Part I
True-False (1 point each, 12 points total) If true, circle "T" on the answer sheet, if false, circle "F".

1. The Financial Accounting Standards Board (FASB) is the rule-making body within the accounting profession which replaced the APB.

2. Under the matching principle, it is possible to have an expense reported on the income statement in one period, while the cash payment for that expense is reported in another period.

3. The economic entity assumption applies to all businesses, regardless of size.

4. Intraperiod tax allocation causes a reduction in income tax expenses for the period in which it is used.

5. An annuity requires that periodic rents (payments) always be the same even though the interval between rents may vary.

6. Advantages of a periodic inventory system include its easy, low-cost maintenance and ability to provide continuous, updated information on both inventory and cost of goods sold.

7. In a merchandising entity, cost of goods available for sale equals beginning inventory plus net purchases.

8. In a period of rising prices, LIFO yields a larger cost of goods sold than does FIFO.

9. Under dollar-value LIFO, there will never be a layer for a particular year unless the quantity of inventory increased during that year.

10. If one of the estimates used in computing depreciation is subsequently found to require adjustments, no change in prior years' financial statements is required.

11. (Rules have changed – disregard) An exchange of dissimilar nonmonetary assets should be based on the book value of the assets involved.

12. (Not covered in current class) Due to FASB Statement No. 2, all research and development (R & D) costs should normally be charged to expense when incurred.
Part II
Multiple Choice (3 points each, 87 points total) Select the one best answer for each of the following questions and place the corresponding letter in the space provided on the answer sheet.

1. The going concern concept is the basis for the rule that
   A. the cost of installing a machine should be added to the invoice cost of the machine in the accounts.
   B. the cost of operational assets should be written off systematically over their useful lives.
   C. the income statement should not include material gains and losses that are both unusual and occur infrequently.
   D. treasury stock should not be reported in the balance sheet as an asset.
   E. none of the above

2. A high rate of inflation most directly affects the
   A. cost principle and the unit of measure assumption
   B. separate entity assumption and the cost principle
   C. time period assumption and the revenue principle
   D. consistency principle and the objectivity principle

3. According to APE Opinion No. 20, a change from the LIFO inventory method to the FIFO inventory method should be accounted for as a
   A. change in accounting principle.
   B. change in an estimate.
   C. accounting error.
   D. prior period adjustment.
   E. none of the above.

4. Intraperiod tax allocation arises because
   A. of the need to allocate income taxes between current and future periods.
   B. items included in the determination of taxable income may be presented in different parts of the financial statements.
   C. certain revenues and expenses appear in the financial statements either before or after they are included in the income tax return.
   D. all of the above are correct.

5. The following data pertains to AB Company for 19x7: Extraordinary gain (pretax) $11,000; dividends declared, $10,000; retained earnings January 1, 19x7, $62,000; income before extraordinary item (pretax), $19,000. The income tax rate is 40%. Retained earnings at the end of 19x7 is
   A. $70,000
   B. $58,000
   C. $66,000
   D. $46,000
   E. none of the above
6. When depreciation is computed for partial periods under a decreasing charge depreciation method, it is necessary in the first year to
   A. charge a full year's depreciation in the year of acquisition to avoid allocation problems.
   B. determine depreciation expense for a full year and then prorate the expense between the periods involved.
   C. use the straight-line method for the year in which the asset is purchased.
   D. use a salvage value equal to the first year's partial depreciation charge.

7. Composite or group depreciation is a depreciation system whereby
   A. the years of useful life of the various assets in the group are added together and the total divided by the number of items.
   B. the cost of individual units within an asset group is charged to expense in the year a unit is retired from service.
   C. a straight-line rate is computed by dividing the total of the annual depreciation expense for all assets in the group by the total cost of the assets.
   D. the original cost of all items in a given group or class of assets is retained in the asset account, and the cost of replacement is charged to expense when they are acquired.

8. Goodwill
   A. generated internally should not be capitalized unless it is measured by an individual independent of the enterprise involved.
   B. is easily computed by assigning a value to the individual attributes which comprise its existence.
   C. represents a unique asset in that its value can only be identified with the business as a whole.
   D. exists in any company which has earnings that differ from those of a competitor.

9. At the end of two years, what will be the balance in a savings account paying 8% annually if $5,000 is deposited today?
   A. $5,000
   B. $5,400
   C. $5,800
   D. $5,830
   E. cannot be computed from the information given.

10. Ajax Company had a beginning inventory of $10,000. Its purchases for the period were $55,000, and Ajax averages 20 percent gross profit on its sales. For the period, its sales were $75,000. Therefore, its ending inventory can be estimated to be
    A. $10,000
    B. $ 5,000
    C. $ 8,750
    D. $18,750
    E. none of the above.
11. A company traded in a printing press with a book value of $1,300 and a market value of $1,500 for a used printing press that had a market value of $2,200. The press acquired was both larger and faster than the one exchanged. The company also paid $700 cash boot to make up for the difference in market value. What should be the capitalized value of the new asset? *(Assume commercial substance)*

A. $2,200  
B. $2,000  
C. $1,500  
D. $1,300  
E. $1,000  
F. none of the above.

14. On September 1, 19X1, a company borrowed cash and signed a one-year interest-bearing note on which both the principal and interest are payable on September 1, 19X2. How will the note payable and the related interest be classified in the December 31, 19X1, balance sheet?

Note Payable  
Accrued Interest  
A. Current liability  
B. Noncurrent liability  
C. Current liability  
D. No entry

15. In preparing its bank reconciliation for the month of March 19X3, Derby Company has available the following information:

Balance per bank statement, 3-31-X3 . . . $36,050  
Deposit in transit, 3-31-X3 . . . . . . . 6,250  
Outstanding checks, 3-31-X3 . . . . . . . 5,750  
Credit erroneously recorded by the bank in Derby's account, 3-31-X3 . . . . . . . 250

What should be the correct balance of cash at March 31, 19X3?

A. $35,250.  
B. $36,250.  
C. $36,300.  
D. $36,550.  
E. none of the above.

16. When the accounts receivable of a company are sold outright to a company which normally buys accounts receivable of other companies without recourse, the accounts receivable have been

A. pledged.  
B. assigned.  
C. factored.  
D. collateralized.

17. When the allowance method of recognizing bad debt expense is used, the typical write-off of a specific customer's account

A. has no effect on net income.  
B. decreases net income.  
C. decreases current assets.  
D. decreases working capital.
22. Satchel Company, which uses the conventional retail method to determine inventory cost, has provided the following information for 19X4:

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inventory, 1-1-X4</td>
<td>$34,200</td>
<td>$60,000</td>
</tr>
<tr>
<td>Net purchases</td>
<td>189,000</td>
<td>291,000</td>
</tr>
<tr>
<td>Net markups</td>
<td></td>
<td>24,000</td>
</tr>
<tr>
<td>Net markdowns</td>
<td></td>
<td>15,000</td>
</tr>
<tr>
<td>Net sales</td>
<td></td>
<td>261,000</td>
</tr>
</tbody>
</table>

What is the cost of Satchel's inventory at December 31, 19X4?
A. $58,925
B. $62,370
C. $63,855
D. $81,270
E. $83,205

23. (Not covered in current class) Using the same information as question 22, but assuming that the price index was 110 at December 31, 19X4, and 100 at January 1, 19X4, what is the cost of Satchel's inventory at December 31, 19X4, under the Dollar Value LIFO retail method?
A. $54,990
B. $54,000
C. $52,200
D. $43,770
E. $34,200

24. In December Belmont Company exchanged an old bottling machine, which cost $60,000 and was two-thirds depreciated, for a similar used machine having a current fair value of $24,000, and received a cash difference of $8,000. What is the amount of gain that Belmont should recognize on this exchange? (Assume transaction has commercial substance.)
A. $0.
B. $3,000.
C. $5,000.
D. $8,000.
E. None of the above.

25. As generally used in accounting, what is depreciation?
A. It is a process of asset valuation for balance sheet purposes.
B. It applies only to long-lived intangible assets.
C. It is used to indicate a decline in market value of a long-lived asset.
D. It is an accounting process which allocates long-lived asset cost to accounting periods.
26. (Not covered in current class) On January 2, 19X5, Hermes Corporation acquired a patent for $192,000. The patent had a remaining legal life of 12 years and an estimated useful life of eight years. In January 19X9 Hermes paid $12,000 in legal fees in a successful defense of the patent. What should Hermes record as patent amortization for 19X9?
A. $16,000.
B. $24,000.
C. $25,500.
D. $27,000.

27. (Not covered in current class) On April 1, 19X9, Union Company paid $1,600,000 for all the issued and outstanding common stock of Cable Corporation. The recorded assets and liabilities on Cable's books on April 1 were as follows:

<table>
<thead>
<tr>
<th>Asset</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$160,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>480,000</td>
</tr>
<tr>
<td>Property, plant, and equipment (net)</td>
<td>960,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td>&lt;360,000&gt;</td>
</tr>
</tbody>
</table>

On April 1, 19X9, it was determined that Cable's inventory had a fair market value of $460,000, and the property, plant, and equipment (net) had a fair market value of $1,040,000. What is the amount of goodwill resulting from the purchase?
A. $0.
B. $20,000.
C. $300,000.
D. $360,000.
E. None of the above.

28. (Not covered in current class) Heart Company is considering the acquisition of Diamond Company. The book value of Diamond's net assets is $25,000. Over the past several years, Diamond has had an average net income of $5,000 per year. A normal rate of return on book value of net assets is 12 percent. The current fair market value of Diamond's net assets is $30,000. If Heart computes goodwill by estimating the discounted present value of five years' excess earnings using a 12 percent discount rate, what is the total price Heart will pay?
A. $ 5,674
B. $ 7,210
C. $30,674
D. $35,674
E. $37,210
Part III
Problems  (26 points) Work the following problems in the space provided and show all work.

1.  (12 points) In 1951, Durango Company completed the construction of a building at a cost of $960,000 and first occupied it in January, 1952. It was estimated that the building would have a useful life of 50 years, and a salvage value of $60,000. Durango used the straight line depreciation method.

Early in 1962, an addition to the building was constructed at a cost of $96,000. At that time it was estimated that the remaining life of the building would be, as originally estimated, an additional 40 years, and that the addition would have a life of 40 years, and a salvage value of $6,000.

In 1982, it was determined that the probable life of the building would extend to the end of 2011, or 10 years beyond the original estimate. Salvage values were unchanged.

Required:

a. Compute the annual depreciation that would have been charged from 1952 to 1961.

b. Compute the annual depreciation that would have been charged from 1962 to 1981.

c. Compute the annual depreciation charged from 1982 until the end of the life.
Solutions

True-False
1. T
2. T
3. T
4. F
5. F
6. F
7. T
8. T
9. T
10. T
11. F
12. T

Multiple Choice
1. B
2. A
3. A
4. B
5. A
6. B
7. C
8. C
9. D
10. B
11. A
14. C
15. C
16. C
17. A
22. A
23. A
24. E (12000)
25. D
26. D
27. C
28. E

Problem 1
a. $18,000  
   960000 - 60000 / 50 = 18000
b. $20,250  
   (960000 + 96000) - (18000 x 10) = 876000
   876000 - (60000 + 6000) / 40 = 20250

   c. $13,500  
      (420000 + 51000) - (60000 + 6000) / 30 = 13500