I. **Multiple Choice Questions.** (2 points each, 34 points in total) Read each question carefully and indicate your answer by circling the letter preceding the one best answer.

1. Which of the following is a change in accounting principle?
   a. A change in the estimated service life of machinery
   b. A change from FIFO to LIFO
   c. A change from straight-line to double-declining-balance
   d. A change from a principle not allowed by GAAP to a principle allowed by GAAP

2. The income statement reveals
   a. resources and equities of a firm at a point in time.
   b. resources and equities of a firm for a period of time.
   c. net earnings (net income) of a firm at a point in time.
   d. net earnings (net income) of a firm for a period of time.

3. What might a manager do during the last quarter of a fiscal year if she wanted to decrease current annual net income?
   a. Delay shipments to customers until after the end of the fiscal year.
   b. Relax credit policies for customers.
   c. Pay suppliers all amounts owed.
   d. Delay purchases from suppliers until after the end of the fiscal year.

4. The single-step income statement emphasizes
   a. the gross profit figure.
   b. the various components of income from continuing operations.
   c. total revenues and total expenses.
   d. extraordinary items and accounting changes more than these are emphasized in the multiple-step income statement.

5. Under which of the following conditions would material flood damage be considered an extraordinary item for financial reporting purposes?
   a. Only if floods in the geographical area are unusual in nature and occur infrequently.
   b. Under any circumstances as an extraordinary item.
   c. Flood damage should never be classified as an extraordinary item.
   d. Only if the flood damage is material in amount and was partially reduced by insurance coverage.
6. Which of the following items would be reported net of tax on the face of the income statement?
   a. Unusual gain
   b. Prior period adjustment
   c. Discontinued operations
   d. Cumulative effect of a change in an accounting principle

7. Which of the following earnings per share figures must be disclosed on the face of the income statement?
   a. EPS for income before taxes.
   b. The effect on EPS from unusual items.
   c. EPS for gross profit.
   d. EPS for income from continuing operations.

8. For Rondelli Company, the following information is available:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cost of goods sold</td>
<td>$270,000</td>
</tr>
<tr>
<td>Dividend revenue</td>
<td>12,000</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>27,000</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>105,000</td>
</tr>
<tr>
<td>Sales revenue</td>
<td>450,000</td>
</tr>
</tbody>
</table>

   In Rondelli's multiple-step income statement, gross profit
   a. should not be reported
   b. should be reported at $60,000.
   c. should be reported at $180,000.
   d. should be reported at $192,000.

9. Which factor would be greater — the present value of $1 for 10 periods at 8% per period or the future value of $1 for 10 periods at 8% per period?
   a. Present value of $1 for 10 periods at 8% per period.
   b. Future value of $1 for 10 periods at 8% per period.
   c. The factors are the same.
   d. Need more information.

10. In the time diagram below, which concept is being depicted?

    | Year 1 | Year 2 | Year 3 | Year 4 | Year 5 |
    |--------|--------|--------|--------|--------|
    | Pmt 1  | Pmt 2  | Pmt 3  | Pmt 4  | Pmt 5  |

    a. Present value of an ordinary annuity
    b. Present value of an annuity due
    c. Future value of an ordinary annuity
    d. Future value of an annuity due
11. If the number of periods is known, the interest rate is determined by
   a. dividing the future value by the present value and looking for the quotient in the future
      value of 1 table.
   b. dividing the future value by the present value and looking for the quotient in the present
      value of 1 table.
   c. dividing the present value by the future value and looking for the quotient in the future
      value of 1 table.
   d. multiplying the present value by the future value and looking for the product in the
      present value of 1 table.

12. Jerry recently was offered a position with a major accounting firm. The firm offered Jerry
    either a signing bonus of $23,000 payable on the first day of work or a signing bonus of
    $26,000 payable after one year of employment. Assuming that the relevant interest rate is
    10%, which option should Jerry choose?
    a. The options are equivalent.
    b. Insufficient information to determine.
    c. The signing bonus of $23,000 payable on the first day of work.
    d. The signing bonus of $26,000 payable after one year of employment.

13. If an annuity due and an ordinary annuity have the same number of equal payments and the
    same interest rates, then
    a. the present value of the annuity due is less than the present value of the ordinary
       annuity.
    b. the present value of the annuity due is greater than the present value of the ordinary
       annuity.
    c. the future value of the annuity due is equal to the future value of the ordinary annuity.
    d. the future value of the annuity due is less than the future value of the ordinary annuity.

14. The installment-sales method of recognizing profit for accounting purposes is acceptable if
    a. collections in the year of sale do not exceed 30% of the total sales price.
    b. an unrealized profit account is credited.
    c. collection of the sales price is not reasonably assured.
    d. the method is consistently used for all sales of similar merchandise.

15. Which of the following is not an accurate statement concerning revenue recognition?
    a. Revenue from selling products is recognized at the date of sale, usually interpreted to
       mean the date of delivery to customers.
    b. Revenue from services rendered is recognized when cash is received or when services
       have been performed.
    c. Revenue from permitting others to use enterprise assets is recognized as time passes or
       as the assets are used.
    d. Revenue from disposing of assets other than inventory is recognized at the date of sale.
16. GAAP that covers revenue recognition for multiple-part arrangements requires that a seller should not recognize revenue for a particular part unless
   a. the part has value on a stand-alone basis.
   b. the customer has paid for the part.
   c. the part constitutes at least a "preponderance of the fair value" of the total arrangement.
   d. no more than five parts are involved in the arrangement.

17. For a typical manufacturing company, the most common critical point for recognizing revenue is the date
   a. an order is received.
   b. production is completed.
   c. the product is delivered.
   d. payment is received.
II. Problems – (66 points in total) **Show all work where appropriate!**

1. (6 points) In the space provided, write the word or phrase that is defined.

   a. Net income minus preferred dividends divided by the weighted average of shares outstanding.  
      a. _________________________________

   b. A correction of an error in a prior financial statement.  
      b. _________________________________

   c. Relating tax expense to specific items on the income statement.  
      c. _________________________________

2. (6 points) Listed below in scrambled order are 12 income statement categories. Use the numerals 1 through 12 to indicate the order in which these categories should appear on a multiple-step income statement.

   ( ) Discontinued operations.
   ( ) Cost of goods sold.
   ( ) Other revenues and gains.
   ( ) Net income.
   ( ) Income tax expense.
   ( ) Sales revenue.
   ( ) Gross profit on sales.
   ( ) Income from operations.
   ( ) Income from continuing operations before income taxes.
   ( ) Operating expenses.
   ( ) Extraordinary item.
   ( ) Income from continuing operations.
3. (7 points) Evian Corporation had income from continuing operations before tax of $1,900 in 2011. During the year, Evian completed the sale of one of its operating divisions that qualifies as a component of the entity according to GAAP regarding discontinued operations. The discontinued division had incurred operating income of $800 in 2011 prior to the sale, and its assets were sold at a loss of $1,800. Evian’s tax rate is 25%.

Required: Present in good form the income statement of Evian Corporation for 2011 starting with "Income from Continuing Operations Before Tax." Omit earnings per share and the statement’s title.
4. (17 points) Answer the five unrelated time value of money problems below. For each question fill in all the blanks and circle your answers where indicated for annuities.

a. If you put $30,000 today in an investment that earns 8% compounded quarterly, what will be the value in 10 years?

N _____
i _____
PV __________
FV __________

b. Your parents plan to give you a gift of $20,000 when you pass the CPA Exam. If you plan to pass the CPA Exam in four years from now, what amount should your parents put on deposit today in an account that will earn 6% compounded annually to have the $20,000 in four years?

N _____
i _____
PV __________
FV __________

c. If you deposit $6,000 in your bank account on January 1 of each of the four years, 2010, 2011, 2012, and 2013, what will be the balance of your bank account on January 1, 2014 if the account pays interest at the rate of 5%?

What type of annuity is this? (circle your answer) Ordinary Annuity Annuity Due

N _____
i _____
PMT __________
FV __________
2. (continued)

d. Tom wants to retire at the end of this year (2012). His life expectancy is 20 years from his retirement date. Tom has come to you, his CPA, to learn how much he should deposit on December 31, 2012 to be able to withdraw $50,000 at the end of each year starting in 2013 for the next 20 years, assuming the amount on deposit will earn 8% interest annually.

What type of annuity is this?  (circle your answer)  Ordinary Annuity  Annuity Due

N  ____ 
i  ____ 
PMT  ____________ 
PV  ____________ 

e. Congratulations, you just won the lottery with a jackpot of $77 million. The lottery offers you two payment options. Option 1 will pay you $42,000,000 now, and Option 2 will pay you $3,080,000 per year for 25 years with the first payment now. If you believe 6% is the appropriate interest rate, which option is better? Base your answer only on time value of money analysis and do not consider tax considerations. Show work to support your answer.

What type of annuity is Option 2?  (circle your answer)  Ordinary Annuity  Annuity Due

N  ____ 
i  ____ 
PMT (Option 2)  ____________ 
PV (Option 1)  ____________ 
PV (Option 2)  ____________ 

Which option is better?  (circle your answer)  Option 1  Option 2

Why?
5. (18 points) Newman and Sons Construction Company (NSC) was awarded the contract to rebuild the intersection at 180th and Pacific. Assume the contract price is $1,200,000 and the project is started on December 1, 2010, and finished on March 6, 2012. NSC uses the percentage-of-completion method of accounting for this contract. Other data is as follows:

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract Price</td>
<td>$1,200,000</td>
<td>$1,200,000</td>
<td>$1,200,000</td>
</tr>
<tr>
<td>Costs Incurred to Date</td>
<td>90,450</td>
<td>841,350</td>
<td>1,145,000</td>
</tr>
<tr>
<td>Estimated Costs to Complete</td>
<td>914,550</td>
<td>343,650</td>
<td>0</td>
</tr>
<tr>
<td>Percentage Completed</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Progress Billings</td>
<td>0</td>
<td>750,000</td>
<td>450,000</td>
</tr>
<tr>
<td>Cash Collections</td>
<td>0</td>
<td>700,000</td>
<td>500,000</td>
</tr>
</tbody>
</table>

Required:

a. For 2010, what is the amount recognized for:

   Revenue ______________________
   Gross Profit __________________

b. Prepare all entries for this project for 2011.

   1.
   2.
   3.
   4.

   If NSC had used the completed contract method instead to account for this project, how much gross profit would be recognized in:

   2010 _______________  2011 _______________  2012 _______________
6. (12 points) Newton Co. had total installment sales of $1,000,000 and cost of installment sales of $650,000 in 2012. One of the 2012 sales that was for $100,000 resulted in a default in 2014, after the customer had made six of the required 10 payments. There was no down payment made. The repossessed merchandise had a fair value of $21,000.

a. What is the gross profit rate on 2012 installment sales?

b. Make the entry to record the repossession in 2014.
Solutions

Multiple Choice

<table>
<thead>
<tr>
<th>Question Number</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>b</td>
</tr>
<tr>
<td>2.</td>
<td>d</td>
</tr>
<tr>
<td>3.</td>
<td>a or d</td>
</tr>
<tr>
<td>4.</td>
<td>c</td>
</tr>
<tr>
<td>5.</td>
<td>a</td>
</tr>
<tr>
<td>6.</td>
<td>c</td>
</tr>
<tr>
<td>7.</td>
<td>d</td>
</tr>
<tr>
<td>8.</td>
<td>c</td>
</tr>
<tr>
<td>9.</td>
<td>b</td>
</tr>
<tr>
<td>10.</td>
<td>d</td>
</tr>
<tr>
<td>11.</td>
<td>a</td>
</tr>
<tr>
<td>12.</td>
<td>d</td>
</tr>
<tr>
<td>13.</td>
<td>b</td>
</tr>
<tr>
<td>14.</td>
<td>c</td>
</tr>
<tr>
<td>15.</td>
<td>b</td>
</tr>
<tr>
<td>16.</td>
<td>a</td>
</tr>
<tr>
<td>17.</td>
<td>c</td>
</tr>
</tbody>
</table>

Problem 1

a. Earnings per share.
b. Prior period adjustment.
c. Intraperiod tax allocation.

Problem 2

10, 2, 6, 12, 8, 1, 3, 5, 7, 4, 11, 9
Problem 3

Income from continuing operations before tax  $1,900
Income tax expense  475
Income before discontinued operations  1,425
Discontinued operations
   Loss on disposal of a component of a business,
   $1,000, net of income tax benefit, $250  (750)
Net income  $ 675

Discontinued operations calculations:
   Income on operating discontinued component  $ 800
   Loss on disposal of discontinued component (1,800)
Total loss on discontinued component before tax (1,000)
Tax benefit  250
After tax loss on discontinued operations $(750)

Problem 4

a.  $66,241
b.  $15,842
c.  $27,154  Annuity Due
d.  $490,907  Ordinary Annuity
e.  Option 1  because has larger PV
   PV of other option = $41,735,101  Annuity Due
Problem 5

<table>
<thead>
<tr>
<th></th>
<th>2010</th>
<th>2011</th>
<th>2012</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contract Price</td>
<td>$1,200,000</td>
<td>$1,200,000</td>
<td>$1,200,000</td>
</tr>
<tr>
<td>Costs Incurred In Year</td>
<td>$90,450</td>
<td>$750,900</td>
<td>$303,650</td>
</tr>
<tr>
<td>Costs Incurred to Date</td>
<td>90,450</td>
<td>841,350</td>
<td>1,145,000</td>
</tr>
<tr>
<td>Estimated Costs to Complete</td>
<td>914,550</td>
<td>343,650</td>
<td>0</td>
</tr>
<tr>
<td>Total Estimated Cost</td>
<td>1,005,000</td>
<td>1,185,000</td>
<td>1,145,000</td>
</tr>
<tr>
<td>Gross Profit</td>
<td>$195,000</td>
<td>$15,000</td>
<td>$55,000</td>
</tr>
<tr>
<td>Percentage Completed</td>
<td>9%</td>
<td>71%</td>
<td>100%</td>
</tr>
<tr>
<td>Progress Billings</td>
<td>0</td>
<td>750,000</td>
<td>450,000</td>
</tr>
<tr>
<td>Cash Collections</td>
<td>0</td>
<td>700,000</td>
<td>500,000</td>
</tr>
</tbody>
</table>

Required:

a. For 2010, what is the amount recognized for:

   Revenue __108,000__________

Gross Profit __17,550__________

<table>
<thead>
<tr>
<th>2010 (not required but shown for your review)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Construction in Progress</td>
<td>90,450</td>
</tr>
<tr>
<td>Cash, A/P, etc.</td>
<td>90,450</td>
</tr>
<tr>
<td>2. Accounts Receivable</td>
<td>0</td>
</tr>
<tr>
<td>Progress Billings</td>
<td>0</td>
</tr>
<tr>
<td>3. Cash</td>
<td>0</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>0</td>
</tr>
<tr>
<td>4. Construction Expense</td>
<td>90,450</td>
</tr>
<tr>
<td>Construction in Progress (.45 x 1100000)</td>
<td>17,550</td>
</tr>
<tr>
<td>Construction Revenue (.45 x 4400000)</td>
<td>108,000</td>
</tr>
</tbody>
</table>
b. Prepare all entries for this project for 2011.

<table>
<thead>
<tr>
<th>2011</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Construction in Progress</td>
<td>750,900</td>
</tr>
<tr>
<td>Cash, A/P, etc.</td>
<td>750,900</td>
</tr>
<tr>
<td>2. Accounts Receivable</td>
<td>750,000</td>
</tr>
<tr>
<td>Progress Billings</td>
<td>750,000</td>
</tr>
<tr>
<td>3. Cash</td>
<td>700,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>700,000</td>
</tr>
<tr>
<td>4. Construction Expense</td>
<td>750,900</td>
</tr>
<tr>
<td>Construction in Progress</td>
<td>6,900</td>
</tr>
<tr>
<td>Construction Revenue</td>
<td>744,000</td>
</tr>
<tr>
<td>(.71 x 1200000 = 852000; 852000 - 108000 = 744000)</td>
<td></td>
</tr>
<tr>
<td>(.71 x 15000 = 10650; 10650 - 17550 = &lt;6900&gt;)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>2012 (not required but shown for your review)</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Construction in Progress</td>
<td>303,650</td>
</tr>
<tr>
<td>Cash, A/P, etc.</td>
<td>303,650</td>
</tr>
<tr>
<td>2. Accounts Receivable</td>
<td>450,000</td>
</tr>
<tr>
<td>Progress Billings</td>
<td>450,000</td>
</tr>
<tr>
<td>3. Cash</td>
<td>500,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>500,000</td>
</tr>
<tr>
<td>4. Construction Expense</td>
<td>303,650</td>
</tr>
<tr>
<td>Construction in Progress (55000-10650)</td>
<td>44,350</td>
</tr>
<tr>
<td>Construction Revenue (1200000-852000)</td>
<td>348,000</td>
</tr>
<tr>
<td>5. Progress Billings</td>
<td>1,200,000</td>
</tr>
<tr>
<td>Construction in Progress</td>
<td>1,200,000</td>
</tr>
</tbody>
</table>

c. If NSC had used the completed contract method instead to account for this project, how much gross profit would be recognized in:

2010 __0__________ 2011 __0__________ 2012 _55,000__________
6.

a. $350,000 ÷ $1,000,000 = 35\%

b. Inventory ................................................................. 21,000
  Deferred Gross Profit ................................................ 14,000
  Loss on Repossession .................................................. 5,000
  Accounts Receivable .................................................. 40,000

Payments: 100,000 / 10 = 10,000
Remaining Balance in A/R: 100,000 – (6 x 10,000) = 40,000
Cash collected: 10,000 x 6 = 60,000
Total Deferred GP: 100,000 – 65,000 = 35,000
Deferred GP Recognized: 60,000 x .35 = 21,000
Remaining Balance of Deferred GP: 35,000 – 21,000 = 14,000