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1. **MCQ-14828**

A nongovernmental not-for-profit organization may report on which of the following basis and remain in compliance with generally accepted accounting principles (GAAP)?

1. Cash
2. Accrual
3. Modified cash
4. Modified accrual

**ANSWER:**

Choice "B" is correct. According to Generally accepted accounting principle, the not-for-profit organizations are required to use accrual basis of accounting.

Choice "A" is incorrect. Cash basis of accounting only presents the activity of the organization based solely on cash receipts and disbursements. The cash basis is not GAAP for not-for-profit reporting.

Choice "C" and “D” are incorrect. Modified cash basis of accounting and modified accrual basis combines elements of cash basis and accrual accounting. Certain transactions are reported on an accrual basis and others on a cash basis. Both methods are not GAAP for not-for-profit reporting.

1. **MCQ-14829**

LLA Inc. was capitalized through the issuance of 10,000 shares of $30 par common stock that was sold at $50 per share. LLA had net income as follows:

|  |  |  |
| --- | --- | --- |
| Year 1 $100,000  Year 2 200,000 | | |
| If, during Year 2. LLA paid dividends to its shareholders at $25 per share, what amount was LLA's | | |
| retained earnings balance and shareholders' equity balance at the end of Year 2? | | |
|  | *Retained earnings* | *Shareholders' equity* |
| A. | $50,000 | $550,000 |
| B. | $50,000 | $800,000 |
| C. | S300.000 | $550,000 |
| D. | S300.000 | $800,000 |

**ANSWER:**

Choice "A" is correct. One approach to calculate shareholder’s equity is show as following equation:

Shareholder’s equity= Capital stocks + Additional paid in capital + Retained earnings – Treasury stock + Accumulated Other Comprehensive Income

Retained earnings at end of Year 2= Year 1 net income + Year 2 net income-dividends= $100,000+$200,000-$25 x10,000 shares= $50,000

Shareholder’s equity= Capital stocks 10,000 shares x $30 + Additional paid in capital 10,000 shares x ($50-$30) + Retained earnings $50,000– Treasury stocks (irrelevant to this question) + Accumulated Other Comprehensive Income (irrelevant to this question) =$550,000

According to above calculation, at end of Year 2, LLA’s retained earnings and shareholder’s equity equal to $50,000 and $550,000 respectively.

1. **MCQ-14830**

A statement of activities prepared by a nongovernmental not-for-profit organization is most similar to which of the following financial statements prepared by a for-profit entity?

1. Income statement
2. Balance sheet
3. Statement of cash flows
4. Statement of changes in stockholders' equity

**ANSWER:**

Choice "A" is correct. A statement of activity is equivalent to a Commercial Income Statement and Statement of Changes in Retained Earnings of a for-profit entity.

Choice "B" is incorrect. The Balance Sheet of a for-profit entity is equivalent to a statement of Financial Position for a not-for-profit organization rather than Statement of Activities.

Choice “C" is incorrect. The Statement of Cash Flows of a for-profit entity is equivalent to a statement of Cash Flows for a not-for-profit organization rather than Statement of Activities.

Choice "D" is incorrect. Not- for-profit organizations do not have an equivalent to a statement of changes in stockholders' equity. The balance sheet of a for-profit entity is equivalent to a statement of Financial Position for a not-for-profit organization rather than statement of activities.

1. **MCQ-14832**

Alpha Co. has $100 billion in assets, $100 billion in revenues, and $10 billion in profits for the current year. There are four operating segments that report directly to the chief operating officer. Which of the following segments is required to present key disclosures?

|  |  |  |  |
| --- | --- | --- | --- |
| *Segment* | *Assets (in billions)* | *Revenues (in billions)* | *Profits (in billions)* |
| 1 | $40 | S70 | $10.5 |
| 2 | 30 | 16 | 0.5 |
| 3 | 21 | 9 | (1.5) |
| 4 | 9 | 5 | 0.5 |

1. Segment 1
2. Segments 1 and 2
3. Segments 1,2, and 3
4. Segments 1,2, 3, and 4

**ANSWER:**

Choice "C" is correct. When a segment meets 10% “size” test, a segment is significant and therefore a disclosure is required. The size test is satisfied when any of following criteria is met:

1. Revenue: the segment’s internal and external revenue is 10% or more of the combined revenue (internal and external) of all reporting segments.
2. Assets: the segment’s asset is 10% or more of the combined assets of all reporting segments.
3. Profit and loss: The absolute value of the segment's reported profit or loss is 10 percent or more of the greater (absolute amount) of the combined profit of all segments that did not report a loss and the combined reported loss of all segments that did report a loss.

Since segment 1,2 and 3 have met the 10% assets test, segments 1, 2, and 3 are required to present a disclosure.

**5.MCQ-14833**

A company reports on the cash basis. During the company's first year of business, it had sales on account of $1,000,000, inventory purchases on account of $400,000, and other expenses of $200,000. At the end of the year, the company had accounts receivable, inventory, and inventory-related accounts payable of $100,000, $10,000, and $50,000, respectively. What is the company's cash basis income for its first year of operations?

1. $300,000
2. $350,000
3. $400,000
4. $450,000

**ANSWER:**

Choice "B" is correct. Under cash basis income, the net income only provides information about the sources of cash and the uses of cash. During the year, the net sale is $1,000,000 and there is a $100,000 account receivable balance, therefore, the cash inflow is $900,000. The company purchased $400,000 inventory and there is $50,000 balance of inventory-related account payable, therefore there is a $350,000 cash outflow. Besides, the company also incurred $200,000 other expenses, there are cash outflows. The net cash basis income, thereby, equals to $350,000($900,000 - $350,000 - $200,000)

**6.MCQ-14834**

A company uses a periodic inventory system and has its cost of ending inventory understated by $4,000. Which of the following describes the effects of this error on the company's current year's cost of goods sold and net income, respectively?

|  |  |  |
| --- | --- | --- |
|  | *Cost of goods sold* | *Net income* |
| A. | Understated | Understated |
| B. | Understated | Overstated |
| C. | Overstated | Understated |
| D. | Overstated | Overstated |

**ANSWER:**

Choice "C" is correct. Under a periodic inventory system, businesses physically count their products at the end of the period and use the information to balance their general ledger. The cost of goods sold equals to the difference between beginning inventory plus purchases less ending inventory.

Cost of goods sold (COGS)↑ = Beginning inventory + Purchases - Ending inventory ↓

According to above equation, when ending inventory is understated by $4,000, the COGS is overstated by $4,000, leading to understatement of net income.

1. **MCQ-14835**

On January 1, Lyle Co. purchased a manufacturing facility. After remodeling was completed, the facility was ready for use on March 1. On April 1, production began. Interest costs were incurred as follows:

|  |  |  |
| --- | --- | --- |
|  | *January 1* to *March 1* | *March 1* to *April 1* |
| Building | $10,000 | $5,000 |
| Remodeling | 2,000 | 3,000 |

What amount of interest should Lyle capitalize during the current year?

1. $10.000
2. $12,000
3. $15,000
4. $20,000

**ANSWER:**

Choice "B" is correct. According to GAAP, the capitalization period shall begin when the following three conditions are present:

a. Expenditures for the asset have been made.

b. Activities that are necessary to get the asset ready for its intended use are in progress.

c. Interest cost is being incurred.

Interest capitalization shall continue as long as those three conditions are present and end when property is ready for the intended use. In this case, the expenditures start from January 1 and the facility is ready for use on March 1. The capitalization period shall start from Jan. 1 to March 1. Both building related interest and remolding related interest should be capitalized. Total amount of capitalized interest should be $12,000 (10,000+2,000).

1. **MCQ-14836**

The equity method would be used if a company owned what percentage of its investee company's stock?

1. 5%
2. 15%
3. 25%
4. 75%

**ANSWER:**

Choice "C" is correct. The equity method is applied when a company's ownership interest in another company is valued at 20–50% (generally investor company can exercise significant influence over the operation and financial policies of the investee) of the stock in the investee. The equity method requires the investing company to record the investee's profits or losses in proportion to the percentage of ownership. In this case, the significant influence exists since there is 25% ownership of investee company’s stock, thereby, equity method is required.

1. **MCQ-14838**

Dale Corp, successfully patented a medical diagnostic machine. Five years after receiving the patent, Dale was legally challenged by Bisk Corp., which had a similar machine. Dale spent $600,000 to successfully defend the patent. How should Dale treat the $600,000?

1. Record it as a research and development expense.
2. Create a separate intangible account and amortize it.
3. Debit the patent account and amortize it.
4. Reduce the stockholders' equity by a prior period adjustment.

**ANSWER:**

Choice "C" is correct. When an existing patent is purchased from another party, that cost is capitalized (while an internally generated patent, most costs be expenses). Legal costs to defend an existing patent will be capitalized if the legal proceedings are successful and will be expensed if the legal proceedings are unsuccessful. Since a purchase patent is an intangible asset, the patent account be amortized each year.

1. **MCQ-14839**

Which of the following statements describes the relationship of interest expense related to bonds payable when a discount on bonds payable has been recorded using the effective interest method?

1. Interest expense will be the same each year.
2. Interest expense will decrease each year.
3. Interest expense will increase by the same amount each year.
4. Interest expense will increase by a larger amount each year.

**ANSWER:**

Choice "D" is correct. Under the effective interest method, interest expense is calculated by multiplying the carrying value of the bond at the beginning of the period by the effective interest rate. As it is a discount bond, the carrying value of the bond should be closer to its face value, meaning the carrying value of the bond will increase years by years. Thereby, the interest expense will increase by a larger amount since increment of the carrying value of the bond years by years.

Choice "A" is incorrect. Only under a straight-line method, the interest expense will be the same each year.

Choice "B" is incorrect. Interest expense will decrease each year if the bond is a premium bond.

Choice "C" is incorrect. Interest expense will increase by a larger amount each year.

1. **MCQ-14840**

Alder Corp, had the following stockholders' equity balances at the beginning of the current year:

Common stock 200,000 shares authorized, $1 par

15,000 shares issued and outstanding $15,000

Additional paid-in capital 24,000

Retained earnings 11,000

During the current year, Alder issued 2,000 shares of common stock with a fair value of $35 per share to Terry Brady on a subscription basis. Terry made a down payment of S3,500, but shortly thereafter defaulted on the subscription. What would be the debit to additional paid-in capital if Alder returned the $3,500 to Terry?

1. $73,500
2. $70,000
3. $68,000
4. S66.500

**ANSWER:**

Choice "C” is correct. Stock subscriptions are a mechanism for allowing employees and investors to consistently purchase shares of company stock over a long period of time, usually at a price that does not include a broker commission. Following are journal entries for Alder Corp.:

When Alder issue the stocks to Terry Brady:

|  |  |  |
| --- | --- | --- |
|  | Debt | Credit |
| Subscriptions receivable ($35 *x* 2,000 shares) | $70,000 |  |
| Common stock subscribed ($1 x 2,000 shares) |  | $2,000 |
| Additional paid-in capital |  | 68,000 |

When Alder received cash from Terry Brady:

|  |  |  |
| --- | --- | --- |
|  | Debt | Credit |
| Cash | $3,500 |  |
| Subscriptions receivable |  | $3,500 |

When Terry Brady returned the stocks:

|  |  |  |
| --- | --- | --- |
|  | Debt | Credit |
| Additional paid-in capital | $68,000 |  |
| Common stock subscribed | 2,000 |  |
| Subscriptions receivable |  | $66,500 |
| Cash |  | 3,500 |

When Alder returns $3,500 to Terry, Alder should debt $68,000 in additional paid-in capital account.

1. **MCQ-14841**

Nelson Corp, paid $1,000,000 cash to purchase 100 percent of the outstanding common stock of Orange Corp, on April 1 of the current year. Examination of Orange's assets and liabilities reveals the following:

|  |  |  |
| --- | --- | --- |
|  | *Book value* | *Fair value on April 1* |
| Cash | $100,000 | $100,000 |
| Marketable securities | 200,000 | 250,000 |
| Land | 50.000 | 300,000 |
| Accounts payable | 75.000 | 75,000 |
| Stockholder equity | 275,000 |  |

Nelson should record what amount of goodwill as a result of this acquisition?

1. S350.000
2. $425,000
3. $725,000

D S1.000.000

**ANSWER:**

Choice "B" is correct. The fair value of the Nelson Corp. will be difference between of the fair market value of its asset and fair market value of its liability. Therefore, the net value of the Nelson Corp, equals to $575,000(cash $100,000+marketable securities $250,000+land $300,000- account payable 75,000). The goodwill represents the intangible resources connected with an entity that cannot be separately identified and reported on the balance sheet. The amount of goodwill the excess of purchase price over fair value of the net asset purchased. The amount of goodwill equals to $425,000(purchase price $1,000,000-FMV of net assets purchased $575,000).

1. **MCQ-14842**

Thompson Corp. owned a machine that cost $80,000 and had accumulated depreciation of $50,000, an estimated salvage value of $5,000, and a fair value of $150,000. In January, the machine was damaged by Snow Corp, and became worthless. In October, a court awarded damages of $150,000 against Snow in favor of Thompson. On December 31, the final outcome of the case was awaiting appeal. Thompson's attorney believes Snow's appeal will be denied. What amount should Thompson accrue for this gain contingency on December 31?

1. $0
2. $5,000
3. $125,000
4. $150,000

**ANSWER:**

Choice "A" is correct. A gain contingency is an uncertain situation that will be resolved in the future, possibly resulting in a gain. Thompson should not recognize any gain contingency prior to the settlement of the underlying event, otherwise violating the conservatism principle. Thereby, no amount should be accrued for the gain contingency. Instead, Thompson should disclose the nature of the contingency in the notes accompanying the financial statements. However, the disclosure should not make any potentially misleading statements about the likelihood of realization of the contingent gain.

1. **MCQ-14843**

Arctic Corp., located in India, was a wholly-owned foreign subsidiary of Axis Corp. Arctic's primary economic environment was within the country of India. On a limited basis. Axis made transactions with its subsidiary denominated in U.S. dollars. At year-end, what would be the functional currency for Arctic?

1. The U.S. dollar
2. The local currency
3. Dependent on each transaction
4. The parent company's currency

**ANSWER:**

Choice “B" is correct. The functional currency is the currency in which an entity records and measures its transactions.It is determined by reference to the currency of the primary economic environment in which that entity operates. Parent company’s currency does not determine the functional currency for a foreign subsidiary. Since Arctic Corp. is located in India and has its primary economic environment in India, the local currency in India should use as the functional currency for Arctic.

1. **MCQ-14844**

Arc Hospital received an unconditional pledge for $1 million, which will be paid in four installments of $250,000 over four years. What amount of installment pledge revenue should be recognized in the second year?

1. $0
2. $250,000
3. $500,000
4. $1,000,000

**ANSWER:**

Choice "A" is correct. The pledge is considered as a long-term unconditional pledge since it will not be collected within one year. This multiyear pledge should be measured at net present value at the date the pledge is made. Thereby, no pledge revenue recognizes in the second year. The difference between the pledged amount and the present value is recorded as contribution revenue. Long-term unconditional pledges are considered as “donor restricted revenue”, since it is time-restricted. When terms and conditions of the bequest are satisfied, the pledge should be reclassified as “without donor restrictions”.

