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QUESTION 1

Belle Co. determined after four years that the estimated useful life of its labeling machine should be 10 years rather than 12 years. The machine originally cost $46,000 and had an estimated salvage value of $1,000. Belle uses straight-line depreciation. What amount should Belle report as depreciation expense for the current year?

A. $3,200

B. $3,750

C. $4,500

D. $5,000

Correct Answer: D

Choice "d" is correct. A change in estimated useful life is a change in accounting estimate, and is therefore accounted for prospectively. The revised useful life should be used as of the beginning of the year of the change and should be applied to the current book value of the fixed asset. The first step in determining the depreciation expense in the year of the change in estimate is to determine the book value of the labeling machine at the time of the change:

Original cost $46,000

-Accumulated depreciation 15,000 = [(46,000 - 1,000) / 12] *4 Current book value $31,000 This book value is then depreciated over the remaining life of the fixed asset based on the new estimated life. In this problem, the new estimated life is 10 years, four of which have already passed, so the asset must be depreciated over the remaining 6 years: ($31,000 - 1,000) / 6 = $5,000 Choice "a" is incorrect. This answer is incorrectly calculated by adding the salvage value to the current book value, and by using the entire 10 year revised estimated life. Salvage value should always be subtracted and the asset should only be depreciated over the remaining life of the asset. Choice "b" is incorrect. This is the annual depreciation before the change in estimated life ($46,000 -$1,000) / 12 = $3,750]. The depreciation after the change in estimate should be calculated as described above. Choice "c" is incorrect. This would have been the annual straight-line depreciation if the original useful life of the asset had been 10 years rather than 12 years. The change in estimated life is applied prospectively, as described above, not retrospectively.

QUESTION 2

During the first quarter of the calendar year, Worth Co. had income before taxes of $100,000, and its effective income tax rate was 15%. Worth\\'s effective annual income tax rate for the previous year was 30% . Worth expects that its effective annual income tax rate for the current year will be 25%. The statutory tax rate for the current year is 35%. In its first quarter interim income statement, what amount of income tax expense should Worth report?

A. $15,000

B. $25,000

C. $30,000

D. $35,000

Correct Answer: B

Choice "b" is correct. When preparing interim financial statements, income tax expense is estimated each

quarter using the effective tax rate expected to apply to the entire year.

Choice "a" is incorrect. Worth should use the effective annual tax rate, not the effective tax rate for the

quarter only.

Choice "c" is incorrect. Worth should use the effective annual tax rate expected to apply to the current

year, not the prior year\\'s effective tax rate.

Choice "d" is incorrect. Worth should use the effective annual tax rate, not the statutory tax rate.

QUESTION 3

Reclassification adjustments must be shown in the financial statement that discloses comprehensive income:

A. To show what portion of comprehensive income is from the realization of current assets.

B. To show the tax effect of items of comprehensive income.

C. To avoid double counting in comprehensive income items, which are currently displayed in net income.

D. To avoid including transactions with shareholders in items of comprehensive income.

Correct Answer: C

Choice "c" is correct. Reclassification entries may be necessary to avoid double counting an item previously reported as comprehensive income (i.e., unrealized gain), which are now reported as part of net income (i.e., realized gain). Choice "a" is incorrect. The classification of assets as current or non-current has no bearing on reporting comprehensive income. Choice "b" is incorrect. All items of comprehensive income must be shown net of the related tax effects, but it is not done with reclassification adjustments. Choice "d" is incorrect. Transactions with shareholders such as paying dividends and issuing capital stock are not included in comprehensive income, thus, reclassification adjustments are not necessary to exclude them.

QUESTION 4

On January 2, 1991, Air, Inc. agreed to pay its former president $300,000 under a deferred compensation arrangement. Air should have recorded this expense in 1990 but did not do so. Air\\'s reported income tax expense would have been $70,000 lower in 1990 had it properly accrued this deferred compensation in its December 31,1991, financial statements, Air should adjust the beginning balance of its retained earnings by a:

A. $230,000 credit.

B. $230,000 debit.

C. $300,000 credit.

D. $370,000 debit.

Correct Answer: B

Less adjustments (shown "net of tax"):	
Deferred compensation	$ 300,000
Less: Applicable tax	(70,000)
Debit to subtract	$ 230,000 **B**

Choice "b" is correct. $230,000 debit.

QUESTION 5

Advertising costs may be accrued or deferred to provide an appropriate expense in each period for: A. Option A

Interim financial reporting	Year-end financial reporting
Yes	No
Yes	Yes
No	No
No	Yes

B. Option B

C. Option C

D. Option D

Correct Answer: B

Choice "b" is correct. Yes - Yes.

Advertising costs may be accrued or deferred to provide an appropriate expense in each period for both

"interim" and "year-end" financial reporting.

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