26. Traditional financial reporting presents forecasted cash flow information.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

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

TRUE

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

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

TRUE

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

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

FALSE

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

30. 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.

TRUE

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

31. To be reported as an extraordinary item on the income statement, an event must be either unusual in nature or an infrequent occurrence.

FALSE

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

32. 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.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

33. 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.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 3 Hard

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

34. 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.

FALSE

Such items **must** be classified on the income statement as a special or unusual item in continuing operations.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 3 Hard

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

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

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

36. Gains or losses from the sale of property, plant or equipment would be reported on the income statement as a special item in continuing operations.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

37. By definition, discontinued operations will not generate future cash flows thus 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.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 1 Easy
Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

38. If a component of an entity is classified as "held for sale," its results of operations are to be reported as discontinued operations.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium
Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

39. A component of an entity may be a reportable segment or operating segment, a reporting unit, a subsidiary, or an asset group. An asset group represents the highest level for which identifiable cash flows are largely independent of the cash flows of other components of the entity.

FALSE

As asset group represents the **lowest** level for which identifiable cash flows are largely independent.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium
Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

40. The disposal group notion under IFRS rules envisions a larger unit than the component of an entity notion under U.S. GAAP.

TRUE

AACSB: Reflective Thinking
AICPA: BB Global
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

41. The business environment in which an enterprise operates is of little consideration in determining whether an underlying event or transaction is unusual in nature and infrequent in occurrence.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

42. Management might, in a "down" earnings year, be tempted to treat nonrecurring gains as part of income from continuing operations and nonrecurring losses as extraordinary.

TRUE

AACSB: Analytic
AICPA: BB Critical Thinking
Blooms: Understand
Difficulty: 3 Hard

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

43. When firms use different accounting principles to account for similar accounting events in adjacent periods, the period-to-period consistency of the reported numbers can be compromised.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

44. Changes in accounting principle and changes in the reporting entity are reported under the retrospective approach.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

45. Changes in accounting principle and changes in accounting estimate are reported under the prospective approach.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

46. The advantage of the retrospective approach to accounting for changes in accounting principle is that the financial statements in the year of the change and for prior years presented for comparative purposes are prepared on the same basis of accounting.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

47. An entry to record a change in accounting principle will typically require an adjustment to the firm's retained earnings balance to reflect the cumulative effect of the change in accounting principle on all prior periods' reported net income.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 3 Hard

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

48. When accounting estimates are changed, the income effect of the changed estimate is accounted for in the period of the change and in future periods if the change affects both.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

49. GAAP states that if it is impractical to determine the cumulative effect of applying a change in accounting principle to prior periods—such as when a firm adopts the LIFO inventory accounting method—the new accounting principle is to be applied as if the change was made prospectively as of the earliest date practicable.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 3 Hard

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

50. Changes in accounting principle arise only when there are changes mandated by a standards-setting body such as the FASB.

FALSE

AACSB: Analytic
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

51. When a company acquires another company, the merger gives rise to a type of accounting change.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

52. Basic earnings per share (EPS) is always computed by dividing net income by the weighted average number of common shares of stock outstanding.

FALSE

If there are preferred stock dividends, the numerator would be net income minus preferred stock dividends.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-08 The distinction between basic and diluted earnings per share (EPS) and required EPS disclosures.

53. While basic earnings per share (EPS) must be disclosed, management may opt to place it in the notes to the financial statements.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-08 The distinction between basic and diluted earnings per share (EPS) and required EPS disclosures.

54. Diluted earnings per share reflects the EPS that would result if all potentially dilutive securities were converted into shares of common stock.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-08 The distinction between basic and diluted earnings per share (EPS) and required EPS disclosures.

55. Diluted earnings per share is a required disclosure for all corporations that have outstanding preferred stock.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-08 The distinction between basic and diluted earnings per share (EPS) and required EPS disclosures.

56. 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.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-08 The distinction between basic and diluted earnings per share (EPS) and required EPS disclosures.

57. The change in equity of an entity during a period from transactions and other events from non-owner sources is known as comprehensive income.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-09 What comprises comprehensive income and how it is displayed in financial statements.

58. Selected unrealized gains (or losses) sometimes bypass the income statement and are reported as direct adjustments to a stockholders' equity account.

TRUE

AACSB: Analytic
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-09 What comprises comprehensive income and how it is displayed in financial statements.

59. The basic accounting equation may be expressed as assets = liabilities - owners' equity.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

60. Debit means increase.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember

61. A contra account is an account that is subtracted from a related account.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

62. Revenue increases owners' equity and expenses decrease owners' equity.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

63. To get revenue and expense account balances to zero an adjusting entry is made.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

64. For each transaction, the dollar total of the debits must equal the dollar total of the credits.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

65. An adjusting entry is required whenever all economic events that have occurred are not already reflected in the accounts.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

66. Adjusting entries always fall into one of two categories: adjustments for prepayments or adjustments for unearned revenue.

FALSE

AACSB: Analytic
AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

67. One difference between U.S. GAAP and IFRS is that IFRS requires companies to present a single statement of comprehensive income while U.S. GAAP allows companies to alternatively present separately a net income statement and a statement of comprehensive income.

FALSE

AACSB: Reflective Thinking

AICPA: BB Global

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-10 Other comprehensive income differences between IFRS and U.S. GAAP.

68. U.S. GAAP permits companies to report components of other comprehensive income (OCI) as part of the statement of changes in stockholders' equity.

FALSE

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-10 Other comprehensive income differences between IFRS and U.S. GAAP.

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

TRUE

AACSB: Reflective Thinking

AICPA: BB Global

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-10 Other comprehensive income differences between IFRS and U.S. GAAP.

70. The shareholders' equity account, Revaluation Surplus, is likely to be found on the balance sheet of a company reporting under U.S. GAAP.

FALSE

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-10 Other comprehensive income differences between IFRS and U.S. GAAP.

71. Both IFRS and U.S. GAAP require companies to report valuation changes to the company's expected liability to its retired employees due to changes in actuarial estimates in other comprehensive income each period.

TRUE

AACSB: Reflective Thinking

AICPA: BB Global

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-10 Other comprehensive income differences between IFRS and U.S. GAAP.

72. U.S. GAAP requires some firms to periodically recategorize a portion of actuarial adjustment losses relating to pensions into periodic net income.

TRUE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-10 Other comprehensive income differences between IFRS and U.S. GAAP.

73. Under IFRS if a company opts to present separately a net income statement and a statement of comprehensive income, the net income statement must immediately follow the statement of comprehensive income.

FALSE

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-10 Other comprehensive income differences between IFRS and U.S. GAAP.

Multiple Choice Questions

74. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

Learning Objective: 02-03 The matching principle and how it is applied to recognize expenses under accrual accounting.

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; Title pays \$16,000, and agrees to pay the balance on November 10.

75. Under the cash basis, how much revenue should Canon recognize in October?

- A. \$0
- B. \$16,000**
- C. \$24,000
- D. \$40,000

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

76. Under the accrual basis, how much revenue should Canon recognize in November?

- A. \$0**
- B. \$16,000
- C. \$24,000
- D. \$40,000

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

77. 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 |

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply

Difficulty: 2 Medium

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

Hickory Furniture Company had the following costs paid 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).

78. 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

Cash expenses = Inventory purchases \$40,000, Advertising \$8,000, Delivery Costs \$2,000

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 1 Easy

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

79. 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

Accrual expenses = Cost of Goods Sold \$32,000, Advertising \$8,000, Delivery Costs \$2,000, and Warranty Costs \$1,600

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

80. What type of cost is the advertising expense?

- A. Product cost
- B. Traceable cost
- C. Inventory cost
- D. Period cost**

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-04 The difference between product and period costs.

81. Revenue is earned when

- A. a contract is signed by both parties.
- B. the seller substantially completes performance required by an agreement.**
- C. the buyer completes payment required under an agreement.
- D. the buyer accepts delivery and completes required payments.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

82. Net income recognition always increases

- A. assets.
- B. net assets.**
- C. liabilities.
- D. net liabilities.

Net income recognition can occur by reducing Unearned Revenue and increasing Service Revenue. In this case, there is no change in assets, but net assets have increased.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

83. 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.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

84. According to generally accepted accounting principles, revenue should be recognized at the earliest time when
- A. the "critical event" has taken place and the proceeds are collected.
 - B.** the "critical event" has taken place and the amount of revenue collected is reasonably assured.
 - C. collection is reasonably assured and the "critical event" can be measured.
 - D. collection has taken place and the "critical event" can be measured.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

85. The "critical event" for revenue recognition is
- A. defined by generally accepted accounting principles for every situation.
 - B. the same for every industry.
 - C.** dependent upon the exact nature of the business and industry.
 - D. easily defined by the FASB.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

86. To recognize revenue during the production phase, a specific customer must be identified, an exchange price agreed upon, remaining costs to complete are reliably estimated, a significant portion of the services contracted are performed, and
- A.** a reasonable estimate of cash collection determined.
 - B. the seller has the right to terminate the exchange.
 - C. a firm delivery date established.
 - D. the product is immediately salable at quoted market prices.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

87. Which one of the following businesses is likely to recognize revenue during the production phase?

- A. Mining company
- B. Cruise ship builder**
- C. Citrus grower
- D. Department store

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Create

Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

88. To recognize revenue upon completion of production, the product must be immediately saleable at quoted market prices, no significant uncertainty exists regarding cost of distributing the product, and

- A. the seller has the right to terminate the exchange.
- B. the units are homogeneous.**
- C. a firm delivery date must be established.
- D. a specific customer must be identified.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

89. To recognize revenue after the time of sale, there must be extreme uncertainty regarding the amount of cash to be collected or

- A. there must be substantial future services required whose costs cannot be reasonably estimated.**
- B. units are heterogeneous.
- C. the product is immediately salable at quoted market prices.
- D. a formal contract must be signed.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

90. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-03 The matching principle and how it is applied to recognize expenses under accrual accounting.

91. Traceable costs are also called

- A. period costs.
- B. expired costs.
- C.** product costs.
- D. administrative costs.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-04 The difference between product and period costs.

92. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-04 The difference between product and period costs.

93. Income statements are classified into sections to

- A. separate earned income from unearned income.
- B.** distinguish between sustainable and transitory income.
- C. separate real income from book income.
- D. distinguish between book income and taxable income.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

94. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

95. The best measure of a firm's sustainable income is

- A. income from continuing operations.**
- B. income before extraordinary items.
- C. income before extraordinary item and change in accounting principle.
- D. net income.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

96. 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.**

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

97. When transitory earnings are present, which of the following correctly depicts the order used on the income statement?
- A. Income from continuing operations, income tax expense, extraordinary loss, discontinued operations, net income.
 - B. Income from continuing operations, extraordinary loss, discontinued operations, income tax expense, net income.
 - C. Income from continuing operations, income tax expense, discontinued operations, extraordinary loss, net income.
 - D. Income tax expense, income from continuing operations, discontinued operations, extraordinary loss, net income.**

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

98. 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 equipment and buys new. 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 extraordinary gains and losses.
 - C. gain or loss on the disposal of discontinued business component.
 - D. income from operation of a discontinued business component.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

99. 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.**

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

100. The discontinued operations section of the income statement is comprised of which one of the following?

- A. Income from the operation of discontinued business component and gain or loss from the disposal of the discontinued component.
- B. Income from the operation of 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 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

101. To be reported as an extraordinary item on the income statement, an event must be

- A. both unusual in nature and an infrequent occurrence.**
- B. either unusual in nature or an infrequent occurrence.
- C. unusual in nature.
- D. an infrequent occurrence.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

102. If a material event is either unusual in nature or an infrequent occurrence it is classified on the income statement as a/an

- A. special item in continuing operations.**
- B. special item in continuing operations shown net of tax.
- C. extraordinary item.
- D. extraordinary item shown net of tax.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

103. Which one of the following events would be considered an extraordinary 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Analyze
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

104. A special one-time charge resulting from corporate restructurings would be reported on the income statement as a/an

- A. extraordinary item shown net of tax.
- 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

105. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

106. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 3 Hard

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

107. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

108. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

109. 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.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

110. 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.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

111. Royal, Inc. discovered that equipment purchased three years ago 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 indicate that the equipment will last a total of five years with no salvage value. How much should Royal, Inc. record as depreciation in year four?

- A. \$40,000
- B. \$60,000
- C. \$90,000**
- D. \$120,000

$\$300,000 - (\$40,000 \times 3) = \$180,000$ (remaining book value) $\div 2$ (remaining useful life) = \$90,000

AACSB: Analytic

AICPA: FN Measurement

Blooms: Apply

Difficulty: 3 Hard

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

112. 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. extraordinary items.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-08 The distinction between basic and diluted earnings per share (EPS) and required EPS disclosures.

113. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-08 The distinction between basic and diluted earnings per share (EPS) and required EPS disclosures.

114. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-09 What comprises comprehensive income and how it is displayed in financial statements.

115. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-09 What comprises comprehensive income and how it is displayed in financial statements.

116. GAAP requires firms to report comprehensive income

- A. at the end of the income statement.
- B. as a 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.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-09 What comprises comprehensive income and how it is displayed in financial statements.

117. 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 financial statement footnotes.
- 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 a part of the statement of changes in stockholders' equity.
- D. as a part of the statement of cash flows.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-09 What comprises comprehensive income and how it is displayed in financial statements.

118. The basic accounting equation may be expressed as:

- A. $\text{assets} = \text{liabilities} - \text{owners' equity}$
- B. $\text{liabilities} = \text{assets} + \text{owners' equity}$
- C.** $\text{owners' equity} = \text{assets} - \text{liabilities}$
- D. $\text{assets} = \text{owners' equity} - \text{liabilities}$

AACSB: Analytic

AICPA: FN Measurement

Blooms: Remember

Difficulty: 2 Medium

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

119. 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.

AACSB: Analytic

AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

120. 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.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Understand
Difficulty: 2 Medium

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

121. A debit

- A. increases Accounts Payable.
- B. increases Cost of Goods Sold.
- C. decreases Accounts Receivable.
- D. decreases Equipment.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Remember
Difficulty: 1 Easy

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

122. 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.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember
Difficulty: 2 Medium

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

123. Accumulated depreciation is a/an

- A. expense account.
- B. liability account.
- C. contra-asset account.
- D. owners' equity account.

AACSB: Reflective Thinking
AICPA: FN Measurement
Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

124. 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.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

125. 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.

AACSB: Analytic

AICPA: FN Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

126. To get revenue and expense account balances to zero requires a/an

- A. adjusting entry.
- B.** closing entry.
- C. operating entry.
- D. reversing entry.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

127. 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.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Understand

Difficulty: 2 Medium

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

128. Working capital accounts include

- A. all assets.
- B. all assets and liabilities.
- C. current assets and all liabilities.
- D. current assets and current liabilities.**

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 1 Easy

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.

129. 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, discontinued operations, extraordinary items.
- D. IFRS; their expected future categorization on the income statement into income from continuing operations, discontinued operations, extraordinary items.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 3 Hard

Learning Objective: 02-10 Other comprehensive income differences between IFRS and U.S. GAAP.

130. 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.

AACSB: Reflective Thinking

AICPA: FN Measurement

Blooms: Remember

Difficulty: 3 Hard

Learning Objective: 02-10 Other comprehensive income differences between IFRS and U.S. GAAP.

Essay Questions

131. In its accrual-basis income statement for the year ended December 31, 2014, Ralph Company reported revenue of \$2,565,000. Additional information was as follows:

Accounts receivable 12/31/13	\$418,500
Uncollectible accounts written off during 2014	17,200
Accounts receivable 12/31/14	391,700

Required:

Under the cash basis of net income determination, how much should Ralph report as revenue for 2014?

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

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.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

132. John Hamilton, D.D.S. keeps his accounting records on the cash basis. During 2014 Dr. Hamilton collected \$220,000 in fees from his patients. At December 31, 2013 Dr. Hamilton had accounts receivable of \$30,000. At December 31, 2014 Dr. Hamilton had accounts receivable of \$35,000 and had collected unearned fees of \$8,000.

Required:

On the accrual basis, what was Dr. Hamilton's patient service revenue for 2014?

Cash basis revenue	\$220,000
– Beginning accounts receivable (12/31/13)	(30,000)
+ Ending accounts receivable (12/31/14)	35,000
– Unearned fees on 12/31/14	<u>(8,000)</u>
= Accrual basis revenue	<u>\$217,000</u>

Feedback: To change Dr. Hamilton's revenue from cash basis to an accrual basis, add the earned but uncollected accounts receivable and subtract the beginning accounts receivable collected in 2014 but earned in 2013. Also subtract fees collected in 2014 but not earned until after 2014 (unearned fees on 12/31/14).

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

133. 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, 2014 is as follows:

Prepaid insurance at December 31, 2013	\$310,000
Charges to insurance expense during 2014, including a year-end adjustment of \$50,000	975,000
Unexpired insurance premiums at December 31, 2014	265,000

Required:

What was the total amount of insurance premiums paid by Bart during 2014?

Charges to insurance expense during 2014	\$975,000
– Decrease in prepaid insurance (\$310,000 – \$265,000)	<u>(45,000)</u>
= Insurance premiums paid in 2014	<u>\$930,000</u>

Feedback: The total amount of insurance premiums paid in 2014 is equal to the insurance expense for 2014 less the decline in the balance in prepaid insurance.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-01 The distinction between cash-basis versus accrual income and why accrual-basis income generally is a better measure of operating performance.

134. 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 12/31/13	\$90,000
2014 sales	400,000
2014 redemptions of prior year sales	60,000
2014 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 2014 income statement, what amount should Schlegel report as gift certificate revenue?

2013 sales redeemed or expired in 2014	\$90,000
2014 sales redeemed in 2014	<u>325,000</u>
2014 gift certificate revenue	<u>\$415,000</u>

Feedback: Any 2013 certificates unredeemed at 1/1/14 will either be redeemed or expire in 2014 and thus should be included in 2014 net income along with the dollar amount of certificates sold and redeemed in 2014.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-02 The criteria for revenue recognition under accrual accounting and how they are used in selected industries.

135. Lazer Industries, Inc. manufactures medical equipment parts and accessories. Assume all amounts are pre-tax and a 30% tax rate for 2014.

Sales	\$1,200,000
Interest expense	\$150,000
Returns from customers	\$100,000
Rent expense	\$450,000
Cost of goods sold	\$300,000
Other selling, general and administrative expenses	\$170,000
Extraordinary loss	\$230,000
Goodwill impairment	\$20,000

Required:

Provide a condensed income statement for Lazer Industries, Inc. based on the available information. Include all subtotals needed (appropriately labeled) to present your income statement in good form.

Lazer Industries Inc.,
Income Statement
For the year ended December 31, 2014

Sales	\$1,200,000
Returns from customers	<u>(100,000)</u>
Net sales	1,100,000
Cost of goods sold	<u>(300,000)</u>
Gross profit	800,000
Rent expense	(450,000)
Other selling, general and administrative expenses	<u>(170,000)</u>
Operating income	180,000
Interest expense	(150,000)
Goodwill impairment	<u>(20,000)</u>
Income before tax	10,000
Income tax expense	<u>(3,000)</u>
Income before extraordinary item	7,000
Extraordinary item (net of tax benefit of \$69,000)	<u>(161,000)</u>
Net income (loss)	<u><u>\$ (154,000)</u></u>

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

136. 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 2014.

Interest expense	\$230,000
Rent expense	390,000
Flood damage to facilities	270,000
Revenue	2,100,000
Salaries expense	450,000
Advertising expense	170,000
Restructuring charges	55,000

Required:

Based on the available information, provide a condensed income statement for Berg, Inc. Include all subtotals needed (appropriately labeled) to present your income statement in good form.

Berg Inc., Income Statement For the year ended December 31, 2014	
Revenue	\$2,100,000
Expenses:	
Salaries	(450,000)
Rent	(390,000)
Advertising	<u>(170,000)</u>
Operating income	1,090,000
Interest expense	(230,000)
Restructuring charges	<u>(55,000)</u>
Income before income tax	805,000
Income tax expense	<u>(241,500)</u>
Income before extraordinary item	563,500
Flood damage to facilities (net of tax benefit of \$81,000)	<u>(189,000)</u>
Net income	<u><u>\$374,500</u></u>

Feedback: The flood damage is considered to be extraordinary given the description of the facilities' location.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 02-05 The format and classifications for a multiple-step income statement and how the statement format is designed to differentiate earnings components that are more sustainable from those that are more transitory.

137. On August 1, 2014, Alpha Co. approved a plan to dispose of an unprofitable segment of its business. Alpha expected that the sale would occur on April 30, 2015, at an estimated gain of \$250,000. The segment had actual and estimated operating profits (losses) as follows:

Realized loss from 1/1/14 to 7/31/14	(\$400,000)
Realized loss from 8/1/14 to 12/31/14	(250,000)
Expected loss from 1/1/15 to 4/30/15	(300,000)

Assume Alpha's tax rate is 30%.

Required:

In its 2014 income statement, what should Alpha report as profit or loss from discontinued operations (net of tax effects)?

Realized loss from 1/1/14 to 7/31/14	(\$400,000)
Realized loss from 8/1/14 to 12/31/14	<u>(250,000)</u>
Total pre-tax loss	(650,000)
Tax benefit at 30%	<u>195,000</u>
Loss from discontinued operations, net of tax effects	<u>(\$455,000)</u>

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 2015 or the estimated gain on sale is recognized in 2014. These amounts will be recognized in 2015 as they occur.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 2 Medium

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

138. On November 15, 2014, 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 operating income of \$1,750,000 for 2014 which included \$360,000 earned by the discontinued segment prior to its disposal. Assume Jones' tax rate is 30%.

Required:

Prepare a partial income statement for Jones Co. for 2014, beginning with pretax income from continuing operations.

Income from continuing operations (\$1,750,000 – \$360,000)	\$1,390,000
Income tax expense (\$1,390,000 × .30)	<u>417,000</u>
Income from continuing operations	973,000
Discontinued operations:	
Operating income (net of taxes of \$108,000) from 1/1/14 through 11/15/14	252,000
Loss on disposal of discontinued operations (net of tax benefit of \$45,000)	<u>(105,000)</u>
Net income	<u>\$1,120,000</u>

Feedback: Sale price of segment - book value of segment = gain (loss) on disposal = \$2,750,000 - \$2,900,000 = (\$150,000) pretax loss.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-06 The distinction between special and unusual items; discontinued operations; and extraordinary items.

139. Delta Co. began operations on January 1, 2012. During 2012 and 2013, the company used the weighted-average method for its inventory costing. In 2014, the company 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 2012 and \$35,000 less in 2013. Delta's income statements, as originally presented, appear below. Delta's tax rate is 30%.

	2012	2013	2014
Sales	\$1,000,000	\$1,100,000	\$1,210,000
Cost of goods sold	<u>645,000</u>	<u>695,000</u>	<u>726,000</u>
Gross profit	355,000	405,000	484,000
Selling, general and administrative expenses	250,000	255,000	265,000
Depreciation expense	<u>55,000</u>	<u>55,000</u>	<u>55,000</u>
Income before tax	50,000	95,000	164,000
Income tax expense	<u>15,000</u>	<u>28,500</u>	<u>49,200</u>
Net income	<u>\$35,000</u>	<u>\$66,500</u>	<u>\$114,800</u>

Required:

- Assume that for comparison purposes Delta presents 2012 and 2013 income statements in its 2014 annual report. Revise Delta's 2012 and 2013 income statements to appear as they should in the 2014 annual report.
- Prepare the journal entry required in 2014 to record Delta's change in accounting principle.

a.

	2012	2013	2014
Sales	\$1,000,000	\$1,100,000	\$1,210,000
Cost of goods sold	<u>600,000</u>	<u>660,000</u>	<u>726,000</u>
Gross profit	400,000	440,000	484,000
Selling, general and administrative expenses	250,000	255,000	265,000
Depreciation expense	<u>55,000</u>	<u>55,000</u>	<u>55,000</u>
Income before taxes	95,000	130,000	164,000
Income tax expense	<u>28,500</u>	<u>39,000</u>	<u>49,200</u>
Net income	<u>\$66,500</u>	<u>\$91,000</u>	<u>\$114,800</u>

b.

DR Inventory	80,000	
CR Taxes payable		24,000
CR Retained earnings		56,000

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. Since pretax income—as restated—is increased by \$80,000, taxes on the increase @ 30% = \$24,000.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-07 How to report a change in accounting principle; accounting estimate; and accounting entity.

140. An analyst gathered the following information about a company whose fiscal year end is December 31.

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, 2014.

The company issued 6 million new shares of common stock on July 1, 2014.

The capital structure does not include any potentially dilutive securities.

Required:

Calculate the company's basic earnings per share for 2014.

Net income - Preferred stock dividend = \$23.7 - \$3 = \$20.7 million.

Weighted Average number of common shares = $(0.5 \times 10) + (0.5 \times 16) = 13$ million shares.

EPS = \$20.7 million net income ÷ 13 million shares = **\$1.59 per share**.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Apply
Difficulty: 3 Hard

Learning Objective: 02-08 The distinction between basic and diluted earnings per share (EPS) and required EPS disclosures.

141. Primo Landscaping commenced its business on January 1, 2014. On December 31, 2014, 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, 2014.
- b. On March 15, 2014 Primo received \$18,000 for landscape maintenance services to be rendered for 24 months (beginning July 1, 2014). This amount was credited to "Landscaping revenue."
- c. The company's fuel bill for \$1,500 for the month of December 2014 was not received until January 15, 2015.
- d. The company borrowed \$100,000 from First Bank on April 1, 2014 at an interest rate of 12% per year. The principal, along with all of the interest, is due on March 30, 2015.
- e. On January 17, 2014 the company purchased a backhoe for \$65,000. The backhoe is expected to last for 10,000 hours and have no salvage value. During 2014, Primo operated the backhoe for 500 hours.

Required:

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.

<u>Item Number</u>	<u>Effect of Omission</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Net Income</u>
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			

<u>Item Number</u>	<u>Effect of Omission</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Net Income</u>
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 \$13,500	OS \$13,500
c.	Direction of effect Dollar amount of effect	NE	US \$1,500	OS \$1,500
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 12/31/2014. b. Unearned revenue not recorded = \$13,500 for services to be rendered from 12/31/2014 to 6/30/2016. c.

Fuel expense not recorded = \$1,500. d. Interest expense for 9 months not accrued = $\$100,000 \times 0.12 \times 9/12 = \$9,000$. e. Depreciation expense not recorded = $\$65,000 \div 100,000 \text{ hours} = \$6.50/\text{hour}$ depreciation rate $\times 500 \text{ hours used in 2014} = \$3,250$.

AACSB: Analytic
AICPA: FN Measurement
Blooms: Analyze
Difficulty: 3 Hard

Learning Objective: 02-11 The procedures for preparing financial statements and how to analyze T-accounts.