Hock 2020 Part 1
Section A – External Financial Reporting Decisions
Answers

1. Question ID: ICMA 19.P1.010 (Topic: Financial Statements - Other Than Statement of Cash Flows)
A company is preparing its financial statements in accordance with U.S. GAAP. Listed below are select financial data for the company.

Net income = $950,000
Depreciation = $40,000
Investment by owners = $60,000
Unrealized gain on available-for-sale securities = $90,000
Foreign currency translation loss = $20,000

What is the amount that would be reported as comprehensive income?

- A. $1,120,000.
- B. $1,020,000.correct
- C. $1,060,000.
- D. $970,000.

Question was not answered

Correct Answer Explanation:

There are certain items that are added to (or subtracted from) net income to calculate comprehensive income. In this question, the unrealized gain on available-for-sale securities ($90,000) and the foreign currency translation loss ($20,000). Adding these two items to net income gives a comprehensive income of $1,020,000.

The investment by owners is not included in comprehensive income and depreciation is already included in net income.

Explanation for Choice A:

There are certain items that are added to (or subtracted from) net income to calculate comprehensive income. This answer choice does not make the necessary adjustments. Depreciation and investment by owners are both incorrectly included as adjustments to net income.

Explanation for Choice C:

There are certain items that are added to (or subtracted from) net income to calculate comprehensive income. This answer choice does not make the necessary adjustments. The foreign currency translation loss was added instead of being subtracted.

Explanation for Choice D:

There are certain items that are added to (or subtracted from) net income to calculate comprehensive income. This answer choice does not make the necessary adjustments. The unrealized gain on available-for-sale securities is not included and the foreign currency translation is added instead of subtracted.

2. Question ID: ICMA 19.P1.002 (Topic: Financial Statements - Other Than Statement of Cash Flows)
An income statement could be used by an external investor for all of the following purposes **except** to

- A. analyze the company's performance compared to the budget.correct

- B. assess the risk of the company achieving future profitability.
- C. compare the company's results to those of its competitors.
- D. predict the company's future revenues.

Question was not answered

Correct Answer Explanation:

The income statement cannot be used to analyze the company's performance compared to the budget because the budget is not part of the financial statements.

Explanation for Choice B:

The income statement may be used to assess the risk of the company achieving future profitability.

Explanation for Choice C:

The income statement may be used to compare the company's results to those of its competitors.

Explanation for Choice D:

The income statement may be used to predict the company's future revenues.

3. Question ID: HOCK LR P2E 1 (Topic: Financial Statements - Other Than Statement of Cash Flows)

The balance sheet (or statement of financial position) helps users to assess the liquidity, financial flexibility, solvency and risk of a company. A company with financial flexibility has the ability to

- A. decide whether to settle a liability or write it off.
- B. respond to unexpected needs and opportunities.correct
- C. choose the valuation methods it will use to report its assets.
- D. meet its financial obligations as they come due.

Question was not answered

Correct Answer Explanation:

Financial flexibility refers to the ability of a company to take actions that will alter the amounts and timing of its cash flows so that it is able to respond to unexpected needs and opportunities. For example, a company with a lot of debt is **not** financially flexible, because its available cash is committed to servicing its debt and it may have loan covenants that it must comply with. It will not have much spare cash available to finance an expansion or to meet an unexpected need, nor will it have the ability to borrow much more. A firm with a high degree of financial flexibility can better survive an economic downturn or other difficult setback, and it is in a better position to take advantage of profitable and unexpected investment opportunities. Moreover, a company with greater financial flexibility has a lower risk of failure.

Explanation for Choice A:

When a company has a liability, it does not have the ability to decide whether or not to settle that liability. It has a legal obligation to settle the liability by paying it or by satisfying the performance obligation represented by the liability, unless the company is relieved of that obligation by a bankruptcy judge.

Explanation for Choice C:

To a degree, all companies can choose the valuation methods they will use to report certain assets. For example, a company has a choice of inventory cost flow assumptions (FIFO, average cost, etc.), and its choice will affect the value of the inventory on its balance sheet. However, this flexibility applies to only certain assets and only as permitted under generally accepted accounting principles; and this is not what financial flexibility means.

Explanation for Choice D:

While it is important for a company to be able to meet its financial obligations as they come due, this is not what financial flexibility means.

4. Question ID: CIA 1192 P4 Q37 (Topic: Financial Statements - Other Than Statement of Cash Flows)
Because of inexact estimates of the service life and the residual value of a plant asset, a fully depreciated asset was sold in the current year at a material gain. This gain should be reported:

- A. As part of sales revenue on the current year income statement.
- B. In the income from continuing operations section of the current year income statement.correct
- C. As an adjustment to prior periods' depreciation on the statement of retained earnings.
- D. As an unusual or infrequent event in the unusual and infrequent events section of the current year income statement.

Question was not answered

Correct Answer Explanation:

The gain on the sale of an asset is reported in the income statement in the section of continuing operations in the year in which it is sold.

Explanation for Choice A:

The sale of a fixed asset is not recorded as revenue in the financial statements.

Explanation for Choice C:

The sale of a fixed asset is not recorded as an adjustment to prior periods' depreciation in the financial statements.

Explanation for Choice D:

The sale of a fixed asset is not recorded as an unusual or infrequent event in the financial statements, and unusual or infrequent events are not reported in a separate section of the income statement. Unusual or infrequent events are reported as separate line items within the income from continuing operations section of the income statement or, alternatively, included in some other line of the income from continuing operations section and disclosed in the notes to the financial statements.

5. Question ID: ICMA 10.P2.004 (Topic: Financial Statements - Other Than Statement of Cash Flows)
The statement of changes in stockholders' equity shows a

- A. listing of all stockholders' equity accounts and their corresponding dollar amounts.
- B. computation of the number of shares outstanding used for earnings per share calculations.
- C. reconciliation of the beginning and ending balances in the Retained Earnings account.
- D. reconciliation of the beginning and ending balances in the individual stockholders' equity accounts.correct

Question was not answered

Correct Answer Explanation:

Firms are required to present a reconciliation of the beginning and ending balances of their stockholders' equity accounts. The statement of changes in stockholders' equity reports the changes in each stockholders' equity account and in total stockholders' equity during the year and reconciles the beginning balance in each account with the ending balance.

Explanation for Choice A:

This is a description of the equity section of the balance sheet. The statement of changes in stockholders' equity shows more than just the ending balances of the stockholders' equity accounts.

Explanation for Choice B:

The computation of the number of shares outstanding used for earnings per share calculations is not shown on the statement of changes in stockholders' equity.

Explanation for Choice C:

The statement of changes in stockholders' equity shows more than just a reconciliation of the beginning and ending balances in the Retained Earnings account.

6. Question ID: ICMA 1603.P1.053 (Topic: Financial Statements - Other Than Statement of Cash Flows)
All of the following are limitations of the balance sheet **except** that

- A. the balance sheet provides information on the liquidity and solvency of the company.correct
- B. assets and liabilities are usually recorded at historical cost, which might differ significantly from current fair value.
- C. the balance sheet is prepared using management judgments and estimates.
- D. the balance sheet omits many items that cannot be recorded objectively but which have financial value to the company.

Question was not answered

Correct Answer Explanation:

Providing information on the liquidity and solvency of the company is not a limitation of the balance sheet. It is a characteristic of the balance sheet. The balance sheet helps to assess the company's liquidity, financial flexibility, solvency, and risk.

Explanation for Choice B:

This is a limitation of the balance sheet.

Explanation for Choice C:

This is a limitation of the balance sheet.

Explanation for Choice D:

This is a limitation of the balance sheet.

7. Question ID: HOCK MP2 AF16 (Topic: Financial Statements - Other Than Statement of Cash Flows)

In times of rising prices, what effect does the use of the historical cost concept have on a company's asset values and profit?

- A. Asset values will be overstated and profit understated in the financial statements.
- B. Asset values and profit will both be understated in the financial statements.
- C. Asset values will be understated and profit overstated in the financial statements.correct
- D. Asset values and profit will both be overstated in the financial statements.

Question was not answered

Correct Answer Explanation:

In a period of rising prices, use of the historical cost concept will cause the value of assets on the financial statements to be understated, since the current fair value of the assets will be more than was paid for them. Similarly, the selling prices of inventory items will go up but their inventory cost will remain the same in the financial statements while they are in inventory. Thus, cost of goods sold is unadjusted and so profits will be overstated. Therefore, in a time of rising prices, assets are understated and profits are overstated in the financial statements.

Explanation for Choice A:

In a time of rising prices, asset values will not be overstated and profit will not be understated in the financial statements.

Explanation for Choice B:

In a time of rising prices, asset values and profit will not both be understated in the financial statements.

Explanation for Choice D:

In a time of rising prices, asset values and profit will not both be overstated in the financial statements.

8. Question ID: ICMA 10.P2.002 (Topic: Financial Statements - Other Than Statement of Cash Flows)

The financial statements included in the annual report to the shareholders are **least** useful to which one of the following?

- A. Managers in charge of operating activities.correct
- B. Competing businesses.
- C. Stockbrokers.
- D. Bankers preparing to lend money.

Question was not answered

Correct Answer Explanation:

The financial statements included in the annual report to shareholders do not contain enough detail for internal managers in charge of operating activities. Managers need internal reports that give them the details about the effectiveness and the efficiency of operations, so they can make the necessary day-to-day decisions.

Explanation for Choice B:

Competing businesses use financial statements of their competitors to analyze how well they are doing versus the competition.

Explanation for Choice C:

Stockbrokers use financial statements of publicly-traded companies to make recommendations to their clients.

Explanation for Choice D:

Bankers use financial statements of both publicly-traded companies and private companies to make loan decisions in response to loan requests from the companies.

9. Question ID: ICMA 1603.P1.006 (Topic: Financial Statements - Other Than Statement of Cash Flows)

A company's net income totaled $12,000,000. The company had an unusual loss of $250,000, an unrealized after-tax gain of $25,000 on available-for-sale debt securities, and a $900,000 distribution of cash dividends. The company's comprehensive income was

- A. $10,875,000.
- B. $11,775,000.
- C. $11,750,000.
- D. $12,025,000.correct

Question was not answered

Correct Answer Explanation:

Comprehensive income includes everything on the income statement plus several specific items that are called Other Comprehensive Income (OCI) that do not appear on the income statement. They do not appear on the income statement because U.S. GAAP requires them to be reported as OCI items in the calculation of comprehensive income. Accumulated other comprehensive income is a line in the equity section of the balance sheet that includes these items that are not reflected on the income statement. The amount of change in the accumulated other comprehensive income account during a given year is included along with net income in calculating comprehensive income.

The unrealized after-tax gain of $25,000 on available-for-sale debt securities was reported in accumulated other comprehensive income. Thus, comprehensive income includes the net income of $12,000,000 (which includes the unusual loss) plus the $25,000 unrealized gain on available-for-sale debt securities reported in accumulated other comprehensive income, for a total of $12,025,000.

Explanation for Choice A:

This answer excludes the unusual loss of $250,000 and the dividend of $900,000. Comprehensive income includes everything on the income statement plus several specific items that are called other comprehensive income (OCI) that do not appear on the income statement.

The unusual loss of $250,000 reduces net income and thus it should not be deducted again.

Comprehensive income includes all transactions of the company **except for** those transactions that are made with the owners of the company, such as distribution of dividends. The components of comprehensive income are net income and the amount of change during the period in accumulated other comprehensive income. Dividends are not reported on the income statement, nor are they reported in accumulated other comprehensive income. Instead, dividends are deducted from retained earnings. Since dividend transactions are not part of the components of comprehensive income, it is not proper to deduct the $900,000 in dividends distributed when calculating comprehensive income.

Explanation for Choice B:

This answer excludes the unusual loss of $250,000. Comprehensive income includes everything on the income statement plus several specific items that are called other comprehensive income (OCI) that do not appear on the income statement. The unusual loss of $250,000 is included in net income and thus is included in comprehensive income.

Explanation for Choice C:

This answer excludes the unusual loss of $250,000 and the unrealized after-tax gain of $25,000 on available-for-sale debt securities. Comprehensive income includes everything on the income statement plus several specific items that are called other comprehensive income (OCI) that do not appear on the income statement. The unusual loss of $250,000 is included in net income and thus is included in comprehensive income. The unrealized after-tax gain of $25,000 on available-for-sale debt securities is reported in accumulated other comprehensive income and thus is also included in comprehensive income.

10. Question ID: ICMA 10.P2.016 (Topic: Financial Statements - Other Than Statement of Cash Flows)
All of the following are limitations to the information provided on the statement of financial position **except** the

- A. quality of the earnings reported for the enterprise.correct
- B. judgments and estimates used regarding the collectibility, salability, and longevity of assets.
- C. omission of items that are of financial value to the business such as the worth of the employees.
- D. lack of current valuation for most assets and liabilities.

Question was not answered

Correct Answer Explanation:

The statement of financial position, or balance sheet, does not report earnings for the enterprise at all. Earnings are reported on the income statement.

Explanation for Choice B:

Judgments and estimates are used in determining many of the items reported in the balance sheet. For example, estimates of the amount of receivables the company will collect are used to value the accounts receivable; the expected useful life of fixed assets is used to determine the amount of depreciation; and the company's liability for future warranty claims is estimated by projecting the number and the cost of the future claims. Because these are estimates, they are by nature not precise.

Explanation for Choice C:

Many assets are not reported on the balance sheet, even though they do have value and will generate future cash flows. Examples of these include the company's employees, or its human resources, its processes and procedures, and its competitive advantages.

Explanation for Choice D:

Values of certain assets are measured at historical cost, not fair (or market) value, replacement cost, or their value to the firm, for the balance sheet. For example, property, plant and equipment are reported on the balance sheet at their historical cost minus accumulated depreciation, although the assets' value in use may be significantly greater.

11. Question ID: HOCK MP2 AF15 (Topic: Financial Statements - Other Than Statement of Cash Flows)
The accounting concept or convention which, in times of rising prices, tends to understate asset values and overstate profits, is the

- A. going concern concept.
- B. historical cost convention.correct
- C. conservatism concept.
- D. prudence concept.

Question was not answered

Correct Answer Explanation:

In a period of rising prices, the value of assets will be understated since the current value of the assets is more than was paid for them. Similarly, the selling prices of inventory items will go up but their inventory cost will remain the same while they are in inventory. Thus, cost of goods sold is unadjusted and so profits will be overstated.

Explanation for Choice A:

The going concern concept says that a company's balance sheet must reflect the value of that company assuming it will remain in existence for, and beyond, the foreseeable future. That concept does not lead to understated asset values or overstated profits.

Explanation for Choice C:

The conservatism concent means that when in doubt, choose the solution that will be least likely to overstate assets and income. The conservatism concept would not lead to **understated** asset values, though, and it certainly would not lead to overstated profits.

Explanation for Choice D:

The prudence concept in accounting is also known as the conservatism doctrine. It means that when in doubt, choose the solution that will be least likely to overstate assets and income. The prudence concept would not lead to **understated** asset values, though, and it certainly would not lead to overstated profits.

12. Question ID: HOCK MP2 AF1 (Topic: Financial Statements - Other Than Statement of Cash Flows)
According to the FASB conceptual framework, the objectives of financial reporting for business enterprises are based on

- A. generally accepted accounting principles.
- B. the needs of investors and creditors in making decisions about providing resources to the entity.correct
- C. reporting on management's stewardship.
- D. the need for conservatism.

Question was not answered

Correct Answer Explanation:

Per SFAC [Statement of Financial Accounting Concepts] No. 8, the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit.

Note: The conceptual framework is part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

Explanation for Choice A:

Generally accepted accounting principles are the princiles used in financial reporting. They are not the objectives of it.

Explanation for Choice C:

Although financial statement users might draw conclusions about management's stewardship from reviewing the company's financial reports, this is not an objective of financial reporting.

Explanation for Choice D:

Conservatism is a doctrine used in financial reporting which states that when in doubt, an accountant should choose the solution that is least likely to overstate assets and income. It is not an objective of financial reporting.

13. Question ID: ICMA 1603.P1.046 (Topic: Financial Statements - Other Than Statement of Cash Flows)
Blue Fox Industries had the following account balances at year end.

Sales	$452,000
Cash	23,400
Accounts payable	14,300
Rent expense	3,700
Accounts receivable	9,400
Cost of goods sold	214,000
Land	104,000
Contract liability	6,800
Gain on sale	17,500
Equipment	28,800
Inventories	2,200
Notes payable	67,000

What is the amount of total current assets reported on the balance sheet?

- A. $59,300.

- B. $63,800.
- C. $35,000.correct
- D. $39,900.

Question was not answered

Correct Answer Explanation:

Current assets include cash of $23,400, accounts receivable of $9,400, and inventories of $2,200, for total current assets of $35,000.

Explanation for Choice A:

This answer results from including the gain on sale and the contract liability as current assets. The gain on sale is an income statement item. The contract liability is a liability.

Explanation for Choice B:

This answer includes equipment in the calculation of current assets. Equipment is a long-term asset.

Explanation for Choice D:

This answer results from including accounts payable in current assets instead of accounts receivable. Accounts payable is a current liability.

14. Question ID: ICMA 1603.P1.033 (Topic: Financial Statements - Other Than Statement of Cash Flows)
A company reported first quarter revenues of $10,000,000, gross profit margin of 25%, and operating income of 15%. To reduce overhead expenses, a consultant recommends that the company outsource some of its operating activities beginning with the second quarter. This recommendation is anticipated to reduce operating expenses by 20% without affecting sales volume. The company has an income tax rate of 35%. Assuming cost of sales remains at 75%, what is the impact on the quarterly income statement if the company implements the recommendation?

- A. Operating expenses will be reduced by $300,000.
- B. Operating income will increase by $200,000.correct
- C. Gross profit will increase by 8.0%.
- D. Operating income will increase by 8.7%.

Question was not answered

Correct Answer Explanation:

The standard multiple-step income statement format includes the following sections:

Sales or service revenues

– Cost of goods sold (COGS)

Gross profit

– Operating expenses

Operating income

The question states that the company's gross profit margin is 25% of revenues and its operating income is 15% of revenues. Therefore, operating expenses must be 10% of revenues, or

$1,000,000. If operating expenses are reduced by 20%, operating expenses should be decreased by $200,000, or 20% of $1,000,000. Since sales volume and cost of goods sold will not be affected, the gross profit should remain the same as well. Therefore, the $200,000 savings in operating expenses will increase operating income by $200,000.

Explanation for Choice A:

$300,000 is 20% of the operating income of $1,500,000 (15% of $10,000,000 revenue). The question says that operating expenses will decrease by 20%, but that does not mean they will decrease by 20% of operating income. The operating expenses will decrease by 20% of operating expense. To answer this question, the amount of the current operating expenses must be calculated from the information given. The question states that the company's gross profit margin is 25% of revenues and its operating income is 15% of revenues. Therefore, operating expenses must be 10% of revenues.

Explanation for Choice C:

The question states that sales volume will not be affected by the outsourcing arrangement. Cost of goods sold will not be affected, either, because only operating expenses will be reduced, not cost of sales. Therefore, the gross profit will be unchanged.

Explanation for Choice D:

This answer results from subtracting income taxes from the amount of the increase in operating income and then calculating a percentage increase in operating income from the previous operating income unreduced by income taxes.

On a multiple-step income statement, the first deduction for income taxes follows the line for income from continuing operations, which is different from operating income. Or, if there is no income from discontinued operations, the first deduction for income taxes follows the line for net income before income taxes. Income from continuing operations/net income before income taxes includes interest and dividend income, interest expense, and non-operating gains and losses, all of which are not included in operating income.

The standard multiple-step income statement format includes the following sections:

	Sales or service revenues
−	Cost of goods sold (COGS)
	Gross profit
−	Operating expenses
	Operating income
+	Interest and dividend income
−	Interest expense
+/−	Non-operating gains/(losses)
	Income from continuing operations (or net income if no discontinued operations)
−	Provision for income taxes

Income from continuing operations
(or net income)

Thus, the provision for income taxes should not be deducted from operating income on the income statement.

15. Question ID: ICMA 10.P2.019 (Topic: Financial Statements - Other Than Statement of Cash Flows)
When a fixed asset is sold for less than book value, which one of the following will decrease?

- A. Total current assets.
- B. Net working capital.
- C. Current ratio.
- D. Net profit.correct

Question was not answered

Correct Answer Explanation:

When a fixed asset is sold for less than book value, the company will have a loss. The loss will be reported on the income statement and will decrease net profit for the period.

Explanation for Choice A:

The sale of a fixed asset will not affect total current assets, because fixed assets are long-term assets, not current assets.

Explanation for Choice B:

Net working capital is total current assets minus total current liabilities. Fixed assets are long-term assets, not current assets. Therefore, the sale of a fixed asset will not affect net working capital.

Explanation for Choice C:

The current ratio is total current assets divided by total current liabilities. Fixed assets are long-term assets, not current assets. Therefore, the sale of a fixed asset will not affect the current ratio.

16. Question ID: HOCK MP2 AF14 (Topic: Financial Statements - Other Than Statement of Cash Flows)
The historical cost convention

- A. has been replaced in accounting records by a system of current cost accounting.
- B. fails to take into account changing price levels over time.correct
- C. values all assets at their cost to the business, without any adjustment for depreciation.
- D. records only past transactions.

Question was not answered

Correct Answer Explanation:

"Historical cost" is the amount of cash, or its equivalent, that is paid to acquire an asset. It is generally used for property, plant and equipment, as well as most inventories. Historical cost may be adjusted after the acquisition for amortization or other allocations without changing the fact that historical cost is being used, because depreciation and amortization are methods of allocating the initial cost to the periods that will benefit from it. However, changes in fair value such as in market prices over time are not reflected in the carrying amount of an asset accounted for using historical cost.

Explanation for Choice A:

US GAAP is fundamentally a historical cost system of accounting, meaning that items are recorded in the books initially at their cost and then written down only over time. Items reported in financial statements are based on historical cost, fair value, current (replacement) cost, net realizable value, and present value of expected cash flows.

Explanation for Choice C:

"Historical cost" is the amount of cash, or its equivalent, that is paid to acquire an asset. It is generally used for property, plant and equipment, as well as most inventories. Historical cost may be adjusted after the acquisition for amortization or other allocations without changing the fact that historical cost is being used, because depreciation and amortization are methods of allocating the initial cost to the periods that will benefit from it.

Explanation for Choice D:

"Historical cost" is the amount of cash, or its equivalent, that is paid to acquire an asset. It is generally used for property, plant and equipment, as well as most inventories. Historical cost may be adjusted after the acquisition for amortization or other allocations without changing the fact that historical cost is being used, because depreciation and amortization are methods of allocating the initial cost to the periods that will benefit from it. Therefore, historical cost can involve current transactions as well as past transactions.

17. Question ID: HOCK MP2 AF20 (Topic: Financial Statements - Other Than Statement of Cash Flows)
Which of the following is the best definition of the going concern concept?

- A. The entity will continue in existence forever.
- B. The entity will continue in operational existence for the foreseeable future.correct
- C. The entity will continue to make profits for the foreseeable future.
- D. The entity will not incur losses in the next three years.

Question was not answered

Correct Answer Explanation:

The idea of going concern is the assumption that the company will continue in operations for the foreseeable future. Nothing in this assumption implies that the company will be profitable in the future or that it will continue in existence forever, only that it will continue to operate for the foreseeable future.

Explanation for Choice A:

It is unlikely that many entities will continue in existence forever.

Explanation for Choice C:

The going concern concept does not include any assumption of profitability.

Explanation for Choice D:

The going concern concept does not include any assumption of profitability.

18. Question ID: ICMA 10.P2.009 (Topic: Financial Statements - Other Than Statement of Cash Flows)
All of the following are elements of an income statement **except**

- A. expenses.
- B. gains and losses.
- C. revenue.
- D. shareholders' equity.correct

Question was not answered

Correct Answer Explanation:

This question is asking for the answer choice that is **not** an element of an income statement. Shareholders' equity is an element of a balance sheet (also called the statement of financial position).

Explanation for Choice A:

This question is asking for the answer choice that is **not** an element of an income statement. Expenses are an element of an income statement.

Explanation for Choice B:

This question is asking for the answer choice that is **not** an element of an income statement. Gains and losses are elements of an income statement.

Explanation for Choice C:

This question is asking for the answer choice that is **not** an element of an income statement. Revenue is an element of an income statement.

19. Question ID: HOCK MP2 AF11 (Topic: Financial Statements - Other Than Statement of Cash Flows)
According to the FASB conceptual framework, revenue may result from

- A. An increase in a liability from incidental transactions.
- B. A decrease in a liability from primary operations.correct
- C. An increase in an asset from incidental transactions.
- D. A decrease in an asset from primary operations.

Question was not answered

Correct Answer Explanation:

SFAC [Statements of Financial Accounting Concepts] No. 6 defines the elements that are used in the financial statements of a business enterprise. According to SFAC 6, **revenue** results from primary business operations. It may result when either an asset is increased or a liability is decreased. Revenue is inflows or other increases in assets of an entity or settlement of its liabilities (or a combination of both) that result from delivering or producing goods, providing services, or performing other activities that constitute the entity's ongoing major or central operations.

An example of a liability arising from primary operations is consideration received from a customer before the company fulfills its performance obligation to the customer. The consideration is recorded as a contract liability under ASC 606, "Revenue Recognition" (debit cash, credit contract liabilities).

As the performance obligation is satisfied by transferring control of the goods or services to the customer, the liability is reduced by reclassifying it to sales revenue.

Note: The conceptual framework is part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

Explanation for Choice A:

SFAC [Statements of Financial Accounting Concepts] No. 6 defines the elements that are used in the financial statements of a business enterprise. An increase in a liability does not constitute revenue according to the definition of revenue in SFAC 6.

Explanation for Choice C:

SFAC [Statements of Financial Accounting Concepts] No. 6 defines the elements that are used in the financial statements of a business enterprise. According to SFAC 6, revenue results from primary business operations. Therefore, an increase in an asset that results from incidental transactions is not revenue according to the definition of revenue in SFAC 6.

Explanation for Choice D:

SFAC [Statements of Financial Accounting Concepts] No. 6 defines the elements that are used in the financial statements of a business enterprise. A decrease in an asset from primary operations is not revenue according to the definition of revenue in SFAC 6.

20. Question ID: ICMA 13.P2.017 (Topic: Financial Statements - Other Than Statement of Cash Flows)
When using fair value accounting, it would be to a firm's benefit to report the liability at fair value when it has

- A. $28 million in outstanding bonds trading at $98.correct
- B. $25 million in putable bonds trading at $102.
- C. $50 million in variable rate preferred shares outstanding.
- D. $32 million in outstanding bonds trading at $101.

Question was not answered

Correct Answer Explanation:

$28 million in outstanding bonds trading at $98 would be reported at 98% of $28 million using fair value accounting, or $27,440,000. It would be to the firm's benefit to be able to report its liability at lower than nominal, or face, value.

Explanation for Choice B:

Putable bonds are bonds that give the bondholders the right to sell the bonds back to the issuer prior to the bonds' maturity date. Whether or not bonds are putable, if the bonds are trading at $102, it means that the fair value of the bonds is higher than the face value of the bonds. Because the bonds are liabilities, it is not to the firm's benefit to report the liabilities at a higher amount.

Explanation for Choice C:

Preferred shares are not reported as a liability. They are reported within owner's equity.

Explanation for Choice D:

If the bonds are trading at $101, it means that the fair value of the bonds is higher than the face value of the bonds. Because the bonds are liabilities, it is not to the firm's benefit to report the liabilities at a higher amount.

21. Question ID: ICMA 1603.P1.067 (Topic: Financial Statements - Other Than Statement of Cash Flows)

A company uses the calendar year as its financial results reporting time period. On May 31 of the prior year, the company committed to a plan to sell a line of business. The sale represents a strategic shift that will have a major effect on the company's operations and financial results. For the period January 1 through May 31 of the prior year, the line of business had revenues of $1,000,000 and expenses of $1,600,000. The assets of the line of business were sold on November 30, at a loss for which no tax benefit is available. In its income statement for the year ended December 31 of the prior year, how should the company report the line of business operations from January 1 through May 31?

- A. $600,000 should be reported as an unusual or infrequent loss.
- B. $1,000,000 and $1,600,000 should be included with revenues and expenses, respectively, as part of continuing operations.
- C. $600,000 should be reported as part of the loss on disposal of a component.
- D. $600,000 should be included in the determination of income or loss from operations of a discontinued component.correct

Question was not answered

Correct Answer Explanation:

The sale of the line of business represents a strategic shift that will have a major effect on the company's operations and financial results. Therefore, it qualifies for financial reporting as a discontinued operation.

All gains or losses that are incurred by a discontinued segment are reported in the period in which the gain or loss occurred and the gains or losses are reported net of associated taxes.

Operating results of a discontinued component or group of components must be reported on the income statement as discontinued operations in the period when management commits to a plan to sell the entity; the entity to be sold is available for immediate sale; an active program to locate a buyer or buyers and other actions required to complete the plan to sell the entity have been initiated; the sale is probable within one year, unless events beyond the entity's control occur; the entity is being actively marketed at a reasonable price in relation to its fair value; or actions required to complete the plan to sell the entity make it unlikely that the plan will be withdrawn or significantly changed.

The period from January 1 through May 31 is in the period in which the criteria were met. Therefore, the operating results of the discontinued component must be reported net of tax in the discontinued operations section of the income statement.

The gain or loss from the actual disposal of the entity, which did not take place until November 30, should be reported separately along with the related results of operations of the discontinued component in the discontinued operations section of the income statement in the period when the sale takes place.

Therefore, for the period January 1 through May 31, a $600,000 loss (revenues of $1,000,000 less expenses of $1,600,000) should be included in the determination of income or loss from operations of a discontinued component.

Explanation for Choice A:

Operating results of a discontinued component or group of components must be reported net of associated taxes on the income statement as discontinued operations, not as an unusual or infrequent loss. An unusual or infrequent loss is reported as part of income from continuing operations.

Explanation for Choice B:

Operating results of a discontinued component or group of components must be reported net of associated taxes as discontinued operations on the income statement.

ASC 205-20-45-1E requires the held-for-sale classification **in the period** in which all of the following criteria are met:

- Management commits to a plan to sell the entity.
- The entity to be sold is available for immediate sale.
- An active program to locate a buyers or buyers and other actions required to complete the plan to sell the entity have been initiated.
- The sale is probable within one year, unless events beyond the entity's control occur.
- The entity is being actively marketed at a reasonable price in relation to its fair value.
- Actions required to complete the plan to sell the entity make it unlikely that the plan will be withdrawn or significantly changed.

Since the period from January 1 through May 31 is in the period in which the criteria were met, the operating results of the discontinued component must be reported net of tax in the discontinued operations section of the income statement.

Explanation for Choice C:

All gains or losses that are incurred by a discontinued segment are reported in the period in which the gain or loss occurred and the gains or losses are reported net of associated taxes. Operating results of a discontinued component or group of components must be reported on the income statement as discontinued operations.

The gain or loss from the actual disposal of the entity, which did not take place until November 30, should be reported separately along with the related results of operations of the discontinued component in the discontinued operations section of the income statement in the period when the sale takes place.

Therefore, for the period January 1 through May 31, a $600,000 loss should not be reported as part of the loss on disposal of a component.

22. Question ID: ICMA 1603.P1.026 (Topic: Financial Statements - Other Than Statement of Cash Flows)
According to U.S. GAAP, where on the income statement should a multinational company report the loss from the disposal sale of a major operating unit?

- A. Report the loss, pretax, in a separate section between income from operations and income before income tax.
- B. Report the loss, net of tax, in a separate section between income before tax and net income.
- C. Report the loss, pretax, in a separate section between income from continuing operations and net income.

- D. Report the loss, net of tax, in a separate section between income from continuing operations and net income.correct
  Question was not answered

Correct Answer Explanation:

The gain or loss from the disposal of a major operating unit should be reported net of tax separately along with the related results of operations of the discontinued component in the discontinued operations section of the income statement. The discontinued operations section of the income statement follows income from continuing operations (after tax).

For example, a loss on a discontinued component would be presented in the discontinued operations section of the income statement as:

Income from continuing operations (after tax)	XXXXXX
Loss from operations of discontinued Component X	
(including loss on disposal of $XXXX)	XXXXX
Income tax benefit on loss from discontinued Component X	XXXX

Explanation for Choice A:

The loss is reported net of tax. The discontinued operations section of the income statement follows income from continuing operations (after tax).

Explanation for Choice B:

The discontinued operations section of the income statement follows income from continuing operations (after tax).

Explanation for Choice C:

The loss is reported net of tax.

23. Question ID: ICMA 19.P1.012 (Topic: Financial Statements - Statement of Cash Flows)
Which one of the following items could be identified on the cash flow statement prepared using the indirect method?

- A. The payment of interest expense of $200,000.
- B. A change in unrealized holding gains of $50,000.
- C. A settlement of a lawsuit that was previously accrued.
- D. Depreciation related to buildings and equipment.correct
  Question was not answered

Correct Answer Explanation:

The indirect method of preparing the operating activities section of the statement of cash flows starts with net income and then makes adjustments to net income. One of the adjustments under the indirect method is to add back the depreciation expense that is on the income statement. Therefore, this item would be shown in the indirect method of the statement of cash flows.

Explanation for Choice A:

The payment of interest expense would not appear in the indirect method of the statement of cash flows.

Explanation for Choice B:

A change in an unrealized holding gain would not appear in the indirect method of the statement of cash flows.

Explanation for Choice C:

A settlement of a lawsuit would not appear in the indirect method of the statement of cash flows.

24. Question ID: ICMA 10.P2.095 (Topic: Financial Statements - Statement of Cash Flows)
Carlson Company has the following payments recorded for the current period.

Dividends paid to Carlson shareholders	$150,000
Interest paid on bank loan	250,000
Purchase of equipment	350,000

The total amount of the above items to be shown in the Operating Activities Section of Carlson's Cash Flow Statement should be

- A. $350,000.
- B. $150,000.
- C. $250,000.correct
- D. $750,000.

Question was not answered

Correct Answer Explanation:

The $250,000 interest paid on the bank loan is the only operating activity noted. The dividends paid to shareholders are a financing activity and the purchase of equipment is an investment activity.

Explanation for Choice A:

The interest paid on the bank loan is the only operating activity noted. The dividends paid to shareholders are a financing activity and the purchase of equipment is an investment activity.

Explanation for Choice B:

The interest paid on the bank loan is the only operating activity noted. The dividends paid to shareholders are a financing activity and the purchase of equipment is an investment activity.

Explanation for Choice D:

The interest paid on the bank loan is the only operating activity noted. The dividends paid to shareholders are a financing activity and the purchase of equipment is an investment activity.

25. Question ID: CMA 1296 P2 Q22 (Topic: Financial Statements - Statement of Cash Flows)
Which one of the following transactions should be classified as a financing activity in a statement of cash flows?

- A. Sale of trademarks.
- B. Purchase of treasury stock.correct

- C. Purchase of equipment.
- D. Payment of interest on a mortgage note.

Question was not answered

Correct Answer Explanation:

The purchase of treasury shares is classified as a cash flow from financing activities in the statement of cash flows.

Explanation for Choice A:

The sale of trademarks would be classified as a cash inflow from investing activities on the statement of cash flows because a trademark is considered to be a long-lived asset.

Explanation for Choice C:

Purchase of equipment is a cash flow from investing activities in the statement of cash flows.

Explanation for Choice D:

The payment of interest is classified as a cash flow from operating activities on the statement of cash flows.

26. Question ID: ICMA 10.P2.011 (Topic: Financial Statements - Statement of Cash Flows)
All of the following are classifications on the Statement of Cash Flows **except**

- A. operating activities.
- B. equity activities.correct
- C. investing activities.
- D. financing activities.

Question was not answered

Correct Answer Explanation:

The Statement of Cash Flows contains three main classifications: operating activities, investing activities, and financing activities. This question is asking for what is **not** a classification on the Statement of Cash Flows. Equity activities is not a classification on the Statement of Cash Flows.

Explanation for Choice A:

The Statement of Cash Flows contains three main classifications. Cash flows from operating activities is one of those classifications. This question is asking for what is **not** a classification on the Statement of Cash Flows.

Explanation for Choice C:

The Statement of Cash Flows contains three main classifications. Cash flows from investing activities is one of those classifications. This question is asking for what is **not** a classification on the Statement of Cash Flows.

Explanation for Choice D:

The Statement of Cash Flows contains three main classifications. Cash flows from financing activities is one of those classifications. This question is asking for what is **not** a classification on the Statement of Cash Flows.

27. Question ID: ICMA 1602.P1.054 (Topic: Financial Statements - Statement of Cash Flows)

For a manufacturing firm, which of the following would be included in cash outflows from financing activities on the Statement of Cash Flows?

- A. Payment of salaries and wages.
- B. Repayment of the principal portion of firm's debt.correct
- C. Issuance of new stock.
- D. Interest payments on firm debt.

Question was not answered

Correct Answer Explanation:

Repayment of the principal portion of firm's debt is a cash outflow from financing activities on the Statement of Cash Flows.

Explanation for Choice A:

Payment of salaries and wages is a cash outflow from operating activities on the Statement of Cash Flows.

Explanation for Choice C:

Issuance of new stock is a cash **inflow** from financing activities on the Statement of Cash Flows.

Explanation for Choice D:

Interest payments on firm debt are cash outflows from operating activities on the Statement of Cash Flows.

28. Question ID: ICMA 10.P2.098 (Topic: Financial Statements - Statement of Cash Flows)
Selected financial information for Kristina Company for the year just ended is shown below.

Net income	$2,000,000
Increase in accounts receivable	300,000
Decrease in inventory	100,000
Increase in accounts payable	200,000
Depreciation expense	400,000
Gain on the sale of available-for-sale debt securities	700,000
Cash received from the issue of common stock	800,000
Cash paid for dividends	80,000
Cash paid for the acquisition of land	1,500,000
Cash received from the sale of available-for-sale debt securities	2,800,000

Kristina's cash flow from investing activities for the year is

- A. $1,220,000.
- B. $1,300,000.correct

- C. $(1,500,000).
- D. $2,800,000.

Question was not answered

Correct Answer Explanation:

$2,800,000 cash received from the sale of available-for-sale debt securities is a cash inflow and cash paid for the acquisition of land is a cash outflow ($1,500,000). Both are investing activities. The net cash flow from investing activities is $2,800,000 − $1,500,000 = $1,300,000.

Explanation for Choice A:

This includes the $80,000 paid for dividends to shareholders. Dividends paid is a financing activity, not an investing activity.

Explanation for Choice C:

This is the cash paid for the acquisition of land. The acquisition of land was not the only investing activity that took place.

Explanation for Choice D:

This is the cash received from the sale of available-for-sale debt securities. The sale of the debt securities was not the only investing activity that took place.

29. Question ID: ICMA 13.P2.014 (Topic: Financial Statements - Statement of Cash Flows)
To calculate cash flows using the indirect method, which one of the following items must be added back to net income?

- A. Revenue.
- B. Marketing expense.
- C. Depreciation expense.correct
- D. Interest income.

Question was not answered

Correct Answer Explanation:

Under the indirect method, depreciation expense is added back to net income because it is a non-cash expense item.

Explanation for Choice A:

Under the indirect method, revenue is not added back to net income.

Explanation for Choice B:

Under the indirect method, marketing expense is not added back to net income.

Explanation for Choice D:

Under the indirect method, interest income is not added back to net income.

30. Question ID: CMA 1295 P2 Q4 (Topic: Financial Statements - Statement of Cash Flows)
Royce Company had the following transactions during the fiscal year ended December 31, 20X1:

- Accounts receivable decreased from $115,000 on December 31, 20X0 to $100,000 on December 31, 20X1.
- Royce's board of directors declared dividends on December 31, 20X1 of $0.05 per share on the 2.8 million shares outstanding, payable to shareholders of record on January 31, 20X2. The company did not declare or pay dividends for fiscal 20X0.
- Sold a truck with a net book value of $7,000 for $5,000 cash, reporting a loss of $2,000.
- Paid interest to bondholders of $780,000.
- The cash balance was $106,000 on December 31, 20X0 and $284,000 on December 31, 20X1.

The total of cash provided/used by operating activities plus cash provided/used by investing activities plus cash provided/used by financing activities is

- A. cash used of $582,000.
- B. equal to net income reported for fiscal year ended December 31, 20X1.
- C. cash provided of $178,000.correct
- D. cash provided of $284,000.

Question was not answered

Correct Answer Explanation:

This question is made simple by the fact that the beginning and ending cash balances are given. Since the beginning cash was $106,000 and the ending balance was $284,000, we know that the cash increased by $178,000 during the year. All transactions that involved cash will be classified as either operating, investing or financing activities, so this question is actually just asking what the change in the cash balance was during the year, which is the ending cash balance minus the beginning cash balance.

The correct answer cannot be calculated using the other amounts given, because not all of the transactions that affected cash have been given. The amounts given net to a cash outflow of $760,000. Since that does not reconcile to the amount of change in the cash balance (a net cash inflow of $178,000), we know that not all the transctions that affected cash are given.

Explanation for Choice A:

This is the decrease in accounts receivable (+$15,000) plus the proceeds from the truck sale (+$5,000) minus the interest paid to bondholders (−$780,000) plus the increase in the cash balance (+$178,000).

This is incorrect because:

1. The question asks for the total of cash provided/used by operating activities plus cash provided/used by investing activities plus cash provided/used by financing activities. All transactions that involved cash will be classified as either operating, investing or financing activities, so this question is actually just asking what the change in the cash balance was during the year. In the calculation above, the amount of change in the cash balance (ending cash balance of $284,000 − beginning cash balance of $106,000) is included as one component of the change in the cash balance, which makes no sense. The beginning and ending cash balances can be used only to calculate the net cash used or provided during the period. The amount of change in the cash balance is the number that any statement of cash flows must reconcile to.

2. The correct answer cannot be calculated using the amounts given, because not all of the transactions that affected cash have been given. The amounts given net to a cash outflow of $760,000. Since that does not reconcile to the amount of change in the cash balance (a net cash inflow of $178,000), we know that not all the transctions that affected cash are given.

Explanation for Choice B:

Net income must be adjusted for noncash items in order to determine the net change in the cash position for the period.

Explanation for Choice D:

This is the ending cash balance.

31. Question ID: CMA 0693 P2 Q13 (Topic: Financial Statements - Statement of Cash Flows)
With respect to the content and form of the statement of cash flows,

- A. the direct method of reporting cash flows from operating activities includes disclosing the major classes of gross cash receipts and gross cash payments.correct
- B. the indirect method adjusts ending retained earnings to reconcile it to net cash flows from operations.
- C. accounting standards covering the statement of cash flows encourage the use of the indirect method.
- D. the reconciliation of the net income to net operating cash flow need not be presented when using the direct method.

Question was not answered

Correct Answer Explanation:

Under the direct method, the statement of cash flows discloses each type of transaction separately. There are individual lines for cash received from customers, cash paid to suppliers, cash paid for rent, cash paid for salaries, and so forth. Under the indirect method, this breakdown by activity is not provided.

Explanation for Choice B:

The indirect method adjusts net income to calculate the cash flows from operations which reconciles net income to net cash flows from operating activities.

Explanation for Choice C:

The FASB does not encourage the use of the indirect method.

Explanation for Choice D:

This reconciliation is required no matter which method is used. When the indirect method of reporting cash flows from operating activities is used, the reconciliation is part of the statement of cash flows. When the direct method is used, the reconciliation must be done separately from the statement.

32. Question ID: CMA 1296 P2 Q24 (Topic: Financial Statements - Statement of Cash Flows)
When using the indirect method to prepare a statement of cash flows, which one of the following should be deducted from net income when determining net cash flows from operating activities?

- A. A loss on the sale of plant assets.
- B. Amortization of premiums on bonds payable.correct

- C. An increase in accrued liabilities.
- D. Depreciation expense.

Question was not answered

Correct Answer Explanation:

Under the indirect method, increases in operating asset accounts and decreases in operating liability accounts and gains from investing and financing activities are deducted from net income. The amortization of bond premium is in essence the amortization of a gain. It decreases interest expense on the income statement, even though it is a non-cash transaction. Since it decreases interest expense, it increases net income, so it should be deducted from net income in the preparation of the operating section of the statement of cash flows, because it does not represent any cash received.

Explanation for Choice A:

The question asks whether a loss on the sale of plant assets should be deducted from net income when determining net cash flows from operating activities.

A loss on the sale of plant assets **decreases** net income and thus should be **added** to net income, not deducted, to reverse its effects on net income when calculating net cash flows from operating activities using the indirect method.

Explanation for Choice C:

The question asks whether an increase in accrued liabilities should be deducted from net income when determining net cash flows from operating activities.

Under the indirect method, increases in operating asset accounts and decreases in operating liability accounts are deducted from net income. An increase in accrued liabilities is an increase in a liability, which would be added to net income.

Explanation for Choice D:

The question asks whether depreciation expense should be deducted from net income when determining net cash flows from operating activities.

Depreciation expense is a non-cash transaction that increases expenses on the income statement. Since it increases expenses, it decreases net income. Since it is a non-cash transaction, its effect on net income needs to be reversed in order to calculate net cash flows from operating activities. To reverse its effect on net income, we add it back to net income. We do not deduct it from net income.

33. Question ID: ICMA 10.P2.015 (Topic: Financial Statements - Statement of Cash Flows)
Which one of the following should be classified as an operating activity on the statement of cash flows?

- A. The payment of a cash dividend from money arising from current operations.
- B. The purchase of additional equipment needed for current production.
- C. A decrease in accounts payable during the year.correct
- D. An increase in cash resulting from the issuance of previously authorized common stock.

Question was not answered

Correct Answer Explanation:

Operating activities are generally part of the company's main business activities and central operations. These are essentially items that generate revenues and expenses. When accounts payable decreases, it means cash has been disbursed for operating activities. Thus a decrease in accounts payable during the year should be classified as an operating activity on the statement of cash flows.

Explanation for Choice A:

The payment of a cash dividend is classified on the statement of cash flows as a financing activity, regardless of where the money to pay the dividend came from. Financing activities are the activities that a company undertakes to raise capital to finance the business, and paying a cash dividend is a financing activity.

Explanation for Choice B:

The purchase of additional equipment needed for current production is classified on the statement of cash flows as an investing activity. Investing activities are those activities that the company undertakes to generate a future profit, or return, such as purchasing fixed assets.

Explanation for Choice D:

An increase in cash resulting from the issuance of previously authorized common stock is classified on the statement of cash flows as a financing activity. Financing activities are the activities that a company undertakes to raise capital to finance the business, and issuing stock raises capital to finance the business.

34. Question ID: ICMA 10.P2.003 (Topic: Financial Statements - Statement of Cash Flows)
Which one of the following would result in a decrease to cash flow in the indirect method of preparing a statement of cash flows?

- A. Amortization expense.
- B. Proceeds from the issuance of common stock.
- C. Decrease in income taxes payable.correct
- D. Decrease in inventories.

Question was not answered

Correct Answer Explanation:

A decrease in income taxes payable results from making payment of taxes due. It represents a decrease in cash flow.

Explanation for Choice A:

Amortization expense is a non-cash transaction that increases expense and decreases net income. Since it is a non-cash transaction, it is added to net income in calculating net cash flow and increases net cash flow from operations.

Explanation for Choice B:

The issuance of common stock results in an increase to cash, not a decrease.

Explanation for Choice D:

A decrease in inventories represents an increase in cash, not a decrease.

35. Question ID: CIA 1188 P4 Q33 (Topic: Financial Statements - Statement of Cash Flows)
The following data were extracted from the financial statements of a company for the year ended December 31:

Net income	$70,000
Depreciation expense	14,000
Amortization of intangibles	1,000
Decrease in accounts receivable	2,000
Increase in inventories	9,000
Increase in accounts payable	4,000
Increase in plant assets	47,000
Increase in contributed capital	31,000
Decrease in short-term notes payable	55,000

There were no disposals of plant assets during the year. Based on the above, a statement of cash flows will report a net increase in cash of

- A. $17,000
- B. $11,000correct
- C. $54,000
- D. $69,000

Question was not answered

Correct Answer Explanation:

This question requires us to do the calculation for all activities of the statement of cash flows: operating activities, investment activities, and financing activities. The net cash flow from all three sources is the amount of change in cash.

The best way to answer this question is to start with net income and then look at each individual item and see if it needs to be added or subtracted from net income if it is an operating activity, or if it was a source or use of cash if it was an investing or operating activity.

- Net income of $70,000 is the starting point.
- Both depreciation expense of $14,000 and amortization expense of $1,000 are noncash expenses that are reductions to net income, so they both need to be added back as part of operating cash flow. This gives us $85,000.
- The $2,000 decrease in accounts receivable needs to be added because the decrease means that we collected more than we had in credit sales during the period, so it was an increase in operating cash flow. This addition of $2,000 gives us $87,000.
- The $9,000 increase in inventories needs to be subtracted because this means we paid for inventory that has not yet been sold, which decreased operating cash flow. This decrease of $9,000 takes us to $78,000.
- The $4,000 increase in accounts payable needs to be added because it means that we have not yet paid for all of the items that were purchased during the period, which increased operating cash flow. This takes us to $82,000.

- The $47,000 increase in plant assets indicates that we purchased plant assets, so this will be a decrease to cash, an investing cash outflow, taking us to $35,000.
- The $31,000 increase in contributed capital means that cash increased due to the sale of shares, a financing cash inflow. This takes us up to $66,000.
- The $55,000 decrease in short-term notes payable means that we have paid off principal of the notes payable during the period, so cash was used, a financing cash outflow. This decrease in cash takes us to $11,000, which is the net increase in cash for the period.

Explanation for Choice A:

This incorrect answer can probably be calculated in more than one way. One way is by omitting (1) the amortization, (2) the decrease in accounts receivable, and (3) the increase in inventory.

If you have calculated this answer in another way, please let us know how you did it so we can add that to this explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice C:

This incorrect answer can be calculated in more than one way. Two ways are:

(1) by omitting (a) the increase in accounts payable and (b) the increase in plant assets; and

(2) by beginning with net income and adjusting it for the increase in plant assets and the increase in contributed capital but omitting all other items that increased or decreased net cash flow.

If you have calculated this answer in another way, please let us know how you did it so we can add that to this explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice D:

This incorrect answer can probably be calculated in more than one way. One way is by omitting (1) the decrease in accounts receivable, (2) the increase in inventory, (3) the increase in accounts payable, and (4) the decrease in short-term notes payable.

If you have calculated this answer in another way, please let us know how you did it so we can add that to this explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

36. Question ID: ICMA 10.P2.092 (Topic: Financial Statements - Statement of Cash Flows)
Larry Mitchell, Bailey Company's controller, is gathering data for the Statement of Cash Flows for the most recent year end. Mitchell is planning to use the direct method to prepare this statement, and has made the following list of cash inflows for the period.

- Collections of $100,000 for goods sold to customers.

- Securities purchased for investment purposes with an original cost of $100,000 sold for $125,000.
- Proceeds from the issuance of additional company stock totaling $10,000.

The correct amount to be shown as cash inflows from operating activities is

- A. $100,000.correct
- B. $135,000.
- C. $225,000.
- D. $235,000.

Question was not answered

Correct Answer Explanation:

The only operating activity noted is the collections of $100,000 for goods sold to customers. The cash received from the sale of securities is a cash inflow from investing activities, and the cash received from the issuance of additional company stock is a cash inflow from financing activities.

Explanation for Choice B:

This includes the $100,000 in collections for goods sold to customers, the $25,000 capital gain on the securities sold, and the $10,000 proceeds from the issuance of additional company stock. Only the collections for goods sold to customers are cash inflows from operating activities. The cash received from the sale of the securities does not consist of only the gain on the sale; so even if that did belong in operating activities (which it does not, because it is an investment activity), the amount would be incorrect. The $10,000 received from issuing stock is a cash inflow from financing activities.

Explanation for Choice C:

This includes the $100,000 in collections for goods sold to customers and the $125,000 received from the sale of the securities. Only the collections for goods sold to customers are cash inflows from operating activities. The cash received from the sale of the securities is a cash inflow from investing activities.

Explanation for Choice D:

This includes the $100,000 in collections for goods sold to customers, the $125,000 received from the sale of the securities, and the $10,000 proceeds from the issuance of additional company stock. Only the collections for goods sold to customers are cash inflows from operating activities. The cash received from the sale of the securities is a cash inflow from investing activities, and the cash received from the issuance of the stock is a cash inflow from financing activities.

37. Question ID: CMA 0695 P2 Q20 (Topic: Financial Statements - Statement of Cash Flows)
With respect to the statement of cash flows, the FASB *Accounting Standards Codification*® classifies business transactions into operating, investing, and financing activities. All of the following should be included in the reconciliation of net income to net operating cash flow except a(n)

- A. increase in income tax payable.
- B. decrease in prepaid insurance.
- C. purchase of land and building in exchange for a long-term note.correct
- D. decrease in inventory.

Question was not answered

Correct Answer Explanation:

The purchase of land and a building in exchange for a long-term note is a noncash investing and financing activity. Because it is a noncash activity, it is not included in the body of the statement of cash flows at all. It should be disclosed in a supplemental schedule following the statement of cash flows.

Explanation for Choice A:

An increase in income taxes payable is included in the reconciliation of net income to net operating cash flows.

Explanation for Choice B:

A decrease in prepaid insurance is included in the reconciliation of net income to net operating cash flows.

Explanation for Choice D:

A decrease in inventory is included in the reconciliation of net income to net operating cash flows.

38. Question ID: ICMA 13.P2.2055 (Topic: Financial Statements - Statement of Cash Flows)
Garnett Company's year-end income statement shows the following.

Revenues	$5,000,000
Selling and general expenses (including depreciation expense of $200,000)	3,800,000
Interest expense	50,000
Gain on sale of equipment	40,000
Income tax expense (including long-term deferred tax expense of $30,000)	320,000
Net income	$ 870,000

During the year, Garnett's noncash current assets rose by $100,000, and current liabilities increased by $150,000. On its statement of cash flows, Garnett would report Cash Provided by Operating Activities of

- A. $1,190,000.
- B. $1,160,000.
- C. $1,080,000.
- D. $1,110,000.correct
  Question was not answered

Correct Answer Explanation:

Cash provided by operating activities is calculated as follows:

Net income	$ 870,000
Plus: Depreciation expenses	200,000

Minus: Gain on sale of equipment	(40,000)
Minus: Increase in current assets	(100,000)
Plus: Increase in current liabilities	150,000
Plus: Increase in long-term deferred tax liability	30,000
Cash provided by operating activities	$1,110,000

Explanation for Choice A:

This answer results from adding the gain on the sale of equipment to net income to calculate operating cash flow instead of subtracting the gain from net income. The gain is included in net income, but the gain is an investing cash flow, not an operating cash flow. Therefore, the gain should be subtracted from net income in calculating cash provided by operating activities.

Explanation for Choice B:

This answer results from two errors:

1. Omitting the increase in long-term deferred tax liability from the calculation of cash provided by operating activities. The deferred tax expense was a debit to the deferred tax expense account and a credit to the deferred long-term taxes liability account, increasing the balance in the liability account. For purposes of calculating cash provided by operating activities, the amount of the increase in the liability account should be treated the same way as an increase in accounts payable would be treated: as an increase to cash provided by operating activities.
2. Adding the gain on the sale of equipment to net income to calculate operating cash flow instead of subtracting the gain from net income. The gain is included in net income, but the gain is an investing cash flow, not an operating cash flow. Therefore, the gain should be subtracted from net income in calculating cash provided by operating activities.

Explanation for Choice C:

This answer results from omitting the increase in long-term deferred tax liability from the calculation of cash provided by operating activities. The deferred tax expense was a debit to the deferred tax expense account and a credit to the deferred long-term taxes liability account, increasing the balance in the liability account. For purposes of calculating cash provided by operating activities, the amount of the increase in the liability account should be treated the same way as an increase in accounts payable would be treated: as an increase to cash provided by operating activities.

39. Question ID: CMA 1295 P2 Q2 (Topic: Financial Statements - Statement of Cash Flows)
Royce Company had the following transactions during the fiscal year ended December 31, 20X1:

- Accounts receivable decreased from $115,000 on December 31, 20X0 to $100,000 on December 31, 20X1.
- Royce's board of directors declared dividends on December 31, 20X1 of $0.05 per share on the 2.8 million shares outstanding, payable to shareholders of record on January 31, 20X2. The company did not declare or pay dividends for fiscal 20X0.
- Sold a truck with a net book value of $7,000 for $5,000 cash, reporting a loss of $2,000.
- Paid interest to bondholders of $780,000.
- The cash balance was $106,000 on December 31, 20X0 and $284,000 on December 31, 20X1.

Royce Company uses the direct method to prepare its statement of cash flows at December 31, 20X1. The interest paid to bondholders is reported in the

- A. financing section, as a use or outflow of cash.
- B. operating section, as a use or outflow of cash.correct
- C. Debt section, as a use or outflow of cash.
- D. Investing section, as a use or outflow of cash.

Question was not answered

Correct Answer Explanation:

The payment of interest is a use or outflow of cash and it is classified as an operating activity in the statement of cash flows.

Explanation for Choice A:

The payment of interest is a use or outflow of cash but it is not classified as a financing activity in the statement of cash flows.

Explanation for Choice C:

The payment of interest is a use or outflow of cash. However, there is no "debt section" on the statement of cash flows.

Explanation for Choice D:

The payment of interest is a use or outflow of cash but it is not classified as an investing activity in the statement of cash flows.

40. Question ID: ICMA 10.P2.097 (Topic: Financial Statements - Statement of Cash Flows)
Selected financial information for Kristina Company for the year just ended is shown below.

Net income	$2,000,000
Increase in accounts receivable	300,000
Decrease in inventory	100,000
Increase in accounts payable	200,000
Depreciation expense	400,000
Gain on the sale of available-for-sale debt securities	700,000
Cash received from the issue of common stock	800,000
Cash paid for dividends	80,000
Cash paid for the acquisition of land	1,500,000
Cash received from the sale of available-for-sale debt securities	2,800,000

Kristina's cash flow from financing activities for the year is

- A. $720,000.correct
- B. $3,520,000.

- C. $800,000.
- D. $(80,000).

Question was not answered

Correct Answer Explanation:

Cash flow from financing activities included $800,000 cash inflow from sale of stock and $80,000 cash outflow for dividends. Net cash flow from financing activities was therefore $800,000 − $80,000 = $720,000.

Explanation for Choice B:

This includes the cash received from the sale of available-for-sale debt securities. The sale of debt securities is an investing activity, not a financing activity.

Explanation for Choice C:

This is the cash received from the sale of stock. The sale of stock was not the only financing activity that took place.

Explanation for Choice D:

This is the cash paid for dividends. Cash paid for dividends was not the only financing activity that took place.

41. Question ID: CMA 1294 P2 Q20 (Topic: Financial Statements - Statement of Cash Flows)
The net income for Cypress Inc. was $3,000,000 for the year ended December 31. Additional information is as follows:

Depreciation on fixed assets	$1,500,000
Gain from cash sale of land	200,000
Increase in accounts payable	300,000
Dividends paid on preferred stock	400,000

The net cash provided by operating activities in the statement of cash flows for the year ended December 31 should be

- A. $4,600,000correct
- B. $4,800,000
- C. $4,200,000
- D. $4,500,000

Question was not answered

Correct Answer Explanation:

In order to calculate the cash flows from operating activities under the indirect method, we must adjust net income for noncash and non-operating items. In this question, net income is $3,000,000. The adjustments that we need to make are:

1) add back $1,500,000 of depreciation expense (noncash),

2) subtract $200,000 gain from sale of land (investing activity), and

3) add back the $300,000 increase in accounts payable (noncash expense).

The dividends paid are not included in this calculation because (1) the payment of dividends is not an operating activity but is instead a financing activity; and (2) dividends paid are not included in net income, so there is no reason to reverse their effect on net income.

Explanation for Choice B:

This answer does not include the adjustment for the gain on the sale of land. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer incorrectly includes the dividends paid. Payment of dividends is a financing activity. See the correct answer for a complete explanation.

Explanation for Choice D:

This answer does not include the adjustments for the gain on the sale of land or the increase in accounts payable. See the correct answer for a complete explanation.

42. Question ID: ICMA 10.P2.005 (Topic: Financial Statements - Statement of Cash Flows)
When using the statement of cash flows to evaluate a company's continuing solvency, the **most** important factor to consider is the cash

- A. balance at the end of the period.
- B. flows from (used for) investing activities.
- C. flows from (used for) operating activities.correct
- D. flows from (used for) financing activities.

Question was not answered

Correct Answer Explanation:

Solvency refers to a firm's ability to cover its liabilities with its assets. If a firm is not able to generate a positive cash flow from its operating activities, it is or soon will be insolvent. Therefore, cash flows from and used for operating activities is the most important factor to consider when using the statement of cash flows to to evaluate a company's continuing solvency.

Explanation for Choice A:

Solvency refers to a firm's ability to cover its liabilities with its assets. The cash balance at the end of the period does not help a user evaluate the company's continuing solvency.

Explanation for Choice B:

Solvency refers to a firm's ability to cover its liabilities with its assets. Cash flows from and used for investing activities does not help a user evaluate the company's continuing solvency.

Explanation for Choice D:

Solvency refers to a firm's ability to cover its liabilities with its assets. Cash flows from and used for financing activities does not help a user evaluate the company's continuing solvency.

43. Question ID: CIA 0593 P4 Q44 (Topic: Financial Statements - Statement of Cash Flows)
In preparing a statement of cash flows using the indirect method of determining cash flows from operating activities, what adjustment is needed to net income because of (1) an increase during the period in prepaid expenses and (2) the periodic amortization of premium on bonds payable?

- A. (1) Add (2) Add
- B. (1) Deduct (2) Add
- C. (1) Deduct (2) Deductcorrect
- D. (1) Add (2) Deduct

Question was not answered

Correct Answer Explanation:

In calculating cash flows from operating activities under the indirect method, an increase in an asset account must be subtracted from net income because it represents cash paid out that is not on the income statement. Therefore, the increase in prepaid expenses will be a deduction from net income.

The amortization of premium on bonds payable reduces interest expense and thus it increases net income without increasing cash. Therefore, it will also need to be deducted from net income.

Explanation for Choice A:

An increase in an asset account must be **deducted** from net income in calculating cash flows from operating activities under the indirect method because it represents cash paid out that is not on the income statement. Therefore, the increase in prepaid expenses will be a deduction from net income.

The amortization of premium on bonds payable reduces interest expense and thus it increases net income without increasing cash. Therefore, it will also need to be **deducted** from net income.

Explanation for Choice B:

The amortization of premium on bonds payable reduces interest expense and thus it increases net income without increasing cash. Therefore, it will need to be **deducted** from net income in calculating cash flows from operating activities under the indirect method.

Explanation for Choice D:

An increase in an asset account must be **subtracted** from net income because it represents cash paid out that is not on the income statement. Therefore, the increase in prepaid expenses will be a deduction from net income in calculating cash flows from operating activities under the indirect method.

44. Question ID: CMA 1295 P2 Q3 (Topic: Financial Statements - Statement of Cash Flows)
Royce Company had the following transactions during the fiscal year ended December 31, 20X1:

- Accounts receivable decreased from $115,000 on December 31, 20X0 to $100,000 on December 31, 20x1.
- Royce's board of directors declared dividends on December 31, 20X1 of $0.05 per share on the 2.8 million shares outstanding, payable to shareholders of record on January 31, 20X2. The company did not declare or pay dividends for fiscal 20X0.
- Sold a truck with a net book value of $7,000 for $5,000 cash, reporting a loss of $2,000.
- Paid interest to bondholders of $780,000.
- The cash balance was $106,000 on December 31, 20X0 and $284,000 on December 31, 20X1.

Royce Company uses the indirect method to prepare its 20X1 statement of cash flows. It reports a(n)

- A. addition of $2,000 in the operating section for the $2,000 loss on the sale of the truck.correct
- B. source or inflow of funds of $5,000 from the sale of the truck in the financing section.

- C. deduction of $15,000 in the operating section, representing the decrease in year-end accounts receivable.
- D. use or outflow of funds of $140,000 in the financing section, representing dividends.

Question was not answered

Correct Answer Explanation:

The loss on the sale of the truck requires an adjustment to net income to calculate net cash flow from operating activities under the indirect method for the statement of cash flows. Because it was a loss that reduced net income but does not relate to an operating activity, it needs to be added back to net income.

Explanation for Choice B:

The sale of the truck should be reported in the investing activities section of the statement of cash flows.

Explanation for Choice C:

The decrease in net receivables should be added to net income under the indirect method of preparing the cash flow from operating activities section of the statement of cash flows.

Explanation for Choice D:

Because this cash flow did not occur in 20X1, it should not be reported in the 20X1 statement of cash flows. The dividends were paid in 20X2.

45. Question ID: ICMA 10.P2.096 (Topic: Financial Statements - Statement of Cash Flows)
Barber Company has recorded the following payments for the current period.

Interest paid on bank loan	$300,000
Dividends paid to Barber shareholders	200,000
Repurchase of Barber Company stock	400,000

The amount to be shown in the Financing Activities section of Barber's Cash Flow Statement should be

- A. $900,000
- B. $600,000correct
- C. $500,000
- D. $300,000

Question was not answered

Correct Answer Explanation:

Dividends paid ($200,000) and repurchase of the company's stock as treasury stock ($400,000) are transactions that should be classified as cash flows from financing activities on the company's cash flow statement.

Interest on debt is classified as a cash flow from operating activities, not financing activities.

Explanation for Choice A:

This answer results from including all of the cash flows given in the calculation of cash flows from financing activities. However, interest on debt is classified as a cash flow from operating activities, not as a cash flow from financing activities.

Explanation for Choice C:

This answer results from including interest paid on debt and dividends paid to shareholders in the calculation of cash flows from financing activities. However, interest on debt is classified as a cash flow from operating activities, not as a cash flow from financing activities. And although it is correct to classify dividends paid to shareholders as a financing activity, that is not the only financing activity among those given.

Explanation for Choice D:

This answer results from classifying interest paid on debt as the only cash flow from financing activities. However, interest on debt is classified as a cash flow from operating activities, not as a cash flow from financing activities.

46. Question ID: CMA 0697 P2 Q2 (Topic: Financial Statements - Statement of Cash Flows)
When preparing the statement of cash flows, companies are required to report separately as operating cash flows all of the following **except**

- A. Interest received on investments in bonds.
- B. Cash dividends paid on the company's stock.correct
- C. Cash collected from customers.
- D. Interest paid on the company's bonds.

Question was not answered

Correct Answer Explanation:

Cash dividends paid are classified as cash flows from financing activities on the statement of cash flows.

Explanation for Choice A:

Interest received is a cash flow from operating activities.

Explanation for Choice C:

Cash collected from customers is a cash flow from operating activities.

Explanation for Choice D:

Interest paid is a cash flow from operating activities.

47. Question ID: CMA 1294 P2 Q21 (Topic: Financial Statements - Statement of Cash Flows)
The following information was taken from the accounting records of Oak Corporation for the year ended December 31:

Proceeds from issuance of preferred stock	$4,000,000
Dividends paid on preferred stock	400,000
Bonds payable converted to common stock	2,000,000
Payment for purchase of machinery	500,000

Proceeds from sale of plant building	1,200,000
2% stock dividend on common stock	300,000
Gain on sale of plant building	200,000

The net cash flows from investing and financing activities that should be presented on Oak's statement of cash flows for the year ended December 31 are, respectively

- A. $900,000 and $3,600,000.
- B. $900,000 and $3,900,000.
- C. $700,000 and $3,900,000.
- D. $700,000 and $3,600,000.correct

Question was not answered

Correct Answer Explanation:

In this question we need to determine which of the activities are investing and which are financing. There are two investing activities: the payment for the purchase of machinery (a $500,000 cash outflow) and the proceeds from the sale of the plant building (a $1,200,000 cash inflow). These two net together to a cash inflow of $700,000. There were also two financing activities: the proceeds from the issuance of preferred stock (a $4,000,000 cash inflow) and the dividends paid on the preferred stock (a $400,000 cash outflow). These net to a $3,600,000 cash inflow.

Explanation for Choice A:

This answer incorrectly includes the gain on the sale of the plant building as an investing activity. The gain on the sale of the plant building is included in the proceeds from the sale of the building, so if we were to include it in cash flows from investing activities, we would be counting it twice. The gain on the sale of the plant building is an adjustment to net income when the indirect method is used to calculate net cash flow from operating activities. See the correct answer for a complete explanation.

Explanation for Choice B:

This answer incorrectly includes the stock dividend as a financing activity. A stock dividend is a distribution of additional shares of stock to existing shareholders. Since no cash is paid out and none is received, the payment of a stock dividend is a noncash item. This answer also incorrectly includes the gain on the sale of the plant building as an investing activity. The gain on the sale of the plant building is included in the proceeds from the sale of the building, so if we were to include it in cash flows from investing activities, we would be counting it twice. The gain on the sale of the plant building is an adjustment to net income when the indirect method is used to calculate net cash flow from operating activities. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer incorrectly includes the stock dividend as a financing activity. A stock dividend is a distribution of additional shares of stock to existing shareholders. Since no cash is paid out and none is received, the payment of a stock dividend is a noncash item. See the correct answer for a complete explanation.

48. Question ID: ICMA 10.P2.012 (Topic: Financial Statements - Statement of Cash Flows)
The sale of available-for-sale debt securities should be accounted for on the statement of cash flows as a(n)

- A. investing activity.correct
- B. noncash investing and financing activity.
- C. operating activity.
- D. financing activity.

Question was not answered

Correct Answer Explanation:

Investing activities are those activities that the company undertakes to generate a future profit, or return, such as purchasing and selling fixed assets, purchasing and selling stock of other companies, purchasing and selling debt instruments, and purchasing and selling available-for-sale or held-to-maturity securities.

Therefore, the sale of available-for-sale debt securities should be classified on the statement of cash flows as an investing activity. According to the FASB *Accounting Standards Codification*®, Paragraph 230-10-45-11, "Cash flows from purchases, sales, and maturities of available-for-sale debt securities shall be classified as cash flows from investing activities and reported gross in the statement of cash flows."

Explanation for Choice B:

Noncash investing and financing activities is not a classification on the statement of cash flows but rather an item to be disclosed as a note to the statement.

The sale of available-for-sale debt securities generates cash, so it would not be disclosed as a noncash transaction but instead must be classified in the body of the statement of cash flows.

Explanation for Choice C:

The sale of available-for-sale debt securities is not classified on the statement of cash flows as an operating activity.

Explanation for Choice D:

Financing activities are the activities that a company undertakes to raise capital to finance the business. The sale of available-for-sale debt securities is not classified on the statement of cash flows as a financing activity.

49. Question ID: CMA 0695 P2 Q21 (Topic: Financial Statements - Statement of Cash Flows)
With respect to the statement of cash flows, the FASB *Accounting Standards Codification*® classifies business transactions into operating, investing, and financing activities. Which one of the following transactions should **not** be classified as a financing activity?

- A. Income tax refund.correct
- B. Purchase of treasury stock.
- C. Issuance of common stock.
- D. Payment of dividends.

Question was not answered

Correct Answer Explanation:

An income tax refund is classified as an operating activity.

Explanation for Choice B:

The purchase of treasury stock is classified as a financing activity.

Explanation for Choice C:

The issuance of common stock is classified as a financing activity.

Explanation for Choice D:

The payment of dividends is classified as a financing activity.

50. Question ID: ICMA 10.P2.093 (Topic: Financial Statements - Statement of Cash Flows)
During the year, Deltech Inc. acquired a long-term productive asset for $5,000 and also borrowed $10,000 from a local bank. These transactions should be reported on Deltech's Statement of Cash Flows as

- A. Outflows for Operating Activities, $5,000; Inflows from Financing Activities, $10,000.
- B. Inflows from Investing Activities, $10,000; Outflows for Financing Activities, $5,000.
- C. Outflows for Investing Activities, $5,000; Inflows from Financing Activities, $10,000.correct
- D. Outflows for Financing Activities, $5,000; Inflows from Investing Activities, $10,000.

Question was not answered

Correct Answer Explanation:

Acquisition of the long-term productive asset is a $5,000 cash outflow for an investing activity, and obtaining the loan is a $10,000 cash inflow from a financing activity.

Explanation for Choice A:

Acquisition of the long-term productive asset is a cash outflow for an investing activity, and obtaining the loan is a cash inflow from a financing activity.

Explanation for Choice B:

Acquisition of the long-term productive asset is a cash outflow for an investing activity, and obtaining the loan is a cash inflow from a financing activity.

Explanation for Choice D:

Acquisition of the long-term productive asset is a cash outflow for an investing activity, and obtaining the loan is a cash inflow from a financing activity.

51. Question ID: CMA 1294 P2 Q18 (Topic: Financial Statements - Statement of Cash Flows)
When using the indirect method to prepare the statement of cash flows, the impairment of goodwill should be presented as a(n)

- A. deduction from net income.
- B. cash flow from investing activities.
- C. investing and financing activity not affecting cash.
- D. addition to net income.correct

Question was not answered

Correct Answer Explanation:

The impairment of goodwill reduces net income but it is a non-cash transaction. In calculating net cash flows from operating activities under the indirect method, the amount of the impairment needs to be added back to net income.

Explanation for Choice A:

The impairment of goodwill reduces net income but it is a non-cash transaction. In calculating net cash flows from operating activities under the indirect method, the amount of the impairment of goodwill is an adjustment to net income, but it needs to be added back to net income, not deducted from it.

Explanation for Choice B:

Impairment of goodwill is not an investing activity. The impairment of goodwill reduces net income but it is a non-cash transaction. It is an adjustment to net income that needs to be added back to net income in calculating net cash flows from operating activities.

Explanation for Choice C:

Impairment of goodwill is an adjustment to net income in calculating net cash flows from operating activities.

52. Question ID: CMA 1296 P2 Q21 (Topic: Financial Statements - Statement of Cash Flows)
All of the following should be adjustments to net income in calculating cash flows from operating activities using the indirect method of preparing the operating activities section of a statement of cash flows **except** a

- A. decrease in inventory.
- B. purchase of land and building in exchange for a long-term note.correct
- C. depreciation expense.
- D. decrease in prepaid insurance.

Question was not answered

Correct Answer Explanation:

The purchase of land and building in exchange for a long-term note is reported in the supplemental schedule of noncash investing and financing activities at the end of the statement of cash flows.

Explanation for Choice A:

A decrease in the inventory account is an adjustment included in calculating cash flows from operating activities.

Explanation for Choice C:

Depreciation expense is an adjustment included in calculating cash flows from operating activities.

Explanation for Choice D:

A decrease in the prepaid insurance account is an adjustment included calculating cash flows from operating activities.

53. Question ID: CIA 1194 P4 Q70 (Topic: Financial Statements - Statement of Cash Flows)
A company has purchased an asset with a 10-year useful life. It will use an accelerated depreciation method for tax purposes. For reporting purposes, it will use straight-line depreciation because this method is believed to reflect better the usage of the asset over its economic life.

When applying the indirect method of calculating an entity's net operating cash flows, using financial statements prepared for tax purposes rather than accrual accounting purposes will result in

- A. No effect on cash flow amounts.correct
- B. An overstatement of cash flows in the early years and then an understatement of cash flows in the later years of the economic life of depreciable assets.
- C. An overstatement of cash flows throughout the economic life of depreciable assets.
- D. An understatement of cash flows throughout the economic life of depreciable assets.

Question was not answered

Correct Answer Explanation:

Cash flow is cash flow, and it does not change because of anything reported in financial statements, whether for book purposes or for tax purposes.

Because depreciation is a non-cash item, the amount of the depreciation is eliminated from net income by adding it back to net income when calculating cash flow from operating activities. If the depreciation amount is different on the tax return from what it is in the company's financial statements, net income on the tax return will be different from that on the financial statements. If depreciation were the only non-cash item on the income statement, net income plus depreciation on the financial statements would be exactly the same as net income plus depreciation on the tax return. Only the net incomes and the depreciation amounts would differ.

Explanation for Choice B:

Because depreciation is not a cash flow item (no cash is paid or received), the method of calculating depreciation expense will not impact the statement of cash flows.

Explanation for Choice C:

Because depreciation is not a cash flow item (no cash is paid or received), the method of calculating depreciation expense will not impact the statement of cash flows.

Explanation for Choice D:

Because depreciation is not a cash flow item (no cash is paid or received), the method of calculating depreciation expense will not impact the statement of cash flows.

54. Question ID: ICMA 10.P2.094 (Topic: Financial Statements - Statement of Cash Flows)
Atwater Company has recorded the following payments for the current period.

Purchase Trillium stock	$300,000
Dividends paid to Atwater shareholders	200,000
Repurchase of Atwater Company stock	400,000

The amount to be shown in the Investing Activities Section of Atwater's Cash Flow Statement should be

- A. $900,000.
- B. $500,000.
- C. $700,000.
- D. $300,000.correct

Question was not answered

Correct Answer Explanation:

The purchase of Trillium stock for $300,000 is the only investing activity noted. Payment of dividends and treasury stock transactions are both financing activities.

Explanation for Choice A:

The purchase of Trillium stock is the only investing activity noted. Payment of dividends and treasury stock transactions are both financing activities.

Explanation for Choice B:

The purchase of Trillium stock is the only investing activity noted. Payment of dividends and treasury stock transactions are both financing activities.

Explanation for Choice C:

The purchase of Trillium stock is the only investing activity noted. Payment of dividends and treasury stock transactions are both financing activities.

55. Question ID: CIA 0592 P4 Q35 (Topic: Financial Statements - Statement of Cash Flows)
A financial statement includes all of the following items: net income, depreciation, operating activities, and financing activities. What financial statement is this?

- A. Balance sheet.
- B. Statement of cash flows.correct
- C. Statement of changes in stockholders' equity.
- D. Income statement.

Question was not answered

Correct Answer Explanation:

Net income, depreciation, operating activities, and financing activities are items that will appear on a statement of cash flows prepared using the indirect method.

Explanation for Choice A:

Net income, operating activities and financing activities are not part of the balance sheet.

Explanation for Choice C:

Depreciation, operating activities, and financing activities are not part of the statement of changes in stockholders' equity.

Explanation for Choice D:

Operating activities and financing activities are not part of the income statement.

56. Question ID: CMA 0688 P4 Q28 (Topic: Financial Statements - Statement of Cash Flows)
In preparing a statement of cash flows, an item included in determining net cash flow from operating activities is the

- A. purchase of treasury stock.
- B. amortization of a bond premium.correct
- C. proceeds from the sale of equipment for cash.

- D. cash dividends paid.

Question was not answered

Correct Answer Explanation:

The adjustment for the amortization of bond premium is part of the calculation of cash flows from operating activities.

Explanation for Choice A:

Purchase of treasury stock is a cash flow from a financing activity.

Explanation for Choice C:

Proceeds from the sale of equipment for cash are cash flows from investing activities.

Explanation for Choice D:

Cash dividends paid are cash flows from financing activities.

57. Question ID: CIA 1191 P4 Q32 (Topic: Financial Statements - Statement of Cash Flows)
In a statement of cash flows (indirect method), depreciation expense should be presented as:

- A. an outflow of cash.
- B. an addition to net income in converting net income to net cash flows from operating activities.correct
- C. a deduction from net income in converting net income to net cash flows from operating activities.
- D. an inflow of cash.

Question was not answered

Correct Answer Explanation:

Because depreciation expense is a reduction to net income on the income statement but it is not a cash expense, the depreciation expense needs to be added back to net income in order to calculate the cash flows from operating activities.

Explanation for Choice A:

Depreciation is not a cash flow so it is not an outflow of cash.

Explanation for Choice C:

Depreciation expense should not be deducted from net income to calculate cash flows from operating activities.

Explanation for Choice D:

Depreciation is not a cash flow so it is not an inflow of cash.

58. Question ID: CIA 1192 P4 Q32 (Topic: Financial Statements - Statement of Cash Flows)
A reader of a statement of cash flows wishes to analyze the major classes of cash receipts and cash payments from operating activities. Which methods of reporting cash flows from operating activities will supply that information?

- A. Only the indirect method.
- B. Neither method.
- C. Both the direct and indirect methods.

- D. Only the direct method.correct
  Question was not answered

Correct Answer Explanation:

Only the direct method provides specific information about the cash inflows or outflows from different operating activities (such as cash received from customers and cash paid to suppliers).

Explanation for Choice A:

The indirect method does not provide specific information about cash inflows and outflows from specific operating activities.

Explanation for Choice B:

One of the methods of reporting cash flows from operating activities does provide specific information about cash inflows and outflows from specific operating activities.

Explanation for Choice C:

The indirect method does not provide specific information about cash inflows and outflows from specific operating activities.

59. Question ID: CMA 1293 P2 Q30 (Topic: Financial Statements - Statement of Cash Flows)
When using the indirect method to prepare a statement of cash flows, net cash flows from operating activities are determined by adding back or deducting from net income those items included in net income that had no effect on cash. Which one of the following items should be deducted from net income when determining net cash flows from operating activities?

- A. An increase in accrued liabilities.
- B. A loss on the sale of plant assets.
- C. A decrease in accounts receivable.
- D. Amortization of a premium on a bond payable.correct
  Question was not answered

Correct Answer Explanation:

The amortization of bond premium reduces interest expense on the bond, thereby increasing net income. Since this is a noncash transaction, however, the amount of the amortization needs to be deducted from net income in order to determine net cash flows from operating activities under the indirect method.

Explanation for Choice A:

An increase in accrued liabilities represents an increase in costs that have been expensed but have not yet been paid. Since net income has been reduced by those unpaid expenses, the amount of the increase in the accrued liabilities should be added to net income to determine net cash flows from operating activities under the indirect method.

Explanation for Choice B:

A loss on the sale of plant assets decreases net income. The loss is a part of investing activities (when combined with the book value of the assets sold to calculate the cash received from the sale) and does not belong in operating activities. Because the loss reduces net income, the amount of the loss should be added back to net income in determining net cash flows from operating activities under the indirect method.

Explanation for Choice C:

A decrease in accounts receivable means more receivables were collected than were created during the period. The amount of the decrease should be added to net income to determine net cash flow from operating activities under the indirect method.

60. Question ID: CMA 1288 P4 Q19 (Topic: Financial Statements - Statement of Cash Flows)
Which of the following items is specifically included in the statement of cash flows?

- A. Acquiring an asset by means of a loan where the lender sends the loan proceeds directly to the seller of the asset.
- B. Conversion of debt to equity.
- C. Operating and nonoperating cash flow information.correct
- D. Purchasing a building by giving a mortgage to the seller.

Question was not answered

Correct Answer Explanation:

Only cash transactions are disclosed in the of the statement of cash flows. This is the only choice that is a cash transaction so this is the correct answer.

Explanation for Choice A:

This is a noncash transaction and noncash transactions are reported in a supplemental schedule at the bottom of the statement of cash flows; they are not reported in the body of the statement of cash flows.

Explanation for Choice B:

This is a noncash transaction and noncash transactions are reported in a supplemental schedule at the bottom of the statement of cash flows; they are not reported in the body of the statement of cash flows.

Explanation for Choice D:

This is a noncash transaction and noncash transactions are reported in a supplemental schedule at the bottom of the statement of cash flows; they are not reported in the body of the statement of cash flows.

61. Question ID: CMA 1295 P2 Q1 (Topic: Financial Statements - Statement of Cash Flows)
Depreciation expense is added to net income under the indirect method of preparing a statement of cash flows in order to

- A. report all assets at gross book value.
- B. reverse noncash charges deducted from net income.correct
- C. ensure depreciation has been properly reported.
- D. calculate net book value.

Question was not answered

Correct Answer Explanation:

Because depreciation is a noncash expense, it should not be included in the statement of cash flows. However, it is included in net income as a reduction to net income and therefore needs to be reversed by adding it back to net income to calculate cash generated from operating activities.

Explanation for Choice A:

The reporting of assets at gross book value is not relevant to the statement of cash flows. See the correct answer for a complete explanation.

Explanation for Choice C:

The adding back of depreciation expense to net income is not done to ensure that depreciation has been properly recorded. See the correct answer for a complete explanation.

Explanation for Choice D:

The adding back of depreciation expense to net income is not done to calculate net book value. See the correct answer for a complete explanation.

62. Question ID: ICMA 10.P2.101 (Topic: Financial Statements - Statement of Cash Flows)
Madden Corporation's controller has gathered the following information as a basis for preparing the Statement of Cash Flows. Net income for the current year was $82,000. During the year, old equipment with a cost of $60,000 and a net carrying value of $53,000 was sold for cash at a gain of $10,000. New equipment was purchased for $100,000. Shown below are selected closing balances for last year and the current year.

	Last Year	Current Year
Cash	$ 39,000	$ 85,000
Accounts receivable, net	43,000	37,000
Inventories	93,000	105,000
Equipment	360,000	400,000
Accumulated depreciation-equipment	70,000	83,000
Accounts payable	22,000	19,000
Notes payable	100,000	100,000
Common stock	250,000	250,000
Retained earnings	93,000	175,000

Madden's cash inflow from operating activities for the current year is

- A. $63,000.
- B. $73,000.
- C. $93,000.
- D. $83,000.correct

Question was not answered

Correct Answer Explanation:

The net cash flow from operating activities, calculated using the indirect method, is:

Net income (the increase to retained earnings)	$ 82,000

Minus: Gain on sale of equipment (given in problem)	(10,000)
Plus: Decrease in accounts receivable	6,000
Minus: Increase in inventory	(12,000)
Plus: Depreciation expense*	20,000
Minus: Decrease in accounts payable	(3,000)
Net cash flow from operating activities	$ 83,000

*Depreciation expense is calculated as follows: The Accumulated Depreciation account had a balance of $70,000 CR at the end of the previous year. When the old equipment was sold, it had a cost of $60,000 and a net carrying value of $53,000. Therefore, the accumulated depreciation assigned to that asset was $7,000 at the time of sale. When the old equipment was sold, the accumulated depreciation assigned to it was reversed, resulting in a debit of $7,000 to the Accumulated Depreciation account. The new balance in the Accumulated Depreciation account after the sale of the equipment was recorded was $63,000 CR. Since the credit balance in the Accumulated Depreciation account was $83,000 at the end of the current year, depreciation expense recorded for the year must have been $20,000 ($83,000 − $63,000).

Explanation for Choice A:

This answer results from not adding back depreciation expense for the year to net income. Net income has been reduced by depreciation expense, so that needs to be added when calculating net cash flow from operating activities using the indirect method. The calculation of the depreciation expense is explained in the correct answer.

Explanation for Choice B:

This answer results from not adding back depreciation expense for the year to net income and not subtracting the gain on the sale of equipment from net income. The gain on the sale of the equipment is given in the problem. Since it is included in net income, it needs to be subtracted from net income when calculating net cash flow from operating activities using the indirect method. Net income has also been reduced by depreciation expense, so that needs to be added. The calculation of the depreciation expense is explained in the correct answer.

Explanation for Choice C:

This answer results from not subtracting the gain on the sale of equipment from net income. The gain on the sale of the equipment is given in the problem. Since it is included in net income, it needs to be subtracted from net income when calculating net cash flow from operating activities using the indirect method.

63. Question ID: CMA 1293 P2 Q29 (Topic: Financial Statements - Statement of Cash Flows)
With respect to the statement of cash flows, the FASB *Accounting Standards Codification®* classifies cash receipts and cash payments as arising from operating, investing, and financing activities. All of the following should be classified as investing activities **except**

- A. cash outflows to purchase manufacturing equipment.
- B. cash outflows to lenders for interest.correct
- C. cash inflows from the sale of bonds of other entities.
- D. cash inflows from the sale of a manufacturing plant.

Question was not answered

Correct Answer Explanation:

Cash paid to lenders for interest is classified as cash flows from operating activities on the statement of cash flows.

Explanation for Choice A:

Outflows to purchase manufacturing equipment are classified as cash flows from investing activities on the statement of cash flows.

Explanation for Choice C:

Inflows from the sale of bonds of other entities are classified as cash flows from investing activities on the statement of cash flows because they are investments held by the company.

Explanation for Choice D:

Inflows from the sale of a manufacturing plant are classified as cash flows from investing activities on the statement of cash flows.

64. Question ID: CIA 1193 P4 Q33 (Topic: Financial Statements - Statement of Cash Flows)
Select the combination below that explains the impact of credit card interest incurred and paid during the period on (1) equity on the balance sheet and (2) the statement of cash flows.

- A. (1) Decrease (2) Operating outflowcorrect
- B. (1) No effect (2) Operating outflow
- C. (1) No effect (2) Financing outflow
- D. (1) Decrease (2) Financing outflow

Question was not answered

Correct Answer Explanation:

Credit card interest that is incurred will decrease equity because it is an expense that will reduce income, and therefore retained earnings. Interest paid is an operating activity on the statement of cash flows so it will be recorded as an operating cash outflow.

Explanation for Choice B:

Interest expense incurred will have an effect on equity on the balance sheet. See the correct answer for a complete explanation.

Explanation for Choice C:

Interest expense incurred will have an effect on equity on the balance sheet, and interest paid will be classified as an operating activity on the statement of cash flows. See the correct answer for a complete explanation.

Explanation for Choice D:

Interest paid is classified as an operating activity on the statement of cash flows. See the correct answer for a complete explanation.

65. Question ID: CMA 1296 P2 Q23 (Topic: Financial Statements - Statement of Cash Flows)
All of the following should be classified as investing activities in the statement of cash flows **except**

- A. cash inflows from the sale of a manufacturing plant.
- B. cash outflows to creditors for interest.correct
- C. cash inflows from the sale of bonds of other entities.
- D. cash outflows to purchase manufacturing equipment.

Question was not answered

Correct Answer Explanation:

Cash outflows for interest are classified as cash outflows from operating activities on the statement of cash flows.

Explanation for Choice A:

Cash inflows from the sale of a manufacturing plant are classified as cash inflows from investing activities on the statement of cash flows.

Explanation for Choice C:

Cash inflows from the sale of bonds of other entities are classified as cash inflows from investing activities on the statement of cash flows.

Explanation for Choice D:

Cash outflows for the purchase of equipment are classified as cash outflows from investing activities on the statement of cash flows.

66. Question ID: CIA 1195 P4 Q34 (Topic: Financial Statements - Statement of Cash Flows)
In the statement of cash flows, the payment of common share dividends appears in the _____ activities section as a _____ of cash.

- A. Financing, Usecorrect
- B. Investing, Use
- C. Investing, Source
- D. Operating, Source

Question was not answered

Correct Answer Explanation:

The payment of dividends is classified as a financing activity and because it a cash outflow, it is a use of cash.

Explanation for Choice B:

The payment of dividends is not classified as an investing activity.

Explanation for Choice C:

The payment of dividends is not an investing activity and is not a source of cash.

Explanation for Choice D:

The payment of dividends is not an operating activity and is not a source of cash.

67. Question ID: CMA 1295 P2 Q5 (Topic: Financial Statements - Statement of Cash Flows)
A statement of cash flows is intended to help users of financial statements

- A. determine a firm's components of income from operations.
- B. evaluate a firm's liquidity, solvency, and financial flexibility.correct
- C. determine whether insiders have sold or purchased the firm's stock.
- D. evaluate a firm's economic resources and obligations.

Question was not answered

Correct Answer Explanation:

The statement of cash flows provides information about the sources and uses of cash. When used with other financial statements, the statement of cash flows will assist users in evaluating a firm's liquidity, solvency and financial flexibility.

Explanation for Choice A:

The income statement, not the statement of cash flows, helps users determine a firm's components of income from operations.

Explanation for Choice C:

The notes to the financial statements will provide information as to whether or not insiders have sold or purchased the firm's stock.

Explanation for Choice D:

The balance sheet, not the statement of cash flows, provides information about a firm's economic resources and obligations.

68. Question ID: HOCK CMA.P1A.04 (Topic: Financial Statements - Integrated Reporting)
Keys Co., a manufacturer of keyboards, incorporates non-financial information into its analysis, reporting, and decision-making. Keys Co. is practicing

- A. Integrated thinking.correct
- B. Global citizenship.
- C. Shareholder wealth growth.
- D. Compliance with international standards.

Question was not answered

Correct Answer Explanation:

Keys Co. is practicing integrated thinking. When integrated thinking is a part of all of an entity's activities, management reporting will naturally incorporate the non-financial information into its management reporting, analysis, and decision-making.

Explanation for Choice B:

Global citizenship is not a non-financial information concept.

Explanation for Choice C:

Shareholder wealth growth is not a non-financial information concept.

Explanation for Choice D:

Compliance with international standards is not a concept of non-financial information.

69. Question ID: ICMA 19.1A1e.01 (Topic: Financial Statements - Integrated Reporting)

A leading manufacturer of electric vehicles has accumulated customer driving interaction data through its unique pilot driver-assist program. This data will be used to further develop more advanced autonomous features that the company plans to implement in the near future on its most popular model. In integrated reporting, the system used to accumulate and analyze the driving data is **best** categorized as

- A. natural capital.
- B. manufactured capital.
- C. human capital.
- D. intellectual capital.correct

Question was not answered

Correct Answer Explanation:

In integrated reporting, "capitals" are the resources an organization uses in producing and providing products and services. There are six capitals, of which intellectual capital is one.

Intellectual capital results from employees' efforts that generate intangible assets. Thus, it is intellectual property such as patents, copyrights, software, rights, and licenses. It is also "organizational capital" such as knowledge, systems, procedures, and protocols.

Intellectual capital is the best description of the type of capital used to create the system to accumulate and analyze driving data for development of an autonomous vehicle.

Explanation for Choice A:

In integrated reporting, "capitals" are the resources an organization uses in producing and providing products and services. There are six capitals, of which natural capital is one.

Natural capital is renewable and non-renewable natural and environmental resources such as air, water, land, forests, and minerals that provide goods or services supporting the past, current, or future prosperity of an organization. Natural capital also includes the health and biodiversity of the ecosystem.

Natural capital is not the best description of the type of capital used to create the system to accumulate and analyze driving data for development of an autonomous vehicle.

Explanation for Choice B:

In integrated reporting, "capitals" are the resources an organization uses in producing and providing products and services. There are six capitals, of which manufactured capital is one.

Manufactured physical capital is manufactured physical objects available to an organization for use in the production of goods or the provision of services. Manufactured capital includes property, plant, and equipment that belong to the organization, as well as external manufactured assets or infrastructure available to the organization such as roads, bridges, and waste and water treatment plants. It also includes assets manufactured by the reporting organization for sale or for retention by the organization for its own use.

Manufactured capital is not the best description of the type of capital used to create the system to accumulate and analyze driving data for development of an autonomous vehicle.

Explanation for Choice C:

In integrated reporting, “capitals” are the resources an organization uses in producing and providing products and services. There are six capitals, of which human capital is one.

Human capital is the skills, capabilities, and experiences of people. The quality of a company’s human capital is improved when employees become better trained.

While human capital is important in developing features for an autonomous vehicle, human capital is not the **best** description of the type of capital used to create the system to accumulate and analyze driving data for development of an autonomous vehicle.

70. Question ID: HOCK CMA.P1A.08 (Topic: Financial Statements - Integrated Reporting)
The earliest framework for reporting on social responsibility and sustainable development was developed by the

- A. European Commission.
- B. Global Reporting Initiative (GRI).correct
- C. International Integrated Reporting Council.
- D. ISO 26000.

Question was not answered

Correct Answer Explanation:

The earliest framework for reporting on social responsibility and sustainable development activities was introduced by the Global Reporting Initiative (GRI). The first GRI reporting guidelines, *Sustainability Reporting Guidelines on Economic, Environmental, and Social Performance*, were launched in 2000.

Explanation for Choice A:

The European Commission has not issued any framework for reporting on social responsibility and sustainable development.

Explanation for Choice C:

The International Integrated Reporting Council developed the *International* < *IR* > *Framework* and issued it in 2013, but the *International* < *IR* > *Framework* was not the earliest reporting framework on social responsibility and sustainable development. An earlier reporting framework was issued in 2000.

Explanation for Choice D:

ISO 26000 provides guidance on how an organization can be socially responsible, but it does not provide a framework for reporting on social responsibility.

71. Question ID: HOCK CMA.P1A.01 (Topic: Financial Statements - Integrated Reporting)
Corporate social responsibility focuses on

- A. Profit sharing.
- B. The impact the organization has on society.correct
- C. The corporation’s responsibility to earn a return for its shareholders.
- D. Meeting the needs of the present without compromising the ability of future generations to meet their needs.

Question was not answered

Correct Answer Explanation:

Corporate social responsibility focuses on organizations' impacts on society.

Explanation for Choice A:

Corporate social responsibility does not focus on profit sharing.

Explanation for Choice C:

Corporate social responsibility does not focus on the corporation's responsibility to earn a return for its shareholders.

Explanation for Choice D:

Sustainable development, not corporate social responsibility, focuses on organizations' meeting the needs of the present without compromising the ability of future generations to meet their own needs.

72. Question ID: HOCK CMA.P1A.05 (Topic: Financial Statements - Integrated Reporting)
Greener Grocers, Inc., publishes an integrated report in which the company reports on its non-financial activities. In the section of its report where it discusses its activities that benefit and improve the lives of the people in the communities where it is located, such as donating to food pantries, it is reporting on which type of capital?

- A. Natural capital.
- B. Social and relationship capital.correct
- C. Financial capital.
- D. Human capital.

Question was not answered

Correct Answer Explanation:

Social and relationship capital derives from the relationship between a company and the society from which it secures its license to operate. When a company reports on its activities that benefit and improve the lives of the people in the communities where it is located, it is reporting on its social and relationship capital.

Explanation for Choice A:

Natural capital is renewable and non-renewable natural and environmental resources such as air, water, land, forests, and minerals that provide goods or services supporting the past, current, or future prosperity of an organization. Reporting on its activities that benefit and improve the lives of the people in the communities where it is located is not reporting on natural capital.

Explanation for Choice C:

Financial capital is the pool of funds available to an organization to use in the production of goods or the provision of services. Reporting on its activities that benefit and improve the lives of the people in the communities where it is located is not reporting on financial capital.

Explanation for Choice D:

Human capital is the skills, capabilities, and experiences of the people who work for the organization. Reporting on its activities that benefit and improve the lives of the people in the communities where it is located is not reporting on human capital.

Hock 2020 Part 1
Section A – External Financial Reporting Decisions
Answers

73. Question ID: HOCK CMA.P1A.02 (Topic: Financial Statements - Integrated Reporting)
Integrated reporting is defined in the *International < IR > Framework* as

- A. Reporting on the organization’s use of externalities to create value.
- B. Reporting on management’s decisions with respect to corporate citizenship.
- C. Reporting on the social capital an organization uses in producing and providing products and services.
- D. A process that results in a periodic integrated report by an organization about value creation over time.correct

Question was not answered

Correct Answer Explanation:

Integrated reporting is defined in the *International < IR > Framework* as a process founded on integrated thinking that results in a periodic integrated report by an organization about value creation over time and related communications regarding aspects of value creation.

Explanation for Choice A:

An externality is a positive or negative consequence of an economic activity that is received or paid for by unrelated third parties that are external to the transaction. Externalities do not create value, so integrated reporting cannot mean reporting on the organization’s use of externalities to create value.

Explanation for Choice B:

Integrated reporting is not reporting on management’s decisions with respect to corporate citizenship.

Explanation for Choice C:

Social and relationship capital is one of the "capitals," or resources, that an organization uses in producing and providing products and services, and an integrated report will include a discussion of it. However, integrated reporting involves more than reporting on an organization's social and relationship capital.

74. Question ID: HOCK CMA.P1A.03 (Topic: Financial Statements - Integrated Reporting)
Value creation in the context of integrated reporting is

- A. A process that optimizes financial performance for the benefit of an organization’s shareholders.
- B. A process caused by the organization’s business activities and outputs that results in increases, decreases, or transformations of its capitals.correct
- C. A process that optimizes financial performance for the benefit of all its stakeholders.
- D. Usage of the organization’s capitals to build wealth.

Question was not answered

Correct Answer Explanation:

Value creation is defined in the *International < IR > Framework* as “the process that results in increases, decreases, or transformations of the capitals caused by the organization’s business activities and outputs."

Explanation for Choice A:

Value creation is not a process that optimizes financial performance for the benefit of an organization's shareholders.

Explanation for Choice C:

Value creation is not a process that optimizes financial performance for the benefit of all its stakeholders.

Explanation for Choice D:

Value creation is not usage of the organization's capitals to build wealth.

75. Question ID: HOCK CMA.P1A.07 (Topic: Financial Statements - Integrated Reporting)
An integrated report should contain which of the following?

- A. Competitive intelligence.
- B. Risks and opportunities.correct
- C. Customer demographics.
- D. Internal usage of data and information technology.

Question was not answered

Correct Answer Explanation:

The risks and opportunities that affect the organization's ability to create value over the short, medium, and long term and how is the organization dealing with them should be a part of the content of its integrated report.

Explanation for Choice A:

Competitive intelligence is not a part of an organization's integrated report.

Explanation for Choice C:

Customer demographics are not a part of an integrated report.

Explanation for Choice D:

An organization's internal usage of data and information technology is not a part of an integrated report.

76. Question ID: HOCK CMA.P1A.06 (Topic: Financial Statements - Integrated Reporting)
Which of the following is **not** an element of the value creation process as communicated in an integrated report?

- A. The organization's history.correct
- B. The organization's external environment.
- C. The organization's outlook.
- D. The organization's business model.

Question was not answered

Correct Answer Explanation:

The organization's history is not one of the elements of the value creation process. The elements of the value creation process as communicated in an integrated report are inputs (the six capitals), the external environment, the organization's mission and vision, governance, its business model, its outcomes, the transformed capitals that result from the process, and information about performance and a focus on the organization’s outlook.

Explanation for Choice B:

An organization’s external environment **is** an element of its value creation process. The elements of the value creation process as communicated in an integrated report are inputs (the six capitals), the external environment, the organization’s mission and vision, governance, its business model, its outcomes, the transformed capitals that result from the process, and information about performance and a focus on the organization’s outlook.

Explanation for Choice C:

An organization’s outlook **is** an element of its value creation process. The elements of the value creation process as communicated in an integrated report are inputs (the six capitals), the external environment, the organization’s mission and vision, governance, its business model, its outcomes, the transformed capitals that result from the process, and information about performance and a focus on the organization’s outlook.

Explanation for Choice D:

An organization’s business model **is** an element of its value creation process. The elements of the value creation process as communicated in an integrated report are inputs (the six capitals), the external environment, the organization’s mission and vision, governance, its business model, its outcomes, the transformed capitals that result from the process, and information about performance and a focus on the organization’s outlook.

77. Question ID: CMA 1295 P2 Q27 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Jordan Inc. is a profitable company with the goal to maximize cash flow. A valid reason for Jordan **not** to adopt the last-in, first-out (LIFO) method of inventory valuation is

- A. The company has high administrative costs.
- B. Prices are falling.correct
- C. The reduction effect on inventory.
- D. Prices are rising.

Question was not answered

Correct Answer Explanation:

In the U.S., LIFO inventory valuation exists only for the purpose of decreasing income taxes owed. In a period of rising prices, use of LIFO will create higher cost of goods sold and lower taxable income, thereby minimizing income taxes. Income tax regulations require that if a company uses LIFO on its income tax return, it must also use LIFO for its financial reporting.

When prices are falling, however, use of LIFO will create a lower cost of goods sold and therefore a higher taxable income. By having a higher taxable income, the company will pay more in income taxes, thus decreasing its cash flows. Since Jordan has a goal of maximizing cash flow, prices that are falling is a reason **not** to adopt LIFO.

Explanation for Choice A:

The administrative costs of the company are irrelevant in determining which inventory method to use.

Explanation for Choice C:

"The reduction effect on inventory" is not a reason for choosing any cost flow assumption over any other cost flow assumption. Inventory is reduced whenever sales are made regardless of the inventory cost flow assumption being used.

Explanation for Choice D:

When prices are rising, LIFO will give a higher cost of goods sold and therefore a lower profit. By having a lower profit, the company will pay less in taxes, thus maximizing its cash flows. This would be a reason to adopt LIFO.

78. Question ID: CMA 696 P2 Q4 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
All sales and purchases for the year at Ross Corporation are credit transactions. Ross shipped goods via FOB shipping point. In error, the goods were not recorded as a sale and were included in ending inventory. Which one of the following statements is correct?

- A. Accounts receivable was understated, inventory was overstated, sales were understated, and cost of goods sold was understated.correct
- B. Accounts receivable was not affected, inventory was overstated, sales were understated, and cost of goods sold was understated.
- C. Accounts receivable was understated, inventory was not affected, sales were understated, and cost of goods sold was understated.
- D. Accounts receivable was understated, inventory was overstated, sales were understated, and cost of goods sold was overstated.

Question was not answered

Correct Answer Explanation:

When goods are shipped FOB Shipping Point, the sales revenue should be recorded when the shipping takes place because that is the point at which the control of the goods is transferred to the buyer. The item should be removed from inventory and its cost debited to cost of goods sold.

Because the sale was not recorded when control passed to the buyer, both accounts receivable and sales revenue will be understated. Because the items were not taken out of inventory when they should have been, inventory is overstated. This overstatement of inventory will also cause cost of goods sold to be understated since it is assumed that these items are still in inventory.

Explanation for Choice B:

Accounts receivable was affected because the sale was not recorded.

Explanation for Choice C:

Inventory was affected because the sale of the inventory was not recorded.

Explanation for Choice D:

Cost of goods sold was not overstated, because the sale was not recorded.

79. Question ID: CIA 594 P4 Q29 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Which of the following is true regarding the assignment (pledging as collateral) of accounts receivable and factoring of accounts receivable for a manufacturing firm?

- A. The factoring of accounts receivable involves the invoice from the manufacturing firm to its customer being stamped with a notification that payment is to be made directly to the other party, whereas the assignment of accounts receivable does not.correct
- B. The lender has recourse to the manufacturing firm under factoring but not under the assignment of accounts receivable.
- C. The factoring of accounts receivable provides collateral for the manufacturing firm, whereas the assignment of receivables provides direct financing.
- D. The assignment of accounts receivable involves the invoice from the manufacturing firm to its customer being stamped with a notification that payment is to be made directly to the other party, whereas the factoring of accounts receivable does not.

Question was not answered

Correct Answer Explanation:

In factoring the payment is made by the customer directly to the factor whereas in assignment, the payment is made to the original holder of the receivable.

Explanation for Choice B:

The lender usually does not have recourse when receivables are factored. The lender usually has recourse when receivables are assigned.

Explanation for Choice C:

This answer is reversed.

Explanation for Choice D:

This answer is reversed. See the correct answer for a complete explanation.

80. Question ID: HOCK CMA.P1A1.01 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Central Merchandising has two divisions, Northern Division and Southern Division. Central maintains four checking accounts: an operating account and a payroll account for each division. Northern Division's checking accounts are at Snow State Bank, close by its Northern Division, and Southern Division's checking accounts are at Sun State Bank, near its Southern Division.

Central maintains a separate general ledger Cash account for each of the four checking accounts. On December 31, 20X5, Central Merchandising had the following balances in its four checking accounts, according to its general ledger:

Snow State Bank Operating Account	$ 20,000
Snow State Bank Payroll Account	$ 4,000
Sun State Bank Operating Account	$ (15,000)
Sun State Bank Payroll Account	$ 5,000

Because of the overdrawn condition of the Sun State Operating Account per the general ledger, Southern Division's accounts payable department is holding several accounts payable checks written on the account and will not mail them until they can be reasonably certain there will be funds available in the account to cover them by the time they reach the bank for payment. Checks being held for mailing total $7,000.

What cash balance should Central Merchandising report on its balance sheet for December 31, 20X5?

- A. $14,000
- B. $24,000correct
- C. $21,000
- D. $31,000

Question was not answered

Correct Answer Explanation:

The amount in the two Snow State accounts, $20,000 + $4,000, or $24,000, is the cash to be reported because the balance in those two combined accounts is positive.

The overdrawn balance in the Sun State Operating Account should be adjusted by increasing it by the $7,000 in unmailed checks, because although unmailed, the checks have been recorded, reducing the balance in the general ledger cash account. $(15,000) + $7,000 = ($8,000). Because the Operating Account remains in an overdraft situation after the adjustment, its adjusted balance of $(8,000) is combined with the $5,000 balance in the Sun State Payroll Account for reporting. However the combined adjusted balance at Sun State Bank is still negative because $(8,000) + $5,000 = $(3,000). That $3,000 negative balance at Sun State Bank will be reported as a current liability, not as a deduction from cash on the balance sheet.

Explanation for Choice A:

This is the combined balance in the four accounts: the balance in the Snow State Operating Account ($20,000) plus the balance in the Snow State Payroll Account ($4,000) minus the overdraft balance in the Sun State Operating account ($15,000) plus the balance in the Sun State Payroll account ($5,000). The correct amount to be reported for cash is the net positive balance per bank. The net negative balance per bank needs to be adjusted for the checks being held and if any negative amount remains, it should be reported as a current liability.

Explanation for Choice C:

This is the combined balance in the four accounts adjusted for the $7,000 in checks that are being held for mailing. The correct amount to be reported for cash is the net positive balance per bank. The net negative balance per bank needs to be adjusted for the checks being held and if any negative amount remains, it should be reported as a current liability.

Explanation for Choice D:

This is the $20,000 and the $4,000 in the two Snow State accounts plus the $7,000 in checks being held on the Sun State Operating Account. The balance in the operating account according to the general ledger has been reduced by all the checks written. The $7,000 in checks being held for mailing later should not be included in reported cash. Instead, that $7,000 will be an adjustment that will increase the net cash held in the two Sun State accounts, which are in an overdraft situation as of year end.

81. Question ID: CMA 1295 P2 Q23 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
An "aging schedule" is used to

- A. Determine depreciation pools.
- B. Classify categories of workers.

- C. Estimate the net realizable value of accounts receivable.correct
- D. Estimate inventory obsolescence.

Question was not answered

Correct Answer Explanation:

An aging schedule is used to identify how old receivables are and to then calculate what the amount is that is expected to be collected. This is the calculation of the net realizable value of the receivables.

Explanation for Choice A:

The aging schedule relates to accounts receivable. See the correct answer for a complete explanation.

Explanation for Choice B:

The aging schedule relates to accounts receivable. See the correct answer for a complete explanation.

Explanation for Choice D:

The aging schedule relates to accounts receivable. See the correct answer for a complete explanation.

82. Question ID: CMA 691 P2 Q2 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Sawyer Corporation is a wholesaler of industrial air compressor parts. The activity for Part Number C-588 during May is as follows.

May	Transaction	Units	Unit Cost	Total Cost
1	Inventory	1,400	$2.45	$3,430
7	Purchase	1,800	2.75	4,950
16	Sales	2,000		
20	Purchase	1,500	2.90	4,350
28	Sales	1,400		

If Sawyer uses a first-in, first-out perpetual inventory system, the total cost of the inventory for Part Number C-588 at May 31 is

- A. $3,230
- B. $3,770correct
- C. $3,575
- D. $3,510

Question was not answered

Correct Answer Explanation:

Under the FIFO method (perpetual or periodic) the ending inventory will consist of the most recently purchased units. In this question, the company had a total of 4,700 units on hand during the period. They sold 3,400, leaving 1,300 units in ending inventory. Under the FIFO method, these 1,300 units will be the most recently purchased units. Therefore, ending inventory will consist of 1,300 of the units that were purchased on May 20, for $2.90 each. This gives an ending inventory of $3,770 (1,300 × $2.90).

Explanation for Choice A:

This is the answer for the perpetual LIFO method. See the correct answer for a complete explanation.

Explanation for Choice C:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice D:

This is not the correct answer. Please see the correct answer for an explanation.

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83. Question ID: CMA 1289 P4 Q23 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Brighton Corporation uses the allowance method of accounting for bad debts on its internal reports and has used a historical rate of 1.5% of credit sales to estimate its bad debt expense. The aging schedule of Brighton's accounts receivable at November 30, 20X4, based upon past collection experience is presented as follows.

Days Outstanding	Amount	Probability of Collection
0-30 days	$640,000	0.98
31-60 days	180,000	0.92
61-90 days	95,000	0.75
over 90 days	40,000	0.60
	$955,000	

Total sales for the 20X3-X4 fiscal year were $6,500,000, of which 85% were on credit. The allowance for uncollectible accounts had a credit balance of $76,500 on December 1, 20X3, and a debit balance of $3,400 on November 30, 20X4, before any entry to record bad debt expense for the 20X3-X4 fiscal year.

The amount of the accounts receivable written off by Brighton Corporation during the 20X3-X4 fiscal year is

- A. $79,900correct
- B. $79,475
- C. $76,500
- D. $73,100

Question was not answered

Correct Answer Explanation:

When an account is written off the journal entry is a credit to accounts receivable and a debit to the allowance account. Since we are given the beginning balance and the ending balance in the allowance account before any entry was made to record bad debt expense for the year, receivables written off during the year would have been the only items responsible for the change in the allowance account balance.[1]

Therefore, we can determine the amount of receivables written off during the year by looking at the amount of change in the allowance account. The allowance account had a credit balance of $76,500 at the start of the year and a debit balance of $3,400 at the end of the year. This means a total of $79,900 ($76,500 + $3,400) of debits were recorded in the allowance account during the year; and this is also the amount of receivables actually written off during the year.

[1]Assuming that no recoveries were made of accounts previously written off.

Explanation for Choice B:

This is the amount of calculated bad debt expense for the year minus the ending debit balance in the allowance account.

It is not necessary to calculate the bad debt expense for the year to answer this question. Since we are given the beginning balance and the ending balance in the allowance account before any entry was made to record bad debt expense for the year, receivables written off during the year would have been the only items responsible for the change in the allowance account balance.[1]

When accounts receivable are written off, accounts receivable is credited and the allowance account is debited. The amount of accounts receivable written off during the year is the total amount of debits to the account during the year. Since the balance in the allowance account changed from a credit balance at the beginning of the year to a debit balance at the end of the year before bad debt expense for the year was recorded, the total amount of debits to the account during the year—and the amount of accounts receivable written off—is the beginning credit balance plus the ending debit balance.

[1]Assuming that no recoveries were made of accounts previously written off.

Explanation for Choice C:

This is simply the beginning balance in the allowance account. The question asks for the amount of the accounts receivable written off during the year.

When accounts receivable are written off, accounts receivable is credited and the allowance account is debited. The amount of accounts receivable written off during the year is the total amount of debits to the account during the year. Since we are given the ending balance in the allowance account before any entry was made to record bad debt expense for the year, receivables written off during the year would have been the only items responsible for the change in the allowance account balance.[1]

Since the balance in the allowance account changed from a credit balance at the beginning of the year to a debit balance at the end of the year before bad debt expense for the year was recorded, the total amount of debits to the account during the year—and the amount of accounts receivable written off—is the beginning credit balance plus the ending debit balance.

[1]Assuming that no recoveries were made of accounts previously written off.

Explanation for Choice D:

This answer results from subtracting the ending debit balance in the allowance account before any entry was made to record bad debt expense from the beginning credit balance in the account.

When accounts receivable are written off, accounts receivable is credited and the allowance account is debited. The amount of accounts receivable written off during the year is the total amount of debits to the account during the year. Since we are given the ending balance in the allowance account before any entry was made to record bad debt expense for the year, receivables written off during the year would have been the only items responsible for the change in the allowance account balance.[1]

Since the balance in the allowance account changed from a credit balance at the beginning of the year to a debit balance at the end of the year before bad debt expense for the year was recorded, the total amount of debits to the account during the year—and the amount of accounts receivable written off—is the beginning credit balance **plus** the ending debit balance.

[1]Assuming that no recoveries were made of accounts previously written off.

84. Question ID: CMA 1295 P2 Q24 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Woody Company sold $150,000 of its accounts receivable without recourse. The purchaser assessed a finance charge of 5%. Woody should record

- A. A debit to cash of $150,000.
- B. A credit to accounts receivable of $150,000.correct
- C. A credit to liability on transferred accounts receivable of $150,000.
- D. Interest expense of $7,500.

Question was not answered

Correct Answer Explanation:

Whether receivables are sold with recourse or without recourse, the sold receivables need to be written off the books. This is done with a credit to accounts receivable for $150,000.

Explanation for Choice A:

A factor charges a factoring fee and deposits funds to the seller's account with the factor. The amount deposited to the seller's account is the amount of the receivables, reduced by the amount of the factoring fee and also reduced by any holdback to cover potential returned merchandise.

If the seller of the receivables withdraws funds from the account, the seller will owe interest on the amount withdrawn for the period until the factor collects the receivabls from the seller's customers.

Woody would not have been able to receive the full face amount of the receivables from the factor because of the deductions for the factor's fee, the holdback, and prepaid interest. Because Woody did not receive $150,000 in cash, the cash account should not be debited for $150,000.

Explanation for Choice C:

Since the receivables were sold without recourse, Woody will have no recourse liability for uncollectible accounts.

Explanation for Choice D:

A factor charges a factoring fee and deposits funds to the seller's account with the factor. The amount deposited to the seller's account is the amount of the receivables, reduced by the amount of the factoring fee and also reduced by any holdback to cover potential returned merchandise.

If the seller of the receivables withdraws funds from the account, the seller will owe interest on the amount withdrawn for the period until the factor collects the receivabls from the seller's customers.

This question does not say whether the 5% "finance charge" represents interest, the factoring fee, or both. However, if it represents an interest rate, the interest will be charged only on the amount of funds disbursed, not the full amount of the receivables sold, because the full amount of the receivables sold is not available to be disbursed since the factor's fee and the holdback are deducted from the face amount of the receivables. Furthermore, interest will be charged for only the period of time until the receivables can be collected, not for a full year.

This answer is incorrect because it represents a full year of interest on the full $150,000 of the receivables factored.

85. Question ID: CMA 1295 P2 Q22 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
The allowance method of recording bad debt expense is preferred over the direct write-off method because it

- A. Is easier to implement.
- B. Achieves a proper matching of expenses and revenues.correct
- C. "Allows" for discrepancies.
- D. Is more flexible.

Question was not answered

Correct Answer Explanation:

Under the allowance method (either the percentage of sales or the percentage of receivables method) the expenses are recognized each period based upon a consistent method. This leads to a better matching of expenses and revenues than under the direct write-off method. Under the direct write-off method receivables are written off only when they are deemed to be uncollectible. There is no allowance created and therefore the company can be flexible as to when bad debt expenses are recognized.

The direct write-off method does not conform to generally accepted accounting principles.

Explanation for Choice A:

The direct write-off method is easier to implement because it requires fewer calculation and estimations than the allowance methods.

Explanation for Choice C:

Discrepancies occur under all methods as there are degrees of estimation in all methods.

Explanation for Choice D:

The direct write-off method is more flexible and this is one of the shortcomings of the direct write-off method.

86. Question ID: CMA 1289 P4 Q22 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Brighton Corporation uses the allowance method of accounting for bad debts on its internal reports and has used a historical rate of 1.5% of credit sales to estimate its bad debt expense. The aging schedule of Brighton's accounts receivable at November 30, 20X4, based upon past collection experience is presented as follows.

Days Outstanding	Amount	Probability of Collection
0-30 days	$640,000	0.98
31-60 days	180,000	0.92
61-90 days	95,000	0.75
over 90 days	40,000	0.60
	$955,000	

Total sales for the 20X3-X4 fiscal year were $6,500,000, of which 85% were on credit. The allowance for uncollectible accounts had a credit balance of $76,500 on December 1, 20X3, and a debit balance of $3,400 on November 30, 20X4, before any entry to record bad debt expense for the 20X3-X4 fiscal year.

If Brighton Corporation determines its bad debt expense by using the aging schedule of its accounts receivable, the bad debt expense for the 20X3-X4 fiscal year would be

- A. $79,475
- B. $82,875
- C. $70,350correct
- D. $66,950

Question was not answered

Correct Answer Explanation:

Using the aging schedule for the calculation of the ending balance in the allowance account requires us to make four calculations, one for each of the different "ages" of receivables. By multiplying the amount in each category by the percentage that is **not** going to be collected, we can calculate what the ending balance in the allowance account needs to be. These calculations are:

($640,000 × 0.02) + ($180,000 × 0.08) + ($95,000 × 0.25) + ($40,000 × 0.40) = $66,950

This is the amount that should be in the allowance account at the end of the year (as a credit balance). Since the account has a debit balance of $3,400 before adjustment, Brighton will need to record a credit of $70,350 to the allowance account to adjust the balance to a credit of $66,950 ($3,400 + $66,950). The corresponding debit will be to bad debt expense.

Explanation for Choice A:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice B:

This is the bad debt expense for the year using the percentage of sales method. The question asks for the bad expense for the year using the percentage of receivables method.

Explanation for Choice D:

This is the required ending balance in the allowance account using the percentage of receivables method. The question asks for the bad debt expense for the year using the percentage of receivables method.

87. Question ID: CMA 1290 P2 Q6 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Madison Corporation uses the allowance method to value its accounts receivable and is making the annual adjustments at fiscal year end, November 30. The proportion of uncollectible accounts is estimated based on past experience, which indicates 1.5% of net credit sales will be uncollectible. Total sales for the year were $2,000,000 of which $200,000 were cash transactions. Madison has determined that the Norris Corporation accounts receivable balance of $10,000 is uncollectible and will write off this account before year-end adjustments are made. Listed below are Madison's account balances at November 30 prior to any adjustments and the $10,000 write-off.

Sales	$2,000,000
Accounts receivable	750,000
Sales discounts	(125,000)
Allowance for doubtful accounts	(16,500)
Sales returns and allowances	(175,000)
Bad debt expense	0

After a suggestion from the company's external auditors, Madison wishes to value its accounts receivable using the balance sheet approach instead. The chart below presents the aging of the accounts receivable subsidiary ledger accounts at November 30, not including the account to be written off.

Account	Balance Due	<60 days	61-90 days	91-120 days	>120 days
Arcadia	**$ 50,000**	$ 50,000			
Dawson	**128,000**	90,000	$ 38,000		

Graceloon	**327,000**	250,000	77,000		
Prentiss	**25,000**				$25,000
Strauss	**210,000**			210,000	
Total	**$740,000**	$390,000	$115,000	$210,000	$25,000
% uncollectible		1%	5%	15%	40%

The final entry to the related accounts is

- A. Credit accounts receivable for $34,650 and debit bad debt expense for $34,650.
- B. Debit allowance for doubtful accounts for $44,650 and credit bad debt expense for $44,650.
- C. Credit allowance for doubtful accounts for $44,650 and debit bad debt expense for $44,650.correct
- D. Debit allowance for doubtful accounts for $34,650 and credit sales for $34,650.

Question was not answered

Correct Answer Explanation:

The journal entry to record the bad debt expense requires a debit to bad debt expense and a credit to the allowance for doubtful debts account. Since the percentage of receivables method is to be used, the amount is calculated by determining what the ending balance in the allowance account should be and then determining what entry is required to bring the balance to that level.

Using the information in the aging schedule: [($390,000 × 0.01) + ($115,000 × 0.05) + ($210,000 × 0.15) + ($25,000 × 0.40)] = $51,150, which is the amount that should be in the allowance account at the end of the period. There was already a credit balance of $16,500 in the account. However, this $16,500 was prior to the write off of $10,000 of receivables that will reduce the credit balance in the allowance account to $6,500. To increase a credit balance of $6,500 to a credit balance of $51,150, a credit of $44,650 is needed. The corresponding debit is to bad debt expense.

Explanation for Choice A:

The credit is not recorded to accounts receivable, and this amount fails to include the write-off of the one $10,000 account in the calculation.

Explanation for Choice B:

The journal entry to record the bad debt expense requires a debit to bad debt expense and a credit to the allowance for doubtful debts account.

Explanation for Choice D:

The journal entry to record the bad debt expense requires a debit to bad debt expense and a credit to the allowance for doubtful debts account.

88. Question ID: CMA 1287 P2 Q18 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Nasus Company began the month of November with 150 units of Model-XL brass hinges on hand at a cost of $2.00 each. These hinges sell for $3.50 each. The following schedule presents the additional activity in this inventory item during November.

Nov.	Qty. Recd.	Unit Price	Units Sold
4			100
6	200	$2.10	
8			150
10	200	2.20	
16			220
21	250	2.40	
28			100

If Nasus uses the periodic weighted average inventory pricing, the gross profit for November would be:

- A. $1,041
- B. $741correct
- C. $1,254
- D. $758

Question was not answered

Correct Answer Explanation:

Under the periodic weighted average method we only need to make one calculation to determine the average cost of all of the units in inventory. Nasus had on hand a total of 800 units during the period for which they paid a total of $1,760. $1,760 ÷ 800 units equals an average cost per unit of $2.20. They sold a total of 570 units during the period. Since the price for each unit sold was $3.50, they earned gross profit of $1.30 per unit ($3.50 − $2.20). If we multiply the gross profit per unit by the number of units sold, we will get the total gross profit: $1.30 × 570, which is equal to $741.

Explanation for Choice A:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice C:

This is the cost of sales for the month of November (570 units sold at an average cost of $2.20 per unit). The question asks for the gross profit. Gross profit is sales minus the cost of sales.

Explanation for Choice D:

This answer results from assuming the perpetual LIFO method is being used. The question says to use the periodic weighted average cost method.

89. Question ID: CMA 693 P3 Q1 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
This information concerns items in Wilson's inventory.

	Cameras	Lenses	Tripods
Historical cost per unit	$210.00	$110.00	$53.00
Selling price per unit	217.00	145.00	73.75
Cost to distribute per unit	19.00	8.00	2.50
Current replacement cost per unit	203.00	109.00	51.00
Normal profit margin per unit	32.00	29.00	21.25

Assume that Wilson uses the LIFO cost flow assumption to value its inventory and determine its cost of goods sold. The limits to the designated market value (i.e., the ceiling and the floor, respectively) that should be used in the lower of cost or market comparison for cameras are

- A. $198 and $166.correct
- B. $217 and $198.
- C. $217 and $185.
- D. $185 and $166.

Question was not answered

Correct Answer Explanation:

Since Wilson uses the LIFO cost flow assumption, its inventory is valued at the lower of cost or market. In the calculation of the lower of cost or market, the designated market value used must fall within a range. The upper limit of the range, the ceiling, is the net realizable value of the inventory. The net realizable value is the selling price minus the costs to complete and sell the inventory. The cameras' selling price is $217 and the distribution (selling) costs are $19, so the net realizable value and the ceiling for the designated market value is $198. The floor for the designated market value is the ceiling (the net realizable value) minus a normal profit. Since the ceiling is $198 and a normal profit is $32, the floor for the designated market value is $166.

Note: The net realizable value is the ceiling for the designated market value even when the replacement cost is higher than the NRV, as in this question.

Explanation for Choice B:

Since Wilson uses the LIFO cost flow assumption, its inventory is valued at the lower of cost or market. In the calculation of the lower of cost or market that is used to value inventory when the LIFO cost flow assumption is being used, the designated market value used must fall within a range.

The upper limit of the range, the ceiling, is the net realizable value of the inventory. The net realizable value is the selling price minus the costs to complete and sell the inventory. The floor is the lower limit of the range, and it is calculated as the ceiling (the net realizable value) minus a normal profit margin. $217 is the cameras' selling price, not the ceiling for the cameras' designated market value; and $198 is the net realizable value, the ceiling for the cameras' designated market value, not the floor. See the correct answer for the numerical part of the solution.

Explanation for Choice C:

Since Wilson uses the LIFO cost flow assumption, its inventory is valued at the lower of cost or market. In the calculation of the lower of cost or market that is used to value inventory when the LIFO cost flow assumption is being used, the designated market value used must fall within a range. The upper limit of the range, the ceiling, is the net realizable value of the inventory. The net realizable value is the selling price minus the costs to complete and sell the inventory. The floor is the lower limit of the range, and it is calculated as the ceiling (the net realizable value) minus a normal profit margin. $217 is the cameras' selling price, not the ceiling for the cameras' designated market value; and $185 is the cameras' selling price minus a normal profit margin, not the floor for the cameras' designated market value. See the correct answer for the numerical part of the solution.

Explanation for Choice D:

Since Wilson uses the LIFO cost flow assumption, its inventory is valued at the lower of cost or market. In the calculation of the lower of cost or market that is used to value inventory when the LIFO cost flow assumption is being used, the designated market value used must fall within a range. The upper limit of the range, the ceiling, is the net realizable value of the inventory. The net realizable value is the selling price minus the costs to complete and sell the inventory. The floor, or the lower limit of the designated market value, is calculated as the ceiling (the net realizable value) minus a normal profit margin. $166 is the floor, but $185 is the cameras' selling price minus a normal profit margin, not the net realizable value or the ceiling.

90. Question ID: CMA 689 P3 Q3 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

This information concerns items in Wilson's inventory.

	Cameras	**Lenses**	**Tripods**
Historical cost per unit	$210.00	$110.00	$53.00
Selling price per unit	217.00	145.00	73.75
Cost to distribute per unit	19.00	8.00	2.50
Current replacement cost per unit	203.00	109.00	51.00
Normal profit margin per unit	32.00	29.00	21.25

Assume that Wilson uses the LIFO cost flow assumption to value its inventory and determine its cost of goods sold. The amount that should be used to value the tripods is

- A. $51.00.correct
- B. $50.00.
- C. $53.00.
- D. $71.25.

Question was not answered

Correct Answer Explanation:

Since Wilson uses the LIFO cost flow assumption, its inventory is valued at the lower of cost or market. In the calculation of the lower of cost or market, the designated market value used must fall within a range. The upper limit of the range, the ceiling, is the net realizable value of the inventory. The floor is the net realizable value minus a normal profit margin. The designated market value is the middle value of three numbers, subject to the ceiling and the floor limitations. The three numbers and the way they are calculated are:

1. the ceiling, or net realizable value (sales price minus the costs to complete and sell),
2. the current replacement cost, and
3. the floor (the ceiling or net realizable value minus a normal profit margin).

Using the numbers given for the tripods, the net realizable value or the ceiling for the designated market value is $71.25 ($73.75 selling price minus $2.50 costs to sell), the replacement value is $51.00, and the floor is $50.00 (the net realizable value or ceiling of $71.25 minus a normal profit margin of $21.25). The middle value of these three numbers, which is the designated market value, is $51.00, the replacement cost. The designated market value is then compared to the historical cost and the lower of the two amounts is used to value the inventory. Since the designated market value ($51.00) is lower than the historical cost ($53.00), the inventory will be valued at its designated market value of $51.00.

Explanation for Choice B:

Since Wilson uses the LIFO cost flow assumption, its inventory is valued at the lower of cost or market, subject to the ceiling and the floor limitations on the designated market value used as the market value. $50.00 is the net realizable value minus a normal profit margin, or the floor that is established in the determination of the designated market value of the tripods. While in some cases the net realizable value minus a normal profit margin is used as the designated market value, that is not the case in this question. See the correct answer for a complete explanation.

Explanation for Choice C:

Since Wilson uses the LIFO cost flow assumption, its inventory is valued at the lower of cost or market, subject to the ceiling and the floor limitations on the designated market value used as the market value. $53.00 is the historical cost of the tripods. While in some cases the historical cost is used as the inventory value, that is not the case in this question. See the correct answer for a complete explanation.

Explanation for Choice D:

Since Wilson uses the LIFO cost flow assumption, its inventory is valued at the lower of cost or market, subject to the ceiling and the floor limitations on the designated market value used as the market value. $71.25 is the net realizable value, or the ceiling that is established in the determination of the designated market value of the tripods. While in some cases the net realizable value is used as the designated market value, that is not the case in this question. See the correct answer for a complete explanation.

91. Question ID: CMA 684 P3 Q14 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

The operations of the firm may be viewed as a continual series of transactions or as a series of separate ventures. The inventory valuation method that views the firm as a series of separate ventures is

- A. First-in, first-out.
- B. Last-in, first-out.
- C. Specific identification.correct
- D. Weighted average.

Question was not answered

Correct Answer Explanation:

Under specific identification, each individual unit of inventory is kept separately from the others and when a sale is made, it is a specific item of inventory that is sold. This is viewing each transaction as separate and individual from others. Under other inventory methods, an assumption is made as to which item of inventory is sold and as a result the purchases and sales of inventory blend together into a larger stream of transactions.

Specific identification is used for high-value items such as serialized electronic inventory or vehicles.

Explanation for Choice A:

Under FIFO an assumption is made as to which item of inventory is sold and as a result the purchases and sales of inventory blend together into a larger stream of transactions.

Explanation for Choice B:

Under LIFO an assumption is made as to which item of inventory is sold and as a result the purchases and sales of inventory blend together into a larger stream of transactions.

Explanation for Choice D:

Under weighted average an assumption is made as to which item of inventory is sold and as a result the purchases and sales of inventory blend together into a larger stream of transactions.

92. Question ID: CMA 1287 P2 Q16 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Nasus Company began the month of November with 150 units of Model-XL brass hinges on hand at a cost of $2.00 each. These hinges sell for $3.50 each. The following schedule presents the additional activity in this inventory item during November.

Nov.	Qty. Recd.	Unit Price	Units Sold
4			100
6	200	$2.10	
8			150
10	200	2.20	
16			220
21	250	2.40	
28			100

If Nasus uses perpetual LIFO inventory pricing, the value of the inventory on November 30 would be

- A. $468
- B. $523correct
- C. $552
- D. $460

Question was not answered

Correct Answer Explanation:

For each individual sale we need to determine what the most recently purchased items in inventory were and then these are the units that will be sold and removed from inventory. The sale on November 4 removed 100 of the units that were in beginning inventory, reducing beginning inventory to 50 units. The sale on November 8 removed 150 of the units that had been purchased on November 6, leaving 50 of those units. The sale of 220 units on November 16 removed all of the units that had been purchased on November 10 as well as 20 of the units that had been purchased on November 6, reducing the November 6 inventory to only 30 units. The sale of 100 units on November 28 was a sale of units purchased on November 21, reducing this purchase to 150 units. So, at the end of the month, ending inventory is made up of 50 units from beginning inventory (at $2.00 each), 30 units from the November 6 purchase (at $2.10 each) and 150 units from the November 21 purchase (at $2.40 each).

(50 × $2.00) + (30 × $2.10) + (150 × $2.40) = $523

The total number of units in ending inventory is 50 + 30 + 150 = 230; and this reconciles with the number of units available to sell (800) minus the number sold (570).

Explanation for Choice A:

This answer results from assuming the periodic LIFO method is being used. The question says to use the perpetual LIFO method.

Explanation for Choice C:

This answer results from assuming the FIFO method (either periodic or perpetual) is being used. The question says to use the perpetual LIFO method.

Explanation for Choice D:

This is the number of units in ending inventory multiplied by the cost of the units in beginning inventory. When LIFO is used, we assume that the most recently purchased units were old first. However, there were only 150 units in beginning inventory, and the company ended the month with more units than that in ending inventory. That means that some units purchased during the month were still in inventory at month end.

Furthermore, when the perpetual LIFO method is being used, for each individual sale we need to determine what the most recently purchased items in inventory were and then these are the units that will be sold and removed from inventory.

93. Question ID: CMA 1295 P2 Q26 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Tony's AutoParts Store is a small retailer. Tony Brown owns the business and has purchased a microcomputer system equipped with bar coding devices. Tony Brown uses the first-in, first-out (FIFO) method to value inventory and is concerned about the impact on inventory valuation of a switch from a periodic inventory system to a perpetual inventory system. Which one of the following statements is correct?

- A. Inventory will be valued higher under a perpetual inventory system.
- B. Inventory and cost of goods sold will be the same whether or not a perpetual or periodic inventory system is used.correct
- C. The impact cannot be calculated.
- D. Inventory will be valued lower under a perpetual inventory system.

Question was not answered

Correct Answer Explanation:

Whether a perpetual or periodic FIFO system is used, the ending inventory and cost of goods sold amounts will be the same.

Explanation for Choice A:

Whether a perpetual or periodic FIFO system is used, the ending inventory and cost of goods sold amounts will be the same.

Explanation for Choice C:

Under FIFO, the perpetual and periodic methods will give the same values. Therefore, there is no impact to calculate.

Explanation for Choice D:

Whether a perpetual or periodic FIFO system is used, the ending inventory and cost of goods sold amounts will be the same.

94. Question ID: CMA 696 P2 Q13 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Thomas Engine Company is a wholesaler of marine engine parts. The activity of carburetor 2642J during the month of March is presented below.

March		No. of Units	Unit Cost	Sales Price
1	Inventory	3,200	$64.30	$86.50
4	Purchase	3,400	64.75	87.00
14	Sales	3,600		87.25
25	Purchase	3,500	66.00	87.25
28	Sales	3,450		88.00

If Thomas uses a last-in, first-out periodic inventory system, the total cost of the inventory for carburetor 2642J at March 31 is

- A. $196,115correct
- B. $201,300
- C. $268,400
- D. $197,488

Question was not answered

Correct Answer Explanation:

Under the periodic LIFO method the ending inventory is made up of the oldest items in inventory. The company had a total of 10,100 units on hand during the period (3,200 units in beginning inventory plus 6,900 units purchased during the period) and sold a total of 7,050 units. This means that there were 3,050 units in ending inventory. The oldest units then are 3,050 of the units that were in beginning inventory at $64.30 per unit. This means that the value of the ending inventory was $196,115 (3,050 × $64.30).

Explanation for Choice B:

This is the answer under the FIFO method. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the number of units in ending inventory multiplied by the sales price on March 28. Units in inventory are costed at their cost to the business, not at the price the business sell them for; and LIFO assumes that the most recently purchased units are sold first.

Explanation for Choice D:

This is the number of units in ending inventory multiplied by the cost per unit of the lot purchased on March 4. LIFO assumes that the last units purchased were sold first, and the units purchased on March 4 had been sold by the end of the month.

95. Question ID: CMA 1289 P4 Q21 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Brighton Corporation uses the allowance method of accounting for bad debts on its internal reports and has used a historical rate of 1.5% of credit sales to estimate its bad debt expense. The aging schedule of Brighton's accounts receivable at November 30, 20X4, based upon past collection experience is presented as follows.

Days Outstanding	Amount	Probability of Collection
0-30 days	$640,000	0.98
31-60 days	180,000	0.92
61-90 days	95,000	0.75
over 90 days	40,000	0.60
	$955,000	

Total sales for the 20X3-X4 fiscal year were $6,500,000, of which 85% were on credit. The allowance for uncollectible accounts had a credit balance of $76,500 on December 1, 20X3, and a debit balance of $3,400 on November 30, 20X4, before any entry to record bad debt expense for the 20X3-X4 fiscal year.

If Brighton Corporation continues to determine its bad debt expense by using the historical percentage of credit sales, the bad debt expense for the 20X3-X4 fiscal year would be:

- A. $86,275
- B. $70,350

- C. $82,875correct
- D. $66,950

Question was not answered

Correct Answer Explanation:

If the percentage of credit sales method is used, all we need to do is to multiply the credit sales by the required percentage of 1.5%. Of the total sales of $6,500,000, 85% were credit sales. This means that the total credit sales were $5,525,000. If the bad debts are 1.5% of this, we can calculate the bad debt expense for the year as $82,875 ($5,525,000 × 0.015).

Explanation for Choice A:

This is the amount of bad debt expense for the year using the percentage of sales method, plus the credit balance in the allowance account before adjustment to record bad debt expense for the year. The question asks only for the amount of bad debt expense for the year.

Explanation for Choice B:

This is the bad debt expense for the year if the percentage of receivables method were being used. The question asks for the amount of bad debt expense using the percentage of sales method.

Explanation for Choice D:

This is the balance that Brighton would need to have in the ending allowance account if the percentage of receivables method were being used. The question asks for the amount of bad debt expense using the percentage of sales method.

96. Question ID: CMA 696 P2 Q16 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Thomas Engine Company is a wholesaler of marine engine parts. The activity of carburetor 2642J during the month of March is presented below.

March		No. of Units	Unit Cost	Sales Price
1	Inventory	3,200	$64.30	$86.50
4	Purchase	3,400	64.75	87.00
14	Sales	3,600		87.25
25	Purchase	3,500	66.00	87.25
28	Sales	3,450		88.00

If Thomas uses a moving-average perpetual inventory system and rounds all calculated average costs to four decimal places, the total cost of the inventory for carburetor 2642J at March 31 is

- A. $265,960
- B. $199,233correct
- C. $198,301
- D. $194,200

Question was not answered

Correct Answer Explanation:

When the moving average perpetual inventory system is used, the company calculates a new average cost for its inventory every time inventory is purchased, and then that new average cost is used for all sales made from then on until the next inventory purchase is made.

The beginning inventory consisted of 3,200 units at a cost of $64.30, for a total cost of $205,760. On March 4, the company purchased 3,400 units at $64.75, at a total cost of $220,150. The total cost of the 6,600 units on hand was $425,910 ($205,760 + $220,150). The average cost per unit was $64.5318 ($425,910 ÷ 6,600).

On March 14, 3,600 units were sold at the average cost of $64.5318, for a total cost of $232,314.48, leaving a total cost on hand of $193,595.52 ($425,910 − $232,314.48). 3,000 units remained on hand.

On March 25, 3,500 units were purchased at $66.00, for a total cost of $231,000. Total units on hand increased to 6,500, and the total on-hand cost increased to $424,595.52 ($193,595.52 + $231,000). The average cost per unit became $65.3224 ($424,595.52 ÷ 6,500).

On March 28, 3,450 units were sold at a cost of $225,362.28 (3,450 × $65.3224). The total on-hand cost remaining in inventory for the 3,050 units remaining on hand was **$199,233.24** ($424,595.52 − $225,362.28).

The remaining 3,050 units on hand cost $65.3224 each, and the cost of the ending inventory can also be calculated as 3,050 × $65.3224, which equals **$199,233.32**. (The $0.08 difference is due to rounding.)

Explanation for Choice A:

This answer results from summing the five sales prices given—$86.50, $87.00, $87.25, $87.25, and $88.00—and dividing by 5, then multiplying the result by the number of units in ending inventory. Inventory is valued at its cost to the business, not at the price the business sells it for. Furthermore, averaging the prices in that way is not the correct way to determine inventory costs using the moving-average perpetual inventory method.

Explanation for Choice C:

This answer results from summing the three different inventory costs—$64.30, $64.75, and $66.00—and dividing by 3, then multiplying the result by the number of units in ending inventory. That is not the correct way to determine inventory costs using the moving-average perpetual inventory method.

Explanation for Choice D:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

97. Question ID: CMA 691 P2 Q3 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Sawyer Corporation is a wholesaler of industrial air compressor parts. The activity for Part Number C-588 during May is as follows.

May	Transaction	Units	Unit Cost	Total Cost
1	Inventory	1,400	$2.45	$3,430
7	Purchase	1,800	2.75	4,950
16	Sales	2,000		
20	Purchase	1,500	2.90	4,350
28	Sales	1,400		

If Sawyer uses a last-in, first-out perpetual inventory system, the total cost of the inventory for Part Number C-588 at May 31 is

- A. $3,575
- B. $3,521
- C. $3,230correct
- D. $3,185

Question was not answered

Correct Answer Explanation:

Under the perpetual LIFO method, each time that inventory is sold the company makes the determination of which units were the most recently purchased, and which units were therefore sold. In the first sale on the 16th, the units that were sold were all of the units purchased on the 7th as well as 200 of the units that were in beginning inventory. The units that were sold on the 28th were 1,400 of the units that had been purchased on the 20th. This means that in ending inventory were 1,200 units that had been in beginning inventory and 100 of the units purchased on the 20th. Given their respective costs of $2.45 and $2.90, this gives an ending inventory of $3,230 [(1,200 × 2.45) + (100 × $2.90).

Explanation for Choice A:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice B:

This answer results from assuming the periodic weighted average cost method is being used. The question says to use the perpetual LIFO method.

Explanation for Choice D:

This is the correct answer under the periodic LIFO method. See the correct answer for a complete explanation.

98. Question ID: ICMA 1603.P1.075 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Bell Retail Company sells antique replica trunks to customers all over the world. Bell's inventory records show the following.

	Quantity (units)	Cost (each)
Beginning inventory	200	$1,055
Purchases:		
June 3	170	1,062
September 18	190	1,070
December 10	160	1,076

Bell sells 470 units this year. Management is researching whether the company should use last in, first out (LIFO) or first in, first out (FIFO). If Bell's management wants to lower the company's income taxes, which inventory cost flow assumption should Bell select?

- A. FIFO, because the cost of goods sold will be $9,870 higher than LIFO.
- B. LIFO, because the cost of goods sold will be $5,250 higher than FIFO.
- C. FIFO, because the operating income will be $840 lower than LIFO.
- D. LIFO, because the operating income will be $4,360 lower than FIFO.correct

Question was not answered

Correct Answer Explanation:

When prices are rising, as they are in this situation, the use of LIFO for tax reporting results in higher cost of goods sold and lower operating and taxable income. Lower taxable income leads to lower income taxes and higher cash flow.

Cost of goods sold under FIFO is: (200 × 1,055) + (170 × 1,062) + (100 × 1,070) = $498,540.

Cost of goods sold under LIFO is: (160 × 1,076) + (190 × 1,070) + (120 × 1,062) = $502,900.

Under LIFO, cost of goods sold will be $4,360 higher and so operating and taxable income will be $4,360 lower than would be the case if FIFO were used.

Explanation for Choice A:

When prices are rising, as they are in this situation, the use of FIFO for tax reporting results in lower cost of goods sold and higher operating and taxable income and thus higher taxes.

Explanation for Choice B:

When prices are rising, as they are in this situation, the use of LIFO for tax reporting results in higher cost of goods sold and lower operating and taxable income. Lower taxable income leads to lower income taxes and higher cash flow. However, the difference between cost of goods sold under LIFO and cost of goods sold under FIFO is not $5,250.

Explanation for Choice C:

When prices are rising, as they are in this situation, the use of FIFO for tax reporting results in lower cost of goods sold and higher operating and taxable income and thus higher taxes.

99. Question ID: CMA 689 P3 Q2 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

This information concerns items in Wilson's inventory.

	Cameras	Lenses	Tripods
Historical cost per unit	$210.00	$110.00	$53.00
Selling price per unit	217.00	145.00	73.75
Cost to distribute per unit	19.00	8.00	2.50
Current replacement cost per unit	203.00	109.00	51.00
Normal profit margin per unit	32.00	29.00	21.25

Assume that Wilson uses the FIFO cost flow assumption to value its inventory and determine its cost of goods sold. The amount that should be used to value the lenses is

- A. $137.
- B. $108.
- C. $109.
- D. $110.correct

Question was not answered

Correct Answer Explanation:

Because the FIFO cost flow assumption is being used, the inventory is valued at the lower of cost or net realizable value. The historical cost of the lenses is $110. Their net realizable value is the selling price of $145 less the cost to distribute of $8, or $137. The lower of the two values is $110, so the lenses will be valued at their historical cost of $110.

Explanation for Choice A:

Because the FIFO cost flow assumption is being used, the inventory is valued at the lower of cost or net realizable value. $137 is the net realizable value of the lenses, but it is not the lower of the two potential values.

Explanation for Choice B:

Because the FIFO cost flow assumption is being used, the inventory is valued at the lower of cost or net realizable value. $108 is the net realizable value of the lenses minus a normal profit margin, which is neither the cost nor the net realizable value.

$108 would be the floor for the determination of the designated market value if LIFO were being used as the cost flow assumption because when LIFO is being used, inventory is valued at the lower of cost or the designated market value. However, even if LIFO were being used, $108 would not be the value for the inventory because $108 would not serve as the designated market value to compare with the cost to find the lower of the two values.

Explanation for Choice C:

Because the FIFO cost flow assumption is being used, the inventory is valued at the lower of cost or net realizable value. $109 is the current replacement cost of the lenses, which is neither the cost nor the net realizable value.

$109 would be the inventory's value if LIFO were being used as the cost flow assumption because when LIFO is being used, inventory is valued at the lower of cost or the designated market value. $109 would be the designated market value of the inventory under LIFO, and since $109 is lower than the historical cost of $110, the inventory would be valued at $109 if LIFO were being used.

However, since FIFO is being used, the inventory is valued at the lower of cost or net realizable value, so this answer is incorrect.

100. Question ID: CMA 1287 P2 Q15 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Nasus Company began the month of November with 150 units of Model-XL brass hinges on hand at a cost of $2.00 each. These hinges sell for $3.50 each. The following schedule presents the additional activity in this inventory item during November.

Nov.	Qty. Recd.	Unit Price	Units Sold
4			100
6	200	$2.10	
8			150
10	200	2.20	
16			220
21	250	2.40	
28			100

Nasus uses periodic LIFO inventory pricing. Nasus' cost of goods sold for November would be

- A. $992.
- B. $1,300.
- C. $1,292.correct
- D. $1,237.

Question was not answered

Correct Answer Explanation:

In this question there are a total of 800 units available for sale (beginning inventory + purchases) and in total 570 units were sold. This means that there are 230 units in ending inventory. Under LIFO, these will be the units that were most recently purchased. Therefore, COGS will be equal to $1,292 [(250 × $2.40) + (200 + $2.20) + (120 × $2.10)].

Explanation for Choice A:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice B:

This answer results from calculating the value of the ending inventory incorrectly as 230 units at a cost of $2.00 each, and then subtracting that amount from the cost of goods available for sale.

The ending inventory does consist of 230 units. However, only the 150 units in the beginning inventory were purchased at a cost of $2.00 each. The other 80 units in the ending inventory were purchased during November at a higher cost.

Explanation for Choice D:

This answer results from assuming the perpetual LIFO method is being used. The question says to use the periodic LIFO method.

101. Question ID: CMA 696 P2 Q12 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Thomas Engine Company is a wholesaler of marine engine parts. The activity of carburetor 2642J during the month of March is presented below.

March		No. of Units	Unit Cost	Sales Price
1	Inventory	3,200	$64.30	$86.50
4	Purchase	3,400	64.75	87.00
14	Sales	3,600		87.25
25	Purchase	3,500	66.00	87.25
28	Sales	3,450		88.00

If Thomas uses a first-in, first-out perpetual inventory system, the total cost of the inventory for carburetor 2642J at March 31 is

- A. $263,825
- B. $196,115
- C. $197,488
- D. $201,300correct

Question was not answered

Correct Answer Explanation:

Under the FIFO method (either perpetual or periodic) the ending inventory is made up of the most recently purchased items. The company had a total of 10,100 units available for sale during the period (3,200 units in beginning inventory plus 6,900 units purchased during the period) and sold a total of 7,050 units. This means that there were 3,050 units in ending inventory. The most recently purchased units then are 3,050 of the units purchased on March 25 at $66 per unit. This means that the value of the ending inventory was $201,300 (3,050 × $66).

Explanation for Choice A:

This is the number of units in ending inventory multiplied by the sales price of the beginning inventory. Inventory is costed at is cost, not its sales price; and FIFO assumes that the oldest units are sold first.

Explanation for Choice B:

This is the answer under the periodic LIFO method. See the correct answer for a complete explanation.

Explanation for Choice C:

This is number of units in ending inventory multiplied by the purchase price of the units purchased on March 4. FIFO assumes that the oldest units are sold first, so the lot purchased on March 4 had been sold by month end.

102. Question ID: CMA 696 P2 Q14 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Thomas Engine Company is a wholesaler of marine engine parts. The activity of carburetor 2642J during the month of March is presented below.

March		No. of Units	Unit Cost	Sales Price
1	Inventory	3,200	$64.30	$86.50
4	Purchase	3,400	64.75	87.00
14	Sales	3,600		87.25
25	Purchase	3,500	66.00	87.25
28	Sales	3,450		88.00

If Thomas uses a last-in, first-out perpetual inventory system, the total cost of the inventory for carburetor 2642J at March 31 is

- A. $197,488
- B. $263,863
- C. $196,200correct
- D. $268,400

Question was not answered

Correct Answer Explanation:

Under the perpetual LIFO method each time a sale is made the company determines which specific units are sold. The units sold are the most recently purchased units. For the sale on March 14, the units sold were all of the units purchased on March 4 and 200 of the units that were in beginning inventory. This reduces the number of units from beginning inventory to 3,000. The sale on March 28 was the sale of 3,450 of the units purchased on March 25. This reduces the number of units from that purchase to 50. Therefore, ending inventory consists of 3,000 units from the beginning inventory (valued at $64.30 each) and 50 units from the March 25 purchase (valued at $66 each). In total, the ending inventory was $196,200 [(3,000 × $64.30) + (50 × $66)].

Explanation for Choice A:

This is the number of units in ending inventory multiplied by the cost per unit of the lot purchased on March 4. LIFO assumes that the last units purchased were sold first, and the units purchased on March 4 had been sold by the end of the month.

Explanation for Choice B:

This is 3,000 units multiplied by the beginning inventory sales price of $86.50 plus 50 units multiplied by the March 25 sales price of $87.25. The analysis of the units in inventory is correct but the unit sales price has been used to cost the units instead of the unit cost price.

Explanation for Choice D:

This is the number of units in ending inventory multiplied by the sales price on March 28. Units in inventory are costed at their cost to the business, not at the price the business sell them for; and LIFO assumes that the most recently purchased units are sold first.

103. Question ID: CIA 1196 P4 Q33 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
An analysis of a company's $150,000 accounts receivable at year-end resulted in a credit ending balance of $5,000 for its allowance for credit losses account and a credit loss expense of $2,000. During the past year, recoveries on credit losses previously written off were correctly recorded at $500. If the beginning balance in the allowance for credit losses account was a credit balance of $4,700, what was the amount of accounts receivable written off as credit losses during the year?

- A. $1,800
- B. $2,200correct
- C. $1,200
- D. $2,800

Question was not answered

Correct Answer Explanation:

In order to solve this question, use the formula that is constructed from the allowance for credit losses T-account, using negative numbers to represent credit balances/credit transactions and positive numbers to represent debit balances/debit transactions:

Beginning balance + Credit loss expense + Previously written off receivables that are collected + Receivables written off = Ending balance.

Putting the numbers from the problem into this equation, we get:

($4,700) + ($2,000) + ($500) + X = ($5,000).
Add 7,200 to both sides of the equation to isolate the X:
X = 2,200

Because the resulting value of X is positive, the transaction is a debit to the allowance account. Receivables written off do result in a debit to the allowance account. (The corresponding credit for a write-off is to accounts receivable.)

Explanation for Choice A:

The formula that should be used to answer this question, constructed from the allowance for credit losses T-account and using negative numbers to represent credit balances/credit transactions and positive numbers to represent debit balances/debit transactions, is:

Beginning balance + Credit loss expense + Previously written off receivables collected + Receivables written off = Ending balance.

This answer results from using a debit for the credit loss expense amount instead of a credit and using a credit amount for the receivables written off (the unknown amount) instead of a debit:

($4,700) + $2,000 + ($500) + (X) = ($5,000)

The equation should instead be constructed as follows:

($4,700) + ($2,000) + ($500) + X = ($5,000)

Explanation for Choice C:

The formula that should be used to answer this question, constructed from the allowance for credit losses T-account and using negative numbers to represent credit balances/credit transactions and positive numbers to represent debit balances/debit transactions, is:

Beginning balance + Credit loss expense + Previously written off receivables collected + Receivables written off = Ending balance.

This answer results from using a debit for previously written off receivables collected instead of a credit, as follows:

($4,700) + ($2,000) + $500 + X = ($5,000)

The equation should instead be constructed as follows:

($4,700) + ($2,000) + ($500) + X = ($5,000)

Explanation for Choice D:

The formula that should be used to answer this question, constructed from the allowance for credit losses T-account and using negative numbers to represent credit balances/credit transactions and positive numbers to represent debit balances/debit transactions, is:

Beginning balance + Credit loss expense + Previously written off receivables collected + Receivables written off = Ending balance.

This answer results from using a debit for the credit loss expense amount instead of a credit, using a debit instead of a credit for the previously written off receivables collected, and using a credit amount for the receivables written off (the unknown amount) instead of a debit, as follows:

($4,700) + $2,000 + $500 + (X) = ($5,000)

The equation should instead be constructed as follows:

($4,700) + ($2,000) + ($500) + X = ($5,000)

104. Question ID: HOCK CMA.P1A1.04 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
A company has the following short-term investments:

- A money market mutual fund valued at $14,000.

- A 5-year bond with a face value of $10,000 that matures in 30 days that was purchased 2 years ago. The market value is also $10,000.
- A 20-year bond with a face value and a market value of $15,000 that matures in 30 days that was purchased 3 months ago.
- 200 shares of common stock with a market value of $30,000.
- A $5,000 bank certificate of deposit that matures in 6 months and has a penalty for early withdrawal.

How much should the company report as cash equivalents?

- A. $69,000
- B. $39,000
- C. $29,000
- D. $14,000correct

Question was not answered

Correct Answer Explanation:

Only the money market mutual fund qualifies as a cash equivalent.

Cash equivalents are very short-term, highly-liquid investments that have a maturity of three months or less **when acquired** by the company.

- The 5-year bond was acquired two years ago, so it does not qualify as a cash equivalent.
- The 20-year bond was purchased 4 months before its maturity (the 30 days to its maturity plus the 3 months since it was purchased). Therefore, it also does not qualify as a cash equivalent.
- The common stock does not qualify as a cash equivalent because common stock is an investment in a publicly-owned company. It is not a cash equivalent.
- The $5,000 bank certificate of deposit does not qualify as a cash equivalent because it matures in 6 months and also because it has a penalty for early withdrawal.

Explanation for Choice A:

This is the money market mutual fund balance ($14,000) plus the 5-year bond's face and market value ($10,000) plus the 20-year bond's face and market value ($15,000) plus the market value of the common stock ($30,000).

Cash equivalents are very short-term, highly-liquid investments that have a maturity of three months or less **when acquired** by the company.

- The 5-year bond was acquired two years ago, so it does not qualify as a cash equivalent.
- The 20-year bond was purchased 4 months before its maturity (the 30 days to its maturity plus the 3 months since it was purchased). Therefore, it also does not qualify as a cash equivalent.
- The common stock does not qualify as a cash equivalent because common stock has no maturity date.

Explanation for Choice B:

This is the money market mutual fund balance ($14,000) plus the 5-year bond's face and market value ($10,000) plus the 20-year bond's face and market value ($15,000).

Cash equivalents are very short-term, highly-liquid investments that have a maturity of three months or less **when acquired** by the company.

- The 5-year bond was acquired two years ago, so it does not qualify as a cash equivalent.
- The 20-year bond was purchased 4 months before its maturity (the 30 days to its maturity plus the 3 months since it was purchased). Therefore, it also does not qualify as a cash equivalent.

Explanation for Choice C:

This is the money market mutual fund balance ($14,000) plus the 20-year bond's face and market value ($15,000).

Cash equivalents are very short-term, highly-liquid investments that have a maturity of three months or less **when acquired** by the company. The 20-year bond was purchased 4 months before its maturity (the 30 days to its maturity plus the 3 months since it was purchased). Therefore, it also does not qualify as a cash equivalent.

105. Question ID: CMA 697 P2 Q19 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Jensen Company uses a perpetual inventory system. The following purchases and sales were made during the month of May:

May	Activity	Description
1	Balance	100 units at $10 per unit
9	Purchase	200 units at $10 per unit
16	Sale	190 units
21	Purchase	150 units at $12 per unit
29	Sale	120 units

If Jensen Company uses the first-in, first-out (FIFO) method of inventory valuation, the May 31 inventory would be

- A. $1,460
- B. $1,680correct
- C. $1,400
- D. $1,493

Question was not answered

Correct Answer Explanation:

Under the FIFO method (either perpetual or periodic) the ending inventory is made up of the most recently purchased items. The company had a total of 450 units available for sale during the period (100 units in beginning inventory plus 350 units purchased during the period) and sold a total of 310 units. This means that there were 140 units in ending inventory. The most recently purchased units then are the 140 units purchased on May 21 at $12 per unit. Doing the math, we get a cost of ending inventory of $1,680 (140 × $12).

Explanation for Choice A:

This is the answer under the perpetual LIFO method. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the answer under the periodic LIFO method. See the correct answer for a complete explanation.

Explanation for Choice D:

This is the answer under the weighted-average (periodic) method. See the correct answer for a complete explanation.

106. Question ID: CMA 691 P2 Q1 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Sawyer Corporation is a wholesaler of industrial air compressor parts. The activity for Part Number C-588 during May is as follows.

May	Transaction	Units	Unit Cost	Total Cost
1	Inventory	1,400	$2.45	$3,430
7	Purchase	1,800	2.75	4,950
16	Sales	2,000		
20	Purchase	1,500	2.90	4,350
28	Sales	1,400		

If Sawyer uses a last-in, first-out periodic inventory system, the total cost of the inventory for Part Number C-588 at May 31 is

- A. $3,510
- B. $3,575
- C. $3,185correct
- D. $3,230

Question was not answered

Correct Answer Explanation:

Under the periodic LIFO method the ending inventory will consist of the oldest units of inventory. In this question, the company had a total of 4,700 units on hand during the period. They sold 3,400, leaving 1,300 units in ending inventory. Under the periodic LIFO method, these 1,300 units will be the oldest units, which are those that were in beginning inventory. Therefore, ending inventory will consist of 1,300 of the units that were in beginning inventory, at a cost of $2.45 each. This gives an ending inventory of $3,185 (1,300 × $2.45).

Explanation for Choice A:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice B:

This is the 1,300 units in ending inventory multiplied by $2.75 per unit, the cost of the first purchase made during May. The cost of the units that were in the beginning inventory should be used first when the LIFO cost flow assumption is being used.

Explanation for Choice D:

This is the answer under the perpetual LIFO method. See the correct answer for a complete explanation.

107. Question ID: CMA 1288 P4 Q14 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Fidler Company has estimated its credit loss expense by using 1% of net sales. However, the company is contemplating aging its accounts receivable and using this as a basis for estimating its credit losses, as it is believed that this will provide a better estimate of the credit losses. The following aging schedule was prepared as of November 30 of the current year, the end of the fiscal year.

Age of Account	Amount	% estimated credit losses
Under 60 days	$730,000	1%
61-90 days	40,000	6%
91-120 days	18,000	9%
Over 120 days	72,000	25%

Net sales for the year were $4,200,000. There is a debit balance of $14,000 in the allowance for credit losses account as of November 30 of the current year.

If Fidler estimates its credit losses by continuing to use the percentage of net sales, the balance in the allowance for credit losses account after the adjusting entry is made at November 30 of the current year will be

- A. $42,000
- B. $29,320
- C. $28,000correct
- D. $56,000

Question was not answered

Correct Answer Explanation:

Under the percentage of sales method the amount that is charged to credit loss expense for the period is simply credited to the allowance account. Under the percentage of sales method, the company recognizes 1% of sales ($4,200,000) as credit loss expense. This is $42,000 and this amount is credited to the allowance account. Since the allowance account has a debit balance of $14,000, a credit of $42,000 to the account will change the ending balance to $28,000.

Explanation for Choice A:

This answer is what the credit loss expense would be under the percentage of sales method. See the correct answer for a complete explanation.

Explanation for Choice B:

This answer is what the ending balance would be under the percentage of receivables method using the aging of receivables schedule.

Explanation for Choice D:

This is the sum of the credit transaction made to the allowance account in the closing entries, calculated using the percentage of sales method ($42,000), and the debit balance in the allowance account before adjustment ($14,000). Since the question asks for the balance in the allowance account after the adjusting entry is made, this answer results from assuming that the allowance account has a $14,000 credit balance before the adjusting entry is made to book the credit loss expense. However, the question says that the allowance account has a **debit** balance of $14,000 before the adjusting entry is made to record the bad debt expense for the period. Therefore, the ending credit balance in the account will be the **difference** between the amount of the credit transaction to book the credit loss expense and the debit balance in the account before the credit transaction is recorded.

108. Question ID: CMA 1292 P2 Q29 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Addison Hardware began the month of November with 150 large brass switchplates on hand at a cost of $4.00 each. These switchplates sell for $7.00 each. The following schedule presents the sales and purchases of this item during the month of November.

November	Quantity Received	Unit Cost	Units Sold
5			100
7	200	$4.20	
9			150
11	200	$4.40	
17			220
22	250	$4.80	
29			100

If Addison uses perpetual LIFO inventory pricing, the value of the inventory at November 30 will be

- A. $1,046.correct
- B. $936.
- C. $1,078.
- D. $1,012.

Question was not answered

Correct Answer Explanation:

For each individual sale we need to determine what the most recently purchased items in inventory were and then those units will be the first ones sold in the next sale and removed from inventory. The 100 units sold on November 5 were from the 150 units that were in beginning inventory at $4.00 each, reducing beginning inventory to 50 units. The 150 units sold on November 9 were from the units that had been purchased on November 7 at $4.20, leaving 50 of those units. The 220 units sold on November 17 included all of the units that had been purchased on November 11 at $4.40 plus 20 of the units that had been purchased on November 7 at $4.20, reducing the number of units purchased November 7 to only 30 units. The 100 units sold on November 29 were from the units purchased on November 22 at $4.80 each, reducing that purchase to 150 units.

So, at the end of the month, ending inventory is made up of 50 units from beginning inventory at $4.00 each, 30 units from the November 7 purchase at $4.20 each and 150 units from the November 22 purchase at $4.80 each.

(50 × $4.00) + (30 × $4.20) + (150 × $4.80) = $1,046

The total of the units in inventory per the above is 50 + 30 + 150 = 230. That reconciles with the number of units remaining in inventory, calculated as 800 units available for sale during the month (150 units in beginning inventory plus 650 units purchased during the month) minus 570 units sold during the month = 230 units in ending inventory.

Explanation for Choice B:

This answer results from assuming the periodic LIFO method is being used. The question says to use the perpetual LIFO method.

Explanation for Choice C:

This answer results from assuming the perpetual moving average cost method is being used. The question says to use the perpetual LIFO method.

Explanation for Choice D:

This answer results from assuming the periodic weighted average cost method is being used. The question says to use the perpetual LIFO method.

109. Question ID: HOCK CMA.P1A1.03 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
A company has the following items that have not yet been recorded in its accounting system.

- A transfer from its checking account to the petty cash fund in the amount of $50.00.
- A post-dated check in the amount of $500 received from a customer, not negotiable for 6 weeks.
- A check for $1,000 that was previously deposited in the company's bank account but has been deducted from the account and returned by the bank due to non-sufficient funds in the payor's account.
- Checks received from customers in payment of accounts receivable totaling $2,500.
- Accounts payable checks mailed totaling $1,500.

After the transactions have been recorded, what amount of change in cash will have taken place?

- A. $0 (no change)correct
- B. $50 increase
- C. $550 increase
- D. $1,000 increase

Question was not answered

Correct Answer Explanation:

The items that will cause a change in the cash balance are the $1,000 NSF check returned by the bank (a decrease), the $2,500 in checks received from customers (an increase), and the $1,500 in accounts payable checks mailed (a decrease). Thus the net amount of change in cash is $(1,000) + $2,500 + $(1,500) = $0. Note that the checks received from customers are cash whether or not they have been deposited in the bank.

Explanation for Choice B:

This is the $50 transferred to petty cash minus the $1,000 NSF check returned by the bank plus the $2,500 in checks received from customers. The $50 transfer from the checking account to petty cash did not affect cash, since both cash in the checking account and cash on hand in petty cash are classified as cash.

Explanation for Choice C:

This is the $50 transferred to petty cash plus the $500 post-dated check minus the $1,000 NSF check returned by the bank plus the $2,500 in checks received from customers minus the $1,500 in accounts payable checks mailed.

The $50 transfer from the checking account to petty cash did not affect cash, since both cash in the checking account and cash on hand in petty cash are classified as cash. The $500 post-dated check is not included in cash until it can be deposited, and this post-dated check cannot be deposited for 6 weeks.

Explanation for Choice D:

This is the $2,500 in checks received from customers minus the $1,500 in accounts payable checks mailed. The $1,000 NSF check returned by the bank needs to be deducted from the cash balance, also.

110. Question ID: CMA 1287 P3 Q25 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
One of the conditions necessary to recognize a transfer of receivables with recourse as a sale is that the

- A. The transferor is not both entitled and obligated to repurchase the receivables.correct
- B. Transferred assets are isolated from the transferee.
- C. Transferee surrenders control of the receivables but retains a beneficial interest.
- D. Transferor has derecognized all assets sold.

Question was not answered

Correct Answer Explanation:

In order for the transfer of receivables to be recognized as a sale, rather than secured financing, by the transferor, three conditions must be met:

1. The transferred assets must be isolated from the transferor (the party that sells the assets). This means the transferor can never collect the receivables. It also means that creditors of the transferor cannot take the receivables in settlement of debts owed them by the transferor, even if the transferor goes bankrupt.

2. The transferee (the factor) can do whatever it wants to with the receivables. The transferee can pledge the receivables as collateral for its own borrowing, if it wants to, or it can exchange them for other assets, or it can re-sell them to some other company.

3. The transferor has no control over the receivables whatsoever. Such control would exist if the transferor has signed an agreement that entitles and obligates it to repurchase the receivables or to pay them off before their maturity, so this type of agreement cannot exist if the receivables are to be considered sold. Also, the transferor cannot have the ability to force the factor to return specific receivables.

The third condition is the same as saying that the transferor is not both entitled and obligated to repurchase the receivables.

Note: The conditions necessary for a transfer of any asset to be accounted for as a sale instead of as secured financing are in ASC 860-10-40-5. They are part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

Explanation for Choice B:

In order for the transfer of receivables to be recognized as a sale, rather than secured financing, by the transferor, three conditions must be met:

1. The transferred assets must be isolated from the transferor (the party that sells the assets). This means the transferor can never collect the receivables. It also means that creditors of the transferor cannot take the receivables in settlement of debts owed them by the transferor, even if the transferor goes bankrupt.

2. The transferee (the factor) can do whatever it wants to with the receivables. The transferee can pledge the receivables as collateral for its own borrowing, if it wants to, or it can exchange them for other assets, or it can re-sell them to some other company.

3. The transferor has no control over the receivables whatsoever. Such control would exist if the transferor has signed an agreement that entitles and obligates it to repurchase the receivables or to pay them off before their maturity, so this type of agreement cannot exist if the receivables are to be considered sold. Also, the transferor cannot have the ability to force the factor to return specific receivables.

The **transferee** is the party who purchased the receivables and to whom the receivables were transferred. The **transferor** is the party that sold the receivables. The first condition says "transferred assets are isolated from the **transferor**." This answer choice says "transferred assets are isolated from the **transferee**," so it is incorrect.

Note: The conditions necessary for a transfer of any asset to be accounted for as a sale instead of as secured financing are in ASC 860-10-40-5. They are part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

Explanation for Choice C:

A transfer of receivables with recourse is a factoring arrangement whereby the seller of the receivables (the transferor) retains liability for any receivables that ultimately prove to be uncollectible.

In order for the transfer of receivables to be recognized as a sale, rather than as secured financing, by the transferor, three conditions must be met:

1. The transferred assets must be isolated from the transferor (the party that sells the assets). This means the transferor can never collect the receivables. It also means that creditors of the transferor cannot take the receivables in settlement of debts owed them by the transferor, even if the transferor goes bankrupt.

2. The transferee (the factor) can do whatever it wants to with the receivables. The transferee can pledge the receivables as collateral for its own borrowing, if it wants to, or it can exchange them for other assets, or it can re-sell them to some other company.

3. The transferor has no control over the receivables whatsoever. Such control would exist if the transferor has signed an agreement that entitles and obligates it to repurchase the receivables or to pay them off before their maturity, so this type of agreement cannot exist if the receivables are to be considered sold. Also, the transferor cannot have the ability to force the factor to return specific receivables.

The "transferee" is the party that the receivables are transferred to--the entity that buys the receivables. The "transferor" is the party that sells the receivables. The **transferee**'s surrendering control of the receivables but retaining a beneficial interest is not one of the three conditions for the **transferor** to recognize the transfer as a sale rather than as secured financing. Furthermore, the **transferee** would not surrender control of the receivables it had purchased.

Note: The conditions necessary for a transfer of any asset to be accounted for as a sale instead of as secured financing are in ASC 860-10-40-5. They are part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

Explanation for Choice D:

A transfer of receivables with recourse is a factoring arrangement whereby the seller of the receivables (the transferor) retains liability for any receivables that ultimately prove to be uncollectible.

In order for the transfer of receivables to be recognized as a sale, rather than secured financing, by the transferor, three conditions must be met:

1. The transferred assets must be isolated from the transferor (the party that sells the assets). This means the transferor can never collect the receivables. It also means that creditors of the transferor cannot take the receivables in settlement of debts owed them by the transferor, even if the transferor goes bankrupt.

2. The transferee (the factor) can do whatever it wants to with the receivables. The transferee can pledge the receivables as collateral for its own borrowing, if it wants to, or it can exchange them for other assets, or it can re-sell them to some other company.

3. The transferor has no control over the receivables whatsoever. Such control would exist if the transferor has signed an agreement that entitles and obligates it to repurchase the receivables or to pay them off before their maturity, so this type of agreement cannot exist if the receivables are to be considered sold. Also, the transferor cannot have the ability to force the factor to return specific receivables.

This answer choice is not one of these three conditions. Furthermore, a transferor's simply derecognizing assets sold (taking them off its balance sheet) is not sufficient because simply derecognizing the receivables does not mean that the three conditions necessary to recognize a transfer of receivables with recourse as a sale have been met.

Note: The conditions necessary for a transfer of any asset to be accounted for as a sale instead of as secured financing are in ASC 860-10-40-5. They are part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

111. Question ID: CMA 1294 P2 Q8 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Devereaux Inc. uses a perpetual inventory system and had the following inventory inflows and outflows during the month of November.

November	Activity	
1	Balance	200 units at $20 per unit
10	Purchases	160 units at $20 per unit
18	Sales	180 units
20	Purchases	140 units at $24 per unit
27	Sales	100 units

If Devereaux Inc. uses the moving average cost method, the value of its inventory at November 30 would be

- A. $4,400
- B. $4,480
- C. $4,960
- D. $4,785correct

Question was not answered

Correct Answer Explanation:

Under the moving average cost method every time that inventory is purchased, the company must calculate a new average cost for its inventory. When the first sale was made on November 18, the company had 360 units that had cost a total of $7,200. This gave an average cost of $20 per unit. After selling 180 units on November 18, the company had 180 units that cost $20 on average, for a total cost of $3,600. On November 20 they purchased 140 more units of inventory that cost in total $3,360, bringing their inventory to a value of $6,960 for the 320 units. This also gave them an average cost per unit of $21.75. On November 27 they sold 100 units, leaving them with 220 units that had an average cost of $21.75. This gives a total value for ending inventory of $4,785.

Explanation for Choice A:

This is the answer under the periodic LIFO method. See the correct answer for a complete explanation.

Explanation for Choice B:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice C:

This is the answer under the FIFO method. See the correct answer for a complete explanation.

112. Question ID: CMA 1294 P2 Q6 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Devereaux Inc. uses a perpetual inventory system and had the following inventory inflows and outflows during the month of November.

November	Activity	
1	Balance	200 units at $20 per unit
10	Purchases	160 units at $20 per unit
18	Sales	180 units
20	Purchases	140 units at $24 per unit
27	Sales	100 units

If Devereaux Inc. uses the first-in, first-out method, the value of its inventory at November 30 would be

- A. $4,960correct
- B. $4,480
- C. $4,560
- D. $4,400

Question was not answered

Correct Answer Explanation:

Under the FIFO method (either perpetual or periodic) the ending inventory is made up of the most recently purchased items. The company had a total of 500 units on hand during the period (200 units in beginning inventory plus 300 units purchased during the period) and sold a total of 280 units. This means that there were 220 units in ending inventory. The most recently purchased units then are the 140 units purchased on November 20 (at $24 per unit) and 80 of the units purchased on November 10 (at $20 per unit). Doing the math, we get a cost of ending inventory of $4,960 [(140 × $24) + (80 × $20)].

Explanation for Choice B:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice C:

This is the answer under the perpetual LIFO method. See the correct answer for a complete explanation.

Explanation for Choice D:

This is the answer under the periodic LIFO method. See the correct answer for a complete explanation.

113. Question ID: CMA 1291 P2 Q27 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

On December 31, Year 1, Johnson Corporation sold on account and shipped merchandise with a list price of $75,000 to Gibsen Company. The terms of the sale were n/30, FOB shipping point. The merchandise arrived at Gibsen on January 5, Year 2. Because of confusion about the shipping terms, the sale was not recorded until January of Year 2 and the merchandise, sold at a markup of 25% of cost, was included in Johnson's inventory on December 31, Year 1. Johnson uses a periodic inventory system. As a result of the above, Johnson's income before income taxes for the year ended December 31, Year 1 was

- A. Understated by $15,000.correct
- B. Correctly stated.
- C. Understated by $75,000.
- D. Understated by $18,750.

Question was not answered

Correct Answer Explanation:

We know that the profit for the company was understated because the sales revenue was not recorded and the inventory was still on the books. The sale should have been recorded because the sale was made FOB shipping point, which means that the sale is recorded when the goods are shipped; and the related cost of the merchandise should have been recorded as well. Since the sales revenue and the related cost of goods sold were omitted, the gross profit from the sale was omitted from the income statement.

We are told that the selling price was $75,000, and that this included a 25% markup on the cost of the inventory. We can calculate what the cost of the merchandise was by using the following formula, in which X represents the cost:

1.25X = $75,000

Solving for X we get $60,000. So, if the cost was $60,000 and the selling price was $75,000, Johnson failed to record $15,000 of gross profit, and net income before income taxes was understated by $15,000.

Explanation for Choice B:

The profit of Johnson is understated as a result of these errors because the sales revenue was not recorded and the inventory was still on the books. The sale should have been recorded because the sale was made FOB shipping point, which means that the sale is recorded when the goods are shipped; and the related cost of the merchandise should have been recorded as well. Since the sales revenue and the related cost of goods sold were omitted, the gross profit from the sale was omitted from the income statement.

To answer the question, first calculate what the cost of the merchandise must have been in order for the markup on the $75,000 sale to have been 25% of the cost. The amount of cost is the unknown, and $75,000 is 125% of the cost. Once the cost is known, subtract the cost from the $75,000 sales revenue to calculate the amount of gross profit that was omitted from the income statement.

Explanation for Choice C:

The amount of income before income taxes for the year would have been understated by $75,000 if the inventory had been written off the books and the cost of goods sold recorded without recording the sales reveue from the sale. However, as we are told that the inventory is still on the books, the cost of goods sold has not been recognized.

The sale should have been recorded because the sale was made FOB shipping point, which means that the sale is recorded when the goods are shipped; and the related cost of the merchandise should have been recorded as well. Since the sales revenue and the related cost of goods sold were omitted, the gross profit from the sale was omitted from the income statement. The correct answer is the amount of gross profit that was omitted from the income statement.

Explanation for Choice D:

We know that the profit for the company was understated because the sales revenue was not recorded and the inventory was still on the books. The sale should have been recorded because the sale was made FOB shipping point, which means that the sale is recorded when the goods are shipped; and the related cost of the merchandise should have been recorded as well. Since the sales revenue and the related cost of goods sold were omitted, the gross profit from the sale was omitted from the income statement.

The correct answer is the amount of gross profit that was omitted from the income statement. This answer is 25% of the unrecorded sales revenue of $75,000. However, the question says that the merchandise was sold at a markup of 25% of cost, not that the gross profit on the unrecorded sale was 25%.

To answer the question, first calculate what the cost of the merchandise must have been in order for the markup on the $75,000 sale to have been 25%. The amount of cost is the unknown, and $75,000 is 125% of the cost. Once the cost is known, subtract the cost from the $75,000 sales revenue to calculate the amount of gross profit that was omitted from the income statement.

114. Question ID: CMA 1290 P2 Q4 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Madison Corporation uses the allowance method to value its accounts receivable and is making the annual adjustments at fiscal year end, November 30. The proportion of uncollectible accounts is estimated based on past experience, which indicates 1.5% of net credit sales will be uncollectible. Total sales for the year were $2,000,000 of which $200,000 were cash transactions. Madison has determined that the Norris Corporation accounts receivable balance of $10,000 is uncollectible and will write off this account before year-end adjustments are made. Listed below are Madison's account balances at November 30 prior to any adjustments and the $10,000 write-off.

Sales	$2,000,000
Accounts receivable	750,000
Sales discounts	(125,000)

Allowance for doubtful accounts	(16,500)
Sales returns and allowances	(175,000)
Bad debt expense	0

The entry to write off Norris Corporation's accounts receivable balance of $10,000 will

- A. Increase total assets and decrease net income.
- B. Have no effect on total assets and net income.correct
- C. Decrease total assets and net income.
- D. Have no effect on total assets and decrease net income.

Question was not answered

Correct Answer Explanation:

The journal entry to write off a receivable is a debit to the allowance for doubtful accounts and a credit to accounts receivable. This entry does not affect total assets or net income.

Explanation for Choice A:

The journal entry to write off a receivable is a debit to the allowance for doubtful accounts and a credit to accounts receivable. This entry does not affect total assets or net income.

Explanation for Choice C:

The journal entry to write off a receivable is a debit to the allowance for doubtful accounts and a credit to accounts receivable. This entry does not affect total assets or net income.

Explanation for Choice D:

The journal entry to write off a receivable is a debit to the allowance for doubtful accounts and a credit to accounts receivable. This entry does not affect total assets or net income.

115. Question ID: CMA 696 P2 Q3 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
An item of inventory purchased in year 1 for $25.00 has been incorrectly written down to a net realizable value of $17.50 at the end of year 1. The item is currently selling in year 2 for $50.00, its normal selling price. Which one of the following statements is correct?

- A. The cost of sales for year 2 will be overstated.
- B. The income for year 1 is overstated.
- C. The income for year 2 will be overstated.correct
- D. The closing inventory of year 1 is overstated.

Question was not answered

Correct Answer Explanation:

Because the inventory was incorrectly written down in year 1, that caused a loss to be recorded in year 1 and caused the inventory to be valued below its correct value. Therefore, when the item is sold in year 2, the company will recognize a lower cost of sales and thus more gross profit than they should have in year 2. In total, however, the income in the two years is correct. It is not allocated properly between the periods, though.

Explanation for Choice A:

The carrying value of the inventory becomes the cost of goods sold when the inventory is sold. Therefore, cost of sales in year 2 will be understated because the inventory was written down to a lower value at the end of year 1.

Explanation for Choice B:

Income in year 1 would be understated because of the loss that was incorrectly recorded in writing down the inventory.

Explanation for Choice D:

Closing inventory for year 1 is understated because the inventory item was incorrectly written down in year 1.

116. Question ID: CMA 1292 P2 Q8 H1 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
In accounting for inventories, generally accepted accounting principles require departure from the historical cost principle when the utility of inventory has fallen below cost. When the inventory cost flow assumption being used is anything **other than** LIFO or the Retail Method, the inventory should be measured at

- A. Lower of cost or the original cost plus a normal profit margin.
- B. Lower of cost or the original cost minus an allowance for obsolescence.
- C. Lower of cost or market.
- D. Lower of cost or net realizable value.correct
  Question was not answered

Correct Answer Explanation:

According to ASC 330-10-35-1A through 35-7, when the inventory cost flow assumption being used is anything **other than LIFO or the Retail Method**, the inventory should be measured at the lower of cost or net realizable value. Net realizable value is defined as the estimated selling price in the ordinary course of business, minus reasonably predictable costs of selling, including costs of completion, disposal, and transportation.

Explanation for Choice A:

This answer is incorrect as the original cost plus a normal profit margin is never used to value inventory. See the correct answer for a complete explanation.

Explanation for Choice B:

This answer is incorrect as the original cost minus an allowance for obsolescence is never used to value inventory. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer is incorrect as the lower of cost or market is used to value inventories **only** when either LIFO or the Retail Method is being used as the inventory cost flow assumption, according to ASC 330-10-35-1A through 35-7. This question asks for the method of valuing inventory when the inventory cost flow assumption being used is anything **other than LIFO or the Retail Method**.

117. Question ID: CMA 1292 P2 Q27 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Addison Hardware began the month of November with 150 large brass switchplates on hand at a cost of $4.00 each. These switchplates sell for $7.00 each. The following schedule presents the sales and purchases of this item during the month of November.

Nov.	Qty. Recd.	Unit Cost	Units Sold
5			100
7	200	$4.20	
9			150
11	200	$4.40	
17			220
22	250	$4.80	
29			100

If Addison uses periodic weighted-average inventory pricing, the gross profit for November will be

- A. $1,516
- B. $1,482correct
- C. $1,574
- D. $1,548

Question was not answered

Correct Answer Explanation:

In order to determine the gross profit, we need to calculate both revenue and COGS. Revenue is fairly simple as it is 570 units × $7 unit selling price, or $3,990. The calculation of COGS under the periodic weighted average method requires that we determine the average cost per unit available for sale. The total cost is:

(150 × $4.00) + (200 × $4.20) + (200 × $4.40) + (250 × $4.80) = $3,520.

The total cost of $3,520 divided by the total number of units available for sale (800, calculated as 150 in beginning inventory plus a total of 650 purchased) equals an average cost per unit of $4.40. To calculate COGS we need to multiply the number of units sold by the average cost: $4.40 × 570 = $2,508. Now that we have both revenue and COGS we can calculate the gross profit as $1,482 ($3,990 − $2,508).

Explanation for Choice A:

This answer results from assuming the perpetual LIFO method is being used. The question says to use the periodic weighted average method.

Explanation for Choice C:

This answer results from assuming the FIFO method (either periodic or perpetual) is being used. The question says to use the periodic weighted average cost method.

Explanation for Choice D:

This answer results from assuming the perpetual moving average cost method is being used. The question says to use the periodic weighted average cost method.

118. Question ID: CMA 1292 P2 Q25 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Addison Hardware began the month of November with 150 large brass switchplates on hand at a cost of $4.00 each. These switchplates sell for $7.00 each. The following schedule presents the sales and purchases of this item during the month of November.

Nov.	Qty. Recd.	Unit Cost	Units Sold
5			100
7	200	$4.20	
9			150
11	200	$4.40	
17			220
22	250	$4.80	
29			100

If Addison uses FIFO inventory pricing, the value of the inventory on November 30 would be

- A. $1,046.
- B. $1,012.
- C. $1,104.correct
- D. $936.

Question was not answered

Correct Answer Explanation:

A total of 800 units was available for sale during the month (beginning inventory + purchases) and in total 570 units were sold. This means that there are 230 units in ending inventory. Under FIFO (either periodic or perpetual) the ending inventory consists of the newest items of inventory. This means that the ending inventory consists of 230 of the units purchased on November 22 for $4.80 per unit. Therefore, ending inventory is equal to $1,104 (230 × $4.80).

Explanation for Choice A:

This answer results from assuming the perpetual LIFO method is being used. The question says to use FIFO.

Explanation for Choice B:

This answer assumes the periodic weighted average cost method is being used. The question says to use FIFO.

Explanation for Choice D:

This answer results from assuming the periodic LIFO method is being used. The question says to use FIFO.

119. Question ID: HOCK CMA.P1A1.02 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Sleepy Time Baby Clothes maintains its corporate checking account at BUY Bank. Sleepy Time also has a $50,000 line of credit at BUY Bank, for which Sleepy Time maintains a compensating balance of $10,000 in its checking account. Sleepy Time had $45,000 outstanding on the line at December 31, 20X4. The requirement to keep a $10,000 compensating balance in its checking account was not a part of the loan agreement that Sleepy Time signed for the line of credit. However, the company's loan officer at BUY Bank monitors its checking account balance and if the balance falls below $10,000, the loan officer calls Sleepy Time.

On December 31, 20X4, the balance in Sleepy Time's checking account was $12,000 according to the company's general ledger. Sleepy Time's accounts receivable department had recorded several customer payments received in the customers' accounts in the accounting system, but as of December 31 had not yet deposited the checks at BUY Bank. The total of the checks received and posted but not yet deposited was $2,000 at December 31, 20X4.

What cash balance should Sleepy Time report on its balance sheet for December 31, 20X4?

- A. $14,000
- B. $12,000correct
- C. zero
- D. $47,000

Question was not answered

Correct Answer Explanation:

The amount reported as cash on the December 31, 20X4 balance sheet should be the general ledger balance of $12,000. The undeposited checks are cash and they have been included in the general ledger balance of cash because they have been recorded, so they should not be deducted from the general ledger balance that includes them.

The amount of the compensating balance should be included in the cash reported because Sleepy Time did not sign an agreement requiring it to keep the compensating balance amount on deposit, so the compensating balance is not a legal requirement.

Explanation for Choice A:

This is the $12,000 balance in the checking account per Sleepy Time's general ledger plus the $2,000 in undeposited checks as of the statement date. The undeposited checks are cash, but they have already been included in the general ledger balance of cash because they have been recorded. Since they are already included in the general ledger balance, they should not be added to it again.

Explanation for Choice C:

This is the $12,000 balance in the checking account per Sleepy Time's general ledger minus the $10,000 compensating balance minus the $2,000 in undeposited checks as of the statement date.

The amount of the compensating balance should be included in the cash reported because Sleepy Time did not sign an agreement requiring it to keep the compensating balance amount on deposit, so the compensating balance is not a legal requirement. The undeposited checks are cash, and they have been included in the general ledger balance of cash because they have been recorded. Since they are cash, they should not be deducted from the general ledger balance that includes them.

Explanation for Choice D:

This is the $45,000 outstanding on the line of credit plus the $12,000 balance in the account per the general ledger minus the $10,000 required compensating balance in the checking account.

The amount outstanding on the line of credit should be reported as a current liability. The amount of the compensating balance should be included in the cash reported because Sleepy Time did not sign an agreement requiring it to keep the compensating balance amount on deposit, so the compensating balance is not a legal requirement.

120. Question ID: ICMA 1603.P1.010 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
A multinational company maintains its financial records under both IFRS and U.S. GAAP. Last year, the company determined its inventory with a carrying amount of $500,000 was impaired because demand for its product collapsed when a competitor launched a new product with innovative features. As a result, the company wrote down its inventory to $0. This year, however, government authorities unexpectedly announced that the competitor's product was defective and the product was removed from the market. As a result, the company's products were again in demand and the company estimated their net realizable value to be $750,000 at the end of the current quarter. How should the company record this new development in the current quarter?

- A. Under IFRS, $750,000 write-up of the inventory; under U.S. GAAP, $750,000 write-up of the inventory.
- B. Under IFRS, $500,000 write-up of the inventory; under U.S. GAAP, $0 write-up of the inventory.correct
- C. Under IFRS, 750,000 write-up of the inventory; under U.S. GAAP, $0 write-up of the inventory.
- D. Under IFRS, $0 write-up of the inventory; under U.S. GAAP, $0 write-up of the inventory.

Question was not answered

Correct Answer Explanation:

Under IFRS, previous write-downs of inventory may be recovered up to the original cost of the inventory. Gains cannot be recognized on appreciated inventory, but previous losses can be reversed. Reversal of previous losses is not permitted under U.S. GAAP.

Explanation for Choice A:

Under IFRS, previous write-downs of inventory may be recovered up to the original cost of the inventory. Gains cannot be recognized on appreciated inventory, but previous losses can be reversed. Therefore, the inventory cannot be written up to 750,000 under IFRS because its carrying value before the write-down was only $500,000. Reversal of previous losses is not permitted under U.S. GAAP.

Explanation for Choice C:

Under IFRS, previous write-downs of inventory may be recovered up to the original cost of the inventory. Gains cannot be recognized on appreciated inventory, but previous losses can be reversed. Therefore, the inventory cannot be written up to 750,000 under IFRS because its carrying value before the write-down was only $500,000.

Explanation for Choice D:

Under IFRS, previous write-downs of inventory may be recovered up to the original cost of the inventory.

121. Question ID: CMA 690 4.11 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Rice, Inc. uses the allowance method to account for uncollectible accounts. An account receivable that was previously determined uncollectible and written off was collected during May. The effect of the collection on Rice's current ratio and total working capital is as follows:

- A. The current ratio will be unchanged, but working capital will increase.
- B. There is no impact on either of the ratios.correct
- C. Both ratios will decrease.
- D. Both ratios will increase.

Question was not answered

Correct Answer Explanation:

When a receivable that was previously written off is collected under the allowance method, the journal entry to record this is a debit (increase) to cash and a credit (increase) to the allowance for doubtful debts account. The allowance for doubtful debts is a contra-asset account, which means that it functions as a liability but is recorded as a current asset, reducing the value of the current asset. So a credit to the allowance account decreases net receivables (accounts receivable minus the balance in the allowance account). This transaction thus increases current assets (cash) and decreases current assets (net accounts receivable) by the same amount, leading to no change in the current ratio or working capital.

Explanation for Choice A:

When a receivable that was previously written off is collected under the allowance method, the journal entry to record this is a debit (increase) to cash and a credit (increase) to the allowance for doubtful debts account. The allowance for doubtful debts is a contra-asset account, which means that it functions as a liability, but is recorded as a current asset, reducing the value of the current asset. This transaction thus increases and decreases current assets by the same amount, leading to no change in the current ratio or working capital.

Explanation for Choice C:

When a receivable that was previously written off is collected under the allowance method, the journal entry to record this is a debit (increase) to cash and a credit (increase) to the allowance for doubtful debts account. The allowance for doubtful debts is a contra-asset account, which means that it functions as a liability, but is recorded as a current asset, reducing the value of the current asset. This transaction thus increases and decreases current assets by the same amount, leading to no change in the current ratio or working capital.

Explanation for Choice D:

When a receivable that was previously written off is collected under the allowance method, the journal entry to record this is a debit (increase) to cash and a credit (increase) to the allowance for doubtful debts account. The allowance for doubtful debts is a contra-asset account, which means that it functions as a liability, but is recorded as a current asset, reducing the value of the current asset. This transaction thus increases and decreases current assets by the same amount, leading to no change in the current ratio or working capital.

122. Question ID: CMA 694 P2 Q6 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

During the year 1 year-end physical inventory count at Tequesta Corporation, $40,000 worth of inventory was counted twice. Assuming that the year 2 year-end inventory was correct, the result of the year 1 error was that

- A. Year 1 cost of goods sold was understated, and year 2 retained earnings was correct.correct
- B. Year 1 cost of goods sold was overstated, and year 2 income was understated.
- C. Year 1 retained earnings was understated, and year 2 ending inventory was correct.
- D. Year 1 income was overstated, and year 2 ending inventory was overstated.

Question was not answered

Correct Answer Explanation:

Cost of goods sold is calculated as follows: beginning inventory + purchases − ending inventory. If the year 1 ending inventory was overstated, that means that cost of goods sold would have been understated. Because the year 2 ending inventory was correctly counted, there is no misstatement to retained earnings at the end of year 2. This is because retained earnings is not closed at the end of a period and the error that resulted was simply an error in the allocation of the income between the two periods. The calculation of cost of goods sold in year 2 would lead to an overstated amount because beginning inventory was too high. The year 1 understatement and the year 2 overstatement cancel each other out leaving retained earnings correctly stated at the end of year 2.

Explanation for Choice B:

Year 1 cost of goods sold was understated. See the correct answer for a complete explanation.

Explanation for Choice C:

Year 1 retained earnings would have been overstated because the error would cause Year 1 cost of goods sold to be understated.

Explanation for Choice D:

Year 2 ending inventory is correct, not overstated. See the correct answer for a complete explanation.

123. Question ID: CMA 1290 P2 Q5 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Madison Corporation uses the allowance method to value its accounts receivable and is making the annual adjustments at fiscal year end, November 30. The proportion of uncollectible accounts is estimated based on past experience, which indicates 1.5% of net credit sales will be uncollectible. Total sales for the year were $2,000,000 of which $200,000 were cash transactions. Madison has determined that the Norris Corporation accounts receivable balance of $10,000 is uncollectible and will write off this account before year-end adjustments are made. Listed below are Madison's account balances at November 30 prior to any adjustments and the $10,000 write-off.

Sales	$2,000,000
Accounts receivable	750,000
Sales discounts	(125,000)
Allowance for doubtful accounts	(16,500)

Sales returns and allowances	(175,000)
Bad debt expense	0

As a result of the November 30 adjusting entry to provide for bad debts, the allowance for doubtful accounts will

- A. Decrease by $22,500.
- B. Increase by $25,500.
- C. Increase by $30,000.
- D. Increase by $22,500.correct

Question was not answered

Correct Answer Explanation:

In order to answer this question we simply need to calculate the net credit sales of the company and multiply it by the 1.5% that they expect not to collect. There were $2,000,000 of sales, but $200,000 were cash sales. In addition, we know that estimated returns were $175,000 and there were $125,000 of estimated sales discounts. This leaves the company with only $1,500,000 of credit sales. 1.5% of this is $22,500 which is the amount that the allowance account will increase as a result of the adjusting entry for bad debts.

The question says that the $10,000 writeoff of the uncollectible account will be done before the year-end adjustments are made. Because the percentage of sales method is being used and this question asks only for the adjusting entry to provide for bad debts, the $10,000 writeoff is not relevant to answering this question.

Explanation for Choice A:

This answer calculates the correct amount, but the adjustment will be to increase the allowance account, not to decrease the allowance account.

Explanation for Choice B:

This answer does not take into account the cash sales. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer does not take into account the cash sales, the discounts or the allowances. It is simply 1.5% of total sales. See the correct answer for a complete explanation.

124. Question ID: CMA 697 P2 Q20 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Jensen Company uses a perpetual inventory system. The following purchases and sales were made during the month of May:

May	Activity	Description
1	Balance	100 units at $10 per unit
9	Purchase	200 units at $10 per unit
16	Sale	190 units

21	Purchase	150 units at $12 per unit
29	Sale	120 units

If Jensen Company uses the perpetual last-in, first-out (LIFO) method of inventory valuation, the May 31 inventory would be

- A. $1,562
- B. $1,400
- C. $1,493
- D. $1,460correct

Question was not answered

Correct Answer Explanation:

Under the perpetual LIFO method each time a sale is made the company determines which specific units are sold. The units sold are the most recently purchased units. For the sale on May 16, the units sold were 190 of the units purchased on May 9. This reduces the number of units from the May 9 purchase to 10. The sale on May 29 was the sale of 120 of the units purchased on May 21. This reduces the number of units from that purchase to 30. Therefore, ending inventory consists of 100 units from the beginning inventory (valued at $10 each) and 10 units from the May 9 purchase (valued at $10 each) and 30 units from the May 21 purchase (valued at $12 each). In total, the ending inventory was $1,460 [(110 × $10) + (30 × $12)].

Explanation for Choice A:

This is the answer under the moving average (perpetual) method. See the correct answer for a complete explanation.

Explanation for Choice B:

This is the answer under the periodic LIFO method. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the answer under the weighted average (periodic) method. See the correct answer for a complete explanation.

125. Question ID: CMA 1288 P4 Q13 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Fidler Company has estimated its credit loss expense by using 1% of net sales. However, the company is contemplating aging its accounts receivable and using this as a basis for estimating its credit losses, as it is believed that this will provide a better estimate of the credit losses. The following aging schedule was prepared as of November 30 of the current year, the end of the fiscal year.

Age of Account	Amount	% estimated credit losses
Under 60 days	$730,000	1%
61-90 days	40,000	6%

91-120 days	18,000	9%
Over 120 days	72,000	25%

Net sales for the year were $4,200,000. There is a debit balance of $14,000 in the allowance for credit losses account as of November 30 of the current year.

If Fidler estimates its credit losses by aging the accounts receivable, the adjusting entry to the allowance for credit losses made on November 30 of the current year will be for

- A. $29,320
- B. $43,320correct
- C. $15,320
- D. $56,000

Question was not answered

Correct Answer Explanation:

In order to determine the credit loss expense using the percentage of receivables method, the first thing that we must do is calculate the required ending balance in the allowance account. Using the aging schedule for the calculation of the ending balance in the allowance account requires us to make four calculations, one for each of the different "ages" of receivables. By multiplying the amount in each category by the percentage that is not going to be collected, we can calculate the required ending balance in the allowance account. These calculations are:

($730,000 × 0.01) + ($40,000 × 0.06) + ($18,000 × 0.09) + ($72,000 × 0.25). Adding these together we get $29,320. This is the amount that should be in the allowance account at the end of the year (as a credit balance).

Since the account had a debit balance of $14,000 before adjustment, Fidler will need to record a credit of $43,320 ($14,000 + $29,320) to the allowance account in order to bring the account balance to the correct ending balance. The corresponding debit will be to credit loss expense.

Explanation for Choice A:

This is the required ending balance in the allowance account, but it does not take into account the $14,000 debit balance that was in this account before adjustment. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer results from subtracting the debit balance in the allowance account from the required ending balance. The account had a debit balance that needed to be changed to a credit balance, so the debit balance needs to be added to the required ending credit balance to calculate the amount of the credit required. See the correct answer for a complete explanation.

Explanation for Choice D:

This is the sum of the credit transaction that would be made to the allowance account if the percentage of sales method were being used ($42,000, or 1% of $4,200,000), and the debit balance in the allowance account before adjustment ($14,000).

However, the question says to use the **percentage of receivables** method. When the percentage of receivables method is used, the required balance in the allowance account is calculated first using either the total balance in accounts receivable or an aging schedule, and the adjusting entry to the allowance account is whatever credit amount is needed to change the balance in the allowance account to the required balance.

126. Question ID: CIA 1196 P4 Q6 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

On a company's December 31, 20X6 balance sheet, which of the following items should be included in the amount reported as cash?

I. A check payable to the company, dated January 2, 20X7, in payment of a sale made in December 20X6.

II. A check drawn on the company's account, payable to a vendor, dated and recorded in the company's books on December 31, 20X6 but not mailed until January 10, 20X7.

- A. I only.
- B. Neither I nor II.
- C. II only.correct
- D. Both I and II.

Question was not answered

Correct Answer Explanation:

The money in the accounts payable check (II) is correctly included because it should continue to be included in the payor's cash balance until the check is mailed. As long as the check remains in the company's possession, they should continue to record the cash in their books. Therefore, this check should be reported as part of the company's cash balance as of December 31, 20X6 since it was not mailed until 20X7.

The check payable to the company that is dated January 2, 20X7 (I) is correctly excluded because it is not negotiable (cannot be deposited to the company's checking account) until the check date. Even if the check was received in 20X6, it should not be recorded in cash until it can be deposited. The amount of the December sale should be reported as an account receivable as of year end 20X6.

Explanation for Choice A:

The check payable to the company (I) that is dated January 2, 20X7 is not negotiable (cannot be deposited to the company's checking account) until the check date. Even if the check was received in 20X6, it should not be recorded in cash until it can be deposited. The amount of the December sale should be reported as an account receivable as of year end 20X6.

The money in the accounts payable check (II) should continue to be included in the payor's cash balance until the check is mailed. As long as the check remains in the company's possession, they should continue to record the cash in their books. Therefore, this check should be reported as part of the company's cash balance as of December 31, 20X6 since it was not mailed until 20X7.

Explanation for Choice B:

The money in the accounts payable check (II) should continue to be included in the payor's cash balance until the check is mailed. As long as the check remains in the company's possession, they should continue to record the cash in their books. Therefore, this check should be reported as part of the company's cash balance as of December 31, 20X6 since it was not mailed until 20X7.

Explanation for Choice D:

The check payable to the company that is dated January 2, 20X7 (I) is not negotiable (cannot be deposited to the company's checking account) until the check date. Even if the check was received in 20X6, it should not be recorded in cash until it can be deposited. The amount of the December sale should be reported as an account receivable as of year end 20X6.

127. Question ID: CMA 1293 P2 Q1 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

On the Statement of Financial Position, accounts receivable is valued at the

- A. Original cost when the asset was acquired.
- B. Estimated net realizable value.correct
- C. Current market value.
- D. Amount payable when due.

Question was not answered

Correct Answer Explanation:

On the balance sheet the accounts receivable should be shown at the amount that is expected to be collected in the future. This is also called the net realizable value.

Explanation for Choice A:

For a company in the business of selling goods or services, accounts receivable are not purchased, so they are not assets that are acquired at a cost. Accounts receivable arise in the course of doing business when a customer receives a good or service that has not yet been paid for. On the balance sheet accounts receivable should be shown at the amount that the company expects to collect in the future. See the correct answer for a complete explanation.

Explanation for Choice C:

On the balance sheet the receivables should be shown at the amount that the company expects to collect in the future. See the correct answer for a complete explanation.

Explanation for Choice D:

On the balance sheet the receivables should be shown at the amount that the company expects to collect in the future. See the correct answer for a complete explanation.

128. Question ID: CIA 1193 P4 Q41 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

An internal auditor is deriving cash flow data based on an incomplete set of facts. Credit loss expense during the period was $2,000. Additional data for this period follow:

Net credit sales	$100,000
Accounts receivable beginning balance	5,000
Allowance for credit losses beginning balance	(500)
Accounts receivable written off	1,000
Increase in net accounts receivable (net of allowance for credit losses)	30,000

How much cash was collected from accounts receivable this period?

- A. $67,000
- B. $70,000
- C. $68,500
- D. $68,000correct

Question was not answered

Correct Answer Explanation:

The Accounts Receivable beginning balance is $5,000. Net credit sales of $100,000 would have increased it by $100,000, and the receivables written off would have decreased it by $1,000. We do not yet know what collections were or what the ending balance was.

The Allowance for Credit Losses beginning balance is a credit $(500). Credit loss expense of $2,000 would be a credit to the account, increasing its credit balance to $(2,500); and the receivables written off would be a debit to the account, decreasing its credit balance by $1,000. Thus, the ending balance in the Allowance for Credit Losses was a credit balance of $(1,500).

We know that Net Accounts Receivable (Gross Accounts Receivable minus the Allowance for Credit Losses) increased by $30,000 during the period. The beginning net accounts receivable balance was $5,000 − $500 in the Allowance account, or $4,500. Therefore, the ending net accounts receivable balance was $4,500 + $30,000, or $34,500.

We also know the ending balance of the Allowance for Credit Losses account was ($1,500). Therefore, the ending Gross Accounts Receivable balance must be $36,000 ($34,500 ending net accounts receivable plus the ending balance of the Allowance account of $1,500).

Therefore, we have all the information we need to calculate the amount of cash collected from accounts receivable:

Beginning accounts receivable of $5,000 + $100,000 net credit sales − $1,000 written off − $36,000 ending accounts receivable = $68,000 collected during the month.

Explanation for Choice A:

An answer of $67,000 is calculated as follows:

Beginning Net A/R	$ 4,500
− Written off amount	(1,000)
− Allowance for credit losses	(2,000)
− Ending Net A/R	(34,500)
Cash Paid	$67,000

When an account is written off, the allowance for credit losses is debited and accounts receivable is credited for the written-off amount. The effect of the write-off on net accounts receivable is zero. Since this calculation is using net receivable amounts, nothing should be deducted for the write-off.

Explanation for Choice B:

This answer results from subtracting the increase in net accounts receivable from net credit sales ($100,000 − $30,000). This is incorrect because it does not account for the $2,000 in credit loss expense that was a non-cash adjustment to net accounts receivable.

Explanation for Choice C:

This answer results from miscalculating the Ending Gross Accounts Receivable balance as $35,500. The ending Gross Accounts Receivable balance can be derived by calculating the ending Net Accounts Receivable balance and the ending Allowance for Credit Losses balance and then grossing up the Ending Net Accounts Receivable Balance using the ending Allowance for Credit Losses balance.

We know that Net Accounts Receivable (Gross Accounts Receivable minus the Allowance for Credit Losses) increased by $30,000 during the period. The beginning Net Accounts Receivable balance was $5,000 − $500, or $4,500. Therefore, the ending Net Accounts Receivable balance was $4,500 + $30,000, or $34,500.

We also know the ending balance of the Allowance for Credit Losses account was ($1,500), calculated as the beginning balance of ($500) plus a ($2,000) credit for the credit loss expense and the $1,000 debit for the receivables written off.

Therefore, the ending Gross Accounts Receivable balance must be $36,000 ($34,500 ending Net Accounts Receivable plus the Ending Allowance for Credit Losses of $1,500).

129. Question ID: CMA 1295 P2 Q25 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Tony's AutoParts Store is a small retailer. Tony Brown owns the business and has purchased a microcomputer system equipped with bar coding devices. Tony Brown has asked Cheryl James, accountant, what she thinks of implementing a perpetual inventory system. Which one of the following statements is correct?

- A. A perpetual system is cheaper to administer than a periodic system.
- B. The cost of implementing and administering a perpetual system for Tony's AutoParts Store would probably exceed any savings generated by achieving better control.correct
- C. A perpetual inventory system requires a daily reconciliation between goods sold per the cash register and goods remaining in stock.
- D. A perpetual system might eliminate the necessity of having to take a physical inventory every year.

Question was not answered

Correct Answer Explanation:

Given that Tony's is a small retailer selling car parts, it is very possible that the benefits of the perpetual system will not be greater than the costs associated with it. Because the car parts have relatively small individual values, the better control over inventory may not provide much financial benefit. While it is possible that this is not the case, of the choices given this is the best answer.

Explanation for Choice A:

Because a perpetual system has more calculation involved, a perpetual system is more expensive than a periodic system to administer.

Explanation for Choice C:

Under the perpetual system there is no need to do a daily reconciliation between the books and physical count of the inventory. This may be done once a year.

Explanation for Choice D:

Even when a perpetual system is used, a physical count must be taken at the end of the year.

130. Question ID: CMA 1292 P2 Q4 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Bad debt expense must be estimated to satisfy the matching principle when expenses are recorded in the same periods as the related revenues. In estimating the provision for doubtful accounts for a period, companies accrue

- A. A percentage of accounts receivable transactions for the period.
- B. A percentage of total sales.
- C. Either an amount based on a percentage of credit sales or an amount based on a percentage of accounts receivable after adjusting for any balance in the allowance for doubtful accounts.correct
- D. Either an amount based on a percentage of total sales or an amount based on a percentage of accounts receivable after adjusting for any balance in the allowance for doubtful accounts.

Question was not answered

Correct Answer Explanation:

In the process of valuing accounts receivable, there are two methods that a company may choose from: to use a percentage of credit sales for the period or a percentage of the ending receivables balance. Under the percentage of receivables method the existing balance (before adjustment) in the allowance account is taken into account in calculating the journal entry for the bad debt expense, because the amount recorded needs to be whatever amount is necessary to bring the ending balance in the allowance account to what it needs to be. Under the percentage of sales method, the amount of bad debt expense recorded is a given percentage of the credit sales made during the period, regardless of the effect the entry has on the ending balance in the allowance account.

Explanation for Choice A:

One of the acceptable methods is a percentage of receivables, but the receivables balance that is used is the ending receivables balance, not the total of all transactions with receivables during the period. See the correct answer for a complete explanation.

Explanation for Choice B:

One of the acceptable methods is a percentage of sales, but the sales figure that is used is the credit sales, not the total sales. See the correct answer for a complete explanation.

Explanation for Choice D:

One of the acceptable methods is a percentage of sales, but the sales figure that is used is the credit sales, not the total sales. See the correct answer for a complete explanation.

131. Question ID: CMA 694 P2 Q5 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
The following inventory valuation errors have been discovered for Knox Corporation.

- The year 1 year-end inventory was overstated by $23,000.
- The year 2 year-end inventory was understated by $61,000.
- The year 3 year-end inventory was understated by $17,000.

The reported income before taxes for Knox was

Year 1 - $138,000
Year 2 - $254,000
Year 3 - $168,000

Reported income before taxes for year 1, year 2, and year 3, respectively, should have been

- A. $115,000, $338,000, and $124,000correct
- B. $161,000, $338,000, and $90,000
- C. $161,000, $170,000, and $212,000
- D. $115,000, $338,000, and $212,000

Question was not answered

Correct Answer Explanation:

Though this is a three year question, we can solve it in the same manner we would a one year question. This is easiest to do if we create an example that first has numbers that the company used and then we make adjustments for the numbers that the company should have had. In this question it is a little bit more difficult because of the fact that we are given an income figure, but we can do it as follows:

	Year 1	Year 2	Year 3
Beginning inventory	200	100	100
Purchases	300	600	500
Ending inventory	100	100	200
Cost of sales	400	600	400
Net income	138	254	168

Now, we can make the corrections to the ending inventory balances and see what income should have been.

	Year 1	Year 2	Year 3
Beginning inventory	200	77	161
Purchases	300	600	500
Ending inventory	77	161	217
Cost of sales	423	516	444
Net income	115	338	124

The question could also be answered by adjusting the reported income before taxes, as follows:

Year 1: Income before taxes was reported as $138,000 and ending inventory was overstated by $23,000. An overstatement of ending inventory leads to COGS that is understated and gross profit that is overstated, so corrected income before taxes was $138,000 − $23,000 = $115,000.

Year 2: Beginning inventory was overstated by $23,000 due to the error in Year 1's ending inventory. An overstatement of beginning inventory leads to COGS that is overstated and gross profit that is understated, so income before taxes was understated by $23,000 due to the Year 1 error. Year 2's income before taxes was reported as $254,000 and ending inventory was understated by $61,000. An understatement of ending inventory leads to COGS that is overstated and gross profit that is understated, so income before taxes was understated by $61,000 due to the Year 2 error. Combining both errors, the corrected income before taxes was $254,000 + $23,000 + $61,000 = $338,000.

Year 3: Beginning inventory was understated by $61,000 due to the error in Year 2's ending inventory. An understatement of beginning inventory leads to COGS that is understated and gross profit that is overstated, so income before taxes was overstated by $61,000 due to the Year 2 error. Year 3's income before tax was reported as $168,000 and ending inventory was understated by $17,000. An understatement of ending inventory leads to COGS that is overstated and gross profit that is understated, so income before taxes was understated by $17,000 due to the Year 3 error. Combining both errors, the corrected income before taxes was $168,000 − $61,000 + $17,000 = $124,000.

Explanation for Choice B:

This answer results from incorrectly treating Year 1's overstated ending inventory as causing understated gross profit. An overstated ending inventory causes overstated gross profit.

The answer also results from incorrectly treating Year 3's understated ending inventory as causing overstated gross profit. An understated ending inventory causes understated gross profit.

Explanation for Choice C:

This answer results from incorrectly treating an overstated ending inventory as causing understated gross profit in the year of the error and overstated gross profit in the following year; and treating understated ending inventory as causing overstated gross profit in the year of the error and understated gross profit in the following year.

The correct calculations are exactly opposite (replace all the additions with subtractions and all the subtractions with additions).

Explanation for Choice D:

This answer results from incorrectly treating Year 3's understated beginning inventory as causing understated gross profit and incorrectly treating Year 3's understated ending inventory as causing overstated gross profit. The correct calculations for Year 3 are the opposite: an understated beginning inventory causes overstated gross profit and an understated ending inventory causes understated gross profit.

132. Question ID: CMA 696 P2 Q5 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
All sales and purchases for the year at Ross Corporation are credit transactions. Ross uses a perpetual inventory system and shipped goods that were correctly excluded from ending inventory. However, in error, the sale was not recorded. Which one of the following statements is correct?

- A. Accounts receivable was understated, inventory was not affected, sales were understated, and cost of goods sold was not affected.correct
- B. Accounts receivable was understated, inventory was overstated, sales were understated, and cost of goods sold was overstated.
- C. Accounts receivable was understated, inventory was not affected, sales were understated, and cost of goods sold was understated.
- D. Accounts receivable was not affected, inventory was not affected, sales were understated, and cost of goods sold was understated.

Question was not answered

Correct Answer Explanation:

Because the goods were not included in ending inventory, inventory is not affected. Also, because the inventory was correctly recorded, cost of goods sold was not affected by the error. However, by failing to record the sale, both accounts receivable and sales revenue were understated.

Explanation for Choice B:

Inventory and cost of goods sold were not overstated because the items sold were excluded from ending inventory.

Explanation for Choice C:

Cost of goods sold was not understated because the items sold were excluded from ending inventory.

Explanation for Choice D:

Accounts receivable was affected because the sale was not recorded. Cost of goods sold was not understated because the items sold were excluded from ending inventory.

133. Question ID: ICMA 1603.P1.058 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
A company uses the IFRS lower-of-cost-or-net realizable value rule to value its inventory of frozen foods. The company applies this method on a total inventory basis, not directly to each item of frozen food. Information on the frozen food inventory at December 31 of the year just ended is provided below.

Replacement cost	$ 80,000
Net realizable value less profit margin	85,000
Weighted average cost	90,000
Net realizable value	100,000

Using this approach, the company should value its inventory at

- A. $100,000.
- B. $85,000.
- C. $90,000.correct
- D. $80,000.

Question was not answered

Correct Answer Explanation:

Under IFRS, all inventory is valued at the lower of cost or net realizable value. The weighted average cost is $90,000 and the net realizable value is $100,000. The lower of those two amounts is $90,000, so $90,000 should be the inventory value reported on the company's balance sheet.

Explanation for Choice A:

Under IFRS, all inventory is valued at the lower of cost or net realizable value. The weighted average cost is $90,000 and the net realizable value is $100,000. The lower of those two amounts is not $100,000.

Explanation for Choice B:

Under IFRS, all inventory is valued at the lower of cost or net realizable value. $85,000 is the net realizable value less profit margin, and that value is not relevant to the determination of the lower of cost or net realizable value.

Explanation for Choice D:

Under IFRS, all inventory is valued at the lower of cost or net realizable value. $80,000 is the replacement cost, and that value is not relevant to the determination of the lower of cost or net realizable value.

134. Question ID: CMA 1287 P2 Q17 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Nasus Company began the month of November with 150 units of Model-XL brass hinges on hand at a cost of $2.00 each. These hinges sell for $3.50 each. The following schedule presents the additional activity in this inventory item during November.

November	Quantity Received	Unit Price	Units Sold
4			100
6	200	$2.10	
8			150
10	200	2.20	
16			220
21	250	2.40	
28			100

If Nasus uses perpetual moving average inventory pricing, the sale of 220 items on November 16 would be recorded at a unit cost of:

- A. $2.20
- B. $2.16correct
- C. $2.08
- D. $2.10

Question was not answered

Correct Answer Explanation:

In order to answer this question, we will have to do all of the calculations for each of the transactions prior to the sale on November 16. This is because under the perpetual moving average method, a new average cost needs to be calculated each time inventory is purchased. Nasus starts with 150 units at a cost of $2.00 each. They then sell 100 of these units on November 4, reducing inventory to 50 units at $2 each, or $100 in total. On November 6, they purchase 200 units (bringing the total to 250 units) for a total of $420 (bringing the total value of inventory to $520). Using these new total figures, we get an average cost of $2.08 ($520 ÷ 250). They then sell 150 units (total cost of $312, calculated as 150 × 2.08). This brings their inventory to 100 units with a total cost of $208. They then purchase 200 more units (bringing the total units to 300) for a cost of $440 (bringing their total cost of inventory to $648). Using these new figures, we can calculate the average cost of their inventory as $2.16 ($648 ÷ 300). This is the average cost that will be used for the items that were sold on November 16.

Explanation for Choice A:

This is the cost of the units purchased on November 10. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the average cost of the units sold on November 8. See the correct answer for a complete explanation.

Explanation for Choice D:

This is the cost of the units purchased on November 6. See the correct answer for a complete explanation.

135. Question ID: CMA 696 P2 Q15 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Thomas Engine Company is a wholesaler of marine engine parts. The activity of carburetor 2642J during the month of March is presented below.

March		No. of Units	Unit Cost	Sales Price
1	Inventory	3,200	$64.30	$86.50
4	Purchase	3,400	64.75	87.00
14	Sales	3,600		87.25
25	Purchase	3,500	66.00	87.25
28	Sales	3,450		88.00

If Thomas uses a weighted-average periodic inventory system, the total cost of the inventory for carburetor 2642J at March 31 is

- A. $198,301
- B. $199,233
- C. $194,200
- D. $198,372correct

Question was not answered

Correct Answer Explanation:

Under the periodic weighted average method we first need to calculate the average cost for all of the items that were in inventory during the period. In total there were 10,100 units available for sale and in total the company paid $656,910 [(3,200 × $64.30) + (3,400 × $64.75) + (3,500 × $66)]. This gives an average cost per unit of $65.04 ($656,910 ÷ 10,100). Since the company sold 7,050 units during the period, there were 3,050 units in ending inventory. Under the weighted average method, each unit is assigned the average cost. Therefore, ending inventory is $198,372 (3,050 × $65.04).

Explanation for Choice A:

This answer results from summing the three different inventory costs—$64.30, $64.75, and $66.00—and dividing by 3, then multiplying the result by the number of units in ending inventory. That is not the correct way to determine inventory costs using the weighted average periodic method.

Explanation for Choice B:

This is the answer for the perpetual moving average method. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer is incorrect. See the correct answer for a complete explanation.

136. Question ID: HOCK MP2 AF4 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
According to the FASB conceptual framework, which of the following attributes would **not** be used to measure inventory?

- A. Historical cost
- B. Net realizable value
- C. Present value of future cash flowscorrect
- D. Replacement cost

Question was not answered

Correct Answer Explanation:

According to Concepts Statement No. 5, the various attributes used to measure items reported in the financial statements include historical cost, current (replacement) cost, current fair value, net realizable value, and the present value of future cash flows. Not all of those attributes are used for valuing inventory, though. The present value of future cash flows is not one of the ways inventory is valued, so it is the correct answer to the question. The present value of future cash flows is used to measure long-term payables and receivables.

The conceptual framework is part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

Explanation for Choice A:

According to Concepts Statement No. 5, the various attributes used to measure items reported in the financial statements include historical cost, current (replacement) cost, current fair value, net realizable value, and the present value of future cash flows. Not all of those attributes are used for valuing inventory, but historical cost is used in valuing inventory. Historical cost is the acquisition price of the inventory.

The conceptual framework is part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

Explanation for Choice B:

According to Concepts Statement No. 5, the various attributes used to measure items reported in the financial statements include historical cost, current (replacement) cost, current fair value, net realizable value, and the present value of future cash flows. Not all of those attributes are used for valuing inventory, but net realizable value is used in valuing inventory. Net realizable value is the amount of cash expected to be received for an asset in the due course of business minus costs of completion and sale.

The conceptual framework is part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

Explanation for Choice D:

According to Concepts Statement No. 5, the various attributes used to measure items reported in the financial statements include historical cost, current (replacement) cost, current fair value, net realizable value, and the present value of future cash flows. Not all of those attributes are used for valuing inventory, but replacement cost is one of the ways inventory may be valued when LIFO or the Retail Method is being used. Replacement cost is the amount that would need to be spent to acquire the inventory currently.

The conceptual framework is part of the accounting knowledge that all CMA candidates are assumed to have before beginning to study for the CMA exams.

137. Question ID: CMA 696 P2 Q20 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)

Devereaux Inc. uses a perpetual inventory system and had the following inventory inflows and outflows during the month of November.

November	Activity	
1	Balance	200 units at $20 per unit
10	Purchases	160 units at $20 per unit
18	Sales	180 units
20	Purchases	140 units at $24 per unit
27	Sales	100 units

If Devereaux Inc. uses the last-in, first-out method, the value of its inventory at November 30 would be

- A. $4,560correct
- B. $4,400
- C. $4,480
- D. $4,785

Question was not answered

Correct Answer Explanation:

Under the perpetual LIFO method each time a sale is made the company determines which specific units are sold. The units sold are the most recently purchased units. For the sale on November 18, the units sold were all of the units purchased on November 10 and 20 of the units that were in beginning inventory. This reduces the number of units from beginning inventory to 180. The sale on November 27 was the sale of 100 of the units purchased on November 20. This reduces the number of units from that purchase to 40. Therefore, ending inventory consists of 180 units from the beginning inventory (valued at $20 each) and 40 units from the November 20 purchase (valued at $24 each). In total, the ending inventory was $4,560 [(180 × $20) + (40 × $24)].

Explanation for Choice B:

This is the answer under the periodic LIFO method. See the correct answer for a complete explanation.

Explanation for Choice C:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice D:

This is the answer under the moving average method. See the correct answer for a complete explanation.

138. Question ID: CMA 1292 P2 Q28 (Topic: Cash & Cash Equiv., Accounts Receivable, and Inventory)
Addison Hardware began the month of November with 150 large brass switchplates on hand at a cost of $4.00 each. These switchplates sell for $7.00 each. The following schedule presents the sales and purchases of this item during the month of November.

November	Quantity Received	Unit Cost	Units Sold
5			100
7	200	$4.20	
9			150
11	200	$4.40	
17			220
22	250	$4.80	
29			100

If Addison uses periodic LIFO inventory pricing, the cost of goods sold for November will be

- A. $2,474.
- B. $2,584.correct
- C. $2,442.
- D. $2,416.

Question was not answered

Correct Answer Explanation:

A total of 570 units were sold during the period. Since periodic LIFO is being used, the cost of the units sold will be the cost of the units most recently purchased. Therefore, COGS will be equal to \$2,584 [(250 × \$4.80) + (200 × \$4.40) + (120 × \$4.20)].

Explanation for Choice A:

This answer results from assuming the perpetual LIFO method is being used. The question says to use the periodic LIFO method.

Explanation for Choice C:

This answer results from assuming the perpetual moving average cost method is being used. The question says to use the periodic LIFO method.

Explanation for Choice D:

This answer results from assuming the FIFO method is being used (either periodic or perpetual). The question says to use the periodic LIFO method.

139. Question ID: CMA Sample Question (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Pearl Corporation acquired manufacturing machinery on January 1 for \$9,000. During the year, the machine produced 1,000 units, of which 600 were sold. There was no work-in-process inventory at the beginning or at the end of the year. Installation charges of \$300 and delivery charges of \$200 were also incurred. The machine is expected to have a useful life of five years with an estimated salvage value of \$1,500. Pearl uses the straight-line depreciation method. The original cost of the machinery to be recorded in Pearl's books is

- A. \$9,000
- B. \$9,300
- C. \$9,200
- D. \$9,500correct
  Question was not answered

Correct Answer Explanation:

Fixed assets are originally recorded at all of the costs necessary to get the asset ready for use. This includes the cost of the asset itself, shipping, installation, testing, insurance during transit, any import taxes, and any other costs that needed to be incurred in order to prepare the asset for its intended use. Therefore, Pearl should include the \$9,000 cost of the asset as well as the installation charges of \$300 and the delivery charges of \$200, for a total of \$9,500. This \$9,500 minus the estimated salvage value of \$1,500 will be used to calculate the straight-line depreciation over the life of the asset.

Explanation for Choice A:

The delivery charges and the installation charges should be included in the initial recorded cost of the asset.

Explanation for Choice B:

The delivery charges of \$200 should also be included in the initial recorded cost of the asset.

Explanation for Choice C:

The installation charges of \$300 should also be included in the initial recorded cost of the asset.

140. Question ID: CMA 1292 P2 Q5 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Aston Company acquired a new machine at a cost of $200,000 and incurred costs of $2,000 to have the machine shipped to its factory. Aston also paid $4,500 to construct and prepare a site for the new machine and $3,500 to install the necessary electrical connections. Aston estimates that the useful life of this new machine will be 5 years and that it will have a salvage value of $15,000 at the end of that period. Assuming that Aston acquired the machine on January 1 and will take a full year's depreciation in the first year of ownership, the proper amount of depreciation expense to be recorded by Aston for the first year if it uses the double-declining-balance method is

- A. $84,000correct
- B. $78,000
- C. $80,800
- D. $74,000

Question was not answered

Correct Answer Explanation:

The first step is to include the initial cost of the asset. Fixed assets are originally recorded at all of the costs necessary to get the asset ready for use. This includes the cost of the asset itself, shipping, installation, testing, insurance during transit, any import taxes, and any other costs that needed to be incurred in order to prepare the asset for its intended use. Therefore, Aston should include the $200,000 cost, the $2,00 in shipping, the $4,500 in construction of a new site and $3,500 in electrical connections. This totals $210,000.

Under the double declining balance method depreciation is calculated as the book value of the asset multiplied by twice what the straight-line percentage would be. The asset has a useful life of 5 years so under the straight-line method depreciation would be 20% per year. Twice this is 40% so Aston should take 40% of the book value of the asset as depreciation expense. The book value was $210,000 for the first year and 40% of this is $84,000. Note that under the double declining balance method the salvage value of the asset is not needed until later in the life of the asset. Salvage value is used only at the end to make sure that the asset is not depreciated below the salvage value.

Explanation for Choice B:

This answer incorrectly takes into account the salvage value when calculating the depreciation expense. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer does not include all of the costs of acquisition in the calculation of the asset cost. See the correct answer for a complete explanation.

Explanation for Choice D:

This answer incorrectly includes the salvage value in the calculation of depreciation and also does not include the costs of acquisition and installation that should be included in the asset cost. See the correct answer for a complete explanation.

141. Question ID: CMA 1292 P2 Q7 H1 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Since Year 1, Ames Steel Company has replaced all of its major manufacturing equipment and now has the following equipment recorded in the appropriate accounts. Ames uses a calendar year as its fiscal year.

- A forge purchased January 1, Year 1 for $100,000. Installation costs were $20,000, and the forge has an estimated 5-year life with a salvage value of $10,000.
- A grinding machine costing $45,000 purchased January 1, Year 2. The machine has an estimated 5-year life with a salvage value of $5,000.
- A lathe purchased January 1, Year 4 for $60,000. The lathe has an estimated 5-year life with a salvage value of $7,000.

Using the double-declining-balance method, Ames' Year 4 depreciation expense is

- A. $45,000
- B. $40,334
- C. $40,848correct
- D. $36,464

Question was not answered

Correct Answer Explanation:

In order to answer this question we will need to calculate the depreciation expense in the fourth year under the double declining balance method for each of the three assets. Under double declining depreciation, the depreciation expense is calculated as follows: (the book value of the asset at the beginning of the period × twice the straight-line percentage). In this question all of the assets have a five year useful life. With a five year useful life the depreciation under the straight-line method would be 20% per year. This means that we will use 40% for the depreciation calculation. Also, remember that this method uses the beginning book value of the asset. Therefore, in order to calculate the depreciation in year 4, we will also need to calculate the depreciation expense for the prior periods of the assets' lives as well. Remember also that the cost of the asset includes all of the costs necessary to get the asset ready for its intended use.

For the forge the original cost is $120,000. In year 1 depreciation was 40% of this, or $48,000. This reduced the book value to $72,000. In year 2 depreciation was 40% of this, or $28,800. This reduced the book value to $43,200 at the start of year 3. Year 3 depreciation was 40% of this, or $17,280, reducing the book value to $25,920 at the start of year 4. Therefore, in year 4 the depreciation expense for the forge was **$10,368**.

For the grinding machine the original cost is $45,000, and this item was purchased in year 2. In year 2 depreciation was 40% of this cost, or $18,000. This reduced the book value to $27,000. In year 3 depreciation was 40% of this, or $10,800. This reduced the book value to $16,200 at the start of year 4. Therefore, in year 4 the depreciation expense for the grinding machine was **$6,480**.

The lathe was purchased at the beginning of year 4, so its depreciation in year 4 is simply 40% of its original cost. Its original cost was $60,000, so 40% of this is **$24,000**.

Adding these three amounts together we get a total depreciation expense of $40,848 for year 4 under the double declining balance method.

Explanation for Choice A:

This answer results from using the straight-line method incorrectly by failing to deduct the salvage values from each of the assets' costs in calculating their depreciable bases. See the correct answer for a complete explanation.

Explanation for Choice B:

This is the answer for the sum-of-the-years digits method. See the correct answer for a complete explanation.

Explanation for Choice D:

This answer results from using the double-declining balance method incorrectly: instead of using the full cost of each asset as the base to begin calculating the annual depreciation, the full cost less the salvage value was used. See the correct answer for a complete explanation.

142. Question ID: CMA 1286 P4 Q11 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

WD Mining Company purchased a section of land for $600,000 in 20X0 to develop a zinc mine. The mine began operating in 20X1. At that time, management estimated that the mine would produce 200,000 tons of quality ore. A total of 100,000 tons of ore was mined and processed from 20X1 through December 31, 20X8. During January 20X9, a very promising vein was discovered. The revised estimate of ore still to be mined was 250,000 tons. Estimated salvage value for the mine land was $100,000 in both 20X1 and 20X9.

Assuming that 10,000 tons of ore was mined in 20X9, the computation WD Mining company should use to determine the amount of depletion to record in 20X9 would be

- A. [($600,000 - $100,000 - $250,000) / 350,000] x 10,000 tons
- B. [($600,000 - $100,000) / 350,000 tons] x 10,000 tons
- C. [($600,000 - $100,000 - $250,000) / 250,000 tons] x 10,000 tonscorrect
- D. [($600,000 - $100,000) / 450,000 tons] x 10,000 tons

Question was not answered

Correct Answer Explanation:

This is a change in accounting estimate. A change in accounting estimate is accounted for prospectively. When the estimated useful life of an asset is changed, the company uses the current book value of the asset as its cost for depreciation (or in this case depletion) calculations going forward.

The current book value of the mine is the $600,000 purchase price minus the $100,000 salvage value minus the amount of depletion recorded during the years from 20X1 through 20X8. The original depreciable base was $500,000 ($600,000 − $100,000 salvage value), and one-half of the previously estimated production had been mined between 20X1 and 20X8, so $250,000 of depletion had been recorded through the end of 20X8. Therefore, the numerator is $600,000 – $100,000 – $250,000, or $250,000. That is the amount of depletion to be recorded going forward.

As of 20X9, the mine is expected to produce another 250,000 tons. This is the denominator that must be used to calculate the usage for the depletion expense.

($600,000 − $100,000 − $250,000) / 250,000 tons] is the amount of depletion to be recorded for each ton of zinc ore produced by the mine, or $1.00 per ton. Since the mine produced 10,000 tons of zinc ore in 20X9, the amount of depletion per ton of ore is multiplied by 10,000 to find the amount of depletion to be recorded in 20X9.

Explanation for Choice A:

This answer does not use the correct number of tons in the denominator.

Explanation for Choice B:

This answer does not take into account the depletion that occurred prior to 20X9 and does not use the correct number of tons in the denominator.

Explanation for Choice D:

This answer does not take into account the depletion that occurred prior to 20X9 and does not use the correct number of tons in the denominator.

143. Question ID: CMA 1295 P2 Q7 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Jason Company's fiscal year ended on November 30 of the current year. Jason has an irrevocable contract to replace its mainframe computer system on December 15 of the current year, at a net cost of $750,000, reflecting the trade-in of the old hardware for $10,000, the fair value. The net book value of the old hardware on November 30 of the current year is $27,000. On its November 30 Statement of Financial Position for the current year, Jason should report the value of the old computer equipment as

- A. $10,000correct
- B. $27,000
- C. $750,000
- D. $760,000

Question was not answered

Correct Answer Explanation:

Because the company has already entered into a contract to exchange its old computer equipment in the purchase of the new computer equipment and the old equipment has been given a fair value of $10,000, $10,000 is the value at which the old equipment should be recorded in the year-end financial statements because it is the value of the old equipment's future benefit to the company. The book value of the hardware should be written down to $10,000.

Explanation for Choice B:

$27,000 is the current book value of the old computer equipment. However, since a contract has been entered into that values the old equipment at $10,000, the equipment should be written down to $10,000. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the value of the new computer. The question asks for the value of the old computer equipment. See the correct answer for a complete explanation.

Explanation for Choice D:

$760,000 is the gross cost of the new equipment before any deduction for the trade-in value of the old hardware. The question asks for the value of the old computer equipment.

144. Question ID: CMA 0687 3.11 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

On January 1, Boggs, Inc. paid $700,000 for 100,000 shares of Mattly Corporation representing 30% of Mattly's outstanding common stock. The following computation was made by Boggs.

Purchase price: $700,000
30% equity in book value of Mattly's net assets: $500,000
Excess cost over book value: $200,000

The excess cost over book value was attributed to goodwill. Mattly reported net income for the year ended December 31 of $300,000. Mattly Corporation had paid cash dividends of $100,000 on July 1.

If Boggs, Inc. exercised significant influence over Mattly Corporation and properly accounted for the long-term investment under the equity method, the amount of net investment revenue Boggs should report from its investment in Mattly would be:

- A. $60,000
- B. $30,000
- C. $80,000
- D. $90,000correct

Question was not answered

Correct Answer Explanation:

Because the equity method is used, Boggs should report as investment income each period their percentage of Mattly's income. Since Mattly had $300,000 of income and Boggs owns 30% of Mattly, their share of the income is $90,000.

Explanation for Choice A:

This answer takes into account the dividends as a reduction of Boggs' investment income. Under the equity method the receipt of dividends does not impact the recognition of income.

Explanation for Choice B:

This is the amount of income that would be recognized under the fair value method. Under the fair value method, income is recognized as dividends are received. See the correct answer for a complete explanation.

Explanation for Choice C:

Because the equity method is used, Boggs should report as investment income each period their percentage of Mattly's income. See the correct answer for a complete explanation.

145. Question ID: CIA 594 P4 Q21 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
The correct form of the journal entry recorded upon the sale of a plant asset sold for an amount of cash in excess of its net book value is as follows:

- A. Dr Cash; Dr Accumulated depreciation - machinery; Dr Gain on disposal of machinery; Cr Machinery
- B. Dr Cash; Dr Machinery; Cr Accumulated depreciation - machinery; Cr Gain on disposal of machinery
- C. No journal entry is required.
- D. Dr Cash; Dr Accumulated depreciation; Cr Machinery; Cr Gain on disposal of machinerycorrect

Question was not answered

Correct Answer Explanation:

In the event of the sale of a plant asset for more cash than the carrying value, this is the correct journal entry to record the event.

Explanation for Choice A:

The gain should be recorded as a credit in the journal entry.

Explanation for Choice B:

The accumulated depreciation and machinery accounts are reversed — the machinery account should be credited and the accumulated depreciation account should be debited.

Explanation for Choice C:

When the machinery is sold a journal entry must be recorded to record the receipt of cash, the sale of the asset and the resulting gain.

146. Question ID: CMA 690 P4 Q29 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

When Pyne Co. decided to go into the business of delivering pizzas at lunch time to a nearby office complex, the company acquired a delivery truck at the cost of $20,000. The truck had an estimated useful life of 5 years and a $2,000 salvage value. The company also acquired a used car for deliveries at a cost of $4,800, with an estimated useful life of 3 years and a $600 salvage value.

The depreciation on Pyne's used delivery car for year three using the sum-of-the-years'-digits (SYD) method would be

- A. $800
- B. $700correct
- C. $1,600
- D. $1,400

Question was not answered

Correct Answer Explanation:

Under the sum-of-the-years'-digits method, the depreciation expense is calculated as the depreciable amount (original cost − salvage value) multiplied by a fraction. For assets with a three year useful life the fraction consists of the number of remaining years of useful life in the numerator and 6 (3 + 2 + 1) in the denominator. This fraction is multiplied by the depreciable amount, which is the cost minus the salvage value. The cost of the car is $4,800 and the salvage value was $600, giving a depreciable amount of $4,200. Multiplying $4,200 by 1/6 we get the year 3 depreciation expense of $700. We use 1 in the numerator because in year 3 there is only one remaining year of use: year 3.

Explanation for Choice A:

This answer does not include the salvage value in the calculation of the depreciable amount. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the answer under the straight-line method with the salvage value incorrectly ignored. See the correct answer for a complete explanation.

Explanation for Choice D:

This is the answer under the straight-line method. See the correct answer for a complete explanation.

147. Question ID: HOCK ICD.002 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

International Industries, Inc. purchased a laser additive manufacturing (LAM) 3-D production machine for £900,000. The machine was expected to have a life of 10 years, but the expected life of the laser component of the equipment was only 5 years. The cost allocated to the laser component was £220,000, with a residual value of £10,000. The cost allocated to the main part of the machine was £680,000 with a residual value of £20,000. Both the laser and the main part of the LAM machine are being depreciated using straight line depreciation.

At the end of 5 years, International Industries replaced the laser at a cost of £250,000. No residual value was assigned to the replacement laser. The original laser was sold for £2,000.

International Industries uses IFRS for its financial reporting.

After the original laser was sold and the replacement laser installed, what was the revised carrying amount of the LAM machine, including the laser?

- A. £600,000.correct
- B. £715,000.
- C. £610,000.
- D. £590,000.

Question was not answered

Correct Answer Explanation:

Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine.

The annual depreciation charge for the main machine is (£680,000 − £20,000) ÷ 10 = £66,000, and the carrying value of the main machine after five years is £680,000 – (£66,000 × 5) = £350,000. The annual depreciation charge for the laser component is (£220,000 − £10,000) ÷ 5 = £42,000, and the carrying value of the laser component after five years is £220,000 – (£42,000 × 5) = £10,000, its residual value since it is fully depreciated after five years.

The sale of the original laser will remove its carrying value of £10,000, and the installation of the new laser will increase the carrying value by £250,000. Thus the revised carrying value of the machine including the new laser will be £350,000 + £10,000 − £10,000 + £250,000 = £600,000.

Explanation for Choice B:

This answer results from depreciating the cost of the machine as a single unit over a 10-year useful life and adding the cost of the new laser to the depreciated cost of the machine after 5 years. Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine. Furthermore, the sale of the laser will remove it's carrying value from the carrying value of the asset.

Explanation for Choice C:

This answer results from not recording the sale of the used laser. The book value of the used laser is deducted from the carrying amount of the LAM machine when the used laser is sold.

Explanation for Choice D:

This answer results from calculating the annual straight-line depreciation using the full cost of each component of the equipment as their depreciable bases and not deducting for the residual values.

148. Question ID: CMA 1287 P4 Q22 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Nella Corporation computes depreciation to the nearest whole month. A new piece of equipment was placed in operation on July 1, 20X1. It was expected to produce 400,000 units of product during its estimated useful life of eight years. Total cost was $300,000; salvage value was estimated to be $30,000. Nella employs a calendar year for financial reporting purposes. Actual production for the period of July 1 through December 31, 20X1 was 34,000 units.

If Nella had used the units-of-production method of depreciation, the amount of depreciation computed for this equipment for book purposes in 20X1 would have been

- A. $11,475
- B. $25,500
- C. $12,750
- D. $22,950correct

Question was not answered

Correct Answer Explanation:

Under the units-of-production method the depreciable amount (original cost − salvage value) is multiplied by the percentage of the total expected output that was produced during the period. In this question the depreciable amount is $270,000 ($300,000 cost − $30,000 salvage value) and the percentage of production done this period was 8.5% (34,000 units out of an expected 400,000). Therefore, the depreciation expense for 20X1 was $22,950 ($270,000 × 0.085).

Explanation for Choice A:

This answer takes only 1/2 of the first year's depreciation. While the asset was purchased on July 1, this is irrelevant when using the units produced method. See the correct answer for a complete explanation.

Explanation for Choice B:

This answer fails to take into account the salvage value when calculating the depreciable amount. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer fails to take into account the salvage value when calculating the depreciable amount. Also, this answer takes only 1/2 of the first years depreciation. While the asset was purchased on July 1, this is irrelevant when using the units produced method. See the correct answer for a complete explanation.

149. Question ID: CMA 697 P2 Q25 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Maple Industries purchased a lathe on June 1, Year 1, the beginning of the fiscal year. The lathe cost $43,200 and has an estimated salvage value of $3,600 and an estimated useful life of 8 years. The lathe has been used throughout the year.

Assuming that Maple Industries recognizes one-half year's depreciation on all assets purchased or sold during the year, the amount of straight-line depreciation that would be taken for financial reporting purposes in the fiscal year ending May 31, Year 2 would be

- A. $2,700

- B. $2,475correct
- C. $5,400
- D. $4,950

Question was not answered

Correct Answer Explanation:

The fiscal year ending May 31, Year 2 is actually the **first** year Maple Industries has owned the lathe. In the year of purchase, the company's fiscal year runs from June 1, Year 1 through May 31, Year 2.

Maple uses the mid year convention meaning that only six months of depreciation is taken in the first year that the asset is owned. This is a little bit confusing in this question since the asset was purchased on June 1, but what this means is that for the period from June 1, year 1 - May 31, year 2, they will take only 6 months of depreciation. Under the straight line method we simply divide the depreciable amount (cost - salvage value) by the estimated useful life to get the annual depreciation. In this question, we will need to divide this by 2 to get the first year's depreciation. The depreciable amount is $39,600 ($43,200 - $3,600) and the useful life is 8 years. The annual depreciation is $4,950, but dividing this by 2 gives us the depreciation expense for the first year of $2,475.

Explanation for Choice A:

This answer does not take into account the salvage value of the asset. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer does not take into account the fact that in the first year Maple takes only 6 months of depreciation and it does not take into account the salvage value of the asset. See the correct answer for a complete explanation.

Explanation for Choice D:

This answer does not take into account the fact that in the first year Maple takes only 6 months of depreciation. See the correct answer for a complete explanation.

150. Question ID: CMA 689 P4 Q7 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Most plant assets have a limited useful physical life. All of the following factors limit the useful life of a plant asset **except**

- A. Obsolescence.
- B. Tax regulations.correct
- C. Deterioration and decay.
- D. Wear and tear.

Question was not answered

Correct Answer Explanation:

The tax regulations in place do not affect how long an asset will be useful. The tax regulations determine the period over which depreciation will be taken for tax purposes, but that does not affect the useful life of the asset.

Explanation for Choice A:

Obsolescence does impact the useful life of plant assets.

Explanation for Choice C:

Deterioration and decay do impact the useful life of plant assets.

Explanation for Choice D:

Wear and tear do impact the useful life of plant assets.

151. Question ID: ICMA 13.P2.016 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Blake Ltd. has determined that an impairment exists on one of its machines, but the company expects to continue using the asset for another three full years as no active market exists for the machine. Selected information on the impaired asset (on the date that impairment was determined to exist) is provided below.

Original cost of machine	£22,000
Book (carrying) value of the machine	20,000
Value in use (present value of future cash flows)	15,000
Net selling price (fair value if sold less costs to sell)	12,000

According to IFRS, what is the amount of the impairment loss to be recorded by Blake?

- A. £3,000.
- B. £8,000.
- C. £7,000.
- D. £5,000.correct

Question was not answered

Correct Answer Explanation:

Under IFRS, the amount of an impairment loss is the difference between the carrying amount of the asset and the recoverable amount. The recoverable amount is the higher of (1) the fair value of the asset if sold minus the cost to sell, and (2) the asset's value in use, which is the present value of the future cash flows to be generated by the asset in use, including its residual value.

The carrying value of the machine is £20,000. The machine's value in use (the present value of the future cash flows) is £15,000. The net selling price, or the fair value if sold less costs to sell, is £12,000.

The recoverable amount is the greater of £15,000 or £12,000, so the recoverable amount is £15,000. The impairment loss—the difference between the carrying value of the £20,000 and the recoverable amount of £15,000—is £5,000.

Explanation for Choice A:

This is the difference between the machine's value in use and its net selling price. Under IFRS, the amount of an impairment loss is the difference between the carrying amount of the asset and the recoverable amount. The recoverable amount is the higher of (1) the fair value of the asset if sold minus the cost to sell, and (2) the asset's value in use, which is the present value of the future cash flows to be generated by the asset in use, including its residual value.

Explanation for Choice B:

This is the difference between the book value of the machine and its net selling price. Under IFRS, the amount of an impairment loss is the difference between the carrying amount of the asset and the recoverable amount. The recoverable amount is the higher of (1) the fair value of the asset if sold minus the cost to sell, and (2) the asset's value in use, which is the present value of the future cash flows to be generated by the asset in use, including its residual value.

Explanation for Choice C:

This is the difference between the machine's original cost and its value in use. Under IFRS, the amount of an impairment loss is the difference between the carrying amount of the asset and the recoverable amount. The recoverable amount is the higher of (1) the fair value of the asset if sold minus the cost to sell, and (2) the asset's value in use, which is the present value of the future cash flows to be generated by the asset in use, including its residual value.

152. Question ID: CMA 1284 P4 Q7 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Sanns, Inc. always charges prepaid insurance when it purchases or renews insurance policies. It adjusts the accounts for insurance used once per year, as of December 31. Thus, the 3-year renewal premium for a policy that expired on July 31 of the current year was charged to prepaid insurance. The 3-year renewal policy cost $63,000, up $27,000 from the $36,000 it had cost 3 years earlier. The adjusting entry necessary to reflect the insurance accounts at December 31 of the current year, Sanns' fiscal year-end, would be to

- A. Debit insurance expense for $54,250 and credit prepaid insurance for $54,250.
- B. Debit prepaid insurance for $15,750 and credit insurance expense for $15,750.
- C. Debit insurance expense for $15,750 and credit prepaid insurance for $15,750.correct
- D. Debit prepaid insurance for $8,750 and credit insurance expense for $8,750.

Question was not answered

Correct Answer Explanation:

There are two ways of arriving at the correct adjusting amounts. One is to calculate the total expense for insurance "used" during the year. The other way is to calculate what the balance in the Prepaid Insurance account actually is before the December 31 adjusting entries, determine what the balance should be at year end, and then calculate the adjustment needed to bring the balance to what it should be.

The total expense for the year consists of 7 months at ($36,000 ÷ 36) plus 5 months at ($63,000 ÷ 36), or (7 × $1,000) + (5 × $1,750), which equals $15,750. That amount is debited to Insurance Expense and credited to Prepaid Insurance.

To calculate the amount the second way, first calculate what the balance in the Prepaid Insurance account was before the December 31 adjusting entries. The year-end balance in the Prepaid Insurance account before adjustments would be the previous year's year-end balance of $1,000 per month × 7 months remaining on the policy at year-end, plus the $63,000 that would have been debited to the account when the new policy was purchased, or $70,000. The year-end balance should be $1,750 per month expense under the new policy × 31 months remaining at year end, or $54,250. To adjust the balance in the Prepaid Insurance account from $70,000 to $54,250, a credit of $15,750 is necessary. The balancing entry is a debit to Insurance Expense.

Explanation for Choice A:

The year-end balance in the Prepaid Insurance account should be $54,250 ($1,750 monthly expense under the new insurance policy × 31 months remaining on the new insurance policy at year end). However, the entry to bring the balance in the Prepaid Insurance account to $54,250 is not a $54,250 credit.

Explanation for Choice B:

Prepaid Insurance should be credited, not debited; and Insurance Expense should be debited, not credited.

Explanation for Choice D:

The monthly expense under the new insurance policy is $1,750 ($63,000 ÷ 36 months), so expense for the 5 months from August 1 to December 31 would be $8,750. However, Prepaid Insurance should be credited, not debited; and Insurance Expense should be debited, not credited. Furthermore, that is not the only item to be included in the year-end adjusting entry.

153. Question ID: CMA 688 4.24 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
In the process of preparing consolidated financial statements, which one of the following items does **not** need to be eliminated?

- A. Profit in beginning inventory acquired from a parent.
- B. Profit on sale of a fixed asset to a subsidiary.
- C. Profit on inventory sold to a nonaffiliate.correct
- D. Dividends receivable from a subsidiary.

Question was not answered

Correct Answer Explanation:

While the profit on inventory that is sold between companies that will be consolidated needs to be eliminated, the profit that is made on inventory sold to unaffiliated companies should not be eliminated in the consolidation process.

Explanation for Choice A:

The profit on inventory that is sold between companies that will be consolidated needs to be eliminated.

Explanation for Choice B:

The profit on the sale of fixed assets sold to a subsidiary needs to be eliminated in the consolidation process.

Explanation for Choice D:

Dividends receivable from a subsidiary need to be eliminated in the consolidation process.

154. Question ID: CMA 1292 2.9 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
In a business combination, the identifiable assets of the acquired company and the liabilities assumed are to be recorded on the books of the acquiring company at

- A. Book values.
- B. Fair values.correct

- C. Original cost minus accumulated depreciation.
- D. Replacement cost.

Question was not answered

Correct Answer Explanation:

In an acquisition of another company, the identifiable assets that are acquired and the liabilities that are assumed are recorded at their fair values on the acquisition date.

Explanation for Choice A:

In an acquisition of another company, the identifiable assets that are acquired and the liabilities that are assumed are not recorded at their book values on the books of the acquired company.

Explanation for Choice C:

In an acquisition of another company, the identifiable assets that are acquired and the liabilities that are assumed are not recorded at their original cost minus accumulated depreciation on the books of the acquired company.

Explanation for Choice D:

In an acquisition of another company, the identifiable assets that are acquired and the liabilities that are assumed are not recorded at their replacement cost.

155. Question ID: CMA 0687 3.12 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
On January 1, Boggs, Inc. paid $700,000 for 100,000 shares of Mattly Corporation representing 30% of Mattly's outstanding common stock. The following computation was made by Boggs.

Purchase price: $700,000
30% equity in book value of Mattly's net assets: $500,000
Excess cost over book value: $200,000

The excess cost over book value was attributed to goodwill. Mattly reported net income for the year ended December 31 of $300,000. Mattly Corporation had paid cash dividends of $100,000 on July 1.

If Boggs, Inc. did not exercise significant influence over Mattly Corporation and properly accounted for the long-term investment under the fair value method, the amount of net investment revenue Boggs should report from its investment in Mattly would be

- A. $90,000
- B. $20,000
- C. $60,000
- D. $30,000correct

Question was not answered

Correct Answer Explanation:

Under the fair value method, investment income is recognized as dividends are received. Since Boggs owned 30% of Mattly, they would recognize as income 30% of the dividend that Mattly distributed, or $30,000.

Explanation for Choice A:

This would be the correct way to account for the investment income under the equity method,not under the fair value method. See the correct answer for a complete explanation.

Explanation for Choice B:

Under the fair value method, investment income is recognized as dividends are received. This is not the amount of dividends received from Mattiy by Boggs. See the correct answer for a complete explanation.

Explanation for Choice C:

This is 30% of the net income of Mattiy minus 30% of the dividends paid by Mattiy. This is not the correct way to account for investment income under either the fair value method or under the equity method.

156. Question ID: CMA 694 P2 Q27 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Maple Industries purchased a lathe on June 1, Year 1, the beginning of the fiscal year. The lathe cost $43,200 and has an estimated salvage value of $3,600 and an estimated useful life of 8 years. The lathe has been used throughout the year.

Assuming that Maple Industries calculates depreciation to the nearest whole month on all assets purchased or sold during the year, the amount of double-declining-balance (DDB) depreciation that would be taken for financial reporting purposes in the fiscal year ending May 31, Year 3 in the second year of the asset's life would be

- A. $8,100correct
- B. $10,800
- C. $9,900
- D. $7,425

Question was not answered

Correct Answer Explanation:

The fiscal year ending May 31, Year 3 is actually the **second** year Maple Industries has owned the lathe. The company's fiscal year runs from June 1 through May 31. The company purchased the lathe on June 1, Year 1, so its first full year of ownership was for the fiscal year from June 1, Year 1 to May 31, Year 2. Its second full year of ownership was for the fiscal year from June 1, Year 2 through May 31, Year 3.

In order to answer this question we will need to calculate the depreciation expense in the second year under the double declining balance method for the lathe. Under double declining depreciation, the depreciation expense is calculated as follows: (the book value of the asset at the beginning of the period × twice the straight-line percentage). In this question the lathe has an eight year useful life. With an eight year useful life the depreciation under the straight-line method would be 12.5% per year. This means that we will use 25% for the depreciation calculation. Also, remember that this method uses the beginning book value of the asset. Therefore, in order to calculate the depreciation in the second year, we will also need to calculate the depreciation expense for the first year for the lathe. Remember also that the cost of the asset includes all of the costs necessary to get the asset ready for its intended use.

In the first year the depreciation expense was $10,800 ($43,200 × 0.25), which reduced the carrying value to $32,400 for year 2. In year 2, the depreciation expense was $8,100 ($32,400 × 0.25).

Explanation for Choice B:

This is the depreciation expense for the first year using the double declining balance method. The question asks about the second year. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the first year's depreciation under the double declining balance method but calculated incorrectly by subtracting the salvage value from the cost. The salvage value of the asset is not subtracted from the cost in calculating depreciation using the double declining balance method. Furthermore, the problem asks for the second year's depreciation, not the first year's depreciation.

Explanation for Choice D:

This answer takes into account the salvage value of the asset, which is not done under the double declining balance method. See the correct answer for a complete explanation.

157. Question ID: CMA 1287 4.12 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Panco, Inc. owns 90% of the voting stock of Spany Corporation. After consolidated financial statements have been prepared, the entries to eliminate intercompany payables and receivables will

- A. Be reflected only in the accounts of Panco.
- B. Be reflected only in the accounts of Spany.
- C. Be reflected in the accounts of both Panco and Spany.
- D. Not be reflected in the accounts of either company.correct
  Question was not answered

Correct Answer Explanation:

The adjustments that are made to eliminate intercompany transactions are not actually recorded in the books of either company. They are simply adjustments in a worksheet that is used to prepare the consolidated accounts. This makes sense because even though payables and receivables are eliminated in the consolidation process, each of the two companies does have a payable or receivable that they will collect or pay. Therefore, this item cannot be eliminated in the consolidation process in either company's books because it does still exist.

Explanation for Choice A:

The adjustments that are made to eliminate intercompany transactions are not actually recorded in the books of either company. They are simply adjustments in a worksheet that is used to prepare the consolidated accounts. This makes sense because even though payables and receivables are eliminated in the consolidation process, each of the two companies does have a payable or receivable that they will collect or pay. Therefore, this item cannot be eliminated in the consolidation process in either company's books because it does still exist.

Explanation for Choice B:

The adjustments that are made to eliminate intercompany transactions are not actually recorded in the books of either company. They are simply adjustments in a worksheet that is used to prepare the consolidated accounts. This makes sense because even though payables and receivables are eliminated in the consolidation process, each of the two companies does have a payable or receivable that they will collect or pay. Therefore, this item cannot be eliminated in the consolidation process in either company's books because it does still exist.

Explanation for Choice C:

The adjustments that are made to eliminate intercompany transactions are not actually recorded in the books of either company. They are simply adjustments in a worksheet that is used to prepare the consolidated accounts. This makes sense because even though payables and receivables are eliminated in the consolidation process, each of the two companies does have a payable or receivable that they will collect or pay. Therefore, this item cannot be eliminated in the consolidation process in either company's books because it does still exist.

158. Question ID: CMA 695 P2 Q11 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
The value of property, plant, and equipment that is included in total assets on the statement of financial position is

- A. Acquisition cost.
- B. Appraisal or market value.
- C. Cost minus accumulated depreciation.correct
- D. Replacement cost.

Question was not answered

Correct Answer Explanation:

The carrying value of property, plant and equipment is determined as the historical cost minus accumulated depreciation. The exception to this is if the asset has been impaired, but this is not given as a choice.

Explanation for Choice A:

Property, plant and equipment is not carried at acquisition cost on the balance sheet.

Explanation for Choice B:

Property, plant and equipment is not carried at appraisal or market value on the balance sheet.

Explanation for Choice D:

Property, plant and equipment is not carried at replacement cost on the balance sheet.

159. Question ID: CMA 688 4.22 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
When preparing consolidated financial statements, the entity being accounted for is the

- A. Legal entity.
- B. Noncontrolling interest.
- C. Economic entity.correct
- D. Parent.

Question was not answered

Correct Answer Explanation:

Consolidated financial statements are prepared as though the parent (the investor corporation) and the subsidiary or subsidiaries (the investee) are a single economic entity, not the legal entities that exist.

Explanation for Choice A:

This answer is incorrect. See the correct answer for a complete explanation.

Explanation for Choice B:

This answer is incorrect. See the correct answer for a complete explanation.

Explanation for Choice D:

This answer is incorrect. See the correct answer for a complete explanation.

160. Question ID: CMA 1286 P4 Q8 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
The factors primarily relied upon to determine the economic life of an asset are

- A. Tax regulations and SEC (Security Exchange Commission) guidelines.
- B. Passage of time, asset usage, and obsolescence.correct
- C. SEC (Security Exchange Commission) guidelines and asset usage.
- D. Tax regulations and asset usage.

Question was not answered

Correct Answer Explanation:

These three items are the factors that are used in the determination of the economic life of an asset.

Explanation for Choice A:

Tax regulations are used to determine the useful life for tax purposes. The SEC has not issued guidance on the economic life of assets.

Explanation for Choice C:

The SEC has not issued guidance on the economic life of assets.

Explanation for Choice D:

Tax regulations are used to determine the useful life for tax purposes.

161. Question ID: CMA 689 P4 Q6 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Depreciation of plant assets refers to

- A. Asset valuation for statement of financial position purposes.
- B. Allocating the cost of the asset to the periods of use.correct
- C. Accounting for costs to reflect the change in general price levels.
- D. Accumulating a fund for the replacement of the asset.

Question was not answered

Correct Answer Explanation:

The definition of depreciation is the systematic and rational allocation of the costs of the asset over the time period in which it is used. This is the allocation of the cost of the asset to the periods of use.

Explanation for Choice A:

While depreciation is a part of the process of determining the valuation of plant assets for the financial statements, it is not used for all assets.

Explanation for Choice C:

Depreciation is not the accounting for costs to reflect changes in price levels.

Explanation for Choice D:

Depreciation does not refer to the accumulation of money to provide for the replacement of the asset.

162. Question ID: CMA 1286 P4 Q12 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Costs that are capitalized with regard to a patent include

- A. Incidental costs of obtaining the patent, costs of successful and unsuccessful patent infringement suits, and the value of any signed patent licensing agreement.
- B. Legal fees of obtaining the patent, incidental costs of obtaining the patent, and research and development costs incurred on the invention that is patented.
- C. Legal fees of obtaining the patent, incidental costs of obtaining the patent, and costs of successful patent infringement suits.correct
- D. Legal fees of obtaining the patent, costs of successful patent infringement suits, and research and development costs incurred on the invention that is patented.

Question was not answered

Correct Answer Explanation:

All of these costs related to a patent may be capitalized.

Explanation for Choice A:

The costs of unsuccessful patent infringement cases should not be capitalized. See the correct answer for a complete explanation.

Explanation for Choice B:

The research and development costs of developing the patent should have been expensed as they were incurred. See the correct answer for a complete explanation.

Explanation for Choice D:

The research and development costs of developing the patent should have been expensed as they were incurred. See the correct answer for a complete explanation.

163. Question ID: CIA 594 P4 Q19 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Under which of the following depreciation methods is it possible for depreciation expense to be higher in the later years of an asset's useful life?

- A. Activity method based on units of production.correct
- B. Straight line.
- C. Weighted average.
- D. Sum of the years' digits.

Question was not answered

Correct Answer Explanation:

Only under the activity method (also called units of production method) can depreciation expense be higher in a later year in the asset's life than an earlier year. This will happen if the asset produces more in a later year than an earlier as this will result in a higher depreciation.

Explanation for Choice B:

Under the straight-line method the depreciation expense will be the same in every year of the asset's life.

Explanation for Choice C:

The weighted average method is not a method of depreciation.

Explanation for Choice D:

Under the sum-of-the-years'-digits method the amount of depreciation expense decreases each year during the asset's life.

164. Question ID: CMA 1293 P2 Q9 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Nichols Corporation renewed an insurance policy for three years beginning September 1, Year 1, and recorded the $81,000 premium in the Prepaid Insurance account. The $81,000 premium represents an increase of $23,400 from the $57,600 premium charged three years ago. Assuming Nichols only records its insurance adjustments at the end of the calendar year, the adjusting entry required to reflect the proper balances in the insurance accounts at December 31, Year 1, Nichols' year end, would be to

- A. Debit Insurance Expense for $21,800 and credit Prepaid Insurance for $21,800.correct
- B. Debit Insurance Expense for $72,000 and credit Prepaid Insurance for $72,000.
- C. Debit Prepaid Insurance for $9,000 and credit Insurance Expense for $9,000.
- D. Debit Insurance Expense for $9,000 and credit Prepaid Insurance for $9,000.

Question was not answered

Correct Answer Explanation:

There are two ways of arriving at the correct adjusting amounts. One is to calculate the total expense for the year. The other is to calculate what the balance in the Prepaid Insurance account actually is before adjusting entries, determine what the balance should be at year end, and then calculate the adjustment needed to bring the balance to what it should be.

The total expense for the year consists of 8 months at ($57,600 ÷ 36) plus 4 months at ($81,000 ÷ 36), or (8 × $1,600) + (4 × $2,250), which equals $21,800. That amount is debited to Insurance Expense and credited to Prepaid Insurance.

To calculate the amount the second way, first calculate what the balance in the Prepaid Insurance account was before the adjusting entries. Since adjustments are done only once a year, the year-end balance in the Prepaid Insurance account before adjustments would be the Year 0 year-end balance of $1,600 per month × 8 months remaining on the policy at year-end Year 0, plus the $81,000 that would have been debited to the account when the new policy was purchased, or $93,800. The year-end balance should be $2,250 per month expense under the new policy × 32 months remaining at year end, or $72,000. To adjust the balance in the Prepaid Insurance account from $93,800 to $72,000, a credit of $21,800 is necessary. The balancing entry is a debit to Insurance Expense.

Explanation for Choice B:

The year-end balance in the Prepaid Insurance account should be $72,000 ($2,250 monthly expense under the new insurance policy × 32 months remaining on the new insurance policy at year end). However, the entry to bring the balance in the Prepaid Insurance account to $72,000 is not a $72,000 credit.

Explanation for Choice C:

The monthly expense under the new insurance policy is $2,250 ($81,000 ÷ 36 months), so expense for the 4 months from September 1 to December 31 would be $9,000. However, that is not the only item to be included in the year-end adjusting entry. Furthermore, debiting Prepaid Insurance and crediting Insurance Expense would not be appropriate. Prepaid expense should be debited to an expense account as it is used up, not credited.

Explanation for Choice D:

The monthly expense under the new insurance policy is $2,250 ($81,000 ÷ 36 months), so expense for the 4 months from September 1 to December 31 would be $9,000. However, that is not the only item to be included in the year-end adjusting entry.

165. Question ID: CMA 1292 P2 Q6 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Since Year 1, Ames Steel Company has replaced all of its major manufacturing equipment and now has the following equipment recorded in the appropriate accounts. Ames uses a calendar year as its fiscal year.

- A forge purchased January 1, Year 1 for $100,000. Installation costs were $20,000, and the forge has an estimated 5-year life with a salvage value of $10,000.
- A grinding machine costing $45,000 purchased January 1, Year 2. The machine has an estimated 5-year life with a salvage value of $5,000.
- A lathe purchased January 1, Year 4 for $60,000. The lathe has an estimated 5-year life with a salvage value of $7,000.

Using the straight-line depreciation method, Ames' Year 4 depreciation expense is

- A. $40,848
- B. $45,000
- C. $36,464
- D. $40,600correct

Question was not answered

Correct Answer Explanation:

In order to answer this question we will need to calculate the depreciation expense in the fourth year under the straight-line method for each of the three assets. Under straight-line depreciation, the depreciation expense is calculated as follows: [(the cost of the asset − salvage value) ÷ useful life]. Remember that the cost of the asset includes all of the costs necessary to get the asset ready for its intended use.

For the forge, the depreciation expense is ($120,000 − $10,000) ÷ 5 = **$22,000**.

For the grinding machine, the depreciation expense is ($450,000 − $5,000) ÷ 5 = **$8,000**.

For the lathe, the depreciation expense is ($60,000 − $7,000) ÷ 5 = **$10,600**.

Adding these three amounts together, we get $40,600 depreciation expense for year 4.

Explanation for Choice A:

This is the answer using the double declining balance method. See the correct answer for a complete explanation.

Explanation for Choice B:

This answer does not take into consideration the salvage values of the assets. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer results from using the double-declining balance method incorrectly: instead of using the full cost of each asset as the base to begin calculating the annual depreciation, the full cost less the salvage value was used.

The straight-line method is to be used.

166. Question ID: CMA 695 P2 Q10 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

A steel press machine is purchased for $50,000 cash and a $100,000 interest bearing note payable. The cost to be recorded as an asset (in addition to the $150,000 purchase price) should include all of the following **except**

- A. Interest on the note payable.correct
- B. Freight and handling charges.
- C. Assembly and installation costs.
- D. Insurance while in transit.

Question was not answered

Correct Answer Explanation:

Any cost that is incurred in order to get the asset ready and available for use should be included in the cost of that asset. Interest that will be incurred on the note payable is a financing decision and is not necessary in order for the asset to be used. This interest will be recognized as interest expense when it is incurred.

Explanation for Choice B:

Any cost that is incurred in order to get the asset ready and available for use should be included in the cost of that asset. Freight and handling are costs necessary to get the asset ready and available for use.

Explanation for Choice C:

Any cost that is incurred in order to get the asset ready and available for use should be included in the cost of that asset. Assembly and installation are costs necessary to get the asset ready and available for use.

Explanation for Choice D:

Any cost that is incurred in order to get the asset ready and available for use should be included in the cost of that asset. Insurance while in transit is a cost necessary to get the asset ready and available for use.

167. Question ID: CIA 1192 P4 Q26 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
A newly acquired plant asset is to be depreciated over its useful life. The best rationale for this process is the

- A. Monetary unit assumption.
- B. Materiality assumption.
- C. Revenue recognition assumption.
- D. Matching assumption.correct

Question was not answered

Correct Answer Explanation:

Depreciation is the systematic and rational allocation of the cost of the asset over its life. It is a process of trying to match the revenues that the asset generates with the expense of the asset.

Explanation for Choice A:

The monetary unit assumption is not the rationale for depreciating an asset over its useful life.

Explanation for Choice B:

The materiality assumption is not the rationale for depreciating an asset over its useful life.

Explanation for Choice C:

The revenue recognition assumption is not the rationale for depreciating an asset over its useful life.

168. Question ID: HOCK MP2 AF18 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
An employee of M, a public company, developed a new product that has just been patented. The development costs of this product were negligible, but the patent rights are almost certainly worth many millions of dollars. Which accounting concept would prevent the company from recognizing the value of this patent as a non-current asset in its balance sheet?

- A. Going concern
- B. Historical costcorrect
- C. Conservatism
- D. Materiality

Question was not answered

Correct Answer Explanation:

Because this was an internally generated asset, there is no transaction with which to measure the true value of the patent. In this case, the development costs were almost zero. But even if the development costs had been substantial, they would not have been capitalized as an asset on the balance sheet. A patent is an intangible asset, and the only costs of patents that can be capitalized as assets on the balance sheet are costs incurred in connection with securing the patent such as registration fees and attorney's fees for filing the patent application. Research and development costs related to the development of a product, process, or idea that is subsequently patented must be expensed as incurred.

Explanation for Choice A:

The going concern concept says that a company's balance sheet must reflect the value of that company assuming it will remain in existence for, and beyond, the foreseeable future. The going concern concept would not prevent the company from recognizing the value of the patent as a non-current asset in its balance sheet.

Explanation for Choice C:

The conservatism concent means that when in doubt, choose the solution that will be least likely to overstate assets and income. However, there would be no cause for doubt in the decision of whether or not to recognize the value of the patent as a non-current asset in the company's balance sheet.

Explanation for Choice D:

Materiality is a constraint that accounting is subject to. An item of information is material and should be reported if it is judged to be significant enough that it would have an effect on a decision maker. Whether or not an item of information is material depends upon the relative size of theitem, the precision withwhich it can be estimated, and the nature of the item. Materiality would not prevent the company from recognizing the value of thepatent as a non-current asset in its balance sheet.

169. Question ID: CMA 1288 P4 Q15 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Lambert Company acquired a machine on October 1 that was placed in service on November 30. The cost of the machine was $63,000, of which $20,000 was given as a down payment. The remainder was borrowed at 12% annual interest. Additional costs included $2,500 for shipping, $4,000 for installation, $3,000 for testing, and $1,290 of interest on the borrowed funds. How much should be reported for this acquisition in the machine account on Lambert Company's statement of financial position as of November 30?

- A. $69,500
- B. $73,790
- C. $63,000
- D. $72,500correct
  Question was not answered

Correct Answer Explanation:

The amount used to record fixed assets includes all of the costs necessary to get the asset ready and available for use. This includes the cost of the asset itself, shipping, installation and testing. It does not include the interest on the borrowed funds.

Per ASC 835-20-05-1, the historical cost of acquiring an asset includes all the costs necessary to bring it to the condition and location necessary for its intended use. If an asset requires a period of time to carry out the activities necessary to bring it to the condition and location necessary for its intended use, any interest cost incurred during that period as a result of money spent for the asset is a part of the historical cost of acquiring the asset. So if an asset is constructed internally over a period of several months, interest applicable to the funds used during the construction period is capitalized.

However, the asset in this question **was not constructed internally**. It was purchased. Furthermore, the question does not say that the activities necessary to get the asset ready for its intended use required two months. The fact that the company did not place the asset into service immediately does not make the interest that was incurred during the 2-month delay in putting it into service capitalizable. The company may have gotten the equipment well in advance of when it planned to use it in order to allow for possible shipping and other delays so they could be sure it would be ready when planned production began. Since the question does not specifically say that two months of work was required to get the equipment ready for use, the interest should not be capitalized.

Adding together all of the items to be included we get $72,500 ($63,000 + $2,500 + $4,000 + $3,000).

Explanation for Choice A:

The cost of testing the asset should also be included in the cost of the asset. See the correct answer for a complete explanation.

Explanation for Choice B:

This includes the interest on the borrowed funds. The interest on the borrowed funds should not be included in the asset cost. See the correct answer for a complete explanation.

Explanation for Choice C:

The shipping, testing and installation should also be included in the cost of the asset. See the correct answer for a complete explanation.

170. Question ID: ICMA 13.P2.2001 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Which one of the following statements is **correct** about the reconciliation of U.S. GAAP and International Financial Reporting Standards (IFRS)?

- A. All costs of research and development must be expensed under both U.S. GAAP and IFRS.
- B. The costs of development must be expensed under U.S. GAAP but are capitalized under IFRS if they meet specific criteria.correct
- C. The costs of research must be expensed under U.S. GAAP but are capitalized under IFRS if they meet specific criteria.
- D. Internally generated goodwill may not be capitalized under U.S. GAAP, but it may be capitalized under IFRS.

Question was not answered

Correct Answer Explanation:

Costs of internal development must be expensed as incurred under U.S. GAAP. Under IFRS, internal development expenditures are capitalized if technical and economic feasibility of a project can be demonstrated in accordance with specific criteria, including intent to complete the asset and ability to sell the asset in the future.

Explanation for Choice A:

Internal costs related to the **research** phase of research and development are expensed as incurred under both standards. However, development costs are accounted for differently under the two standards.

Explanation for Choice C:

This statement is true about development costs but it is not true about research costs.

Explanation for Choice D:

The cost of internally-generated intangible assets are not recorded on the balance sheet under either standard.

171. Question ID: CMA 0693 2.17 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
A decline in the fair value below amortized cost of an available-for-sale investment in a debt security that the company does not intend to sell before a possible recovery of its amortized cost basis and that is deemed to be other than temporary should

- A. be accumulated in a valuation allowance resulting from the passage of time.
- B. be treated as an unrealized loss and included in the equity section of the balance sheet as a separate item.
- C. be evaluated for potential separation of the loss into the amount representing a credit loss, which is recognized in net income, and the amount due to other factors, which is recognized in equity.correct
- D. not be realized until the security is sold.

Question was not answered

Correct Answer Explanation:

When a decline in the market value of an available-for-sale debt security accounted for at fair value with holding gains and losses recognized in equity is considered to be other than temporary, the loss should be evaluated for potential separation into the amount representing a credit loss and the amount due to other factors. A credit loss is recognized in net income while the loss due to other factors is recognized in equity.

Explanation for Choice A:

If a decline in the fair value below amortized cost of an available-for-sale investment in a debt security that the company does not intend to sell before a possible recovery of its amortized cost basis is deemed to be other than temporary, the portion of the loss that is a credit loss is recognized in net income while the portion of the loss due to other factors is recognized in equity.

Explanation for Choice B:

If a decline in the fair value below amortized cost of an available-for-sale investment in a debt security that the company does not intend to sell before a possible recovery of its amortized cost basis is deemed to be other than temporary, the portion of the loss that is a credit loss is recognized in net income while the portion of the loss due to other factors is recognized in equity.

Explanation for Choice D:

If a decline in the fair value below amortized cost of an available-for-sale investment in a debt security that the company does not intend to sell before a possible recovery of its amortized cost basis is deemed to be other than temporary, the portion of the loss that is a credit loss is recognized in net income while the portion of the loss due to other factors is recognized in equity.

172. Question ID: HOCK ICD.004 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
International Industries, Inc. purchased a laser additive manufacturing (LAM) 3-D production machine for £900,000. The machine was expected to have a life of 10 years, but the expected life of the laser component of the equipment was only 5 years. The cost allocated to the laser component was £220,000, with a residual value of £10,000. The cost allocated to the main part of the machine was £680,000 with a residual value of £20,000. Both the laser and the main part of the LAM machine are being depreciated using straight line depreciation.

At the end of 5 years, International Industries replaced the laser at a cost of £250,000. No residual value was assigned to the replacement laser. The original laser was sold for £2,000.

International Industries uses IFRS for its financial reporting.

What is the future annual depreciation charge on the LAM machine, including the laser, after the replacement of the laser?

- A. £114,000.
- B. £115,000.
- C. £118,000.
- D. £116,000.correct

Question was not answered

Correct Answer Explanation:

Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine.

The annual depreciation charge on the main machine will be the same as it has been: (£680,000 − £20,000) ÷ 10 = £66,000. Since no residual value was assigned to the new laser for the purpose of calculating its depreciable base, the annual depreciation charge on the newly-installed laser component of the machine will be its full cost divided by the number of years of estimated useful life: £250,000 ÷ 5 = £50,000. Thus the total annual depreciation charge in future years will be £66,000 + £50,000 = £116,000.

Explanation for Choice A:

This answer assumes a $10,000 residual value for the replacement laser. However, no residual value was assigned to the replacement laser.

Explanation for Choice B:

This is the £900,000 original cost of the LAM machine plus the £250,000 cost of the replacement laser, the sum divided by 10 years. This is incorrect because (1) Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine. And (2) The original laser is sold after 5 years, after it is fully depreciated. It will not be depreciated further.

Explanation for Choice C:

This is the full cost allocated to the main machine (£680,000) divided by its useful life of 10 years, plus the full cost allocated to the replacement laser component of the machine (£250,000) divided by its useful life of 5 years. The annual depreciation charge for the main machine should be calculated on the basis of the main machine's depreciable base, which is its cost less its residual value.

173. Question ID: CIA 1190 IV.32 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
MKT Corporation's assets on December 31, Year 1, include the following:

I. U.S. Treasury Bills, acquired on October 15, Year 1, which mature on April 15, Year 2. MKT plans to hold the Treasury Bills until they mature because the company has no need for the cash earlier than the maturity date.

II. Shares of PF Company. PF has been very profitable and MKT Corporation plans to increase its ownership in PF as it believes PF has strong growth potential.

III. Bonds of ABC Corporation that mature in 3 years. These bonds will be sold, as needed, to meet MKT's current financing needs.

Which of the above should be classified as available-for-sale securities?

- A. III only.correct
- B. I, II, and III.
- C. I and II only.
- D. II and III only.

Question was not answered

Correct Answer Explanation:

Per ASU 2016-01, effective for fiscal years beginning after December 15, 2017, only debt securities are classified as trading securities, available-for-sale securities, and held-to-maturity securities. All equity securities are accounted for under the fair value method with unrealized gains and losses reported on the income statement, unless they are accounted for using the equity method or are consolidated.

The shares of PF Company cannot be classified as available-for-sale because they are equity securities. Since the bonds of ABC Corporation will be sold as needed to meet MKT's current financing needs, those bonds are classified as available-for-sale. The U.S. Treasury Bills should be classified as held-to-maturity securities, because MKT has both the positive intent and the ability to hold them to their maturity.

Thus, only the bonds of ABC Corporation are classified as available-for-sale.

Explanation for Choice B:

Per ASU 2016-01, effective for fiscal years beginning after December 15, 2017, only debt securities are classified as trading securities, available-for-sale securities, and held-to-maturity securities. All equity securities are accounted for under the fair value method with unrealized gains and losses reported on the income statement, unless they are accounted for using the equity method or are consolidated.

The shares of PF Company cannot be classified as available-for-sale because they are equity securities. Since the bonds of ABC Corporation will be sold as needed to meet MKT's current financing needs, those bonds are classified as available-for-sale. The U.S. Treasury Bills should be classified as held-to-maturity securities, because MKT has both the positive intent and the ability to hold them to their maturity.

Thus, only one of these securities should be classified as available-for-sale.

Explanation for Choice C:

Per ASU 2016-01, effective for fiscal years beginning after December 15, 2017, only debt securities are classified as trading securities, available-for-sale securities, and held-to-maturity securities. All equity securities are accounted for under the fair value method with unrealized gains and losses reported on the income statement, unless they are accounted for using the equity method or are consolidated.

The U.S. Treasury Bills should not be classified as available-for-sale because MKT has both the positive intent and the ability to hold them to their maturity. The shares of PF Company cannot be classified as available-for-sale because they are equity securities.

Explanation for Choice D:

Per ASU 2016-01, effective for fiscal years beginning after December 15, 2017, only debt securities are classified as trading securities, available-for-sale securities, and held-to-maturity securities. All equity securities are accounted for under the fair value method with unrealized gains and losses reported on the income statement, unless they are accounted for using the equity method or are consolidated.

Since the bonds of ABC Corporation will be sold as needed to meet MKT's current financing needs, those bonds are classified as available-for-sale. However, the shares of PF Company cannot be classified as available-for-sale because they are equity securities.

174. Question ID: CMA 1293 2.4 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

An investment in available-for-sale debt securities is valued on the Statement of Financial Position at the

- A. Par value of the debt securities.
- B. Fair value.correct
- C. Cost to acquire the security.
- D. Amortized cost.

Question was not answered

Correct Answer Explanation:

Investments in available-for-sale debt securities are reported at their fair value.

Explanation for Choice A:

Investments in available-for-sale debt securities are not reported at their par value. See the correct answer for a complete explanation.

Explanation for Choice C:

Investments in available-for-sale debt securities are not reported at their historical cost. See the correct answer for a complete explanation.

Explanation for Choice D:

Investments in available-for-sale debt securities are not reported at their amortized cost. See the correct answer for a complete explanation.

175. Question ID: CMA 694 P2 Q26 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Maple Industries purchased a lathe on June 1, Year 1, the beginning of the fiscal year. The lathe cost $43,200 and has an estimated salvage value of $3,600 and an estimated useful life of 8 years. The lathe has been used throughout the year.

Assuming that Maple Industries recognizes a full year's depreciation on all assets purchased during the year but no depreciation on assets retired during the year, the amount of sum-of-the-years'-digits (SYD) depreciation that would be taken for financial reporting purposes in the fiscal year ending May 31, Year 2 would be

- A. $1,100
- B. $8,800correct
- C. $9,600
- D. $10,800

Question was not answered

Correct Answer Explanation:

The fiscal year ending May 31, Year 2 is actually the **first** year Maple Industries has owned the lathe. In the year of purchase, the company's fiscal year runs from June 1, Year 1 through May 31, Year 2.

Under the sum-of-the-years'-digits method the depreciation expense is calculated as the depreciable amount (cost − salvage value) multiplied by a fraction. The numerator of the fraction is the **number** of remaining years of useful life, including the current year. The denominator is the **sum** of the years of useful life remaining, including the current year, and for an 8 year asset it is 36 (8 + 7 + 6 + 5 + 4 + 3 + 2 + 1). For year 1 the depreciation expense is therefore $8,800 ($39,600 × 8/36).

Explanation for Choice A:

This is the depreciable amount ($39,600) divided by the sum of the years of useful life remaining (8 + 7 + 6 + 5 + 4 + 3 + 2 + 1, which equals 36). Under the sum-of-the-years'-digits method the depreciation expense is calculated as the depreciable amount multiplied by a fraction. The numerator of the fraction is the **number** of years of remaining useful life, including the current year. The denominator is the **sum** of the years of useful life remaining, including the current year (for instance, 8 + 7 + 6 + 5 + 4 + 3 + 2 + 1 in this question).

Explanation for Choice C:

This answer does not take into account the salvage value of the asset. See the correct answer for a complete explanation.

Explanation for Choice D:

This is the answer under the double-declining balance method of depreciation. See the correct answer for a complete explanation.

176. Question ID: HOCK ICD.003 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
International Industries, Inc. purchased a laser additive manufacturing (LAM) 3-D production machine for £900,000. The machine was expected to have a life of 10 years, but the expected life of the laser component of the equipment was only 5 years. The cost allocated to the laser component was £220,000, with a residual value of £10,000. The cost allocated to the main part of the machine was £680,000 with a residual value of £20,000. Both the laser and the main part of the LAM machine are being depreciated using straight line depreciation.

At the end of 5 years, International Industries replaced the laser at a cost of £250,000. No residual value was assigned to the replacement laser. The original laser was sold for £2,000.

International Industries uses IFRS for its financial reporting.

What was the gain or loss on the disposal of the original laser?

- A. £108,000 loss.

- B. £8,000 loss.correct
- C. £2,000 gain.
- D. £113,000 loss.

Question was not answered

Correct Answer Explanation:

Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine.

The carrying value of the original laser is £10,000 when it is sold after 5 years of use. Because its expected useful life was 5 years when the machine was purchased, when it is sold after 5 years it is fully depreciated, and its carrying value is equal to its residual value of $10,000.

The original laser is sold for £2,000. Thus the loss on the disposal is £2,000 − £10,000, which equals £(8,000).

Explanation for Choice A:

This answer results from two errors: (1) failing to deduct the residual value of the laser from its cost before calculating the annual straight-line depreciation, and (2) calculating the annual straight-line depreciation of the laser over a 10-year life instead of over its expected useful life of 5 years.

Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine, so it is depreciated over 5 years instead of 10 years.

Explanation for Choice C:

The expected life of the original laser was 5 years when it was purchased. This answer results from assuming the original laser's book value is zero after 5 years of use, as it is fully depreciated. However, the original laser was assigned a residual value of £10,000 when the laser was purchased. When fully depreciated, the book value of the laser is equal to its residual value.

Explanation for Choice D:

This answer results from calculating the annual straight-line depreciation of the laser over a 10-year life instead of over its expected useful life of 5 years.

Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine, so it is depreciated over 5 years instead of 10 years.

177. Question ID: CMA 0694 P2 Q21 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
According to ASC 730-10-25-2, Research and Development-Elements of Costs to Be Identified with Research and Development Activities, expenditures for equipment for research and development

- A. must be expensed in the period incurred, unless the costs are for testing a prototype.
- B. must be capitalized in the period incurred and amortized over the estimated life of the asset.

- C. must be expensed in the period incurred, unless the equipment has alternative uses in other R&D projects or otherwise.correct
- D. may be expensed in the period incurred or capitalized if the probability of future benefits can readily be determined.

Question was not answered

Correct Answer Explanation:

Research and development costs are usually expensed as they are incurred. However, if the equipment will have an alternative use on other R&D projects or otherwise, the asset may be capitalized and depreciated. When it is used in R&D projects, the depreciation expense should be recorded as R&D expense and not as depreciation expense.

Explanation for Choice A:

R&D costs are usually expensed in the period in which they are incurred. Capitalization and depreciation may take place only if the asset has an alternative use on R&D projects other than the R&D project for which it was originally acquired or otherwise. Whether the costs are for testing a prototype is not the criterion used for determining whether the asset may be capitalized.

Explanation for Choice B:

R&D costs are usually expensed in the period in which they are incurred. Capitalization and depreciation may take place only if the asset has an alternative use on R&D projects other than the R&D project for which it was originally acquired or otherwise.

Explanation for Choice D:

R&D costs are usually expensed in the period in which they are incurred. Capitalization and depreciation may take place only if the asset has an alternative use on R&D projects other than the R&D project for which it was originally acquired or otherwise. The determination of future benefits is not the criterion used to determine if the asset may be depreciated.

178. Question ID: CMA 0695 P2 Q13 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
On September 1, 20X3, for $4,000,000 cash and $2,000,000 notes payable, Norbend Corporation acquired the net assets of Crisholm Company, which had a fair value of $5,496,000 on that date. During the December 31, 20X5 year-end audit after all adjusting entries have been made, the goodwill is determined to be worthless. The amount of the write-off as of December 31, 20X5 should be

- A. $474,600
- B. $478,800
- C. $466,200
- D. $504,000correct

Question was not answered

Correct Answer Explanation:

When Norbend acquired Crisholm, the goodwill on the transaction was $504,000. This is calculated as the difference between the amount paid and the fair value of the net assets received. Goodwill is not amortized but is rather checked for impairment at the end of each period. As there is no indication that prior to the 20X5 audit that the goodwill was impaired, the entire $504,000 will need to be written off in 20X5.

Explanation for Choice A:

The difference between the amount paid and the fair value of the net assets received is accounted for as goodwill. Goodwill is not amortized but is rather checked for impairment at the end of each period. As there is no indication that prior to the 20X5 audit that the goodwill was impaired, the entire amount of the goodwill will need to be written off in 20X5.

Explanation for Choice B:

The difference between the amount paid and the fair value of the net assets received is accounted for as goodwill. Goodwill is not amortized but is rather checked for impairment at the end of each period. As there is no indication that prior to the 20X5 audit that the goodwill was impaired, the entire amount of the goodwill will need to be written off in 20X5.

Explanation for Choice C:

The difference between the amount paid and the fair value of the net assets received is accounted for as goodwill. Goodwill is not amortized but is rather checked for impairment at the end of each period. As there is no indication that prior to the 20X5 audit that the goodwill was impaired, the entire amount of the goodwill will need to be written off in 20X5.

179. Question ID: CIA 594 P4 Q30 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Which of the following is **not** a correct statement regarding the historical cost of fixed assets?

- A. Proceeds obtained in the process of readying land for its intended purpose, such as from the sale of cleared timber, should be recognized immediately in income.correct
- B. Special assessments imposed by a local government for sewage and drainage systems are recorded by the owner of the land in the land account.
- C. The costs of improvements to equipment incurred after its acquisition should be added to the asset's cost if they provide future service potential.
- D. The purchase price, freight costs, and installation costs of a productive asset should be included in the asset's cost.

Question was not answered

Correct Answer Explanation:

Any proceeds that are received from the sale of something in getting land ready for its use should be treated as a reduction of the cost of the land, not as income. The question asks which is not a correct statement and since this is an incorrect statement, it is the correct answer.

Explanation for Choice B:

Because these assessments are for permanent items, they should be included in the land account.

Explanation for Choice C:

If a subsequent expenditure will provide future benefits, that cost should be added to the historical cost of the asset.

Explanation for Choice D:

All of these costs should be included in the determination of the historical cost of a fixed asset.

180. Question ID: CIA 594 P4 Q20 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

A company has just purchased a machine for $100,000 that has a five-year estimated useful life and a zero estimated salvage value. It is expected to be used to produce 250,000 units of output, and 75,000 of those units are expected to be produced in the first year. Which of the following depreciation methods will result in the greatest amount of depreciation expense for this machine in its first year?

- A. Activity method based on units of production.
- B. Sum of the years' digits.
- C. Double declining balance method.correct
- D. Straight line.

Question was not answered

Correct Answer Explanation:

In order to answer this question we can calculate the depreciation expense under the four methods listed as choices. Under straight-line the depreciation expense will be $20,000 ($100,000 ÷ 5). Under the units of production method it will be $30,000 ($100,000 × 75,000/250,000). Under the sum-of-the-years'-digits method it will be $33,333 ($100,000 × 5/15). Under the double declining balance method it will be $40,000 ($100,000 × 0.4). The highest is the double declining balance method.

Explanation for Choice A:

The activity method based on units of production will result in depreciation that is higher in the first year than in some subsequent years, but it will not result in the greatest amount of depreciation expense for this machine in its first year among the choices given.

Explanation for Choice B:

The sum of the years' digits method is a form of accelerated depreciation and as such, it will result in depreciation that is higher in the first year than in subsequent years, but it will not result in the greatest amount of depreciation expense for this machine in its first year among the choices given.

Explanation for Choice D:

The straight-line method of depreciation results in the same amount of depreciation every year of the asset's life. It will not result in the greatest amount of depreciation expense for this machine in its first year among the choices given.

181. Question ID: CMA 1286 P4 Q13 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Pie Baker, Ltd. purchased a secret fruit pie recipe for $75,000. An additional $10,000 was spent in securing the secret recipe and safeguarding its contents. Pie Baker expects to keep the recipe a secret indefinitely. Because of taste changes, the industry has found that recipes have been used for an average of 8 years. Based on this information, Pie Baker should

- A. Capitalize the $85,000 cost and amortize it over 8 years.correct
- B. Expense the $85,000 cost because the secret formula cost should not be capitalized.
- C. Capitalize the $85,000 cost and then amortize it over the period the recipe is to remain a secret.
- D. Capitalize the $85,000 cost and then amortize it over 40 years.

Question was not answered

Correct Answer Explanation:

This is an example of a process patent, since it is a trade secret. If a patent is purchased from an inventor or other owner, the purchase price represents its cost and the cost is to be capitalized. Other costs incurred in connection with securing a patent, attorney's fees and other unrecovered costs of a successful legal suit to protect the patent, can be capitalized as part of the patent cost. However, research and development costs related to the development of the product, process, or idea that is subsequently patented must be expensed as incurred. The cost of a patent should be amortized over its legal life or its useful life, whichever is shorter. In this case, the expected useful life of the recipe is 8 years. The fact that the recipe will be kept a secret indefinitely is irrelevant. Therefore, the cost of the recipe, $85,000, should be capitalized and amortized over a period of 8 years.

Explanation for Choice B:

This is an example of a process patent. If a patent is purchased from its original developer, the cost of the patent should be capitalized and amortized over its legal life or its useful life, whichever is shorter. Thus, the purchase price should be capitalized and amortized over a period of 8 years.

Explanation for Choice C:

This is an example of a process patent. If a patent is purchased from its original developer, the cost of the patent should be capitalized and amortized over its legal life or its useful life, whichever is shorter. Thus, the purchase price should be capitalized and amortized over a period of 8 years. The length of time the recipe is to remain a secret is irrelevant.

Explanation for Choice D:

The maximum amortization period for a patent (and a secret recipe is a process patent) is 20 years, and that would apply only if the patent were owned from the date it was granted and was expected to be useful for its maximum legal life of 20 years. In this case the patent (i.e., recipe) has been purchased from the original developer. Furthermore, it is expected to have a useful life of only 8 years. The cost of the patent should be amortized over its legal life or its useful life, whichever is shorter. In this case, that is 8 years.

182. Question ID: CMA 1293 2.3 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

An investment in trading securities is valued on the Statement of Financial Position at the

- A. Lower of cost or market.
- B. Cost to acquire the asset.
- C. Accumulated income minus accumulated dividends since acquisition.
- D. Fair value.correct

Question was not answered

Correct Answer Explanation:

Investments in trading securities are reported at their fair value.

Explanation for Choice A:

Investments in trading securities are not reported at the lower of cost or market. See the correct answer for a complete explanation.

Explanation for Choice B:

Investments in trading securities are not reported at their historical cost. See the correct answer for a complete explanation.

Explanation for Choice C:

Investments in trading securities are not reported at a value equal to their accumulated income minus accumulated dividends since acquisition. See the correct answer for a complete explanation.

183. Question ID: CIA 591 IV.34 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
When the equity method is used to account for an investment in an associate, the recording of the receipt of a cash distribution from the investee will result in

- A. The recognition of investment income.
- B. An increase in a liability account.
- C. An increase in a special equity account.
- D. A reduction in the investment balance.correct
  Question was not answered

Correct Answer Explanation:

When the equity method is used, the investor's share of investee income is recorded as the investee reports income. A cash distribution (dividend) from the investee is recorded as a reduction of the investor's investment account and an increase in the investor's cash.

Explanation for Choice A:

When the equity method is used, the investor's share of investee income is recorded as the investee reports income. A cash distribution (dividend) from the investee is recorded as a reduction of the investor's investment account.

Explanation for Choice B:

When using the equity method, a cash distribution from the investee will result in a decrease of the investment account, not an increase in a liability account.

Explanation for Choice C:

When using the equity method, a cash distribution from the investee will result in a decrease of the investment account, not an increase.

184. Question ID: ICMA 08.P2.392 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Alton Corporation purchased 100% of the shares of Jones Corporation for $600,000. Financial information for Jones Corporation is provided below.

The amount of goodwill resulting from this purchase, if any, would be

	Jones Corporation ($000)	
	Book Value	Fair Value
Cash	$ 50	$ 50

Accounts receivable	100	100
Inventory	150	100
Total current assets	$300	$250
Property, plant & equipment (net)	500	600
Total assets	$800	$850
Current liabilities	$150	$150
Long-term debt	200	200
Total liabilities	$350	$350
Common stock	$150	$150
Paid-in capital	80	80
Retained earnings	220	
Total shareholders' equity	$450	
Total liabilities & shareholders' equity	$800	

The amount of goodwill resulting from this purchase, if any, would be

- A. $150,000.
- B. Zero.
- C. $200,000.
- D. $100,000.correct

Question was not answered

Correct Answer Explanation:

Goodwill is the amount by which the price paid for a company is greater than the fair value of the company's net assets. "Net assets" means total assets minus total liabillities. The fair value of the total assets purchased is $850,000, and the fair value of the total liabilities purchased is $350,000. The difference, or $500,000, is the fair value of the company's net assets. The difference between the purchase price ($600,000) and the fair value of the net assets purchased ($500,000), is goodwill, and that is equal to $100,000.

Explanation for Choice A:

This is the difference between the purchase price of $600,000 and the book value of the company's net assets, i.e., total shareholders' equity, of $450,000. Goodwill is the amount by which the price paid for a company is greater than the **fair value** of the company's net assets (total assets minus total liabilities).

Explanation for Choice B:

Goodwill is the amount by which the price paid for a company is greater than the fair value of the company's net assets (total assets minus total liabilities). Because the company is being sold for more than the fair value of its net assets, goodwill does need to be recognized.

Explanation for Choice C:

This is the amount by which the book value of the total assets of the company is greater than the purchase price. Goodwill is the amount by which the price paid for a company is greater than the fair value of the company's net assets (total assets minus total liabilities).

185. Question ID: ICMA 1603.P1.023 ADAPTED (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
How does IFRS differ from U.S. GAAP with respect to accounting for development costs?

- A. U.S. GAAP requires expensing of all development costs and IFRS requires capitalizing all development costs.
- B. U.S. GAAP treats development costs as part of goodwill, whereas IFRS treats these costs as an intangible asset.
- C. U.S. GAAP does not allow capitalization of development costs unless they are for materials, equipment, or facilities that have alternative future uses. IFRS allows capitalization of development costs but only if technical feasibility has been established.correct
- D. U.S. GAAP requires capitalization of development costs, whereas IFRS makes capitalization of these costs optional.

Question was not answered

Correct Answer Explanation:

Under U.S. GAAP, research and development costs are expensed as incurred, per ASC 730-10-25-1. Development costs may not be capitalized unless they are for materials, equipment, or facilities that have alternative future uses, for R&D or otherwise, according to ASC 730-10-25-2.

IFRS does permit capitalization of development costs, but only if technical feasibility has been established. IAS 38.57, specifies that development costs may be recognized as an intangible asset if and only if an entity can demonstrate all of the following: (a) technical feasibility of completing the asset so it will be available for use or sale; (b) its intention to complete the asset and use or sell it; (c) its ability to use or sell the intangible asset; (d) how the intangible asset will generate probable future economic benefits; (e) the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; (f) its ability to measure reliably the expenditure attributable to the intangible asset during its development.

Explanation for Choice A:

IFRS does not require capitalizing all development costs.

Explanation for Choice B:

U.S. GAAP does not treat development costs as part of goodwill, and IFRS does not treat these costs as an intangible asset except under very specific circumstances.

Explanation for Choice D:

U.S. GAAP does not require capitalization of development costs, and IFRS does not make capitalization of these costs optional.

186. Question ID: CIA 593 P4 Q30 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
An organization purchased a computer on January 1 of the current year for $108,000. It was estimated to have a 4-year useful life and a residual (salvage) value of $18,000. The double-declining-balance method is to be used. The amount of depreciation to be reported for the current year is:

- A. ($108,000) x (25% x 1/2)
- B. ($108,000) x (25% x 2)correct
- C. ($108,000 - $18,000) x (25% x 2)
- D. ($108,000 - $18,000) x (25% x 1/2)

Question was not answered

Correct Answer Explanation:

Depreciation expense under the double declining balance is calculated as the book value at the beginning of the period (here $108,000) multiplied by twice the straight-line depreciation rate (here the straight-line rate is 25% since the asset has a four-year useful life).

Explanation for Choice A:

Under the double declining balance method, the straight-line percentage should be multiplied by two, not divided by two.

Explanation for Choice C:

Under the double declining balance method, the residual (salvage) value is not taken into account.

Explanation for Choice D:

Under the double declining balance method, the residual (salvage) value is not taken into account. Also, the straight-line percentage should be multiplied by two, not divided by two.

187. Question ID: CMA 0695 P2 Q12 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
All of the following are specifically identifiable intangible assets **except**

- A. Goodwill.correct
- B. Copyrights.
- C. Leaseholds.
- D. Patents and trademarks.

Question was not answered

Correct Answer Explanation:

Goodwill is not a specifically identifiable intangible asset. Rather, it is an unidentifiable intangible asset because it is not known specifically what the asset arises from.

Explanation for Choice B:

A copyright is a specifically identifiable intangible asset.

Explanation for Choice C:

Leasehold improvements are specifically identifiable intangible assets.

Explanation for Choice D:

Patents and trademarks are specifically identifiable intangible assets.

188. Question ID: CMA 1284 P4 Q27 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

The following information is available for Paragon as of November 30, 20X5.

Property, plant and equipment

Land	$27,500
Building	$36,000
Accumulated depreciation	(13,500)

Paragon's building is being depreciated using the straight-line method. The building has a 20-year estimated useful life and an estimated salvage value of $6,000. The number of years the building has been depreciated by Paragon as of November 30, 20X5 is

- A. 7.5 years.
- B. 15.0 years.
- C. 9.0 years.correct
- D. 12.5 years.

Question was not answered

Correct Answer Explanation:

Since land is not a depreciable asset, the full amount of the balance in the accumulated depreciation account is related to the building. Given that the building has a salvage value of $6,000 and a cost of $36,000, the depreciable amount of the building is $30,000. Since it is being depreciated by the straight-line method over 20 years, the annual depreciation expense is $1,500. Since there has been a total depreciation of $13,500 recognized, the building has been depreciated by nine years ($13,500 ÷ $1,500).

Explanation for Choice A:

This answer does not take into account the salvage value of the asset in calculating the depreciation expense.

Explanation for Choice B:

The number of years the building has been depreciated can be determined by dividing the accumulated depreciation by the annual depreciation charge, which under straight-line depreciation is the same every year.

Explanation for Choice D:

The number of years the building has been depreciated can be determined by dividing the accumulated depreciation by the annual depreciation charge, which under straight-line depreciation is the same every year.

189. Question ID: CMA 1292 P2 Q8 H2 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Since Year 1, Ames Steel Company has replaced all of its major manufacturing equipment and now has the following equipment recorded in the appropriate accounts. Ames uses a calendar year as its fiscal year.

- A forge purchased January 1, Year 1 for $100,000. Installation costs were $20,000, and the forge has an estimated 5-year life with a salvage value of $10,000.
- A grinding machine costing $45,000 purchased January 1, Year 2. The machine has an estimated 5-year life with a salvage value of $5,000.
- A lathe purchased January 1, Year 4 for $60,000. The lathe has an estimated 5-year life with a salvage value of $7,000.

Using the sum-of-the-years'-digits method, Ames' Year 4 depreciation expense (rounded to the nearest dollar) is

- A. $36,464
- B. $40,334correct
- C. $40,600
- D. $40,848

Question was not answered

Correct Answer Explanation:

In order to answer this question we will need to calculate the depreciation expense in the fourth year under the sum-of-the-years'-digits method for each of the three assets. Under this method, the depreciation expense is calculated as the depreciable amount (original cost − salvage value) multiplied by a fraction. For assets of a five year useful life the fraction consists of the number of remaining years of useful life in the numerator and 15 in the denominator (5 + 4 + 3 + 2 + 1).

For the forge the depreciable amount is $110,000 and since it was purchased in year 1, it has 2 years of remaining life in year 4 (year 4 and year 5). Therefore, depreciation expense in year 4 for the forge is **$14,667** ($110,000 × 2/15).

For the grinding machine the depreciable amount is $40,000 and since it was purchased in year 2, it has 3 years of remaining life in year 4 (year 4, year 5 and year 6). Therefore, depreciation expense in year 4 for the forge is **$8,000** ($40,000 × 3/15).

For the lathe the depreciable amount is $53,000 and since it was purchased in year 4, it has 5 years of remaining life in year 4 (years 4-8). Therefore, depreciation expense in year 4 for the forge is **$17,667** ($53,000 × 5/15).

Adding these three amounts together we get a total depreciation expense of $40,334 for year 4 under the sum-of-the-years'-digits method.

Explanation for Choice A:

This answer results from using the double-declining balance method incorrectly: instead of using the full cost of each asset as the base to begin calculating the annual depreciation, the full cost less the salvage value was used.

Explanation for Choice C:

This is the answer for the straight-line method. See the correct answer for a complete explanation.

Explanation for Choice D:

This is the answer for the double declining balance method. See the correct answer for a complete explanation.

190. Question ID: CMA 690 4.27 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
When a fixed plant asset with a 5-year estimated useful life is sold during the second year, how would the use of an accelerated depreciation method instead of the straight-line method affect the gain or loss on the sale of the fixed plant asset?

- A. A gain would increase, and a loss would decrease.correct
- B. A gain would decrease, and a loss would increase.
- C. A gain would decrease, and a loss would decrease.
- D. A gain would increase, and a loss would increase.

Question was not answered

Correct Answer Explanation:

The accelerated method will depreciate the asset faster in the early years of the asset's life than the straight-line method would, thereby reducing its book value faster. As a result, any gain on a sale during the second year would be greater with the accelerated method than with the straight-line method and any loss would be less with the accelerated method than with the straight-line method.

Explanation for Choice B:

The accelerated method will depreciate the asset faster than the straight-line method would in the early years, thereby reducing its book value faster than would be the case under the straight-line method.

Explanation for Choice C:

The accelerated method would cause the gain to be greater than with straight-line depreciation, not less.

Explanation for Choice D:

The use of an accelerated method would decrease a loss since assets are depreciated at a faster rate in the early years under an accelerated method than they are under the straight-line method.

191. Question ID: CMA 1292 2.23 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
A company should apply the equity method of accounting for an investment whenever it can exercise significant influence over the investee. Usually, the minimum level of ownership at which an investor can exercise significant influence is

- A. 10% ownership.
- B. 25% ownership.
- C. 50% ownership.
- D. 20% ownership.correct

Question was not answered

Correct Answer Explanation:

Usually a 20% ownership share indicates significant influence. However, the share ownership by itself does not determine whether significant influence exists, it is merely an indicator. Other factors such as other owners, board membership and past history also need to be considered.

Explanation for Choice A:

This is not the minimum percentage of ownership at which an investor is usually considered to be able to exercise significant influence. See the correct answer for a complete explanation.

Explanation for Choice B:

This is not the minimum percentage of ownership at which an investor is usually considered to be able to exercise significant influence. See the correct answer for a complete explanation.

Explanation for Choice C:

This is not the minimum percentage of ownership at which an investor is usually considered to be able to exercise significant influence. See the correct answer for a complete explanation.

192. Question ID: HOCK ICD.001 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

International Industries, Inc. purchased a laser additive manufacturing (LAM) 3-D production machine for £900,000. The machine was expected to have a life of 10 years, but the expected life of the laser component of the equipment was only 5 years. The cost allocated to the laser component was £220,000, with a residual value of £10,000. The cost allocated to the main part of the machine was £680,000 with a residual value of £20,000. Both the laser and the main part of the LAM machine are being depreciated using straight line depreciation.

At the end of 5 years, International Industries replaced the laser at a cost of £250,000. No residual value was assigned to the replacement laser. The original laser was sold for £2,000.

International Industries uses IFRS for its financial reporting.

What was the carrying value of the LAM machine, including the laser, **just before** the replacement of the laser?

- A. £450,000.
- B. £465,000.
- C. £340,000.
- D. £360,000.correct

Question was not answered

Correct Answer Explanation:

Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine.

The annual depreciation charge for the main machine is (£680,000 − £20,000) ÷ 10 = £66,000. The annual depreciation charge for the laser component is (£220,000 − £10,000) ÷ 5 = £42,000. Thus the total annual depreciation charge (for the first five years until the laser is fully depreciated) is £66,000 + £42,000 = £108,000. Therefore, the depreciation booked over the first five years is £108,000 × 5 = £540,000. The net carrying value after five years is £900,000 − £540,000 = £360,000.

Explanation for Choice A:

This answer results from (1) not deducting the residual values from the original cost before calculating the annual straight-line depreciation charge and (2) not depreciating separately the components that have different useful lives.

Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine.

Explanation for Choice B:

This answer results from depreciating the laser and the main machine together. Under IFRS, if individual components of a large fixed asset have different usage patterns and/or different useful lives, the individual components are depreciated separately. The laser has a shorter useful life than the main machine has. Therefore, the laser is depreciated separately from the main machine.

Explanation for Choice C:

This answer results from not deducting the residual values of the main machine and the laser component before calculating the annual straight-line depreciation to be charged.

193. Question ID: CMA 690 P4 Q28 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
When Pyne Co. decided to go into the business of delivering pizzas at lunch time to a nearby office complex, the company acquired a delivery truck at the cost of $20,000. The truck had an estimated useful life of 5 years and a $2,000 salvage value. The company also acquired a used car for deliveries at a cost of $4,800, with an estimated useful life of 3 years and a $600 salvage value.

The depreciation on Pyne's delivery truck for year two using the double-declining-balance (DDB) method would be

- A. $6,000
- B. $7,200
- C. $4,320
- D. $4,800correct
  Question was not answered

Correct Answer Explanation:

In order to answer this question we will need to calculate the depreciation expense in the second year under the double declining balance method for the truck. Under double declining depreciation, the depreciation expense is calculated as follows: (the book value of the asset at the beginning of the period × twice the straight-line percentage). In this question the truck has a five year useful life. With a five year useful life the depreciation under the straight-line method would be 20% per year. This means that we will use 40% for the depreciation calculation. Also, remember that this method uses the beginning book value of the asset. Therefore, in order to calculate the depreciation in the second year, we will also need to calculate the depreciation expense for the first year for the truck. Remember also that the cost of the asset includes all of the costs necessary to get the asset ready for its intended use.

In the first year the depreciation expense was $8,000 ($20,000 × 0.4), which reduced the carrying value to $12,000 for year 2. In year 2, the depreciation expense was $4,800 ($12,000 × 0.4).

Explanation for Choice A:

This answer results from using the sum-of-the-years' digits method to calculate depreciation expense for the first year of the truck's useful life, then switching to the double-declining balance method for the truck's second year of useful life, based on its remaining life of 4 years at that point.

To answer the question, use the double-declining balance method for both the first and the second years of the truck's useful life.

Explanation for Choice B:

This answer results from multiplying $18,000 by 0.40 and is the result of two errors.

In double declining balance depreciation, the annual depreciation is twice the amount that would be recognized under straight-line depreciation, except that the percentage is applied to the net book value of the asset at the beginning of the year instead of to the depreciable amount (which is the cost of the asset less salvage value). The salvage value is not used in calculating double declining balance depreciation until the end of the asset's life, and then the salvage value is used only to make certain that the asset is not depreciated to a level below its salvage value.

The first error in this answer is that the $18,000 used in calculating it is the depreciable value, which is the asset's cost less salvage value. $18,000 is not the net book value of the asset at the beginning of any year.

The second error is that multiplying $18,000 by 0.40 fails to recognize the depreciation that would have been booked for the first year of the asset's life. The question asks for the depreciation for Year 2. To determine the Year 2 depreciation, it is first necessary to calculate the Year 1 depreciation by multiplying 0.40 by the asset's full cost (which was its net book value at the beginning of Year 1, since no depreciation had yet been booked at that date). Then, the Year 2 depreciation can be calculated by multiplying 0.40 by the asset's net book value at the beginning of Year 2, after its full cost has been reduced by the Year 1 depreciation.

Explanation for Choice C:

This answer incorrectly includes the salvage value in the depreciation calculation. See the correct answer for a complete explanation.

194. Question ID: CMA 1293 P2 Q2 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)
Prepaid expenses are valued on the Statement of Financial Position at the

- A. Cost less expired or used portion.correct
- B. Face amount collectible at maturity.
- C. Cost to acquire the asset.
- D. Cost to acquire minus accumulated amortization.

Question was not answered

Correct Answer Explanation:

Prepaid expenses expire. Their expiration is either due to the passage of time, such as rent or insurance, or it is due to use and consumption, such as supplies. Prepaid expenses are valued on the Statement of Financial Position at their cost less the expired portion.

Explanation for Choice B:

Prepaid expenses are not receivables and they are not collected.

Explanation for Choice C:

Prepaid expenses expire. Their expiration is either due to the passage of time, such as rent or insurance, or it is due to use and consumption, such as supplies. Prepaid expenses are valued on the Statement of Financial Position at their cost less the expired portion.

Explanation for Choice D:

Prepaid expenses are not amortized. Instead, they expire.

195. Question ID: CMA 1287 P4 Q19 (Topic: Investments, PP&E (Fixed Assets), and Intangible and Other Assets)

Nella Corporation computes depreciation to the nearest whole month. A new piece of equipment was placed in operation on July 1, 20X1. It was expected to produce 400,000 units of product in its estimated useful life of eight years. Total cost was $300,000; salvage value was estimated to be $30,000. Nella employs a calendar year for financial reporting purposes. Actual production for the past 3 years was as follows.

Year 1 - 34,000 units
Year 2 - 62,500 units
Year 3 - 58,400 units

If Nella uses the sum-of-the-years'-digits method of depreciation, the amount of depreciation computed for this equipment for book purposes in 20X3 would be

- A. $52,500
- B. $48,750correct
- C. $45,000
- D. $18,750

Question was not answered

Correct Answer Explanation:

Under the sum-of-the-years'-digits method, the depreciation expense is calculated as the depreciable amount (original cost − salvage value) multiplied by a fraction. For the amount of annual depreciation, the numerator of the fraction is the number of years remaining in the asset's useful life, and the denominator is the sum of all of its expected years of life. For an asset with an 8-year life, the denominator is 8 + 7 + 6 + 5 + 4 + 3 + 2 + 1 = 36.

However, since Nella calculates depreciation to the nearest whole month rather than by year and this asset was purchased on July 1, the amount of depreciation in the first year (20X1) will be only half of a year's depreciation. Therefore, in 20X1 the fraction will be 4/36. This is the same as taking half of the first year's depreciation in 20X1, or 0.5 × 8/36. In 20X2 it will be 7.5/36. This is the same as taking half of the first year's depreciation (0.5 × 8/36) and half of the second year's depreciation (0.5 × 7/36). In 20X3 the fraction to use will be 6.5/36. This fraction is multiplied by the depreciable amount, which is the cost minus the salvage value. The cost of the asset is $300,000 and the salvage value is $30,000, giving a depreciable amount of $270,000. Multiplying $270,000 by 6.5/36 we get the 20X3 depreciation expense of $48,750.

Explanation for Choice A:

This is the depreciation for the second full year of the asset's life, or the amount that would be recorded from July 1, 20X2 through June 30, 20X3. It is not the amount that would be recorded from January 1, 20X3 through December 31, 20X3. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the depreciation for the third full year of the asset's life, or the amount that would be recorded from July 1, 20X3 through June 30, 20X4. It is not the amount that would be recorded froim January 1, 20X3 through December 31, 20X3. See the correct answer for a complete explanation.

Explanation for Choice D:

This is equal to one-half of the depreciation for the fourth full year of the asset's life, or the amount that would be recorded from July 1, 20X4 through December 31, 20X4. See the correct answer for a complete explanation.

196. Question ID: ICMA 19.P1.013 (Topic: Liabilities and Taxes)
A company has $100 million of debt that is due in March Year 3. In December Year 2, the company entered into a non-cancelable agreement with its lender to refinance the debt with the same interest rate, and the full principal is due in December Year 5. How should the debt be classified on the December Year 2 balance sheet of the company?

- A. Classified as a contingent liability.
- B. Classified as a current liability.
- C. Classified as a long-term liability.correct
- D. Considered as an off-balance sheet liability.

Question was not answered

Correct Answer Explanation:

Because the company has refinanced the debt that is coming due in March of the next year, the debt is classified on the balance sheet as a long-term liability.

Explanation for Choice A:

This is not a contingent liability.

Explanation for Choice B:

Even though the debt matures during the next 12 months, because the company has entered into a non-cancelable agreement to refinance it, the debt will be shown on the balance sheet as a long-term liability.

Explanation for Choice D:

This is not an off-balance sheet liability.

197. Question ID: CMA 0697 P2 Q22 (Topic: Liabilities and Taxes)
Paxton Company started offering a 3-year assurance-type warranty on its products sold after June 1, 20X0. Paxton's actual sales for the year ended May 31, 20X1 were $2,695,000. The total cost of the warranty is expected to be 3% of sales. The actual 20X1 warranty expenditures were $31,500 in labor and $9,100 in parts. The amount of warranty expense that should appear on Paxton's income statement for the year ended May 31, 20X1 is:

- A. $40,600
- B. $80,850correct
- C. $40,250
- D. $31,500

Question was not answered

Correct Answer Explanation:

The amount of the assurance-type warranty expense that should be accrued is calculated as the sales for the period multiplied by the amount of expected future warranty costs for each item. The sales were $2,695,000 and the expected future warranty costs were 3% of the sales, or $80,850. This is the amount that should have been accrued as an expense and a liability during the period. The amount actually spent during the period is relevant only to determine the remaining liability for the company for warranties.

Explanation for Choice A:

This is the total amount of warranty expenditures during the period ended May 31, 20X5.

Explanation for Choice C:

This is the remaining liability at the end of the period calculated as the total warranty expense minus the actual expenditures made paid during the period.

Explanation for Choice D:

This is the amount of expenditures made for labor in respect to warranties during the period ended May 31, 20X5. This is used to calculate the remaining liability and is not used to determine the expense for the period.

198. Question ID: CIA 0596 FARE Q21 (Topic: Liabilities and Taxes)
The selling price of a new company's units is $10,000 each. The buyers are provided with a 2-year assurance-type warranty that is expected to cost the company $250 per unit in the year of the sale and $750 per unit in the year following the sale. The company sold 80 units in the first year of operation and 100 units in the second year. Actual payments for warranty claims were $10,000 and $65,000 in years one and two, respectively. The amount charged to assurance-type warranty expense during the second year of operation is:

- A. $100,000correct
- B. $25,000
- C. $85,000
- D. $65,000

Question was not answered

Correct Answer Explanation:

The amount that should be recognized as assurance-type warranty expense in Year 2 is calculated as the number of sales made in Year 2 multiplied by all of the expected future warranty costs for those sales. The company sold 100 units and the expected future total two-year warranty cost is $1,000 for each sale: $250 in the year of purchase and $750 in the year following purchase (it does not matter that the costs are split over two future periods). Therefore, during its second year of operation, the company should recognize warranty expense of $100,000 (100 units sold × $1,000). The information about costs incurred and paid is relevant only if the question asks about the assurance-type warranty liability.

Explanation for Choice B:

This is the amount of warranty claims that were expected to be incurred in Year 2 for the sales made in Year 2 (100 units sold × $250). The amount of the expense recognized for Year 2 should be for all future costs after the point of sale, no matter which year the costs are incurred in.

Explanation for Choice C:

This is the amount of warranty expenditures expected to be incurred in Year 2 from both Year 1 and Year 2 sales: (80 x $750) + (100 x $250). The amount of the warranty expense recognized for Year 2 should be the number of sales made in Year 2 multiplied by all of the expected future warranty costs for those sales.

Explanation for Choice D:

This is the actual payments made for warranty claims in Year 2. The amount of the warranty expense recognized for Year 2 should be the number of sales made in Year 2 multiplied by all of the expected future warranty costs for those sales.

199. Question ID: CMA 1291 P2 Q28 (Topic: Liabilities and Taxes)
Beginning January 1, Year 1, Center Company offered a 3-year assurance-type warranty from date of sale on any of its products sold after January 1, Year 1. The warranty offer was part of a program to increase sales. Meeting the terms of the warranty was expected to cost Center 4% of sales. Sales made under warranty in Year 1 totaled $9,000,000, and one-fifth of the units sold were returned. These units were repaired or replaced at a cost of $65,000. The amount of assurance-type warranty expense that should appear on Center's Year 1 income statement is

- A. $72,000
- B. $65,000
- C. $360,000correct
- D. $137,000

Question was not answered

Correct Answer Explanation:

This is an assurance-type warranty, because it is given by the manufacturer along with the sale of the product without any additional payment being required from the customer.

For an expense warranty, the warranty expense to be accrued at the end of the first period during which the warranty is offered is the amount of sales covered by the warranty multiplied by the percentage of those sales expected to become future costs under the warranty. Sales were $9,000,000 and the estimated future costs were 4% of sales. This is $360,000 and this is what should be recorded as the warranty expense.

The fact that one-fifth of the sales were returned is not relevant to this calculation, and the cost to repair or replace the returned units is also not relevant. The calculated warranty expense of $360,000 is debited to assurance-type warranty expense and credited to assurance-type warranty liability. As costs are incurred for repair or replacement of returned units, they will be debited to the assurance-type warranty liability account.

Explanation for Choice A:

This is the returned sales ($9,000,000 × 1/5) multiplied by 4%. The fact that one-fifth of the sales were returned for repair or replacement is not relevant to the calculation of assurance-type warranty expense.

This is an assurance-type warranty, because it is given by the manufacturer along with the sale of the product without any additional payment being required from the customer. For an assurance-type warranty, the warranty expense to be accrued at the end of the first period during which the warranty is offered is the amount of sales covered by the warranty multiplied by the percentage of those sales expected to become future costs under the warranty. The amount calculated is debited to assurance-type warranty expense and credited to assurance-type warranty liability. As costs are incurred for repair or replacement of returned units, they will be debited to the assurance-type warranty liability account.

Explanation for Choice B:

This is the cost of the units that were repaired or replaced under the assurance-type warranty. This is not the same as the assurance-type warranty expense.

This is an assurance-type warranty, because it is given by the manufacturer along with the sale of the product without any additional payment being required from the customer. For an assurance-type warranty, the warranty expense to be accrued at the end of the first period during which the warranty is offered is the amount of sales covered by the warranty multiplied by the percentage of those sales expected to become future costs under the warranty. The amount calculated is debited to assurance-type warranty expense and credited to assurance-type warranty liability. As costs are incurred for repair or replacement of returned units, they will be debited to the assurance-type warranty liability account.

Explanation for Choice D:

This is the returned sales ($9,000,000 × 1/5) multiplied by 4% plus the $65,000 cost to repair or replace the units returned under the assurance-type warranty. The fact that one-fifth of the sales were returned for repair or replacement is not relevant to the calculation of warranty expense, and the $65,000 cost to repair or replace the defective units is also not relevant.

This is an assurance-type warranty, because it is given by the manufacturer along with the sale of the product without any additional payment being required from the customer. For an assurance-type warranty, the warranty expense to be accrued at the end of the first period during which the warranty is offered is the amount of sales covered by the warranty multiplied by the percentage of those sales expected to become future costs under the warranty. The amount calculated is debited to assurance-type warranty expense and credited to assurance-type warranty liability. As costs are incurred for repair or replacement of returned units, they will be debited to the assurance-type warranty liability account.

200. Question ID: CMA 0688 P3 Q25 (Topic: Liabilities and Taxes)
In Year 1, the Voorhees Corporation introduced a new line of computer products that carry a 2-year assurance-type warranty against defects in workmanship. The company estimates that the total warranty cost will be 10% of sales, with 40% of the expenditures occurring during the first year and 60% during the second year. Sales and actual warranty expenditures for Year 1 and Year 2 were as follows:

Year	Actual Sales	Warranty Expenditures
1	$300,000	$12,000
2	400,000	30,000

At the end of Year 2, the balance in the assurance-type warranty liability account will be:

- A. $58,000
- B. $46,000
- C. $28,000correct
- D. $24,000

Question was not answered

Correct Answer Explanation:

Because the assurance-type warranty is a two-year warranty, all of the sales from Year 1 and Year 2 are covered by the warranty. The question asks what the liability is at the end of Year 2, so we must take the warranty expense for the two years and subtract the amount of expenditures under the warranty during the two years to get the remaining liability. The total expense was $70,000 ($700,000 of sales × the 10% expected warranty cost). Of this, the company has paid $42,000 ($12,000 + $30,000), so the remaining warranty liability at the end of Year 2 is $28,000.

Explanation for Choice A:

This answer does not take into account the warranty expenditures that were made in Year 2.

Explanation for Choice B:

This answer results from treating the actual warranty expenditures for each year ($12,000 for Year 1 and $30,000 for Year 2) as though they were expected total expenditures during the entire warranty period for their corresponding years' sales. However, the warranty expenditures given are actual expenditures made during each of the two years. The $12,000 in warranty expenditures for Year 1 represents actual expenditures made during Year 1 for warranty costs on products sold during Year 1, and the $30,000 expenditure in Year 2 represents actual warranty expenditures made during Year 2 for products sold during Year 1 and Year 2.

Explanation for Choice D:

An answer of $24,000 results from multiplying the Year 2 sales of $400,000 by the 10% expected total warranty cost and then multiplying that by the 60% of expenditures expected during the second year of ownership.

The balance in the accrued warranty liability account at the end of Year 2 can be calculated correctly by including all the accrued warranty expenses ([$300,000 + $400,000] × 0.10) as credits to the account, including the actual warranty expenditures ($12,000 + $30,000) as debits to the account, and calculating the resulting balance in the account.

201. Question ID: CMA 696 P2 Q7 (Topic: Liabilities and Taxes)
Bearings Manufacturing Company Inc. purchased a new machine on January 1, 20X0 for $100,000. The company uses the straight-line depreciation method with an estimated equipment life of 5 years and a zero salvage value for financial statement purposes, and uses the 3-year Modified Accelerated Cost Recovery System (MACRS) and the half-year convention with an estimated equipment life of 3 years for income tax reporting purposes. Bearings is subject to a 35% marginal income tax rate. Assume that the deferred tax liability at the beginning of the year is zero and that Bearings has a positive earnings tax position. The MACRS depreciation rates for 3-year equipment are shown below.

Year	Rate
1	33.33%

2	44.45%
3	14.81%
4	7.41%

What is the deferred tax liability at December 31, 20X0 (rounded to the nearest whole dollar)?

- A. $11,666
- B. $33,330
- C. $4,666correct
- D. $7,000

Question was not answered

Correct Answer Explanation:

This question is made easier for us by the fact that the tax rate remains 35% throughout all of the years of the asset's life. In order to calculate the deferred tax liability at the end of 20X0 we simply need to determine the difference between the book depreciation and the tax depreciation for 20X0 and multiply it by the 35% tax rate. The book depreciation is straight-line with no salvage value, and with a cost of $100,000 and useful life of 5 years, the book depreciation is $20,000 per year. For tax purposes, 33.33% of the asset's cost (or $33,333) will be depreciated in the first year. The difference between the two methods is $13,333 and this is what needs to be multiplied by 35%. This gives us a deferred tax liability of $4,666. If the tax rate had changed in future periods the calculation would have been more involved than it is in this problem.

Explanation for Choice A:

This is the tax effect of the tax deductible depreciation from the first year.

Explanation for Choice B:

This is the tax deductible depreciation expense for the first year.

Explanation for Choice D:

This is the tax effect of the $20,000 of book depreciation.

202. Question ID: CMA 686 P3 Q10 (Topic: Liabilities and Taxes)
This data pertains to Lally Corporation for 20X4 and 20X5.

	20X5	**20X4**
Income before income taxes	$5,000,000	$4,000,000
Interest income included above that was not subject to income taxes	100,000	100,000

- Income before income taxes in 20X4 included rent revenue of $80,000 that was not subject to income tax until its receipt in 20X5.
- Lally was subject to an effective income tax rate of 40% in 20X4 and 20X5.

The deferred tax asset or liability reported on Lally Corporation's statement of financial position on December 31, 20X5 is

- A. $8,000.
- B. $0.correct
- C. $40,000.
- D. $32,000.

Question was not answered

Correct Answer Explanation:

In this question there is only one temporary difference: the rent revenue that was earned in 20X4 but not received until 20X5. The rent revenue earned in 20X4 created a deferred tax liability for 20X4. By the end of 20X5, the rent revenue had been received, so the deferred tax liability had fully reversed, and there is no deferred tax asset or liability at the end of 20X5.

The interest income that was not subject to income taxes is a permanent difference. Permanent differences do not give rise to deferred tax assets or liabilities.

Explanation for Choice A:

This is the $100,000 interest income received each year minus the $80,000 rent revenue earned in 20X4, the difference of $20,000 multiplied by the 40% tax rate.

The interest income that was not subject to income taxes is a permanent difference. Permanent differences do not give rise to deferred tax assets or liabilities. The rent revenue earned in 20X4 created a deferred tax liability for 20X4, but by the end of 20X5, the rent revenue had been received, so the deferred tax liability had fully reversed.

Explanation for Choice C:

This answer treats the interest revenue as a temporary difference (which it is not) instead of the rent revenue (which is a temporary difference). This answer also looks at the year 20X4 instead of 20X5.

Explanation for Choice D:

This is the deferred tax liability at the end of 20X4.

203. Question ID: CMA 696 P2 Q9 (Topic: Liabilities and Taxes)
Which one of the following temporary differences will result in a deferred tax asset?

- A. Advance rental receipts accounted for on the accrual basis for financial statement purposes and on a cash basis for tax purposes.correct
- B. Revenue and gross profit on a long-term contract reported over time on the financial statements as the company makes progress toward satisfying its performance obligations but not reported on the tax return until the contract's performance obligations have been completely satisfied.
- C. Investment gains on a privately-held equity investment accounted for under the equity method for financial statement purposes and under the cost less impairment method for income tax purposes.
- D. Use of the straight-line depreciation method for financial statement purposes and the Modified Accelerated Cost Recovery System (MACRS) for income tax purposes.

Question was not answered

Correct Answer Explanation:

A deferred tax asset arises when there is either: 1) a revenue that is included in taxable income before it is included in book income, or 2) an expense that is included in book income before it is deductible for tax purposes. Because these are advance rental receipts, they will not be recognized until the following period for book purposes, but they will be recognized immediately for tax purposes. This is the first of the two situations listed that lead to a deferred tax asset.

Explanation for Choice B:

Though the use of the different methods of revenue recognition as described will cause a temporary difference, this difference will lead to a deferred tax liability, not a deferred tax asset. Using these two methods, income will be recognized earlier for book purposes than for tax purposes. The recognition of income for book purposes but not for tax purposes leads to a deferred tax liability.

Explanation for Choice C:

Though the use of the different methods of accounting for investments will cause a temporary difference, this difference will lead to a deferred tax liability, not a deferred tax asset. This is because the revenue will be recognized first on the financial statements under the equity method while for tax purposes, it will be reported later when a dividend is distributed, subject to the dividends received deduction.

Explanation for Choice D:

Though the use of an accelerated depreciation method for income tax purposes and the use of the straight-line method for financial statement purposes will cause a temporary difference, this difference will lead to a deferred tax liability in the early years of the asset's life, not a deferred tax asset.

204. Question ID: CIA 0596 P4 Q31 (Topic: Liabilities and Taxes)
Which of the following leases would be classified as a finance lease by the lessee?

	Lease A	Lease B	Lease C	Lease D
The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise	Yes	No	No	No
The lease term is for the major part of the remaining economic life of the underlying asset	No	No	Yes	No
The present value of the sum of the lease payments and any residual value guaranteed by the lessee amounts to at least substantially all of the fair value of the underlying asset	No	No	Yes	Yes

- A. Lease A only.
- B. Lease B only.
- C. Leases A, C, and D.correct
- D. Leases C and D only.

Question was not answered

Correct Answer Explanation:

Under U.S. GAAP, a lease should be classified as a finance lease if any one of five criteria are met. The five criteria are:

1. Ownership of the underlying asset transfers to the lessee by the end of the lease term.
2. The lease grants the lessee an option to purchase the underlying asset that the lessee is reasonably certain to exercise.
3. The lease term is for a major part of the remaining economic life of the asset.
4. The present value of the sum of the lease payments and any residual value guaranteed by the lessee not already reflected in the lease payments is equal to or greater than substantially all of the fair value of the leased asset.
5. The underlying asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term.

Lease A meets the second requirement, Lease C meets the third and fourth requirements, and Lease D meets the fourth requirement. Lease B does not meet any of the requirements and therefore should not be recorded as a finance lease.

Explanation for Choice A:

Lease A is not the only lease that should be classified as a finance lease.

Explanation for Choice B:

Lease B should not be classified as a finance lease. See the correct answer for a complete explanation.

Explanation for Choice D:

Leases C and D are not the only leases that should be classified as finance leases. Lease A also meets the requirement.

205. Question ID: CMA 1293 P2 Q12 (Topic: Liabilities and Taxes)
As part of a program to increase sales, Chatham, Inc. began offering a 3-year assurance-type warranty on all products sold after January 11 of the current year. Chatham's actual current year sales were $3,850,000; the cost of the warranty is expected to be four percent of sales. The actual current year warranty expenditures consisted of $45,000 in labor and $13,000 in parts. The amount of warranty expense that should appear on Chatham's Income Statement at December 31 of the current year is

- A. $109,000.
- B. $96,000.
- C. $154,000.correct
- D. $58,000.

Question was not answered

Correct Answer Explanation:

The assurance-type warranty expense that should be reported in a period is calculated as the sales for the period multiplied by the expected future warranty expenses, no matter in which future period the warranty costs will actually be incurred. In the current year sales were $3,850,000 and the future expected warranty costs are 4% of sales. Therefore, the current period warranty expense is $154,000. The information about the costs paid during the period would be relevant if the question asked about the warranty liability at the end of the period.

Explanation for Choice A:

This is the assurance-type warranty expense minus the costs incurred during the period for labor on warranty work. This is neither the warranty expense or the warranty liability. See the correct answer for a complete explanation.

Explanation for Choice B:

This is the estimated assurance-type warranty liability at the end of the period. See the correct answer for a complete explanation.

Explanation for Choice D:

This is the amount of expenditures actually made for assurance-type warranties during the period. Assurance-type warranty expense is the total amount of future expected warranty costs, not those expenses incurred in the current period. See the correct answer for a complete explanation.

206. Question ID: CIA 594 4.28 (Topic: Liabilities and Taxes)
Which of the following is **not** a criterion for classifying and accounting for a lease agreement as a finance lease?

- A. The present value of the sum of the lease payments and any residual value guaranteed by the lessee equals or is greater than substantially all of the fair value of the underlying asset.
- B. The lease transfers ownership of the underlying asset to the lessee by the end of the lease term.
- C. The underlying asset is expected to have an alternative use to the lessor at the end of the lease term.correct
- D. The lease grants the lessee an option to purchase the underlying asset and the lessee is reasonably certain to exercise the option.

Question was not answered

Correct Answer Explanation:

One of the criteria for classifying and accounting for a lease as a finance lease is that the underlying asset is of such a specialized nature that it is expected to have **no** alternative use to the lessor at the end of the lease term.

Explanation for Choice A:

One of the criteria for classifying and accounting for a lease as a finance lease is that the present value of the sum of the lease payments and any residual value guaranteed by the lessee equals or is greater than substantially all of the fair value of the underlying asset.

Explanation for Choice B:

One of the criteria for classifying and accounting for a lease as a finance lease is that the lease transfers ownership of the underlying asset to the lessee by the end of the lease term.

Explanation for Choice D:

One of the criteria for classifying and accounting for a lease as a finance lease is that the lease grants the lessee an option to purchase the underlying asset and the lessee is reasonably certain to exercise the option.

207. Question ID: CIA 596 P4 Q75 (Topic: Liabilities and Taxes)
Which one of the following statements describes the asset-liability method of accounting for deferred income taxes?

- A. The appropriate tax rate to be reported on the income statement is the tax actually levied in that year, meaning no deferred taxes would be reported.
- B. The amount of deferred income tax is based on the tax rates expected to be in effect during the periods in which the temporary differences reverse.correct
- C. The amount of deferred income tax is based on tax rates in effect when temporary differences originate.
- D. The tax effects of temporary differences are not reported separately but are reported as adjustments to the amounts of specific assets and liabilities and the related revenues and expenses.

Question was not answered

Correct Answer Explanation:

By definition this is the tax rate that is used in the calculation of deferred taxes. The amount of the temporary liability is multiplied by the tax rate that is expected to be in force for the period in which it reverses. Whether it is a deferred tax asset or liability depends upon the nature of the temporary difference.

Explanation for Choice A:

Deferred taxes are calculated using the tax rate that is expected to be in effect in the time period in which the temporary difference will reverse. Because this rate is usually different from the current period tax rate, there are deferred tax assets and liabilities and they do need to be reported.

Explanation for Choice C:

The amount of deferred tax is not based on the tax rate in effect when temporary differences originate.

Explanation for Choice D:

The tax effects of temporary differences are reported separately from the items to which they relate.

208. Question ID: CIA 594 P4 Q73 (Topic: Liabilities and Taxes)
Temporary and permanent differences between taxable income and pre-tax financial income differ in that:

- A. Temporary differences do not give rise to future taxable or deductible amounts.
- B. Only permanent differences have deferred tax consequences.
- C. Temporary differences include items that enter into pre-tax financial income but never into taxable income.
- D. Only temporary differences have deferred tax consequences.correct

Question was not answered

Correct Answer Explanation:

Only temporary differences will give rise to deferred tax items.

Explanation for Choice A:

Temporary differences do give rise to future taxable or deductible amounts.

Explanation for Choice B:

Permanent differences do not give rise to deferred tax amounts.

Explanation for Choice C:

Items that enter financial income but will never enter taxable income are permanent differences, not temporary differences, and they do not give rise to deferred taxes.

209. Question ID: ICMA 19.P1.001 (Topic: Liabilities and Taxes)
On July 15, a company entered into a three-month agreement to rent a machine the company needed to complete a special order. The machine would be delivered on August 1, and rental payments are due on the first day of each rental month. Assuming the lessee has made an accounting policy election to not recognize lease assets or lease liabilities for short-term leases of equipment, the effect this event would have on the company's July 31 financial statements would be to

- A. increase both assets and liabilities.
- B. increase both assets and income.
- C. increase liabilities and decrease income.
- D. cause no change in assets, liabilities, or income.correct
  Question was not answered

Correct Answer Explanation:

For leases having a term of 12 months or less, the lessee may make an accounting policy election, by class of underlying asset, to not recognize lease assets and lease liabilities. Because the asset is on a short term lease of less than one year and the company has made such an election, no asset is recorded by the company. Because the asset will not be delivered until August 1 and the first payment will not be due until the asset is received, there is no liability recorded on July 31. Because the leased asset will be going in service only in August, there is no expense on the income statement as of July 31.

Explanation for Choice A:

For leases having a term of 12 months or less, the lessee may make an accounting policy election, by class of underlying asset, to not recognize lease assets and lease liabilities. Because the asset is on a short term lease of less than one year and the company has made such an election for short-term leases of equipment, no asset or liability is recorded by the company.

Explanation for Choice B:

For leases having a term of 12 months or less, the lessee may make an accounting policy election, by class of underlying asset, to not recognize lease assets and lease liabilities. Because the asset is on a short term lease of less than one year and the company has made such an election for short-term leases of equipment, no asset is recorded by the company. There is no effect on the July 31 income statement. There is no expense because the leased asset will be going in service only in August, and a lessee would never record income on a lease.

Explanation for Choice C:

For leases having a term of 12 months or less, the lessee may make an accounting policy election, by class of underlying asset, to not recognize lease assets and lease liabilities. Because the asset is on a short term lease of less than one year and the company has made such an election for short-term leases of equipment, liability is recorded by the company. Because the leased asset will be going in service only in August, there is no expense on the income statement as of July 31.

210. Question ID: CMA 0695 P2 Q15 (Topic: Liabilities and Taxes)

Equip Corp., a manufacturer of small commercial heating units, follows the generally accepted method of accounting for assurance-type warranties in accounting for estimated future warranty costs. The company recently designed and manufactured a new model, 250 units of which were sold (with a one-year warranty) for $6,000 per unit during November of the current year. Estimated future warranty costs ($150 per unit, based on past experience) were not accounted for at the time of sale, and the company incurred no warranty cost during November and December of the current year. The year-end adjusting entry required at December 31 of the current year to account for estimated future warranty costs would be to

- A. Debit sales for $37,500 and credit contract liabilities for $37,500.
- B. Debit contract liabilities and credit cash or accounts receivable for $37,500.
- C. Debit sales for $37,500 and credit assurance-type warranty liability for $37,500.
- D. Debit assurance-type warranty expense for $37,500 and credit assurance-type warranty liability for $37,500.correct

Question was not answered

Correct Answer Explanation:

Because no assurance-type warranty expense was recorded at the time of the sale, the full warranty expense needs to be recognized at the end of the period. This will be done with a debit to the assurance-type warranty expense account and a credit to the assurance-type warranty liability account. The amount will be the estimated amount of warranty costs to be incurred in the future. The company sold 250 units and the expected warranty costs are $150 per unit, for a total of $37,500. This is the amount of the journal entry.

Explanation for Choice A:

Both the accounts in this answer are incorrect. See the correct answer for a complete explanation.

Explanation for Choice B:

Both the accounts in this answer are incorrect. See the correct answer for a complete explanation.

Explanation for Choice C:

The debit in this journal entry should not be to sales. It should be recognized as an expense in the period. See the correct answer for a complete explanation.

211. Question ID: CIA 1192 FARE Q45 (Topic: Liabilities and Taxes)
A company is subject to assurance-type warranty claims. It is estimated that between $1,000,000 and $3,000,000 will probably be paid out. No estimate of loss within this range is a better estimate than any other amount. The company should:

- A. Defer a loss of $1,000,000 to $3,000,000.
- B. Accrue a loss of $1,000,000.correct
- C. Make no journal entry at this time.
- D. Disclose only a possible loss.

Question was not answered

Correct Answer Explanation:

When there is a range for an estimated probable, contingent loss, and no item within that range is a better estimate than any other amount, the minimum amount in the range should be accrued.

Therefore, the company should accrue an assurance-type warranty liability and recognize an assurance-type warranty expense of $1,000,000.

Explanation for Choice A:

When there is a range for an estimated probable, contingent loss, and no item within that range is a better estimate than any other amount, a loss should be accrued.

Explanation for Choice C:

When there is a range for an estimated probable, contingent loss, even if no item within that range is a better estimate than any other amount, a loss should be accrued.

Explanation for Choice D:

When there is a range for an estimated probable, contingent loss, and no item within that range is a better estimate than any other amount, a loss should be accrued.

212. Question ID: CIA 0595 P4 Q8 (Topic: Liabilities and Taxes)
Suppose that a company pays one of its liabilities twice during the year, in error. What are the effects of this mistake?

- A. Assets and liabilities will be understated.correct
- B. Assets and net income and owners' equity will be understated, and liabilities are overstated.
- C. Assets, net income, and owners' equity will be unaffected.
- D. Assets, liabilities, and owners' equity will be understated.

Question was not answered

Correct Answer Explanation:

The journal entry to record this event is a debit to a liability and a credit to cash. If this entry is made a second time the liabilities and cash will be understated, but there will be no impact on income or owners' equity.

Explanation for Choice B:

Liabilities will be understated and net income and owners' equity will not be affected by this error.

Explanation for Choice C:

Assets will be affected by this error. See the correct answer for a complete explanation.

Explanation for Choice D:

Owners' equity will not be affected by this error. See the correct answer for a complete explanation.

213. Question ID: CIA 1194 P4 Q69 (Topic: Liabilities and Taxes)
A company has purchased an asset with a 10-year useful life. It will use an accelerated depreciation method for tax purposes. For reporting purposes, it will use straight-line depreciation because this method believed to reflect better the usage of the asset over its economic life.

During the 10-year life of the asset, the company will report as deferred tax an amount that

- A. Decreases and then increases.
- B. Increases steadily for the 10 years.
- C. Increases and then decreases.correct

- D. Is constant.

Question was not answered

Correct Answer Explanation:

Because the company uses accelerated depreciation for tax purposes and straight-line for book purposes, the depreciation expense for tax purposes will be higher in the early years than the book depreciation. This will lead to taxable income being lower than book income. The company will therefore have a deferred tax liability in the early years. This deferred tax liability will increase during the years in which tax depreciation is larger than book depreciation. However, in the latter years of the asset's life when book depreciation exceeds tax depreciation, the deferred tax liability will decrease until it becomes zero at the end of the useful life of the asset.

Explanation for Choice A:

The deferred tax liability will increase in the early years of the asset's life and will then decrease over the later years so that at the end of the asset's life, it will be 0.

Explanation for Choice B:

The deferred tax amount cannot increase steadily over the life of the asset. This is because the deferred tax position must return to 0 at the end of the asset life since the total amount of depreciation recognized over the life of the asset will be the same under both tax and book depreciation.

Explanation for Choice D:

The deferred tax liability will increase in the early years of the asset's life and will then decrease over the later years so that at the end of the asset's life, it will be 0.

214. Question ID: CIA 595 P4 Q27 (Topic: Liabilities and Taxes)
Which of the following statements is **not** true of a long-term operating lease?

- A. The lessee records amortization of the right-of-use asset.
- B. The lessee recognizes a right-of-use asset.
- C. The lease represents off-balance sheet financing for the lessee.correct
- D. The lease arrangement represents a form of financing for the lessee.

Question was not answered

Correct Answer Explanation:

A long-term operating lease is reported on the balance sheet of the lessee as a right-of-use asset and a lease liability that represents the lessee's obligation to make the lease payments. It is therefore **not** off-balance sheet financing for the lessee.

Explanation for Choice A:

For both long-term operating and finance leases, the lessee does record amortization on the right-of-use asset. This is therefore a true statement and not the correct answer.

Explanation for Choice B:

The lessee does record a right-of-use asset for both a long-term operating lease and a finance lease. This is therefore a true statement and not the correct answer.

Explanation for Choice D:

Both long-term operating and finance leases represent a form of financing for the lessee. This is therefore a true statement and not the correct answer.

215. Question ID: ICMA 08.P2.294 (Topic: Liabilities and Taxes)
Harrison Corporation entered into a three-year contract in which it was required under U.S. GAAP (ASC 606), to recognize revenue and gross profit over time for financial sttement reporting as it made progress toward satisfying its performance obligation. For income tax, however, the contract qualified for reporting of revenue and gross profit when the performance obligation in the contract was completely satisfied, and Harrison reported it that way on its income tax return. The effect on Harrison's financial statements for the third year of this contract would be a(n)

- A. increase in the Deferred Tax Asset account.
- B. decrease in the Deferred Tax Asset account.
- C. increase in the Deferred Tax Liability account.
- D. decrease in the Deferred Tax Liability account.correct
  Question was not answered

Correct Answer Explanation:

Reporting income and gross profit on a long-term contract for tax purposes when the performance obligation has been completely satisfied while reporting income and gross profit over time for financial reporting purposes would have resulted in a deferred tax liability that increased during the performance of the contract. The liability resulted from the fact that income was recognized in the financial statements before it was reported on the tax return, causing a liability for deferred taxes to build up during the contract period.

In the third year, when the performance obligation in the contract was satisfied, the deferred tax liability would reverse because the income and related expenses of the contract would become part of Harrison's net taxable income in that year and the taxes would be paid on it. The reversal of the liability would cause a decrease in the Deferred Tax Liability account.

Explanation for Choice A:

Reporting income and gross profit on a long-term contract for tax purposes when the performance obligation has been completely satisfied while reporting income and gross profit over time for financial reporting purposes would not lead to a Deferred Tax Asset. It would have resulted in a liability due to the fact that income was recognized in the financial statements before it was reported on the tax return. As a result, a liability for deferred taxes arose in the first year of the contract and increased during each subsequent year until the performance obligation in the contract was completely satisfied. At that time, the deferred tax liability would reverse because the income and related expenses of the contract would become part of Harrison's net taxable income in that year and the taxes would be paid on it.

Explanation for Choice B:

Reporting income and gross profit on a long-term contract for tax purposes when the performance obligation has been completely satisfied while reporting income and gross profit over time for financial reporting purposes would not lead to either a Deferred Tax Asset or the reversal of the same.

Explanation for Choice C:

Reporting income and gross profit on a long-term contract for tax purposes when the performance obligation has been completely satisfied while reporting income and gross profit over time for financial reporting purposes would have resulted in a deferred tax liability that increased each of the three years of the contract. The liability resulted from the fact that income was recognized in the financial statements before it was recognized on the tax return, causing a liability to build up during the contract period.

However, the Deferred Tax Asset account would not increase in the third year of the contract. In the third year, when the performance obligation in the contract was completely satisfied, the deferred tax liability would reverse because the income and related expenses of the contract would become part of Harrison's net taxable income in that year and the taxes would be paid on it.

216. Question ID: ICMA 08.P2.297 (Topic: Liabilities and Taxes)
A tax rate other than the current tax rate may be used to calculate the deferred income tax amount on the statement of financial position if a(n)

- A. net operating loss carryback exists.
- B. future tax rate has been enacted into law.correct
- C. election has been made to apply past tax rates.
- D. future tax rate change is considered more likely than not to occur.

Question was not answered

Correct Answer Explanation:

If the future tax rate has actually been codified into law and it will be the effective tax rate when the deferred tax asset or liability reverses, then that future tax rate should be used to calculate the amount of the deferred tax asset or liability. If a future tax rate change is merely being considered, the current tax rate should be used to calculate the amount of the deferred tax asset or liability.

Explanation for Choice A:

If a net operating loss carryback exists and the company had taxable income during the past one or two taxable years, the company can request a refund of taxes already paid. That will have no effect on deferred taxes or the tax rate used to calculate the deferred income tax amount on the statement of financial position.

Explanation for Choice C:

A business does not have the liberty to decide what tax rate will be applicable to its taxable income, either present or future. It must use the enacted tax rates that have been codified into law.

Explanation for Choice D:

If the future tax rate has actually been codified into law and it will be the effective tax rate when the deferred tax asset or liability reverses, then that future tax rate should be used to calculate the amount of the deferred tax asset or liability. However, if a future tax rate change is merely considered more likely than not to occur, the current tax rate should be used to calculate the amount of the deferred tax asset or liability.

217. Question ID: CMA 0689 P4 Q16 (Topic: Liabilities and Taxes)
Trade accounts payable are valued on the statement of financial position at the

- A. Historical cost.
- B. Net settlement value.correct
- C. Current cost.
- D. Current market value.

Question was not answered

Correct Answer Explanation:

Accounts payable are recorded on the balance sheet at the amount that will be needed to settle the liability. This is called the net settlement value.

Explanation for Choice A:

Accounts payable are not recorded at the historical cost on the balance sheet. See the correct answer for a complete explanation.

Explanation for Choice C:

Accounts payable are not recorded at their current cost on the balance sheet. See the correct answer for a complete explanation.

Explanation for Choice D:

Accounts payable are not recorded at their current market value on the balance sheet. See the correct answer for a complete explanation.

218. Question ID: ICMA 19.P2.062 (Topic: Profitability Ratios and Profitability Analysis)
According to its public financial statements, a company's gross profit margin decreased by 5% while its operating profit margin increased by 3%. Which one of the following factors could cause both of these changes?

- A. A lowered selling price to increase quantities sold.correct
- B. An increase in the cost per unit of the goods purchased from a supplier.
- C. Sale of fully-depreciated production machinery at a gain and replacement of the machines with newer models.
- D. A change to the variable costing income statement format.

Question was not answered

Correct Answer Explanation:

The difference between gross profit and operating profit is the selling, general and administrative costs of the company. This can be proven by creating an example, like this:

We start by assuming a selling price of $100, sales of 100,000 units, COGS of 75% of sales price and SG and A of $2,000,000.
Selling price $100:

Sales: 100,000 @ $100 = $10,000,000

COGS: 100,000 @ $75 = $7,500,000

Gross profit: $2,500,000 = **Gross profit margin 0.25**

SG&A: $2,000,000

Operating profit: $500,000 = **Operating profit margin 0.05**

We then assume that we decrease selling price to $90, and sales doubles. All other assumptions are the same.

Sales: 200,000 @ $90 = $18,000,000

COGS: 200,000 @ $75: $15,000,000

Gross profit: $3,000,000 = **Gross profit margin 0.17**

SG&A: $2,000,000

Operating profit: $1,000,000 = **Operating profit margin 0.056**

Those these changes are not exactly the % of changes given in the question, this example shows that it is possible for these changes to the gross profit margin and the operating profit margin to change like this.

This question can also be answered by recognizing that the other three choices will not cause the gross profit margin and the operating profit margin to change like this. Therefore, this choice must be correct.

Explanation for Choice B:

This would not cause operating profit to increase. See the correct answer for a full explanation.

Explanation for Choice C:

This would not cause the changes to gross profit margin and operating profit margin. See the correct answer for a full explanation.

Explanation for Choice D:

This would not cause the changes to gross profit margin and operating profit margin. See the correct answer for a full explanation.

219. Question ID: ICMA 19.P1.007 (Topic: Owners\' Equity)
Which one of the following transactions would affect retained earnings but not additional paid-in capital?

- A. Impairment of a long-term asset.correct
- B. Declaration of a small stock dividend.
- C. Purchase of treasury stock using the cost method.
- D. Decrease in the value of an available-for-sale investment.

Question was not answered

Correct Answer Explanation:

Impairment of a long-term asset is accounted for by debiting an impairment loss account on the income statement and crediting accumulated depreciation on the balance sheet. Thus, accounting for the impairment of a long-term asset would affect retained earnings because net income flows to retained earnings, but it would not affect additional paid-in capital.

Explanation for Choice B:

Declaration of a small stock dividend is accounted for by debiting retained earnings, crediting common stock, and crediting additional paid-in capital. Thus, accounting for the declaration of a small stock dividend would affect both retained earnings and additional paid-in capital.

Explanation for Choice C:

Purchase of treasury stock using the cost method is accounted for by debiting treasury stock and crediting cash. Thus, although accounting for the purchase of treasury stock using the cost method would not affect additional paid-in capital, it would also not affect retained earnings.

Explanation for Choice D:

A decrease in the value of an available-for-sale debt security is accounted for by debiting accumulated other comprehensive income in equity and crediting a fair value adjustment account. Thus, although accounting for a decrease in the value of an available-for-sale security would not affect additional paid-in capital, it also would not affect retained earnings.

220. Question ID: CIA 1194 P4 Q50 (Topic: Owners\' Equity)
A company has 1,000 shares of $10 par value common stock and $5,000 of retained earnings. Two proposals are under consideration. The first is a stock split giving each shareholder two new shares for each share formerly held. The second is to declare and distribute a 50% stock dividend. The stock split proposal will <> earnings per share <> than will the proposal for a stock dividend.

- A. Decrease; Morecorrect
- B. Increase; Less
- C. Decrease; Less
- D. Increase; More

Question was not answered

Correct Answer Explanation:

If the company executes a 2-for-1 stock split, there will be 2,000 shares outstanding after the stock split. If the company declares a 50% stock dividend there will be 1,500 shares outstanding after the dividend. While both of these items will decrease earnings per share, the stock split will decrease earnings per share more than the stock dividend, because more new shares will be outstanding as a result of the stock split than will be as a result of the stock dividend.

Explanation for Choice B:

The stock split will decrease earnings per share because the same amount of earnings will be divided among more shares outstanding.

Explanation for Choice C:

While the stock split will decrease earnings per share, the decrease will be larger than the decrease that results from the stock dividend.

Explanation for Choice D:

The stock split will decrease earnings per share because the same amount of earnings will be divided among more shares outstanding.

221. Question ID: CIA 1195 P4 Q47 (Topic: Owners\' Equity)
Which of the following is usually **not** a feature of cumulative preferred stock?

- A. Cumulative preferred stock has the right to receive dividends in arrears before common stock dividends can be paid.
- B. Cumulative preferred stock has priority over common stock with regard to earnings.
- C. Cumulative preferred stock has voting rights.correct
- D. Cumulative preferred stock has priority over common stock with regard to assets.

Question was not answered

Correct Answer Explanation:

Usually preferred stock does not have voting rights, and that is true for both cumulative and noncumulative preferred stock. This is the one main benefit that common shares provide for a shareholder that preferred shares do not provide.

Explanation for Choice A:

This is correct. Cumulative preferred shares must be paid their dividend before common shares are able to receive a dividend.

Explanation for Choice B:

This is a feature of cumulative preferred stock. Cumulative preferred dividends must be paid before common dividends may be paid.

Explanation for Choice D:

This is a feature of preferred stock. All preferred stock has a priority over common stock in the distribution of assets in the event of a liquidation of the corporation.

222. Question ID: CMA 1289 P4 Q17 (Topic: Owners\' Equity)
Excerpts from the statement of financial position for Landau Corporation as of September 30 of the current year are presented as follows.

Cash	$ 950,000
Accounts receivable (net)	1,675,000
Inventories	2,806,000
Total current assets	$5,431,000
Accounts payable	$1,004,000
Accrued liabilities	785,000
Total current liabilities	$1,789,000

The board of directors of Landau Corporation met on October 4 of the current year and declared the regular quarterly cash dividend amounting to $750,000 ($0.60 per share). The dividend is payable on October 25 of the current year to all shareholders of record as of October 12 of the current year.

Assume that the only transactions to affect Landau Corporation during October of the current year are the dividend transactions and that the closing entries have been made.

If the dividend declared by Landau Corporation had been a 10% stock dividend instead of a cash dividend, Landau's total shareholders' equity would have been

- A. Unchanged by either the dividend declaration or the dividend distribution.correct
- B. Decreased by the dividend declaration and increased by the dividend distribution.
- C. Increased by the dividend declaration and unchanged by the dividend distribution.
- D. Unchanged by the dividend declaration and increased by the dividend distribution.

Question was not answered

Correct Answer Explanation:

A stock dividend occurs when the company distributes a dividend in the form of additional shares instead of in cash. In the stock dividend there is a debit to Retained Earnings (decreasing total equity) and a credit that is made to Common Stock and Additional Paid in Capital (increasing total equity). So, a stock dividend does not change total equity.

Explanation for Choice B:

A stock dividend occurs when the company distributes a dividend in the form of additional shares instead of in cash. The journal entries to record a stock dividend simply transfer some amount from Retained Earnings to the Common Stock and APIC accounts. Therefore, a stock dividend does not affect total equity.

Explanation for Choice C:

A stock dividend occurs when the company distributes a dividend in the form of additional shares instead of in cash. The journal entries to record a stock dividend simply transfer some amount from Retained Earnings to the Common Stock and APIC accounts. Therefore, a stock dividend does not affect total equity.

Explanation for Choice D:

A stock dividend occurs when the company distributes a dividend in the form of additional shares instead of in cash. The journal entries to record a stock dividend simply transfer some amount from Retained Earnings to the Common Stock and APIC accounts. Therefore, a stock dividend does not affect total equity.

223. Question ID: ICMA 1603.P1.004 (Topic: Owners\' Equity)
A publicly-traded company has 100,000 outstanding shares of common stock, with a par value of $5. The company uses U.S. GAAP to prepare its financial statements. The company recently declared a 5% stock dividend. On the date the stock dividend was declared, the company's stock was trading at $25 per share. On the date of declaration, the company's

- A. outstanding shares will decrease.
- B. total shareholders' equity will decrease.
- C. additional paid-in capital will increase.correct
- D. retained earnings will increase.

Question was not answered

Correct Answer Explanation:

A stock dividend is a dividend payable in additional shares of stock. A 5% stock dividend is a small stock dividend. A small stock dividend is accounted for on the date of declaration by debiting (decreasing) retained earnings by the fair value of the shares distributed, crediting (increasing) the common stock account by the par value of the shares distributed, and crediting (increasing) the additional paid-in-capital account by the difference. Thus additional paid-in capital will increase on the date of declaration.

Explanation for Choice A:

A stock dividend is a dividend payable in additional shares of stock. The number of outstanding shares increases, not decreases, when a stock dividend is declared.

Explanation for Choice B:

A stock dividend is a dividend payable in additional shares of stock. Total shareholders' equity is unchanged by the declaration of a stock dividend.

Explanation for Choice D:

A stock dividend is a dividend payable in additional shares of stock. Retained earnings are decreased, not increased, on the date a stock dividend is declared.

224. Question ID: CIA 595 P4 Q48 (Topic: Owners\' Equity)
Preferred and common stock differ in that:

- A. Preferred stock dividends are deductible as an expense for tax purposes, while common stock dividends are not.
- B. Common stock dividends are a fixed amount, while preferred stock dividends are not.
- C. Failure to pay dividends on common stock will not force the firm into bankruptcy, while failure to pay dividends on preferred stock will force the firm into bankruptcy.
- D. Preferred stock has a higher priority than common stock with regard to earnings and assets in the event of bankruptcy.correct

Question was not answered

Correct Answer Explanation:

In the case of bankruptcy or other liquidation, preferred shareholders do have a priority over common shareholders in the distribution of the assets of the company.

Explanation for Choice A:

Neither preferred dividends nor common dividends are tax deductible.

Explanation for Choice B:

Common dividends are not a fixed amount. Preferred dividends are not always a fixed amount, though they generally are stated in terms of a certain percentage of the preferred stock's par value which is effectively a fixed amount, subject to declaration each period by the board of directors, of course.

Explanation for Choice C:

The failure to pay dividends on either common stock or preferred stock will not force the company into bankruptcy.

225. Question ID: HOCK 2005 H4 (Topic: Owners\' Equity)
When cash dividends are declared, which account is affected?

- A. Additional paid-in capital.
- B. Dividends receivable.
- C. Retained earnings.correct
- D. Common shares.

Question was not answered

Correct Answer Explanation:

When dividends are declared the journal entry is a debit to Retained Earnings and a credit to Dividends Payable. When the dividend is paid the debit is to Dividends Payable and the credit is to Cash.

Explanation for Choice A:

The payment of cash dividends does not affect the additional paid in capital account.

Explanation for Choice B:

When dividends are declared and paid the account that is credited would be Dividends Payable, not Dividends Receivable.

Explanation for Choice D:

The payment of a cash dividend does not affect the common share account.

226. Question ID: CMA 686 P3 Q4 (Topic: Owners\' Equity)
Hessler received cash in the amount of $180,000 on March 11 for 10,000 shares of common stock sold. Hessler's common stock has $5 per share par value. The amount recorded as a credit to common stock for this transaction would have been

- A. $50,000correct
- B. $80,000
- C. $180,000
- D. $130,000

Question was not answered

Correct Answer Explanation:

When common stock is initially sold by the issuer, the Common Stock account is credited for the par value of the shares issued. There were 10,000 shares issued and the par value of each share is $5. Therefore, the credit to the Common Stock account was $50,000.

Explanation for Choice B:

When common stock is initially sold by the issuer, the Common Stock account is credited for the par value of the shares issued. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the amount of cash received in the transaction. The full amount of cash received is usually not credited to the Common Stock account because when common stock is initially sold by the issuer, the Common Stock account is credited for only the par value of the shares issued.

Explanation for Choice D:

This is the amount credited to Additional Paid in Capital. When common stock is initially sold by the issuer, the Common Stock account is credited for the par value of the shares issued. Amounts received over and above the par value are credited to Additional Paid-In Capital.

227. Question ID: CMA 694 P2 Q4 (Topic: Owners\' Equity)
The board of directors of Markham Corp. met on May 5, 20X5 and declared a 10% stock dividend. The dividend was distributed on May 28, 20X5 to shareholders of record as of May 15, 20X5.

As a result of this declaration and distribution, Markham's current liabilities would have been

- A. Unchanged by either the dividend declaration or the dividend distribution.correct
- B. Unchanged by the dividend declaration and decreased by the dividend distribution.
- C. Unchanged by the dividend declaration and increased by the dividend distribution.
- D. Decreased by the dividend declaration and increased by the dividend distribution.

Question was not answered

Correct Answer Explanation:

When a stock dividend is declared, the credit is to the account Common Stock - Issuable as a Dividend. When the dividend is distributed, this account is closed and is replaced with Common Stock. Therefore, current liabilities are not changed by the declaration and subsequent distribution of a stock dividend.

Explanation for Choice B:

When a stock dividend is declared, the credit is to the account Common Stock - Issuable as a Dividend. When the dividend is distributed, this account is closed and is replaced with Common Stock. Therefore, current liabilities are not changed by the declaration and subsequent distribution of a stock dividend.

Explanation for Choice C:

When a stock dividend is declared, the credit is to the account Common Stock - Issuable as a Dividend. When the dividend is distributed, this account is closed and is replaced with Common Stock. Therefore, current liabilities are not changed by the declaration and subsequent distribution of a stock dividend.

Explanation for Choice D:

When a stock dividend is declared, the credit is to the account Common Stock - Issuable as a Dividend. When the dividend is distributed, this account is closed and is replaced with Common Stock. Therefore, current liabilities are not changed by the declaration and subsequent distribution of a stock dividend.

228. Question ID: CIA 1195 P4 Q10 (Topic: Owners\' Equity)
A company declares and pays both a $200,000 cash dividend and a 10% stock dividend. The effect of the <<___>> dividend is to <<___>>.

- A. Stock; Decrease retained earnings and decrease equity
- B. Stock; Decrease retained earningscorrect
- C. Cash; Decrease retained earnings and increase equity
- D. Cash; Increase retained earnings

Question was not answered

Correct Answer Explanation:

A stock dividend does decrease retained earnings.

Explanation for Choice A:

A stock dividend does not affect total equity as it simply transfers the value from retained earnings to contributed capital.

Explanation for Choice C:

A cash dividend decreases retained earnings and it decreases equity.

Explanation for Choice D:

A cash dividend decreases retained earnings.

229. Question ID: CMA 1292 P2 Q7 H2 (Topic: Owners\' Equity)
On December 1, Charles Company's board of directors declared a cash dividend of $1.00 per share on the 50,000 shares of common stock outstanding. The company also has 5,000 shares of treasury stock. Shareholders of record on December 15 are eligible for the dividend, which is to be paid on January 1. On December 1, the company should

- A. Make no accounting entry.
- B. Debit retained earnings for $50,000 and paid-in capital for $5,000.
- C. Debit retained earnings for $55,000.
- D. Debit retained earnings for $50,000.correct

Question was not answered

Correct Answer Explanation:

On the date that dividends are declared the company should record a journal entry that debits Retained Earnings for the amount of the dividend that is expected to be paid and credits Dividends Payable for the same amount. The dividend is paid only to shares that are outstanding. This means that treasury stock does not receive the dividend. The company declared a $1 per share dividend and the company has 50,000 shares outstanding, so retained earnings should be debited for $50,000.

Explanation for Choice A:

On the date of declaration the company should make a journal entry that reduces retained earnings and establishes a dividend payable.

Explanation for Choice B:

The debit to retained earnings is correct, but there is no debit to paid-in-capital.

Explanation for Choice C:

The debit to retained earnings is incorrect because treasury shares do not receive the dividend. The dividend is paid only to shares outstanding, and treasury shares are not outstanding.

230. Question ID: CMA 695 P1 Q11 (Topic: Owners\' Equity)
Brady Corporation has 6,000 shares of 5% cumulative, $100 par value preferred stock outstanding and 200,000 shares of common stock outstanding. Brady's board of directors last declared dividends for the year ended May 31, 20X0, and there were no dividends in arrears at that time. For the year ended May 31, 20X2, Brady had net income of $1,750,000. The board of directors is declaring a dividend for common shareholders equivalent to 20% of net income. The total amount of dividends to be paid by Brady at May 31, 20X2 is:

- A. $350,000
- B. $380,000
- C. $410,000correct
- D. $206,000

Question was not answered

Correct Answer Explanation:

There are two dividends that Brady must pay. Before paying the common dividend, all cumulative dividends that have been earned this period or are in arrears need to be paid. A total of $600,000 par value of preferred, cumulative shares are outstanding that earn a 5% dividend. The last dividend was declared for the year ended May 31, 20X0. Therefore, the company needs to pay two years worth of preferred, cumulative dividends before it can pay a common dividend. At 5%, the dividend is $30,000 per year, for a total of $60,000 for the two years that needs to be paid. The second dividend is the common dividend. It is 20% of net income. Net income was $1,750,000 and 20% of this is $350,000. Adding together the two dividends, we get a total dividend to be paid of $410,000.

Explanation for Choice A:

This is the amount of the common dividend only. The preferred dividend also needs to be paid.

Explanation for Choice B:

This includes only one year of the preferred cumulative dividend. However, since the company has not paid the preferred, cumulative dividend for two years, two years of the preferred dividend needs to be paid.

Explanation for Choice D:

206,000 is the total number of common and preferred shares outstanding. It is not the total dividends to be paid.

231. Question ID: CMA 1289 P4 Q14 (Topic: Owners\' Equity)
Excerpts from the statement of financial position for Landau Corporation as of September 30 of the current year are presented as follows.

Cash	$ 950,000
Accounts receivable (net)	1,675,000
Inventories	2,806,000
Total current assets	$5,431,000
Accounts payable	$1,004,000
Accrued liabilities	785,000
Total current liabilities	$1,789,000

The board of directors of Landau Corporation met on October 4 of the current year and declared the regular quarterly cash dividend amounting to $750,000 ($0.60 per share). The dividend is payable on October 25 of the current year to all shareholders of record as of October 12 of the current year.

Assume that the only transactions to affect Landau Corporation during October of the current year are the dividend transactions and that the closing entries have been made.

Landau Corporation's current ratio was

- A. Unchanged by either the dividend declaration or the dividend payment.
- B. Decreased by the dividend declaration and unchanged by the dividend payment.
- C. Increased by the dividend declaration and unchanged by the dividend payment.

- D. Decreased by the dividend declaration and increased by the dividend payment.correct
  Question was not answered

Correct Answer Explanation:

The current ratio is calculated as current assets divided by current liabilities. Prior to the dividend events, the current ratio of the company was 3.04 ($5,431,000 ÷ $1,789,000). After the declaration of the dividend, the current liabilities increased by $750,000 and this would decrease the current ratio to 2.14 ($5,431,000 ÷ $2,539,000).

When the dividend is paid, both current assets and current liabilities will decrease by $750,000, with current liabilities returning to its pre-dividend level of $1,789,000. Now, the current ratio is 2.62 ($4,681,000 ÷ $1,789,000). Since the current ratio was 2.14 before the dividend payment, the dividend payment increased the current ratio.

Explanation for Choice A:

The current ratio is changed by both of these events. See the correct answer for a complete explanation.

Explanation for Choice B:

The payment of the dividend increased the current ratio. See the correct answer for a complete explanation.

Explanation for Choice C:

The declaration of the dividend decreased the current ratio, and the payment of the dividend increased the current ratio. See the correct answer for a complete explanation.

232. Question ID: CMA 1288 P4 Q30 (Topic: Owners\' Equity)
Morton Company declared and issued a 10% stock dividend during the current year. The effect of this stock dividend on the following was:

Par Value Per Share / Retained Earnings / Total Equity

- A. Decrease / Decrease / No effect
- B. No effect / Decrease / Decrease
- C. Decrease / No effect / No effect
- D. No effect / Decrease / No effectcorrect
  Question was not answered

Correct Answer Explanation:

A small stock dividend is recorded at the fair value of the shares issued. The journal entry is a debit to Retained Earnings and a credit to Common Stock and APIC.

- There is no effect on the par value per share because the newly-issued shares have the same par value as the existing shares.
- Since retained earnings is debited in the journal entry, the debit decreases retained earnings.
- There is no effect on the total equity of the company since all of the accounts used in the journal entry are equity accounts.

Explanation for Choice A:

Par value per share is not affected by a small stock dividend because the newly-issued shares have the same par value as the existing shares. See the correct answer for a complete explanation.

Explanation for Choice B:

Total equity is not decreased by a stock dividend because all of the accounts used in the journal entry are equity accounts. See the correct answer for a complete explanation.

Explanation for Choice C:

Par value per share is not affected by a small stock dividend because the newly-issued shares have the same par value as the existing shares. Retained earnings is decreased. See the correct answer for a complete explanation.

233. Question ID: CIA 596 P4 Q54 (Topic: Owners\' Equity)
On May 28, a company announced that its directors had met on May 26 and declared a dividend of 25 cents per share, payable to shareholders of record on June 20, with payment to be made on July 5. The date on which the declared dividend becomes a liability of the company is

- A. July 5.
- B. June 20.
- C. May 26.correct
- D. May 28.

Question was not answered

Correct Answer Explanation:

The dividend becomes a liability to the company on the date the dividend is declared.

Explanation for Choice A:

The dividend becomes a liability to the company on the date the dividend is declared.

Explanation for Choice B:

The dividend becomes a liability to the company on the date the dividend is declared.

Explanation for Choice D:

The dividend becomes a liability to the company on the date the dividend is declared.

234. Question ID: CMA 689 P1 Q7 (Topic: Owners\' Equity)
A stock dividend

- A. increases the debt-to-equity ratio of a firm.
- B. decreases future earnings per share.correct
- C. decreases the size of the firm.
- D. increases shareholders' wealth.

Question was not answered

Correct Answer Explanation:

In a stock dividend more shares are issued to existing shareholders. Since there is no increase in income from this event but there are more shares outstanding, future earnings per share will decrease as a result of the stock dividend.

Explanation for Choice A:

A stock dividend has no impact on the company's liabilities or the book value of the company's total equity. Therefore, there is no effect on the firm's debt-to-equity ratio.

Explanation for Choice C:

A stock dividend does not impact the size of the firm.

Explanation for Choice D:

A stock dividend does not in itself increase shareholder wealth. The stock dividend provides more shares to each shareholder, but since the value of each share decreases, the total value of the shares remains unchanged.

235. Question ID: CMA 695 P1 Q13 (Topic: Owners\' Equity)
The equity section of Smith Corporation's statement of financial position is presented below.

Preferred stock, $100 par	$12,000,000
Common stock, $5 par	10,000,000
Paid-in capital in excess of par	18,000,000
Retained earnings	9,000,000
Net worth	$49,000,000

The common shareholders of Smith Corporation have preemptive rights. If Smith Corporation issues 400,000 additional shares of common stock at $6 per share, a current holder of 20,000 shares of Smith Corporation's common stock must be given the option to buy

- A. 3,333 additional shares.
- B. 3,774 additional shares.
- C. 1,000 additional shares.
- D. 4,000 additional shares.correct
  Question was not answered

Correct Answer Explanation:

Because the shareholder currently owns 1% of the company's shares ($10,000,000 in the common stock account divided by $5 par value gives 2,000,000 shares), the shareholder is entitled to buy 1% of the newly issued shares. Since the company is issuing 400,000 new shares, 1% of this is 4,000 shares.

Explanation for Choice A:

Because the shareholder currently owns 1% of the company's shares ($10,000,000 in the common stock account divided by $5 par value gives 2,000,000 shares), the shareholder is entitled to buy 1% of the newly issued shares.

Explanation for Choice B:

Because the shareholder currently owns 1% of the company's shares ($10,000,000 in the common stock account divided by $5 par value gives 2,000,000 shares), the shareholder is entitled to buy 1% of the newly issued shares.

Explanation for Choice C:

Because the shareholder currently owns 1% of the company's shares ($10,000,000 in the common stock account divided by $5 par value gives 2,000,000 shares), the shareholder is entitled to buy 1% of the newly issued shares.

236. Question ID: CIA 1193 P4 Q45 (Topic: Owners\' Equity)
At December 31, a company has total assets at book value of $300,000. Liabilities are $120,000. Also, on December 31, the stock is selling at $20 per share, and there are 10,000 shares outstanding. As a result, the company should take the difference between the carrying amount and market value of the stock and

- A. not capitalize any asset, record any revenue, or change equity at this time.correct
- B. capitalize it as an asset (and amortize over the estimated useful life), with the offset to revenue.
- C. capitalize it as an asset (and amortize over 5 years), with the offset to equity.
- D. capitalize it as an asset (and amortize over the estimated useful life not to exceed 40 years), with the offset to equity.

Question was not answered

Correct Answer Explanation:

Increases or decreases in the market value of the shares after they have been issued are not recorded on the books of the issuing company. Therefore, no accounting entries should be recorded.

Explanation for Choice B:

Increases or decreases in the market value of the shares after they have been issued are not recorded on the books of the issuing company. Therefore, this difference between the market value and book value of the shares should not be capitalized.

Explanation for Choice C:

Increases or decreases in the market value of the shares after they have been issued are not recorded on the books of the issuing company. Therefore, this difference between the market value and book value of the shares should not be capitalized.

Explanation for Choice D:

Increases or decreases in the market value of the shares after they have been issued are not recorded on the books of the issuing company. Therefore, this difference between the market value and book value of the shares should not be capitalized.

237. Question ID: CMA 693 P1 Q18 (Topic: Owners\' Equity)
The par value of common stock represents

- A. The liability ceiling of a shareholder when a company undergoes bankruptcy proceedings.correct
- B. The amount that must be recorded on the issuing corporation's record as paid-in capital.
- C. The estimated fair value of the stock when it was issued.
- D. The total value of the stock that must be entered in the issuing corporation's records.

Question was not answered

Correct Answer Explanation:

The par value of a share is the amount of the legal capital that share represents. It also represents the maximum liability of a shareholder when the company goes through bankruptcy. Many companies have shares with a low par value. The amount of the legal capital is also unable to be distributed by the company.

Explanation for Choice B:

The amount that is recorded as paid in capital is the difference between the fair value of what was received and the par value of the shares that were issued.

Explanation for Choice C:

Though the par value may in some cases be equal to the fair value of the stock, this is not what par value represents.

Explanation for Choice D:

The value that is entered into the company's records for the stock is the fair value of all assets or services received in exchange for the stock. This amount will be split between two accounts, common stock and additional paid-in capital, but the total fair value of what was received is entered into the company's books.

238. Question ID: CMA 682 P3 Q14 (Topic: Owners\' Equity)
Which one of the following is true regarding small stock dividends?

- A. The amount of equity capital available for future dividends is increased.
- B. Each common shareholder's percentage of ownership in the corporation increases.
- C. An amount equal to the current fair value of shares issued is transferred from retained earnings to contributed capital.correct
- D. Retained earnings equal to the par value of shares issued is converted to contributed capital.

Question was not answered

Correct Answer Explanation:

In a small stock dividend, retained earnings is debited for the fair value of the shares issued, the common stock account is credited for the par value of the newly issued shares, and additional paid-in capital is credited for the difference. The effect of this is to transfer an equal amount of money from retained earnings to contributed capital.

Explanation for Choice A:

The amount of capital available for future dividends is decreased by a small stock dividend because the retained earnings account is debited (reduced) by the amount of the fair value of the shares issued in the dividend.

Explanation for Choice B:

In a stock dividend the proportional ownership of each of the owners is unchanged.

Explanation for Choice D:

In a small stock dividend, the amount of retained earnings that is converted to contributed capital is the fair value of the shares, not the par value of the shares. If the stock dividend is a **large** stock dividend (more than 20-25% of the outstanding shares issued as the stock dividend), then the journal entry is based on the par value of the shares.

239. Question ID: CMA 1289 P4 Q13 (Topic: Owners\' Equity)

Excerpts from the statement of financial position for Landau Corporation as of September 30 of the current year are presented as follows.

Cash	$ 950,000
Accounts receivable (net)	1,675,000
Inventories	2,806,000
Total current assets	$5,431,000
Accounts payable	$1,004,000
Accrued liabilities	785,000
Total current liabilities	$1,789,000

The board of directors of Landau Corporation met on October 4 of the current year and declared the regular quarterly cash dividend amounting to $750,000 ($0.60 per share). The dividend is payable on October 25 of the current year to all shareholders of record as of October 12 of the current year.

Assume that the only transactions to affect Landau Corporation during October of the current year are the dividend transactions and that the closing entries have been made.

Landau Corporation's working capital was

- A. Decreased by the dividend declaration and increased by the dividend payment.
- B. Unchanged by the dividend declaration and decreased by the dividend payment.
- C. Unchanged by either the dividend declaration or the dividend payment.
- D. Decreased by the dividend declaration and unchanged by the dividend payment.correct
  Question was not answered

Correct Answer Explanation:

Working capital is current assets minus current liabilities. In the process of declaring and paying a dividend, the working capital of the company decreases at the declaration date and is unchanged at all other dates. The decrease at declaration occurs because the liabilities of the company increase with the dividend payable while all other assets and liabilities remain the same. When the dividend is paid, both liabilities (dividends payable) and assets (cash) are decreased by the same amount, which leaves working capital unchanged.

Explanation for Choice A:

Working capital is current assets minus current liabilities. In the process of paying and declaring dividends, working capital is changed only by the declaration of the dividend. At that date working capital decreases and at all other dates it is unchanged.

Explanation for Choice B:

Working capital is current assets minus current liabilities. In the process of paying and declaring dividends, working capital is changed by the declaration of the dividend. At that date working capital decreases and at all other dates it is unchanged.

Explanation for Choice C:

Working capital is current assets minus current liabilities. In the process of paying and declaring dividends, working capital is changed by the declaration of the dividend. At that date working capital decreases and at all other dates it is unchanged.

240. Question ID: CMA 1284 P4 Q24 (Topic: Owners\' Equity)
The following information is available for Paragon as of November 30, 20X5.

- The market price of Paragon's common stock was $4 per share on November 30, 20X5.
- Common stock - $1 par value; 20,000,000 shares issued and outstanding - $20,000,000
- Paid-in capital in excess of par value - $12,200,000
- Retained earnings - $16,000,000

If Paragon had declared a 10% stock dividend on November 30, 20X5, retained earnings would have been:

- A. Reduced by $8,000,000.correct
- B. Reduced by $6,000,000.
- C. Reduced by $1,600,000.
- D. Reduced by $2,000,000.

Question was not answered

Correct Answer Explanation:

A 10% stock dividend is a small stock dividend (a small stock dividend is less than 20-25% of the shares outstanding). In a small stock dividend, retained earnings is reduced by the fair value of the shares that will be issued, using the value on the date of declaration to value the shares. In a 10% dividend, Paragon would have issued 2,000,000 shares. At the date of declaration the shares had a market value of $4, so the retained earnings of Paragon would have decreased by $8,000,000 as a result of this stock dividend.

Explanation for Choice B:

This is the difference between the market price per share and the par value per share multiplied by the number of new shares issued. That is not the way the amount of the reduction in retained earnings is calculated.

Explanation for Choice C:

This amount is 10% of retained earnings, which does not mean anything in this problem. See the correct answer for a complete explanation.

Explanation for Choice D:

This answer uses the par value of the shares to value the transaction. That is not the amount of the reduction in retained earnings because this is a small stock dividend (a small stock dividend is less than 20-25% of the shares outstanding).

241. Question ID: CMA 1289 P4 Q15 (Topic: Owners\' Equity)
Excerpts from the statement of financial position for Landau Corporation as of September 30 of the current year are presented as follows.

Cash	$ 950,000

Accounts receivable (net)	1,675,000
Inventories	2,806,000
Total current assets	$5,431,000
Accounts payable	$1,004,000
Accrued liabilities	785,000
Total current liabilities	$1,789,000

The board of directors of Landau Corporation met on October 4 of the current year and declared the regular quarterly cash dividend amounting to $750,000 ($0.60 per share). The dividend is payable on October 25 of the current year to all shareholders of record as of October 12 of the current year.

Assume that the only transactions to affect Landau Corporation during October of the current year are the dividend transactions and that the closing entries have been made.

Landau Corporation's total equity was

- A. Decreased by the dividend declaration and unchanged by the dividend payment.correct
- B. Decreased by the dividend declaration and increased by the dividend payment.
- C. Unchanged by either the dividend declaration or the dividend payment.
- D. Unchanged by the dividend declaration and decreased by the dividend payment.

Question was not answered

Correct Answer Explanation:

When the dividend was declared, retained earnings was debited (decreased). All of the remaining events do not affect any of the equity accounts. Therefore, equity was decreased by the dividend declaration and unchanged by the dividend payment.

Explanation for Choice B:

While total equity is decreased by the dividend declaration, the payment of the dividend does not change the equity of the company.

Explanation for Choice C:

The total equity of the company was decreased by the dividend declaration.

Explanation for Choice D:

The declaration of the dividend decreased retained earnings (an equity account) but the payment of the dividend did not affect any equity account.

242. Question ID: CMA 694 P2 Q3 (Topic: Owners\' Equity)
The board of directors of Markham Corp. met on May 5, 20X5 and declared a quarterly cash dividend in the amount of $800,000 ($0.50 per share). The dividend was paid on May 28, 20X5 to shareholders of record as of May 15, 20X5.

Assume that the only transactions that affected Markham during May 20X5 were the dividend transactions and that the closing entries have been made.

Markham's total equity is

- A. Increased by the dividend declaration and unchanged by the dividend payment.
- B. Unchanged by either the dividend declaration or the dividend payment.
- C. Decreased by the dividend declaration and unchanged by the dividend payment.correct
- D. Unchanged by the dividend declaration and decreased by the dividend payment.

Question was not answered

Correct Answer Explanation:

When the dividend is declared, the journal entry is a credit to Dividend Payable and a debit to Retained Earnings. The debit to retained earnings reduces the equity of the company. When the dividend is paid there is no impact on equity as the journal entry debits Dividends Payable and credits Cash. So, the equity of the company is reduced when the dividend is declared and unchanged at the date of payment.

Explanation for Choice A:

The dividend declaration decreased the total equity of the company because the dividend creates a debit to Retained Earnings. The dividend payment does not change the company's total equity.

Explanation for Choice B:

The dividend declaration decreased the total equity of the company because the dividend creates a debit to Retained Earnings. The dividend payment does not change the company's total equity.

Explanation for Choice D:

The dividend declaration decreased the total equity of the company because the dividend creates a debit to Retained Earnings. The dividend payment does not change the company's total equity.

243. Question ID: CIA 593 P4 Q46 (Topic: Owners\' Equity)
The policy decision that by itself is **least likely** to affect the value of the firm is the

- A. Use of a more highly leveraged capital structure that resulted in a lower cost of capital.
- B. Investment in a project with a large net present value.
- C. Distribution of stock dividends to shareholders.correct
- D. Sale of a risky division that will now increase the credit rating of the entire company.

Question was not answered

Correct Answer Explanation:

A stock dividend should not affect the value of the company. The distribution of a stock dividend does not increase or decrease equity and will not generate a profit or cause a loss.

Explanation for Choice A:

A structure that results in a lower cost of capital should increase the value of a firm.

Explanation for Choice B:

If the company enters into a project that has a large net present value, this should increase the value of the company.

Explanation for Choice D:

If the company sells a risky division and improves its credit rating, this should increase the value of the company.

244. Question ID: CIA 1196 P4 Q55 (Topic: Owners\' Equity)
Stock dividends and stock splits differ in that

- A. In a stock split, a larger number of new shares replaces the outstanding shares.correct
- B. A stock dividend results in a decline in the par value per share.
- C. Stock splits involve a bookkeeping transfer from retained earnings to the capital stock account.
- D. Stock splits are paid in additional shares of common stock, whereas a stock dividend results in replacement of all outstanding shares with a new issue of shares.

Question was not answered

Correct Answer Explanation:

In a stock split, there is no journal entry. However, the result is that a larger number of shares replaces the existing shares that are outstanding.

Explanation for Choice B:

It is in a stock split that the par value of the shares is reduced.

Explanation for Choice C:

Stock splits do not require a journal entry. Stock dividends involve a transfer from retained earnings to the common stock account.

Explanation for Choice D:

This answer reverses the effect of stock splits and stock dividends.

245. Question ID: CIA 595 P4 Q30 (Topic: Owners\' Equity)
Which of the following types of dividends do not reduce equity in the corporation?

- A. Liquidating dividends.
- B. Property dividends.
- C. Stock dividends and split-ups in the form of a dividend.correct
- D. Cash dividends.

Question was not answered

Correct Answer Explanation:

Stock dividends and stock splits do not affect the equity of the company. In a stock dividend, some of the equity is transferred from retained earnings to contributed capital, but the total equity remains the same. In a stock split, there is no effect, not even a reclassification, on the equity of the company.

Explanation for Choice A:

A liquidating dividend reduces additional paid-in capital (and therefore the equity) of a company.

Explanation for Choice B:

A property dividend reduces retained earnings (and therefore the equity) of a company.

Explanation for Choice D:

A cash dividend reduces retained earnings (and therefore the equity) of a company.

246. Question ID: CIA 1194 P4 Q51 (Topic: Owners\' Equity)
A company has 1,000 shares of $10 par value common stock and $5,000 of retained earnings. Two proposals are under consideration. The first is a stock split giving each shareholder two new shares for each share formerly held. The second is to declare and distribute a 50% stock dividend.

Under the _____, the par value per outstanding share will _____.

- A. Stock split, Decreasecorrect
- B. Stock dividend, Decrease
- C. Stock split, Increase
- D. Stock dividend, Increase

Question was not answered

Correct Answer Explanation:

In a stock split the par value of the shares is reduced. The total capital from the shares remains the same, but that capital needs to be split among more shares because of the stock split.

Explanation for Choice B:

Under a stock dividend there is no effect on the par value of the shares.

Explanation for Choice C:

In a stock split the par value of the shares is adjusted, but the par value is decreased in a stock split.

Explanation for Choice D:

Under a stock dividend there is no effect on the par value of the shares.

247. Question ID: CMA 693 P1 Q7 (Topic: Owners\' Equity)
When a company desires to increase the market value per share of its common stock, the company can

- A. Implement a reverse stock split.correct
- B. Sell preferred stock.
- C. Sell treasury stock.
- D. Split the stock.

Question was not answered

Correct Answer Explanation:

In a reverse stock split the company reduces the number of shares outstanding. For example, in a 1-for-2 reverse stock split, every two shares that are held by an investor become one share. This one share, however, has a value that is twice as high as an individual share before the reverse stock split. Therefore, a reverse stock split will increase the market value of a common share.

Explanation for Choice B:

Selling preferred stock will have only an indirect effect on the market value of the company's common stock, and it would decrease the common stock's market value, not increase it. Preferred stock reduces the income available to common shareholders which in turn reduces basic and diluted earnings per share. The reduction of earnings per share would reduce the value of the common stock in the judgment of the market, so the market value of the common stock could decline. It would not increase.

Explanation for Choice C:

If the company sells treasury shares there will be more shares outstanding among which the value of the company needs to be divided. A sale of treasury shares will reduce the value of an individual common share.

Explanation for Choice D:

In a stock split each share is split into an increased number of shares. For example, in a 2-for-1 split, each share that is held by an investor becomes two shares. However, the market value of each of those shares is half what it had been before the split. A stock split reduces the market value of each common share. It does not increase it.

248. Question ID: CMA 1289 P4 Q16 (Topic: Owners\' Equity)
Excerpts from the statement of financial position for Landau Corporation as of September 30 of the current year are presented as follows.

Cash	$ 950,000
Accounts receivable (net)	1,675,000
Inventories	2,806,000
Total current assets	$5,431,000
Accounts payable	$1,004,000
Accrued liabilities	785,000
Total current liabilities	$1,789,000

The board of directors of Landau Corporation met on October 4 of the current year and declared the regular quarterly cash dividend amounting to $750,000 ($0.60 per share). The dividend is payable on October 25 of the current year to all shareholders of record as of October 12 of the current year.

Assume that the only transactions to affect Landau Corporation during October of the current year are the dividend transactions and that the closing entries have been made.

If the dividend declared by Landau Corporation had been a 10% stock dividend instead of a cash dividend, Landau's current liabilities would have been

- A. Increased by the dividend declaration and unchanged by the dividend distribution.
- B. Unchanged by the dividend declaration and increased by the dividend distribution.
- C. Unchanged by either the dividend declaration or the dividend distribution.correct
- D. Unchanged by the dividend declaration and decreased by the dividend distribution.

Question was not answered

Correct Answer Explanation:

A stock dividend is not recorded as a liability, even if the shares are not distributed at the declaration date. All of the journal entries to record the declaration and distribution of a stock dividend are made within the equity section. Therefore a stock dividend will not impact the current liabilities of the company.

Explanation for Choice A:

A stock dividend is not recorded as a liability, even if the shares are not distributed at the declaration date. All of the journal entries to record the declaration and distribution of a stock dividend are made within the equity section. Therefore a stock dividend will not impact the current liabilities of the company.

Explanation for Choice B:

A stock dividend is not recorded as a liability, even if the shares are not distributed at the declaration date. All of the journal entries to record the declaration and distribution of a stock dividend are made within the equity section. Therefore a stock dividend will not impact the current liabilities of the company.

Explanation for Choice D:

A stock dividend is not recorded as a liability, even if the shares are not distributed at the declaration date. All of the journal entries to record the declaration and distribution of a stock dividend are made within the equity section. Therefore a stock dividend will not impact the current liabilities of the company.

249. Question ID: CMA 688 P4 Q19 (Topic: Owners\' Equity)
Which one of the following items most likely increases earnings per share (EPS) of a corporation?

- A. Payment of a stock dividend.
- B. Purchase of treasury stock.correct
- C. A reduction in the amount of cash dividends paid to common shareholders.
- D. Declaration of a stock split.

Question was not answered

Correct Answer Explanation:

When the company purchases treasury shares, it reduces the number of shares outstanding. This will result in an increase in the earnings per share of the common shares that remain outstanding.

Explanation for Choice A:

A stock dividend increases the number of shares outstanding, which therefore **decreases** earnings per share.

Explanation for Choice C:

A reduction in the cash dividends paid to common shareholders will have no impact on the earnings per share of the company. No new shares are issued and the dividend is an after tax distribution of profit and will not impact the income available for common shareholders.

Explanation for Choice D:

A stock split increases the number of shares outstanding, which therefore **decreases** earnings per share.

250. Question ID: CIA 0590 P4 Q31 (Topic: Revenue Recognition)
DEF is the consignee for 1,000 units of product X for ABC Company. ABC should recognize the revenue from these 1,000 units when

- A. ABC ships the goods to DEF.
- B. DEF sells the goods and informs ABC of the sale.correct
- C. DEF receives the goods from ABC.
- D. The agreement between DEF and ABC is signed.

Question was not answered

Correct Answer Explanation:

The consignor recognizes revenue only when control transfers. Usually the transfer of control occurs and thus the revenue is recognized when the goods are sold to the final customer.

Explanation for Choice A:

The consignor does not recognize revenue when the goods are shipped to the consignee. The consignor recognizes revenue only when control transfers. Usually the transfer of control occurs and thus the revenue is recognized when the goods are sold to the final customer.

Explanation for Choice C:

The consignor does not recognize revenue when the consignee receive the goods. The consignor recognizes revenue only when control transfers. Usually the transfer of control occurs and thus the revenue is recognized when the goods are sold to the final customer.

Explanation for Choice D:

The consignor does not recognize revenue when the agreement is signed. The consignor recognizes revenue only when control transfers. Usually the transfer of control occurs and thus the revenue is recognized when the goods are sold to the final customer.

251. Question ID: HOCK RR606.04 (Topic: Revenue Recognition)
Blue Water Shipbuilders obtained a contract to construct a cruise ship for Gateway Cruises at a contract price of $1 billion. Blue Water's estimated cost at the inception of the contract was $800 million, so at the inception of the contract, Blue Water estimated its profit on the contract would be $200 million. The construction was expected to require three years. The contract specified that Gateway Cruises owned the work-in-process as the cruise ship was being built. By the end of Year One, the engineer estimated that 20 percent of the performance obligation had been satisfied, and Blue Water's costs totaled $285 million. Blue Water's estimated cost to complete the construction and satisfy the performance obligation at that time was $665 million.

Blue Water recognizes revenue and gross profit on shipbuilding contracts using the cost-to-cost input method. How much revenue and gross profit should Blue Water recognize at the end of Year One?

- A. Revenue $200 million, gross profit $40 million.
- B. Revenue $300 million, gross profit $60 million.
- C. Revenue $300 million, gross profit $15 million.correct
- D. Revenue $200 million, gross profit $10 million.

Question was not answered

Correct Answer Explanation:

Because Gateway Cruises owns the work-in-process, control of the asset is transferred to Gateway over time and Blue Water accounts for the contract over time. Using the cost-to-cost input method to measure progress on the contract, 30% of the performance obligation has been satisfied at the end of Year One, calculated as $285 million divided by total estimated cost of $950 million ($285,000,000 + $665,000,000).

Therefore, Blue Water recognizes 30% of the contract price of $1 billion, or $300 million, as revenue for Year One. Estimated gross profit on the contract at the end of Year One is $50 million: $1 billion less $950 million ($285 million + $665 million). Therefore, gross profit recognized at the end of Year One is 30% of $50 million, which equals $15 million.

Explanation for Choice A:

This answer results from two errors:

(1) Using 20% as the proportion of the performance obligation that is complete at the end of Year One. Even though the question says that "the engineer estimated that 20 percent of the construction was complete," the question also says that Blue Water recognizes revenue and gross profit using the cost-to-cost input method. Therefore, the engineer's estimate is not relevant and the percentage to use in calculating the amount of revenue and gross profit to recognize at the end of Year One should be calculated as the costs incurred through the end of Year One divided by the total estimated costs.

(2) Using the estimated costs and estimated gross profit at the inception of the contract to calculate the gross profit to recognize at the end of Year One, instead of using the estimated gross profit as of the end of Year One.

Explanation for Choice B:

This answer results from using the estimated costs and estimated gross profit at the inception of the contract to calculate the gross profit to recognize at the end of Year One, instead of using the estimated gross profit as of the end of Year One.

Explanation for Choice D:

This answer results from using 20% as the proportion of the performance obligation that is complete at the end of Year One. Even though the question says that "the engineer estimated that 20 percent of the construction was complete," the question also says that Blue Water recognizes revenue and gross profit using the cost-to-cost input method. Therefore, the engineer's estimate is not relevant and the percentage to use in calculating the amount of revenue and gross profit to recognize at the end of Year One should be calculated as the costs incurred through the end of Year One divided by the total estimated costs.

252. Question ID: CMA 0696 P2 Q1 (Topic: Revenue Recognition)
Diamond Clover Construction Inc. is recognizing revenue over time on Job #4115, a long-term contract with a contract price of $5,000,000. In Year 1, the company began work on the job. Other data are shown below.

	Year 1	Year 2
Costs incurred during the year	$ 900,000	$2,350,000
Estimated costs to complete	2,700,000	0
Billings during the year	1,000,000	4,000,000
Collections during the year	700,000	4,300,000

The amount of gross profit to be recognized in Year 1 using the cost-to-cost method is:

- A. $766,667
- B. $350,000correct
- C. $1,400,000
- D. $700,000

Question was not answered

Correct Answer Explanation:

The amount of gross profit to be recognized in Year 1 is calculated as follows: [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized]. The estimated gross profit is calculated by subtracting from the contract price ($5,000,000) the actual costs incurred to date as of Year 1 ($900,000) and the estimated cost to complete as of Year 1 ($2,700,000). $5,000,000 − $900,000 − $2,700,000 = $1,400,000. The estimated gross profit is **$1,400,000**.

The calculation of the percentage satisfied is done by dividing the actual costs incurred to date as of Year 1 ($900,000) by the total estimated costs for the project ($900,000 + $2,700,000, or $3,600,000). $900,000 ÷ $3,600,000 = 0.25. Thus, at the end of Year 1, the performance obligation in the contract is **25% satisfied**.

Therefore, Diamond Clover should have recognized in total $350,000 of gross profit by the end of Year 1 (25% of the $1,400,000 estimated gross profit on the contract). Since this is the first year of the project, there is no previously recognized gross profit to be subtracted. Therefore, the company should have recognized in total **$350,000** in gross profit at the end of Year 1.

Explanation for Choice A:

The amount of gross profit to be recognized in Year 1 is: [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

This answer results from not including the actual cost incurred to date as of Year 1 in the calculation of the estimated gross profit and the total estimated cost (used in calculating the percentage of the contract satisfied).

[1] The estimated gross profit is the contract price minus the actual costs incurred to date as of Year 1 and minus the estimated costs to complete as of the end of Year 1 (**not** the contract price minus only the estimated costs to complete as of the end of Year 1).

[2] The percentage satisfied as of the end of Year 1 is the actual costs incurred to date as of Year 1 divided by the total of the costs incurred to date as of Year 1 and the estimated costs to complete as of the end of Year 1 (**not** the actual costs incurred to date as of Year 1 divided by only the estimated costs to complete as of the end of Year 1).

[3] The amount of profit to be recognized in Year 1 is [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized]. Since this is the first year of the project, there is no previously recognized gross profit to be subtracted. Therefore, the amount of gross profit to be recognized in Year 1 is the Estimated Gross Profit (calculated in [1] above) multiplied by the Percentage Satisfied (calculated in [2] above).

Explanation for Choice C:

This is the estimated gross profit on the contract as a whole. The amount of gross profit to be recognized in Year 1 is: [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

Explanation for Choice D:

This is the amount of cash collected during Year 1. The amount of gross profit to be recognized in Year 1 is: [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

253. Question ID: CIA 1196 P4 Q12 (Topic: Revenue Recognition)
A company began work on a long-term construction contract in 20X1. The contract price was $3,000,000. Year-end information related to the contract is as follows:

	20X1	20X2	20X3
Estimated total cost	$2,000,000	$2,000,000	$2,000,000
Cost incurred	700,000	900,000	400,000
Billings	800,000	1,200,000	1,000,000
Collections	600,000	1,200,000	1,200,000

If the company recognizes the revenue for this contract at a point in time, when the performance obligations in the contract have been completely satisfied, the gross profit to be recognized in 20X3 is:

- A. $1,000,000correct
- B. $600,000
- C. $200,000
- D. $800,000

Question was not answered

Correct Answer Explanation:

When revenue is recognized at a point in time for a contract, it is recognized when the performance obligations in the contract have been completely satisfied. No revenue, cost, or gross profit are recognized until the project is complete. Then, in the period when the performance obligations in the contract have been satisfied, all of the revenue, cost, and gross profit of the project are recognized. 20X3 is the year in which the performance obligations in the contract are satisfied, and the total gross profit on the contract is $1,000,000 (calculated as the $3,000,000 price minus the $2,000,000 in costs incurred). This entire $1,000,000 of gross profit is recognized in 20X3.

Explanation for Choice B:

This is the difference between billings and cost incurred in 20X3. This is not the way to calculate the gross profit to be recognized in 20X3. When revenue is recognized at a point in time for a contract, all revenue, costs, and gross profit on the contract are recognized when the performance obligations in the contract have been completely satisfied.

Explanation for Choice C:

This is the difference between collections and billings in 20X3. This is not the way to calculate the gross profit to be recognized in 20X3. When revenue is recognized at a point in time for a contract, all revenue, costs, and gross profit on the contract are recognized when the performance obligations in the contract have been completely satisfied.

Explanation for Choice D:

This is the difference between total cost and collections received in 20X3. This is not the way to calculate the gross profit to be recognized in 20X3. When revenue is recognized at a point in time for a contract, all revenue, costs, and gross profit on the contract are recognized when the performance obligations in the contract have been completely satisfied.

254. Question ID: CMA 1292 P2 Q14 (Topic: Revenue Recognition)
Allan Construction signed a $48,000,000 contract on September 1, 20X4 with the City of Springfield to construct a tunnel under the Maple River. On that date, the estimated cost to complete the tunnel, which was to be completed by June 20X7, was $36,000,000. Allan's fiscal year ends November 30, and the company recognized revenue on this contract over time using the cost-to-cost method.

Data regarding the tunnel contract, which was begun December 1, 20X4, are as follows.

At November 30 (in thousands)

	20X5	**20X6**
Actual costs to date	$12,000	$30,000
Estimated costs to complete	24,000	10,000
Progress billings to date	10,000	28,000
Cash collected to date	8,000	24,000

The gross profit or loss recognized for the fiscal year ended November 30, 20X5 from the tunnel contract using the cost-to-cost method is:

- A. $12,000,000 gross profit.
- B. $4,000,000 gross profit.correct
- C. $6,000,000 gross profit.
- D. $3,000,000 gross profit.

Question was not answered

Correct Answer Explanation:

The amount of gross profit to be recognized for the year ended November 30, 20X5 is calculated as follows: [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized]. The estimated gross profit is calculated by subtracting from the contract price ($48,000,000) the actual costs incurred to date as of fiscal year-end 20X5 ($12,000,000) and the estimated cost to complete as of that date ($24,000,000). $48,000,000 − $12,000,000 − $24,000,000 = $12,000,000. The estimated gross profit is **$12,000,000**.

The calculation of the percentage satisfied is done by dividing the actual costs incurred to date as of November 30, 20X5 ($12,000,000) by the total estimated costs for the project ($12,000,000 + $24,000,000, or $36,000,000). $12,000,000 ÷ $36,000,000 = 0.333. Thus, at the end of 20X5, the performance obligation in the contract is **1/3 satisfied**.

Therefore, Allen should have recognized in total $4,000,000 of gross profit by the end of 20X5 (1/3 of the $12,000,000 estimated gross profit on the contract). Since this is the first year of the project, there is no previously recognized gross profit to be subtracted. Therefore, the company should recognize **$4,000,000** in gross profit for the fiscal year ended November 30, 20X5.

Explanation for Choice A:

This is the estimated gross profit on the whole contract. However, not all of it can be recognized in the year ended November 30, 20X5. See the correct answer for a complete explanation.

Explanation for Choice C:

This is the total gross profit to be recognized during 20X5 and 20X6.

Explanation for Choice D:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

255. Question ID: CMA 1296 P2 Q11 (Topic: Revenue Recognition)
Under ASC 606, recognition of revenue does not occur until the

- A. performance obligation is satisfied and it is probable that the company will be able to collect substantially all of the consideration that it is entitled to receive for the goods or services that will be transferred to the customer under a valid contract.correct
- B. cash is collected.
- C. performance obligation has been satisfied.
- D. entity has signed a binding contract.

Question was not answered

Correct Answer Explanation:

Revenue should be recognized in the accounting period in which the performance obligation is satisfied and in an amount that reflects the consideration the entity expects to be entitled to receive under the contract.

The contract must be valid, meaning it creates enforceable rights and obligations and meets the following criteria: (1) the parties have approved the contract and are committed to perform their obligations under the contract; (2) the rights of each party can be identified; (3) the payment terms can be identified; (4) the contract has commercial substance; and (5) it is probable that the company will be able to collect substantially all of the consideration it is entitled to receive for the goods or services that will be transferred to the customer.

A performance obligation is satisfied when the customer obtains control of the asset, which is the good or service that is transferred to the customer.

The company must assess the collectibility of the contract, including an assessment of the customer's credit risk. Based on that assessment, the company must conclude that it is probable (meaning “likely to occur,” which generally means there is a 75% to 80% probability of occurrence) that the company will be able to collect substantially all of the consideration it is entitled to receive for the goods or services that will be transferred to the customer under the contract.

Explanation for Choice B:

The collection of the cash is not required for the recognition of revenue. Furthermore, the collection of cash does not, by itself, imply that revenue can be recognized. If the company has received a portion of the consideration due from the customer but the contract does not qualify as a valid contract under the requirements of ASC 606, any consideration received should be accounted for as a contract liability.

Explanation for Choice C:

By itself, satisfaction of the performance obligation is not sufficient for revenue to be recognized. Revenue is recognized when the performance obligation is satisfied by tranferring goods or services to the customer in an amount that reflects the consideration the company expects to be entitled to receive in exchange for those goods or services.

Before revenue can be recognized, the company must also assess the collectibility of the contract, including an assessment of the customer's credit risk. Based on that assessment, the company must conclude that it is probable (meaning "likely to occur," which generally means there is a 75% to 80% probability of occurrence) that the company will be able to collect substantially all of the consideration that it is entitled to receive for the goods or services transferred to the customer under the contract.

Explanation for Choice D:

A contract is an agreement between two or more parties that creates enforceable rights and obligations. While an approved contract is required before revenue can be recognized, the contract need not be in writing or signed. The approval may be oral, in writing, or simply implied by the entity's customary business practices.

256. Question ID: CMA 0691 P2 Q14 (Topic: Revenue Recognition)
On September 1, 20X4, Beach Construction Company entered into a $10 million contract with City University to build a five-story parking garage. On that date, Beach's estimated total cost of constructing the building was $8 million. The estimated completion date for the garage was August 20X6. Beach's fiscal year ends May 31. Because Beach's performance creates an asset that City University controls as the work is being done, Beach accounts for the contract over time. Beach uses the cost-to-cost method to determine the percentage of the performance obligation in the contract that has been satisfied. Data regarding the contract are as follows.

At May 31 (in thousands of dollars)

	20X5	**20X6**
Actual costs incurred to date	$2,000	$6,750
Estimated costs to complete	6,000	2,250
Progress billings to date	1,800	6,000
Cash collected to date	1,450	5,500

The current assets reported on Beach Construction Company's May 31, 20X6 statement of financial position as a result of this contract would be

- A. Accounts receivable of $6,000,000 and contract asset of $6,750,000.
- B. Accounts receivable of $500,000 and contract asset of $1,500,000.correct
- C. Accounts receivable of $6,000,000 and contract asset of $1,500,000.
- D. Accounts receivable of $500,000 and contract asset of $6,750,000.

Question was not answered

Correct Answer Explanation:

When the customer is invoiced for progress payments, the amount invoiced is debited to Accounts Receivable and credited to Billings on Construction in Process, a contract liability account.

Beach's Accounts Receivable balance related to the City University contract is **$500,000** on May 31, 20X6, the difference between the invoices issued through May 31, 20X6 ($6,000,000) and the cash collected through the same date ($5,500,000).

The net amount that should be reported as a contract asset is the difference between the balance in the CIP (the contract asset) account and the Billings on Construction in Process (the contract liability) account. The CIP account balance includes all of the costs incurred to date through May 31, 20X6 ($6,750,000) plus the gross profit that has been recognized through that date.

The amount of gross profit that has been recognized to date through May 31, 20X6 is the total estimated gross profit at May 31, 20X6 multiplied by the percentage of the performance obligation in the contract satisfied at that date. The estimated gross profit at May 31, 20X6 is calculated by subtracting from the contract price ($10,000,000) the actual costs incurred to date as of that date ($6,750,000) and the estimated costs to complete the contract as of that date ($2,250,000). $10,000,000 − $6,750,000 − $2,250,000 = $1,000,000. The estimated gross profit is $1,000,000. The percentage satisfied is the actual costs incurred to date divided by the estimated total costs. The estimated total costs are $6,750,000 in costs incurred to date as of May 31, 20X6 plus $2,250,000 estimated costs to complete, or $9,000,000. $6,750,000 ÷ $9,000,000 = 0.75, so the performance obligation in the contract is 75% satisfied. Since the estimated gross profit at May 31, 20X6 is $1,000,000, the total gross profit recognized to date through May 31, 20X6 should be 75% of that, or $750,000.

Therefore, the balance in the Construction in Process (contract asset) account should be $6,750,000 + $750,000, or $7,500,000.

The progress billings to date have been credited to Billings on Construction in Process, the contract liability account. The progress billings to date through May 31, 20X6 are $6,000,000.

Since the balance in the CIP contract asset account ($7,500,000) is greater than the balance in the BCP contract liability account ($6,000,000), the contract will be reported on the balance sheet as a contract asset at its net amount: $7,500,000 − $6,000,000, or **$1,500,000**.

Explanation for Choice A:

The accounts receivable amount in this answer is the total of progress billings to date through May 31, 20X6, but it has not been adjusted (rduced) for the collections that have occurred. The contract asset figure in this answer is simply the costs incurred to date. This cost amount needs to be adjusted for the gross profit recognized to date and the invoices that have been issued. See the correct answer for a complete explanation.

Explanation for Choice C:

The accounts receivable amount in this answer is the total of progress billings to date through May 31, 20X6, but it has not been adjusted (rduced) for the collections that have occurred. See the correct answer for a complete explanation.

Explanation for Choice D:

The contract asset figure in this answer is simply the costs incurred to date as of May 31, 20X6. This amount needs to be adjusted for the gross profit recognized to date and the invoices that have been issued. See the correct answer for a complete explanation.

257. Question ID: HOCK RR606.03 (Topic: Revenue Recognition)

Stander Construction Company signed a contract with the state of Ohio to build a short stretch of highway for $42 million. During 20X1, $8 million was spent and company officials anticipated that another $24 million would be needed to complete the work. During 20X2, another $13 million was spent and current information indicated that another $14 million would be required to finish the project. The contract contained a clause indicating that the state of Ohio owns the work-in-process as the highway is being constructed.

Using the cost-to-cost input method to calculate Stander's progress toward satisfaction of the performance obligation, what amount of profit should the company recognize in 20X2?

- A. $2,600,000.
- B. Zero.
- C. $1,700,000.correct
- D. $4,200,000.

Question was not answered

Correct Answer Explanation:

Because the state of Ohio controls the work-in-process as the work is being done, the contract is accounted for over time.

In 20X1, Stander spent $8 million out of an estimated total of $32 million ($8 million spent and $24 million expected) so that the performance obligation was 25 percent satisfied. The anticipated profit was $10 million ($42 million contract price – $32 million estimated cost) so that a profit of $2.5 million was recognized (25 percent of $10 million) in 20X1.

By the end of 20X2, Stander had spent a total of $21 million ($8 million in 20X1 and $13 million in 20X2). Because $14 million more in costs was expected, the total estimated cost was $35 million ($21 million + $14 million) and the estimated profit had fallen to $7 million ($42 million – $35 million). The performance obligation was 60 percent satisfied ($21 million divided by $35 million) so profit to date of $4.2 million needed to be recognized (60 percent of the $7 million total) through 20X2.

The company had recognized $2.5 million in 20X1, so another $1.7 million should be recognized in 20X2 ($4.2 million less $2.5 million).

Explanation for Choice A:

This answer results from using the total estimated cost and total estimated profit as of the end of 20X2 as the total estimated cost and profit at the end of 20X1, as well.

Explanation for Choice B:

If the contract were being accounted for at a point in time, the profit recognized during 20X2 would be zero. However, because the state of Ohio controls the work-in-process as the work is being done, the contract is accounted for over time. Thus, some profit is recognized during each year of the contract.

Explanation for Choice D:

This is the profit to be recognized to date on the contract through the end of 20X2. It is not the amount of profit to be recognized for the year 20X2.

258. Question ID: CIA 0590 P4 Q26 (Topic: Revenue Recognition)
The ABC Company operates a catering service that specializes in business luncheons for large corporations. ABC requires customers to place their orders 2 weeks in advance of the scheduled

events. ABC bills its customers on the tenth day of the month following the date of service and requires that payment be made within 30 days of the billing date. Conceptually, ABC should recognize revenue from its catering services at the date when a

- A. Customer's payment is received.
- B. Customer places an order.
- C. Luncheon is served.correct
- D. Billing is mailed.

Question was not answered

Correct Answer Explanation:

Under ASC 606, revenue should be recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration the company expects to be entitled to in exchange for those goods and services. Revenue is recognized when the performance obligation is satisfied. Therefore, the revenue should be recognized when the luncheon is served.

Explanation for Choice A:

Revenue should not be recognized when payment is received. Under ASC 606, revenue should be recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration the company expects to be entitled to in exchange for those goods and services. Revenue is recognized when the performance obligation is satisfied.

Explanation for Choice B:

Revenue should not be recognized when the customer places the order. Under ASC 606, revenue should be recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration the company expects to be entitled to in exchange for those goods and services. Revenue is recognized when the performance obligation is satisfied.

Explanation for Choice D:

Revenue should not be recognized when the invoice is mailed. Under ASC 606, revenue should be recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration the company expects to be entitled to in exchange for those goods and services. Revenue is recognized when the performance obligation is satisfied.

259. Question ID: CIA 1196 P4 Q11 (Topic: Revenue Recognition)
A company began work on a long-term construction contract in 20X1. The contract price was $3,000,000. Year-end information related to the contract is as follows:

	20X1	20X2	20X3
Estimated total cost	$2,000,000	$2,000,000	$2,000,000
Cost incurred	700,000	900,000	400,000
Billings	800,000	1,200,000	1,000,000
Collections	600,000	1,200,000	1,200,000

If the company recognizes the revenue for this contract over time using the cost-to-cost method, the gross profit to be recognized in 20X1 is:

- A. $350,000correct
- B. $200,000
- C. ($100,000)
- D. $100,000

Question was not answered

Correct Answer Explanation:

The amount of gross profit to be recognized for the year 20X1 is calculated as follows: [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

The estimated gross profit is calculated by subtracting from the contract price ($3,000,000) the estimated total cost as of that date ($2,000,000). $3,000,000 − $2,000,000 = $1,000,000. The estimated gross profit is $1,000,000.

Note that in this question, the estimated total cost for the contract is given. In another, different, question, it might be necessary to calculate the estimated total cost by summing the actual cost incurred to date and the estimated remaining cost that will be required to completely satisfy the contract at that point.

The calculation of the percentage satisfied is done by dividing the actual costs incurred to date as of 20X1 on the contract ($700,000) by the total estimated costs for the project ($2,000,000) as of 20X1. $700,000 ÷ $2,000,000 = 0.35. Thus, as of 20X1 the performance obligation in the contract is **35% satisfied**.

Therefore, the company should have recognized in total $350,000 in gross profit by the end of 20X1 (35% of the $1,000,000 estimated gross profit on the contract). Since 20X1 is the first year of the contract, there is no previously recognized profit to subtract, so the amount of gross profit to recognize in 20X1 is $350,000.

Explanation for Choice B:

This is the difference between the billings and the collections in 20X1. This is not the way to calculate the gross profit to be recognized in 20X1. The amount of gross profit to be recognized for the year 20X1 is calculated as [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

Explanation for Choice C:

This is the collections for 20X1 minus the cost incurred in 20X1. This is not the way to calculate the gross profit to be recognized in 20X1. The amount of gross profit to be recognized for the year 20X1 is calculated as [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

Explanation for Choice D:

This is the 20X1 billings minus the cost incurred in 20X1. This is not the way to calculate the gross profit to be recognized in 20X1. The amount of gross profit to be recognized for the year 20X1 is calculated as [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

260. Question ID: CMA 1292 P2 Q15 (Topic: Revenue Recognition)
Allan Construction signed a $48,000,000 contract on September 1, 20X4 with the City of Springfield to construct a tunnel under the Maple River. On that date, the estimated cost to complete the tunnel, which was to be completed by June 20X7, was $36,000,000. Allan's fiscal year ends November 30, and the company recognized revenue on this contract over time using the cost-to-cost method.

Data regarding the tunnel contract, which was begun December 1, 20X4, are as follows.

At November 30 (in thousands)

	20X5	20X6
Actual costs to date	$12,000	$30,000
Estimated costs to complete	24,000	10,000
Progress billings to date	10,000	28,000
Cash collected to date	8,000	24,000

The gross profit or loss recognized in the fiscal year ended November 30, 20X6 from the tunnel contract is:

- A. $6,000,000 gross profit.
- B. $4,000,000 gross loss.
- C. $8,000,000 gross profit.
- D. $2,000,000 gross profit.correct

Question was not answered

Correct Answer Explanation:

The amount of gross profit to be recognized for the year ended November 30, 20X6 is calculated as follows: [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

The estimated gross profit is calculated by subtracting from the contract price ($48,000,000) the actual costs incurred to date as of fiscal year-end 20X6 ($30,000,000) and the estimated costs to complete the project as of that date ($10,000,000). $48,000,000 − $30,000,000 − $10,000,000 = $8,000,000. The estimated gross profit is $8,000,000.

The calculation of the percentage satisfied is done by dividing the actual costs incurred to date as of November 30, 20X6 ($30,000,000) by the total estimated costs for the project ($30,000,000 + $10,000,000, or $40,000,000). $30,000,000 ÷ $40,000,000 = 0.75. Thus, at November 30, 20X6, the performance obligation in the contract is **75% satisfied**.

Therefore, Allan should have recognized in total $6,000,000 in gross profit by November 30, 20X6 (75% of the $8,000,000 estimated gross profit on the contract). However, some of that profit was recognized in 20X5, so that profit recognized in 20X5 needs to be subtracted from $6,000,000 to determine the profit that needs to be recognized at November 30, 20X6.

The gross profit recognized in 20X5 is calculated in the same manner as we calculated it for 20X6: by subtracting from the contract price ($48,000,000) the actual costs incurred to date as of November 30, 20X5 ($12,000,000) and the estimated cost to complete as of that date ($24,000,000) $48,000,000 − $12,000,000 − $24,000,000 = $12,000,000. The estimated gross profit is $12,000,000. The percentage satisfied as of November 30, 20X5 was the actual costs incurred to date as of November 30, 20X5 ($12,000,000) divided by the total estimated costs for the project as of that date ($12,000,000 + $24,000,000, or $36,000,000). $12,000,000 ÷ $36,000,000 = 0.333, so at the end of 20X5, the performance obligation in the contract was 1/3 satisfied. Therefore, Allan had recognized $4,000,000 of gross profit by the end of 20X5 (1/3 of the $12,000,000 estimated gross profit on the contract as of that date).

Since gross profit to recognize to date as of November 30, 20X6 is $6,000,000 and Allan had recognized $4,000,000 of it in 20X5, only $2,000,000 of gross profit is to be recognized in 20X6.

Explanation for Choice A:

This is the total gross profit that needs to be recognized **through** 20X6, in other words, in both 20X5 and 20X6. However, some of that $6,000,000 gross profit was recognized during the year ended November 30, 20X5 and therefore, not all of it is recognized in 20X6.

Explanation for Choice B:

This answer results from summing the actual costs to date for 20X5 and 20X6 along with the estimated costs to complete as of 20X6 and subtracting their total from the contract amount. The costs on the Actual Costs to Date line are costs **to date**, not costs for each individual year. Thus the $12,000,000 in costs incurred to date through the end of 20X5 are included in the $30,000,000 costs incurred to date through the end of 20X6. Summing the two amounts results in double counting the $12,000,000 costs incurred to date through 20X5. When that amount is not double counted, there is a gross profit on the contract, not a gross loss.

See the correct answer for a complete explanation.

Explanation for Choice C:

This is the total estimated gross profit from the project as of November 30, 20X6. However, not all of this gross profit is recognized in the year ended November 30, 20X6. See the correct answer for a complete explanation.

261. Question ID: CMA 0696 P2 Q19 (Topic: Revenue Recognition)
On May 28, Markal Company purchased a tooling machine from Arens and Associates for $1,000,000, payable as follows: 50 percent at the transaction closing date and 50 percent due June 28. The cost of the machine to Arens is $800,000. Markal paid Arens $500,000 at the transaction closing date and took possession of the machine. On June 10, Arens determined that a change in the business environment has created a great deal of uncertainty regarding the collection of the balance due from Markal, and the amount is probably uncollectible. Arens and Markal have a fiscal year end of May 31.

The revenue recognized by Arens and Associates on May 28 is

- A. $800,000
- B. $0
- C. $200,000
- D. $1,000,000correct

Question was not answered

Correct Answer Explanation:

On the date of the sale (May 28), Markal obtained control of the tooling machine, so Arens' performance obligation with respect to the sales contract was satisfied. At that time, Arens expected the consideration it would be entitled to in exchange for the machine to be $1,000,000, as there was no indication that the receivable would not be collectible. Therefore, on May 28, the entire $1,000,000 selling price is recognized as revenue.

Explanation for Choice A:

This is the cost of goods sold under the sales contract, not the revenue recognized.

Explanation for Choice B:

On the date of the sale (May 28), Markal obtained control of the tooling machine, so Arens' performance obligation with respect to the sales contract was satisfied. At that time, Arens expected the consideration it would be entitled to in exchange for the machine to be the full selling price, as there was no indication that the receivable would not be collectible.

Explanation for Choice C:

This is the gross profit on the sales contract, not the revenue that was recognized.

262. Question ID: CMA 0695 P2 Q14 (Topic: Revenue Recognition)
After a successful promotion aimed at members of a specific national association, Gorham Publishing Company received a total of $90,000 for three-year subscriptions to a monthly publication beginning April 1, 20X5 and properly recorded this consideration received in the contract liabilities account. Assuming Gorham records adjustments only at the end of the calendar year, the adjusting entry required to reflect the proper balances in the accounts at December 31, 20X5, would be to:

- A. Debit subscription revenue for $67,500 and credit contract liabilities for $67,500.
- B. Debit contract liabilities for $22,500 and credit subscription revenue for $22,500.correct
- C. Debit contract liabilities for $67,500 and credit subscription revenue for $67,500.
- D. Debit contract liabilities for $30,000 and credit subscription revenue for $30,000.

Question was not answered

Correct Answer Explanation:

When the subscriptions were recorded the journal entry was a debit to cash for $90,000 and a credit to contract liabilities for $90,000. At the end of 20X5, Gorham needs to recognize revenue for the portion of the performance obligation that has been satisfied. Since there are 36 months in the subscription period and nine months have passed, Gorham should recognize 25% of the consideration received as revenue. This is done by debiting contract liabilities for $22,500 ($90,000 × 0.25) and crediting subscription revenue for $22,500.

Note: The correct amount can also be calculated by dividing $90,000 by 36 to find the amount of consideration received to be recognized as revenue each month and multiplying the monthly revenue by nine months. $90,000 ÷ 36 × 9 = $22,500.

Explanation for Choice A:

This would be the answer if the initial entry had been to credit revenue and not to credit contract liabilities. However, in the question we are told that the initial entry was a credit to contract liabilities. See the correct answer for a complete explanation.

Explanation for Choice C:

This answer assumes 75% of the subscription period has passed instead of 25%. See the correct answer for a complete explanation.

Explanation for Choice D:

This answer assumes that 1/3 of the subscription period has passed. Since the subscriptions started April 1, only 9 months have passed, and that is 1/4 of the subscription period (9 months ÷ 36 months). See the correct answer for a complete explanation.

263. Question ID: CIA 1195 P4 Q27 (Topic: Revenue Recognition)

The practice of recording consideration received from a customer before the performance obligation in the contract has been satisfied as a contract liability is an example of applying the

- A. Revenue recognition principle.correct
- B. Monetary-unit assumption.
- C. Going-concern assumption.
- D. Historic cost principle.

Question was not answered

Correct Answer Explanation:

According to ASC 606, *Revenue Recognition*, when the seller receives consideration from a customer before transferring to the customer control of the goods or services represented by the payment, the seller has not yet satisfied the performance obligations in the contract and therefore cannot recognize revenue. Instead, the receipt represents the seller's obligation to satisfy the performance obligations in the contract and so is recorded as a contract liability.

Explanation for Choice B:

The monetary-unit assumption is the assumption that the financial statements are presented in a monetary unit. This is not relevant to the issue of consideration received from a customer before the performance obligation in the contract has been satisfied.

Explanation for Choice C:

The going concern assumption is the assumption that the business will continue operating for the foreseeable future. This is not relevant to the issue of consideration received from a customer before the performance obligation in the contract has been satisfied.

Explanation for Choice D:

The historical cost principle is the principle that assets are recorded at the amount that was paid to acquire them. This is not relevant to the issue of consideration received from a customer before the performance obligation in the contract has been satisfied.

264. Question ID: CMA 1292 P2 Q16 (Topic: Revenue Recognition)
Allan Construction signed a $48,000,000 contract on September 1, 20X4 with the City of Springfield to construct a tunnel under the Maple River. On that date, the estimated cost to complete the tunnel, which was to be completed by June 20X7, was $36,000,000. Allan's fiscal year ends November 30, and the company recognized revenue on this contract over time using the cost-to-cost method.

Data regarding the tunnel contract, which was begun December 1, 20X4, are as follows.

At November 30 (in thousands)

	20X5	**20X6**
Actual costs to date	$12,000	$30,000
Estimated costs to complete	24,000	10,000
Progress billings to date	10,000	28,000
Cash collected to date	8,000	24,000

Assume that the estimated costs to complete at November 30, 20X6 were $20 million rather than the $10 million shown in the given schedule. The gross loss recognized on the contract from its inception through November 30, 20X6 is

- A. $7,500,000.
- B. $2,000,000.correct
- C. $1,200,000.
- D. $8,000,000.

Question was not answered

Correct Answer Explanation:

The actual costs incurred to date as of November 30, 20X6 were $30,000,000. If the estimated costs to complete at the end of 20X6 were $20,000,000, the anticipated total cost for the project would be $30,000,000 + $20,000,000, or $50,000,000 at that date.

Since revenue from the contract will be only $48,000,000, the entire project would have an estimated loss of $2,000,000. Estimated losses always need to be recognized in full in the period in which they arise, so by the end of 20X6, Allan would need to have recognized a $2,000,000 loss on the contract from its inception through November 30, 20X6.

Explanation for Choice A:

This is not the correct answer. Please see the correct answer for an explanation.

We have been unable to determine how to calculate this incorrect answer choice. If you have calculated it, please let us know how you did it so we can create a full explanation of why this answer choice is incorrect. Please send us an email at support@hockinternational.com. Include the full Question ID number and the actual incorrect answer choice -- not its letter, because that can change with every study session created. The Question ID number appears at the top of the question. Thank you in advance for helping us to make your HOCK study materials better.

Explanation for Choice C:

This is the loss that would be recognized if the loss were recognized based on the percentage of the contract that has been satisfied. However, estimated losses are always recognized in full in the period in which they arise. See the correct answer for a complete explanation.

Explanation for Choice D:

An answer of an $8,000,000 loss results from two errors in reading the question:

1. The question asks for the gross loss on the contract **from its inception through November 30, 20X6**, in other words, for both years. The question does not ask for the gross loss recorded just for the year ended November 30, 20X6. This calculation is for the year ended November 30, 20X6.

2. The question says to assume the 20X6 estimated costs to complete were $20,000,000 instead of $10,000,000. An answer of an $8,000,000 loss for 20X6 results from assuming that gross profit of $4,000,000 for the year ended November 30, 20X5 had been recorded and gross profit of $2,000,000 for the year ended November 30, 20X6 had been recorded using the $10,000,000 estimated costs to complete, and **then** the estimated costs to complete as of the same date had been changed and a loss had been recorded for the same period. If that were the case, the **second** transaction dated November 30, 20X6 **would** be an $8,000,000 loss, to reverse the $6,000,000 recorded previously during the two years and recognize the expected $2,000,000 loss on the contract. However, since the question says to assume that the expected costs for complete

as of November 30, 20X6 were $20,000,000 instead of $10,000,000, that change was made **before** any profit or loss on the contract was recorded for 20X6. Therefore, the loss recorded for 20X6 would have been not $8,000,000 but $6,000,000: the total expected loss on the contract of $2,000,000 ($48,000,000 − $50,000,000) plus the reversal of the $4,000,000 profit recorded in 20X5.

The correct answer to this question is the contract price ($48,000,000) less the expected total cost on the contract as of November 30, 20X6 using $20,000,000 as the expected costs to complete as of that date and total estimated costs for the contract of $50,000,000.

265. Question ID: CMA 1288 P4 Q24 (Topic: Revenue Recognition)
When the right of return exists, the contract consideration is

- A. reported as a contract liability.
- B. variable consideration and the contract price excludes the consideration for products expected to be returned or amounts expected to be refunded.correct
- C. provisional and revenue cannot be recognized until the return privilege period has expired.
- D. the amount the seller expects to be entitled to receive.

Question was not answered

Correct Answer Explanation:

When the right of return exists, the contract consideration is **variable**. The contract's transaction price should exclude consideration related to products expected to be returned or amounts expected to be refunded. The seller should recognize revenue at the amount it expects to be entitled to receive, which is the revenue only for goods or services **not** expected to be returned or refunded.

Explanation for Choice A:

Contract consideration when the right of return exists is not reported as a contract liability.

Explanation for Choice C:

"Provisional" is not used to refer to contract consideration when the right of return exists, and the seller does not wait to recognize revenue until the return privilege period has expired.

Explanation for Choice D:

The amount the seller expects to be entitled to receive is the amount of revenue the seller recognizes from the contract when the right of return exists. The revenue recognized is not the same as the contract consideration.

266. Question ID: HI-RR0718-01 (Topic: Revenue Recognition)
A conditional contract asset is

- A. a right to receive consideration because the company has partially satisfied the performance obligations in the contract but it must satisfy another performance obligation or obligations before it can invoice the customer.correct
- B. cash consideration received by the seller before any performance obligations in the contract have been satisfied.
- C. revenue recognized when the right of return exists.
- D. a receivable that management believes may be uncollectible.

Question was not answered

Correct Answer Explanation:

A conditional contract asset is a conditional right to receive consideration because the company has satisfied one of, or some of, the performance obligations in the contract and thus recognizes revenue for the performance obligations that are satisfied, but it must satisfy another performance obligation or obligations before it can invoice the customer. Conditional rights to receive consideration should be reported on the balance sheet as contract assets.

Explanation for Choice B:

Cash consideration received by the seller before any performance obligations in the contract have been satisfied is a contract liability.

Explanation for Choice C:

When the right of return exists, the contract consideration is variable consideration.

Explanation for Choice D:

A conditional contract asset is not a receivable that management believes may be uncollectible. It is not a receivable at all because it does not represent an invoice that has been issued to a customer.

267. Question ID: CIA 0593 P4 Q27 (Topic: Revenue Recognition)
An airline should recognize revenue from an airline ticket in the period in which

- A. Passenger reservations are confirmed.
- B. The related flight takes place.correct
- C. Passenger reservations are booked.
- D. The ticket is issued.

Question was not answered

Correct Answer Explanation:

Under ASC 606, revenue should be recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration the company expects to be entitled to in exchange for those goods and services. Revenue is recognized when the performance obligation is satisfied. The performance obligation for an airline ticket is satisfied when the flight takes place, so the revenue from the airline ticket should be recognized at that time.

Explanation for Choice A:

Revenue should not be recognized when the reservations are confirmed. Under ASC 606, revenue is recognized when the performance obligation is satisfied.

Explanation for Choice C:

Revenue should not be recognized when the reservations are booked. Under ASC 606, revenue is recognized when the performance obligation is satisfied.

Explanation for Choice D:

Revenue should not be recognized when the ticket is issued. Under ASC 606, revenue is recognized when the performance obligation is satisfied.

268. Question ID: HOCK RR606.06 (Topic: Revenue Recognition)
Heights Homes, Inc. is a builder that purchases building sites and builds homes on them for sale. Most of the homes are built to an identified buyer's specifications. However, Heights Homes owns all the properties throughout the construction period, and the buyer of a home does not obtain control of

the property until all work is complete. An identified buyer could "walk away" during the construction period, and Heights Homes could sell the home to someone else.

On January 1, Year One, Heights Homes begins work on a home for an identified buyer for which the contract price is $200,000. The company estimates the work will cost $192,000. During Year One, $36,000 is spent on the work, and the company's engineers believe that work costing $144,000 remains to be completed. During Year Two, another $90,000 is spent but because of problems with the construction, $79,000 of work is now estimated to remain.

What is the impact on net income to be recognized by Heights Homes in Year Two?

- A. $9,000 loss.
- B. Zero.
- C. $5,000 loss.correct
- D. $4,000 profit.

Question was not answered

Correct Answer Explanation:

Since Heights Homes' buyers do not obtain control of the property until construction is complete, all of Heights Homes' construction is accounted for at a point in time. When recognizing revenue and gross profit at a point in time, revenue, costs, and gross profit are not recognized on the income statement until the performance obligation has been satisfied and the customer has obtained control of the asset. However, if a loss is anticipated at any point during the contract, the estimated loss must be recognized immediately.

In Year One, $36,000 is spent with $144,000 remaining, for a total estimated cost of $180,000, so Heights Homes estimates that a profit of $20,000 will ultimately be earned. Since the gross profit is not recognized until the performance obligation has been satisfied and the customer has obtained control of the asset, however, no profit is recognized in Year One.

In Year Two, another $90,000 is spent and the estimation is that another $79,000 in costs remain to complete the home, for a total cost of $205,000. Because the contract price is only $200,000, Heights Homes now estimates that a loss of $5,000 will eventually be incurred. The entire loss must be recognized immediately.

Since the company accounts for its contracts at a point in time, no profit has been previously recognized and thus no previously-recognized profit needs to be reversed. Therefore, only the $5,000 anticipated loss on the contract is recognized in Year Two.

Explanation for Choice A:

$9,000 is the amount of loss that Heights Homes would have recognized in Year Two if it were recognizing revenue and gross profit over time.

However, because the customer has not obtained control of the asset, the contract is accounted for at a point in time, so no revenue or gross profit is recognized until the contract is complete and the customer has obtained control of the asset. Because a loss is projected on the contract as of the end of Year Two, though, the company will recognize a loss for Year Two; but because the contract is accounted for at a point in time, the amount of the loss is not $9,000.

Explanation for Choice B:

If a loss is anticipated at any point during a contract, the estimated loss must be recognized immediately. There will be an impact on net income to be recognized by Heights Homes in Year Two because the company estimates a loss on the contract as of Year Two.

Explanation for Choice D:

$4,000 profit is the amount of gross profit Heights Homes would have recognized in Year One if it were recognizing revenue and gross profit over time.

However, because the customer has not obtained control of the asset, the contract is accounted for at a point in time, so no revenue or gross profit is recognized until the contract is complete and the customer has obtained control of the asset. However, if a loss is anticipated at any point during a contract, the estimated loss must be recognized immediately.

269. Question ID: HOCK RR606.01 (Topic: Revenue Recognition)
AAA Construction Company was hired by the California state government on January 1, Year One to build a section of a new highway. The contract price was $100 million and AAA estimated that the work would cost $92 million. During Year One, $18 million was spent on the work and the company's engineers believed that work costing $72 million remained to complete the work and satisfy the performance obligation. During Year Two, another $39 million was spent and $38 million of work was estimated to remain. The contract contained a clause indicating that the state owned the work-in-process as the highway was being constructed.

Using the cost-to-cost input method to calculate progress toward satisfaction of the performance obligation, what amount of profit or loss should AAA recognize on the contract in Year Two?

- A. $3,360,000 profit.
- B. $1,000,000 profit.correct
- C. $2,000,000 profit.
- D. $4,300,000 profit.

Question was not answered

Correct Answer Explanation:

Because the state controls the work-in-process as the work is being done, the contract is accounted for over time. In Year One, $18 million was spent with $72 million remaining for a total estimated cost of $90 million at that time. Because the contract price was $100 million, the company estimated that a profit of $10 million would eventually be earned.

At the end of Year One, the performance obligation was 20% satisfied ($18 million divided by $90 million). Thus, AAA recognized a profit of $2 million (20% of $10 million) on the contract for Year One.

In Year Two, another $39 million was spent, bringing the total cost incurred to date to $57 million ($18 million plus $39 million). The company's engineers estimated at the end of Year Two that another $38 million of cost remained to satisfy the performance obligation, for a total estimated cost of $95 million ($57 million plus $38 million). The total cost estimate had changed, but that is not uncommon with estimates.

Because the contract price was $100 million and at the end of Year Two, the total estimated cost on the contract was $95 million, AAA estimated at that time that a profit of only $5 million would eventually be earned. At the end of Year Two, $57 million had been spent of the estimated total $95 million cost so that the work was 60% complete ($57 million divided by $95 million). Thus, AAA should have recognized a profit to date as of Year Two of $3 million (60% of $5 million). Because $2 million had already been recognized in Year One, another $1 million should be recognized for Year Two.

Explanation for Choice A:

This answer results from using the original total cost estimate of $92 million as the total cost estimate throughout Year One and Year Two instead of updating it to the current estimate of total costs as of the end of each year.

Explanation for Choice C:

$2 million is the profit recognized in Year One of the contract.

Explanation for Choice D:

This answer results from using the total cost estimate as of the end of Year One as the total cost estimate for Year Two, as well, instead of updating it to the current estimate of total costs as of the end of Year Two.

270. Question ID: CIA 0594 P4 Q26 (Topic: Revenue Recognition)
In accounting for long-term construction contracts, the difference between recognizing the revenue at a point in time versus recognizing the revenue over time is that

- A. It is only when revenue is recognized over time that gross profit earned to date is accumulated in the construction in process contract asset account.correct
- B. When revenue is recognized over time, all revenues and gross profit on the contract are recognized only when the performance obligations in the contract are completely satisfied.
- C. It is only when revenue is recognized at a point in time that accumulated construction costs are included in a construction in process contract asset account.
- D. It is only when the revenue is recognized over time that progress billings are accumulated in a contract liability account, billings on construction in process.

Question was not answered

Correct Answer Explanation:

When revenue is recognized over time, the gross profit that is recognized each period is added to the construction in process contract asset account. When revenue is recognized at a point in time, no gross profit is recognized until the obligations in the contract have been completely satisfied.

Explanation for Choice B:

When the revenue is recognized **at a point in time** (not over time), all revenues and gross profit on the contract are recognized when the performance obligations in the contract are completely satisfied.

Explanation for Choice C:

Accumulated construction costs are included in a construction in process contract asset account under both methods.

Explanation for Choice D:

Progress billings are accumulated in a contract liability account called billings on construction in process under both methods.

271. Question ID: CMA 1292 P2 Q17 (Topic: Revenue Recognition)

According to ASC 606, under what circumstances should a long-term contract be accounted for over time?

- A. Cash has been received from the customer.
- B. The production process can be readily divided into definite stages.
- C. The company's performance creates an asset with an alternative use to the company.
- D. The company's performance creates or enhances an asset that the customer controls as the work is being done.correct

Question was not answered

Correct Answer Explanation:

Under ASC 606, a company satisfies a performance obligation over time and recognizes the revenue and costs over time if at least **one** of the following three criteria is met:

1. The customer simultaneously receives and consumes the benefits provided by the company's performance as the company is performing its obligations under the contract.
2. The company's performance creates or enhances an asset such as work in process that the customer controls as the work is being done.
3. The company's performance **does not** create an asset with an alternative use to the company, and the company has an enforceable right to payment for performance completed to date.

Explanation for Choice A:

Though it may be that cash has been received from the customer on an individual long-term contract, that is not a criterion under ASC 606 for recognizing revenue, costs, and gross profit over time.

Explanation for Choice B:

Though it may be that production on an individual long-term contract can be divided into definite stages, that is not a criterion under ASC 606 for recognizing revenue, costs, and gross profit over time.

Explanation for Choice C:

Under ASC 606, a company satisfies a performance obligation over time and recognizes the revenue and costs over time if the company's performance **does not create an asset with an alternative use to the company**, and the company has an enforceable right to payment for performance completed to date. That is one of three criteria for recognizing revenue, costs, and gross profit over time.

The other two criteria for over-time recognition are: (1) the customer simultaneously receives and consumes the benefits provided by the company's performance as the company is performing its obligations under the contract or (2) the company's performance creates or enhances an asset such as work in process that the customer controls as the work is being done.

Only one of the three criteria needs to be met for over-time recognition to take place.

272. Question ID: HOCK RR606.05 (Topic: Revenue Recognition)
Commercial Contractors is a commercial builder that purchases building sites and builds office buildings on them for sale to investors. Most of the buildings are built to an identified investor's specifications, and the investor who buys the property then leases the offices to professionals and small businesses. However, Commercial Contractors maintains ownership of all the properties

throughout the construction period, and the investor does not obtain control of the property until all work is complete. An identified investor could "walk away" during the construction period, and Commercial Contractors could sell the building to another investor.

On January 1, Year One, Commercial Contractors begins work on an office building for an identified investor for which the contract price is $10,000,000. The company estimates the work will cost $9,200,000 and require three years to complete. During Year One, $1,800,000 is spent on the construction, and the company's engineers believe that work costing $7,200,000 remains to be completed. During Year Two, another $3,900,000 is spent and $3,800,000 of work is now estimated to remain.

What is the impact on net income to be recognized by Commercial Contractors in Year Two?

- A. $200,000.
- B. $100,000.
- C. Zero.correct
- D. $500,000.

Question was not answered

Correct Answer Explanation:

Because Commercial Contractors' buyers do not obtain control of the properties until construction is complete, all of Commercial Contractors' construction is accounted for at a point in time, that is, when the buyer obtains control of the completed structure. When recognizing revenue and gross profit at a point in time, recognition on the income statement does not take place until the performance obligation has been satisfied and the customer has obtained control of the asset, as long as a profit is anticipated ultimately. However, if a loss is anticipated at any point during the contract, the estimated loss must be recognized immediately.

No revenue and no gross profit will have been recognized in either Year One or Year Two because the building is not complete and the customer has not obtained control of the asset.

No loss needs to be recognized, either. As of the end of Year Two, total cost incurred is $5,700,000 ($1,800,000 incurred during Year One and $3,900,000 incurred during Year Two) and estimated cost remaining is $3,800,000, for a total estimated cost of $9,500,000. The contract is for $10,000,000, so Commercial Contractors is not projecting a loss on the contract.

Therefore, there is no impact on net income to be recognized by Commercial Contractors in Year Two (or in Year One, either) because the contract is accounted for at a point in time, the customer has not obtained control of the asset, and no loss is expected on the contract.

Explanation for Choice A:

$200,000 would be the amount of gross profit Commercial Contractors would have recognized in Year One if the contract were accounted for over time.

However, because the customer has not obtained control of the asset, the contract is accounted for at a point in time, so no revenue or gross profit is recognized until the contract is complete and the customer obtains control of the asset. And since no loss is expected on the contract, no loss needs to be recognized, either. Thus, there is no impact on net income to be recognized by Commercial Contractors in Year Two (or in Year One, either).

Explanation for Choice B:

$100,000 would be the amount of gross profit Commercial Contractors would have recognized in Year Two if the contract were accounted for over time.

However, because the customer has not obtained control of the asset, the contract is accounted for at a point in time, so no revenue or gross profit is recognized until the contract is complete and the customer obtains control of the asset. And since no loss is expected on the contract, no loss needs to be recognized, either. Thus, there is no impact on net income to be recognized by Commercial Contractors in Year Two (or in Year One, either).

Explanation for Choice D:

$500,000 is the projected gross profit on the contract as of the end of Year Two. However, because the customer has not obtained control of the asset, the contract is accounted for at a point in time, so no revenue or gross profit is recognized until the contract is complete and the customer obtains control of the asset. And since no loss is expected on the contract, no loss needs to be recognized, either. Thus, there is no impact on net income to be recognized by Commercial Contractors in Year Two (or in Year One, either).

273. Question ID: CMA 0691 P2 Q13 (Topic: Revenue Recognition)
On September 1, 20X4, Beach Construction Company entered into a $10 million contract with City University to build a five-story parking garage on the university's campus. On that date, Beach's estimated total cost of constructing the building was $8 million. The estimated completion date for the garage was August 20X6. Beach's fiscal year ends May 31. Because Beach's performance creates an asset that City University controls as the work is being done, Beach accounts for the contract over time. Beach uses the cost-to-cost method to determine the percentage of the performance obligation in the contract that has been satisfied. Data regarding the contract are as follows.

At May 31 (in thousands of dollars)

	20X5	20X6
Actual costs incurred to date	$2,000	$6,750
Estimated costs to complete	6,000	2,250
Progress billings to date	1,800	6,000
Cash collected to date	1,450	5,500

The gross profit recognized for the fiscal year ended May 31, 20X6 from this contract would be

- A. $1,000,000
- B. $750,000
- C. $250,000correct
- D. $500,000

Question was not answered

Correct Answer Explanation:

The amount of gross profit to be recognized for the year ended May 31, 20X6 is calculated as follows: [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

The estimated gross profit is calculated by subtracting from the contract price ($10,000,000) the actual costs incurred to date as of fiscal year-end 20X6 ($6,750,000) and the estimated costs to complete the project as of that date ($2,250,000). $10,000,000 − $6,750,000 − $2,250,000 = $1,000,000. The estimated gross profit is **$1,000,000**.

The calculation of the percentage satisfied is done by dividing the actual costs incurred to date as of May 31, 20X6 ($6,750,000) by the total estimated costs for the project ($6,750,000 + $2,250,000, or $9,000,000). $6,750,000 ÷ $9,000,000 = 0.75. Thus, at May 31, 20X6, the performance obligation in the contract is **75% satisfied**.

Therefore, Beach should have recognized in total $750,000 in gross profit by May 31, 20X6 (75% of the $1,000,000 estimated gross profit on the contract). However, some of that profit was recognized in 20X5, so that profit recognized in 20X5 needs to be subtracted from $750,000 to determine the profit that needs to be recognized at May 31, 20X6.

The gross profit recognized in 20X5 is calculated in the same manner as we calculated it for 20X6: by subtracting from the contract price ($10,000,000) the actual costs incurred to date as of May 31, 20X5 ($2,000,000) and the estimated cost to complete as of that date ($6,000,000) $10,000,000 − $2,000,000 − $6,000,000 = $2,000,000. The estimated gross profit is $2,000,000. The percentage satisfied as of May 31, 20X5 was the actual costs incurred to date as of May 31, 20X5 ($2,000,000) divided by the total estimated costs for the project as of that date ($2,000,000 + $6,000,000, or $8,000,000). $2,000,000 ÷ $8,000,000 = 0.25, so at the end of 20X5, the performance obligation in the contract was 25% satisfied. Therefore, Beach had recognized $500,000 of gross profit by the end of 20X5 (25% of the $2,000,000 estimated gross profit on the contract as of that date).

Since gross profit to recognize to date as of May 31, 20X6 is $750,000 and Beach had recognized $500,000 of it in 20X5, only $250,000 of gross profit is to be recognized in 20X6.

Explanation for Choice A:

This is the total estimated gross profit on the contract as of May 31, 20X6. The amount of gross profit to be recognized for the year ended May 31, 20X6 is calculated as [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

Explanation for Choice B:

This is the total amount of gross profit that needs to be recognized by May 31, 20X6. However, some of this gross profit was recognized at May 31, 20X5. The amount of gross profit to be recognized for the year ended May 31, 20X6 is calculated as [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

Explanation for Choice D:

This is the amount of gross profit that was recognized at May 31, 20X5. The question asks for the gross profit recognized for the fiscal year ended May 31, 20X6. The amount of gross profit to be recognized for the year ended May 31, 20X6 is calculated as [(Estimated Gross Profit × Percentage Satisfied) − Gross Profit Previously Recognized].

274. Question ID: CIA 1192 P4 Q27 (Topic: Revenue Recognition)

A company provides fertilization, insect control, and disease control services for a variety of trees, plants, and shrubs on a contract basis. For $50 per month, the company will visit the subscriber's premises and apply appropriate mixtures. If the subscriber has any problems between the regularly scheduled application dates, the company's personnel will promptly make additional service calls to correct the situation. Some subscribers elect to pay for an entire year because the company offers an annual price of $540 if paid in advance. For a subscriber who pays the annual fee in advance, the company should recognize the related revenue

- A. When the cash is collected.
- B. At the end of the fiscal year.
- C. Evenly over the year as the services are performed.correct
- D. At the end of the contract year after all of the services have been performed.

Question was not answered

Correct Answer Explanation:

This is an example of a contract where the customer simultaneously receives and consumes the benefits provided by the company's performance as the company is performing its contract obligations. Revenue should be recognized over time as the company performs its obligations. Consideration received in advance is recorded as a contract liability.

Explanation for Choice A:

The collection of cash is not the event that triggers revenue recognition. This is an example of a contract where the customer simultaneously receives and consumes the benefits provided by the company's performance as the company is performing its contract obligations. Revenue should be recognized over time as the company performs its obligations.

Explanation for Choice B:

This is an example of a contract where the customer simultaneously receives and consumes the benefits provided by the company's performance as the company is performing its contract obligations. Revenue should be recognized over time as the company performs its obligations.

Explanation for Choice D:

This is an example of a contract where the customer simultaneously receives and consumes the benefits provided by the company's performance as the company is performing its contract obligations. Revenue should be recognized over time as the company performs its obligations.

275. Question ID: HOCK RR606.02 (Topic: Revenue Recognition)
AAA Construction Company was hired by the California state government on January 1, Year One to build a section of a new highway. The contract price was $100 million and AAA estimated that the work would cost $96 million. During Year One, $18 million was spent on the work and the company's engineers believed that work costing $72 million remained to complete the work and satisfy the performance obligation. During Year Two, another $45 million was spent and $42 million of work was estimated to remain. The contract contained a clause indicating that the state owned the work-in-process as the highway was being constructed.

Using the cost-to-cost input method to calculate progress toward satisfaction of the performance obligation, what amount of profit or loss should AAA recognize on the contract in Year Two?

- A. $2,000,000 profit.
- B. $4,760,000 profit.
- C. $7,000,000 loss.correct
- D. $5,000,000 loss.

Question was not answered

Correct Answer Explanation:

Because the state controls the work-in-process as the work is being done, the contract is accounted for over time. In Year One, $18 million was spent with $72 million remaining for a total estimated cost of $90 million at that time. Because the contract price was $100 million, the company estimated that a profit of $10 million would eventually be earned.

At the end of Year One, the performance obligation was 20% satisfied ($18 million divided by $90 million). Thus, AAA recognized a profit of $2 million (20% of $10 million) in Year One.

In Year Two, another $45 million was spent, bringing the total cost incurred to date to $63 million ($18 million plus $45 million). The company'e engineers estimated at the end of Year Two that another $42 million of cost remained to satisfy the performance obligation, for a total estimated cost of $105 million ($63 million plus $42 million). Because the contract price was $100 million and at the end of Year Two, the total estimated cost on the contract was $105 million, AAA estimated at that time that a loss of $5 million would eventually be incurred.

Therefore, the entire loss must be recognized as of the end of Year Two. AAA Company had previously recognized a $2 million profit in Year One but now anticipates a $5 million loss on the contract as a whole. Changing the $2 million profit already recognized to a $5 million overall loss requires the recognition of a $7 million loss in Year Two of the contract.

Explanation for Choice A:

$2,000,000 is the profit recognized in Year One of the contract.

Explanation for Choice B:

This answer results from omitting the costs incurred during Year One from the Year Two calculations.

Explanation for Choice D:

$5,000,000 is the amount of the loss to be recognized to date, that is, through the end of Year Two of the contract. It is not the loss to be recognized in Year Two.

276. Question ID: CMA 0696 P2 Q2 (Topic: Revenue Recognition)
Diamond Clover Construction Inc. is recognizing revenue at a point in time on Job #4115, a long-term contract with a contract price of $5,000,000. In Year 1, the company began work on the job. Other data are shown below.

	Year 1	Year 2
Costs incurred during the year	$ 900,000	$2,350,000
Estimated costs to complete	2,700,000	0
Billings during the year	1,000,000	4,000,000
Collections during the year	700,000	4,300,000

The total amount to be recognized as gross profit in Year 2 using the cost-to-cost method, when the contract's performance obligations have been satisfied, is:

- A. $700,000
- B. $2,650,000
- C. $1,400,000
- D. $1,750,000correct
  Question was not answered

Correct Answer Explanation:

When revenue is recognized at a point in time, no revenue, expense, or gross profit is recognized until the performance obligations under the contract have been satisfied. In the year the performance obligations are satisfied, the entire amount of revenue, expenses, and gross profit are recognized.

The gross profit is calculated as the contract price ($5,000,000) minus the total costs incurred to satisfy the performance obligations in the contract ($900,000 + $2,350,000). So, the total gross profit recognized in Year 2 was $1,750,000.

Explanation for Choice A:

$700,000 may have been calculated as the contract price ($5,000,000) minus the collections during Year 2 ($4,300,000). It is also the collections during Year 1. However, it is not the gross profit to be recognized in Year 2 when the contract's performnce obligations have been satisfied.

The gross profit recognized in Year 2 is the contract price minus the total costs incurred to satisfy the performance obligations in the contract.

Explanation for Choice B:

This is the contract price minus the costs incurred during Year 2. The calculation of the gross profit on the contract also needs to include the $900,000 of costs incurred during Year 1.

When revenue is recognized at a point in time, no revenue, expense, or gross profit is recognized until the performance obligations under the contract have been satisfied. In the year the performance obligations are satisfied, the entire amount of revenue, expenses, and gross profit are recognized.

The gross profit is calculated as the contract price minus the total costs incurred to satisfy the performance obligations in the contract.

Explanation for Choice C:

This is the estimated gross profit at the end of year 1. When revenue is recognized at a point in time, no revenue, expense, or gross profit is recognized until the performance obligations under the contract have been satisfied. In the year the performance obligations are satisfied, the entire amount of revenue, expenses, and gross profit are recognized.

The gross profit is calculated as the contract price minus the total costs incurred to satisfy the performance obligations in the contract.