

I. PURPOSE OF INCOME MEASUREMENT

- A. **In general accountants measure income to assess the effectiveness of operations as they relate to the goal(s) of an enterprise.** More specifically, income measurement is used to:
1. compute return on investment,
 2. evaluate the past performance of the enterprise,
 3. provide a basis for predicting future performance.
 4. serve as a motivator for improved managerial performance,
 5. help assess the risk or uncertainty of achieving future cash flows
 6. measure changes in the "efficiency" of the enterprise,
 7. report on operating effectiveness for external and internal purposes,
 8. provide a means of evaluating the performance of competing investment opportunities for both investors and stockholders
 9. meet the information needs of regulatory and taxing agencies.

II. TYPES OF INCOME

- A. In his book The theory of Interest economist Irving Fisher identified three types of income:
1. **Psychic or enjoyment income**, consisting of agreeable sensations and experiences;
 2. **Real income** as measured by what money will buy, i.e., in terms of purchasing power or effectiveness.
 3. **Money income**, consisting of the money available for purchasing.
 - a. Accountants deal with this third concept of income
 - b. Traditionally, the accounting system has measured only this type of income for financial reporting purposes. But efforts are being made to extend income measurement to category (2) for financial reporting purposes, as illustrated by the progress toward price-level accounting.
 - c. This external effort toward measuring real income is matched by the increasing emphasis that is being given to costeffectiveness effectiveness in internal management.

III. INCOME MEASUREMENT AND ACCOUNTING

- A. Problems with accounting income measurement
1. The process of income measurement is elusive and presents an ever-present challenge.
 - a. Income that cannot be measured reliably are not reported in the income statement.
 2. Measurement is the assignment of numerical values to events to some rule or standard.
 - a. Measurement involves judgement and is subject to evaluation by both management and auditor.
 3. The assignment of numerals to economic transactions is the principal function of accounting.
 - a. There are often different methods of assigning (computing) the value of economic transactions.
 - b. Accounting/Income measurement is not an exact science
 4. In most cases these numerals are in the form of money values.
 - a. The aggregation of these values is used measure the wealth and income of businesses and individuals.
 - b. From these assessments of wealth and income, policy makers control the distribution of economic resources through taxation and other means.
 - c. It is obviously very important that close attention be paid to how accounting numbers are generated if we seek to optimize social controls.

IV. WEALTH (Retained Earnings) AND INCOME

- A. The process of accumulating wealth is related to earning revenue in excess of expenses.
1. Wealth is owners' equity (OE) at any particular point in time.
 - a. Retained earnings represents wealth and can be defined as all the income of the business since its inception up to the present date less dividends.
 2. Wealth is often measured as follows:
 - a. Value of assets owned – debts owed to others = net worth
 - b. In terms of the accounting equation $A = L + OE$, we can restate wealth as follows: $A - L = OE$
 1. Income is the difference between wealth (OE) at different points in time.
 - a. Note that income measures the change in wealth for a specific period
 - b. Income is a "from-to" concept
 1. Income always starts the period at zero and measures the change in wealth to the end of a period.

V. SPECIAL PROBLEMS WITH INCOME MEASUREMENT

1. Some special problems attach to the measurement of business income.
 - a. Accounting is based on combination of historical costs and current costs.
 1. This means that income will be based on a mixture of current values (today's costs) and old values (the cost of items at acquisition).
 - b. Accounting costs are not inclusive in that they do not measure all types of input (consumption of human resources, for example) nor do they measure all types of output (goodwill, employee morale, etc.).
 - c. Income cannot be measured accurately until we have completed an investment life-cycle but if accountants waited for that to occur, the information, more likely than not would be worthless.
 1. Consequently, accountants must "trade-off" the accuracy of accounting information against its timeliness

VI. THE ACCOUNTANT'S DEFINITION OF INCOME

1. Accounting income is based on the principle of cost assumption where income is defined as the difference between revenues earned and expenses incurred in producing those revenues.
2. Appreciation or "gains" on the acquired assets are not recognized as income for accounting purposes until such gains are realized (sold to outsiders).
3. Income can be realized under the accrual method of accounting at the time when a transaction is effected rather than when cash payment is made.

VII. INCOME TERMINOLOGY (Refer to 1A)

1. **Revenue**
 - a. Differs from income in that it includes sales, non-operating income, and extraordinary gains;
 - b. Another way to define revenue would be "**the sum of all transactions which increase retained earnings**"
2. **Income**
 - a. Includes only the increases from those activities for which the business exists.
3. **Cost:**
 - a. Cost represents the outlay of cash, equities, or services required to purchase assets and pay for business expenses.
 - b. A cost can either be an asset (an unexpired cost that will benefit current and future periods) or an expense (an expired cost that has been used to earn revenue in the current period).
 - i. Unexpired costs are assets and appear on the balance sheet.
 - ii. Expired costs are expenses and appear on the income statement
4. **Expense:**
 - a. The cost of assets used up in the current period to earn income;
 - b. Expenses may consist of costs incurred in the current period and the use of assets purchased in the past but used in the current period to earn income.

VIII. THE INCOME STATEMENT

1. The financial document that is used currently to measure income is the income statement. It is also referred to as "the statement of income," "the operating statement," or less frequently as "the profit and loss statement."
2. Income statements are typically presented in either the **Single Step or Multi Step** format

a. **Single Step Income Statements:**

Revenue
 (Expenses)
 Net Income

b. **Multi Step Income Statements:**

Sales or Operating Revenue
 (Cost of Sales)
 Gross Profit
 (Operating Expenses)
 (Selling Expenses)
 Costs directly related to sales such as marketing/Advertising/Freight out and other costs related to selling
 (Administrative Expense)
 Costs indirectly related to sales such as office salaries, legal expenses, depreciation etc.

Special Items

(Items that are infrequent or unusual, but not both)

Net Operating Income

Other Non-Operating Income and/or expenses

Revenue and Expenses not related to the normal course of business such as rental revenue, dividends from investments etc.

Total Income

(Tax Expense)

(Extraordinary Items, sales of segments of the business etc) net of tax affects

+ Changes resulting from changes in GAAP (the cumulative effect is reported net of tax)

Net income

Note that Prior Period Adjustment are not included in net income, but appear in the Statement of Retained Earnings

See examples below

IX. NON-OPERATING INCOME AND EXPENSES

1. Extraordinary gains and losses (Extraordinary Items, EI)
 - a. Extraordinary gains and losses are items of material value that both unusual in nature and infrequent in occurrence .
 - b. EI result from unusual and generally unpredictable events, such as gain or loss on the sale of long-lived assets, or losses by fire, earthquake, or theft. The treatment of extraordinary items in income measurement has been the subject of intensive debate among accountants, as discussed below.
 - c. Note that Prior Period Adjustment (Changes and credits that result from items that were mistakenly included or excluded from reported in income of prior periods are not reported on the income statement and are not a component of non-operating income.

X. STATEMENT OF RETAINED EARNINGS

Items that are not Extraordinary Items

Retained Earnings (BOY)
 + Net Income (or – Net Loss)
 - Dividends
 - Appropriations
+/- Prior Period Adjustments (net of tax effects)
 Retained Earnings (EOY)

Certain transactions are specifically excluded from being treated as EI:

1. Write-down/write-off of
 - a. A/R
 - b. Inventory
 - c. Leased equipment (for lessor)
 - d. R&D costs
 - e. Intangible assets
2. Gains/losses from foreign currency fluctuations
3. Gains and losses from sales of a segment of the business
 - a. Note: While not E.I. a sale of a segment is treated separately and reported net of tax affect
4. Gains and losses from abandonments of PP&E
5. Effects of a labor strike (including strikes against suppliers).
6. Adjustments of accruals on long-term contracts
7. Changes in estimates

XI. SPECIAL ITEMS

1. Certain events are either infrequent or unusual, but not both.
2. These items are referred to as special items and are
 - a. Reported separately before operating income

XII. CHANGES IN GAAP

1. Changes from one generally accepted accounting principle to another are reported cumulatively as of the beginning of the year and reported on the income statement (net of tax effect) as a separate item following EI.

XIII CHANGES IN ACCOUNTING ESTIMATES

1. Changes in estimates are common and are not reported separately or cumulatively.
 - a. Changes in estimate are reported in a prospective manner; i.e. they are reflected in the current and future periods and are given no special disclosure treatment.

Income Statement Practice Questions:

1. The major elements of the income statement are
 - a. revenue, cost of goods sold, selling expenses, and general expense.
 - b. operating section, nonoperating section, discontinued operations, extraordinary items, and cumulative effect.
 - c. revenues, expenses, gains, and losses.
 - d. all of these.
2. Information in the income statement helps users to
 - a. evaluate the past performance of the enterprise.
 - b. provide a basis for predicting future performance.
 - c. help assess the risk or uncertainty of achieving future cash flows.
 - d. all of these.
3. Which of the following is an acceptable method of presenting the income statement?
 - a. A single-step income statement
 - b. A multiple-step income statement
 - c. A consolidated statement of income
 - d. All of these
4. The single-step income statement emphasizes
 - a. the gross profit figure.
 - b. total revenues and total expenses.
 - c. extraordinary items and accounting changes more than these are emphasized in the multiple-step income statement.
 - d. the various components of income from continuing operations.
5. Limitations of the income statement include all of the following except
 - a. items that cannot be measured reliably are not reported.
 - b. only actual amounts are reported in determining net income.
 - c. income measurement involves judgment.
 - d. income numbers are affected by the accounting methods employed.
6. Which of the following is *not* a generally practiced method of presenting the income statement?
 - a. Including prior period adjustments in determining net income
 - b. The single-step income statement
 - c. The consolidated statement of income
 - d. Including gains and losses from discontinued operations of a segment of a business in determining net income
7. The occurrence which most likely would have no effect on 2001 net income (assuming that all amounts involved are material) is the
 - a. sale in 2001 of an office building contributed by a stockholder in 1978.
 - b. collection in 2001 of a receivable from a customer whose account was written off in 2000 by a charge to the allowance account.
 - c. settlement based on litigation in 2001 of previously unrecognized damages from a serious accident which occurred in 1999.
 - d. worthlessness determined in 2001 of stock purchased on a speculative basis in 1997.
8. In order to be classified as an extraordinary item in the income statement, an event or transaction should be
 - a. unusual in nature, infrequent, and material in amount.
 - b. unusual in nature and infrequent, but it need not be material.
 - c. infrequent and material in amount, but it need not be unusual in nature.
 - d. unusual in nature and material, but it need not be infrequent.
9. Classification as an extraordinary item on the income statement would be appropriate for the
 - a. gain or loss on disposal of a segment of the business.
 - b. substantial write-off of obsolete inventories.
 - c. loss from a strike.
 - d. none of these.
10. Which of these is generally an example of an extraordinary item?
 - a. Loss incurred because of a strike by employees.
 - b. Write-off of deferred marketing costs believed to have no future benefit.
 - c. Gain resulting from the devaluation of the U.S. dollar.
 - d. Gain resulting from the state exercising its right of eminent domain on a piece of land used as a parking lot.
11. Under which of the following conditions would material flood damage be considered an extraordinary item for financial reporting purposes?
 - a. Only if floods in the geographical area are unusual in nature and occur infrequently.
 - b. Only if the flood damage is material in amount and could have been reduced by prudent management.
 - c. Under any circumstances as an extraordinary item.
 - d. Flood damage should never be classified as an extraordinary item.
12. An item that should be classified as an extraordinary item is
 - a. write-off of goodwill.
 - b. gains from transactions involving foreign currencies.
 - c. losses from moving a plant to another city.
 - d. gains from extinguishment of debt.
13. How should an unusual event not meeting the criteria for an extraordinary item be disclosed in the financial statements?
 - a. Shown as a separate item in operating revenues or expenses if material and supplemented by a footnote if deemed appropriate.
 - b. Shown in operating revenues or expenses if material but not shown as a separate item.
 - c. Shown net of income tax after ordinary net earnings but before extraordinary items.
 - d. Shown net of income tax after extraordinary items but before net earnings.

14. Which of the following is a change in accounting principle?
- A change in the estimated service life of machinery
 - A change from FIFO to LIFO
 - A change from straight-line to double-declining balance
 - A change from FIFO to LIFO and a change from straight-line to double-declining balance
15. Which of the following is a required disclosure in the income statement when reporting a change in accounting principle?
- A per share amount for the cumulative effect of the change.
 - The cumulative effect on prior years net of tax.
 - The cumulative effect should be disclosed immediately after extraordinary items.
 - All of these.
16. Which of the following is a required disclosure in the income statement when reporting the disposal of a segment of the business?
- The gain or loss on disposal should be reported as an extraordinary item.
 - Results of operations of a discontinued segment should be disclosed immediately below extraordinary items.
 - Earnings per share from both continuing operations and net income should be disclosed on the face of the income statement.
 - The gain or loss on disposal should not be segregated, but should be reported together with the results of continuing operations.
17. When a company discontinues an operation and disposes of the discontinued operation (segment), the transaction should be included in the income statement as a gain or loss on disposal reported as
- a prior period adjustment.
 - an extraordinary item.
 - an amount after continuing operations and before extraordinary items.
 - a bulk sale of plant assets included in income from continuing operations.
18. Income taxes are allocated to
- cumulative effect of a change in accounting principle.
 - discontinued operations.
 - prior period adjustments.
 - all of these.
19. Which of the following is true about intraperiod tax allocation?
- It arises because certain revenue and expense items appear in the income statement either before or after they are included in the tax return.
 - It is required for extraordinary items and cumulative effect of accounting changes but not for prior period adjustments.
 - Its purpose is to allocate income tax expense evenly over a number of accounting periods.
 - Its purpose is to relate the income tax expense to the items which affect the amount of tax.
20. Which of the following items will *not* appear in the retained earnings statement?
- Net loss
 - Prior period adjustment
 - Change in accounting principle, net of taxes
 - Dividends
21. Which one of the following types of losses is excluded from the determination of net income in income statements?
- Material losses resulting from transactions in the company's investments account.
 - Material losses resulting from unusual sales of assets not acquired for resale.
 - Material losses resulting from the write-off of intangibles.
 - Material losses resulting from correction of errors related to prior periods.
22. Shank Corporation made a very large arithmetical error in the preparation of its year-end financial statements by improper placement of a decimal point in the calculation of depreciation. The error caused the net income to be reported at almost double the proper amount. Correction of the error when discovered in the next year should be treated as
- an increase in depreciation expense for the year in which the error is discovered.
 - a component of income for the year in which the error is discovered, but separately listed on the income statement and fully explained in a note to the financial statements.
 - an extraordinary item for the year in which the error was made.
 - a prior period adjustment.
23. Comprehensive income includes all of the following except
- dividend revenue.
 - losses on disposal of assets.
 - investments by owners.
 - unrealized holding gains.
24. The approach most companies will probably use to provide information related to the components of other comprehensive income is a
- second separate income statement.
 - combined income statement of comprehensive income.
 - separate column in the statement of changes in stockholders' equity.
 - footnote disclosure.
- *25. Which of the following is a required separate disclosure in the income statement when reporting a discontinued operation which has a measurement date during the year and a disposal date next year?
- Income (loss) from operation of the discontinued segment during the year.
 - Income (loss) from operation of the discontinued segment up to the measurement date.
 - Income (loss) from operation of the discontinued segment from the measurement date to the end of the year.
 - Income (loss) from operation of the discontinued segment from the measurement date to the disposal date.

- *26. Which of the following is included in the gain or loss on disposal when reporting a discontinued operation which has a disposal date next year?
1. Income (loss) from operation of the discontinued segment from the beginning of the year to the measurement date.
 2. Income (loss) from operation of the discontinued segment from the measurement date to the end of the year.
 3. Expected income (loss) from operation of the discontinued segment from the end of the year to the disposal date.
- a. 1
 - b. 2
 - c. 3
 - d. 2 and 3

Multiple Choice Answers—Conceptual

- | | | | | | | |
|------|------|-------|-------|-------|-------|--------|
| 1. c | 5. b | 9. d | 13. a | 17. c | 21. d | *25. b |
| 2. d | 6. a | 10. d | 14. d | 18. d | 22. d | *26. d |
| 3. d | 7. b | 11. a | 15. d | 19. d | 23. c | . |
| 4. b | 8. a | 12. d | 16. c | 20. c | 24. c | |

Solution to Multiple Choice question for which the answer is "none of these."

9. Many answers are possible.

MULTIPLE CHOICE—Computational

27. Gross billings for merchandise sold by Pye Company to its customers last year amounted to \$12,720,000; sales returns and allowances were \$270,000, sales discounts were \$175,000, and freight-out was \$140,000. Net sales last year for Pye Company were
- a. \$12,720,000.
 - b. \$12,450,000.
 - c. \$12,275,000.
 - d. \$12,135,000.
28. If plant assets of a manufacturing company are sold at a gain of \$900,000 less related taxes of \$270,000, and the gain is not considered unusual or infrequent, the income statement for the period would disclose these effects as
- a. a gain of \$900,000 and an increase in income tax expense of \$270,000.
 - b. operating income net of applicable taxes, \$630,000.
 - c. a prior period adjustment net of applicable taxes, \$630,000.
 - d. an extraordinary item net of applicable taxes, \$630,000.
29. Catt Company, with an applicable income tax rate of 30%, reported net income of \$280,000. Included in income for the period was an extraordinary loss from flood damage of \$40,000 before deducting the related tax effect. The company's income before income taxes and extraordinary items was
- a. \$320,000.
 - b. \$400,000.
 - c. \$440,000.
 - d. \$308,000.
30. A review of the December 31, 2001, financial statements of Carey Corporation revealed that under the caption "extraordinary losses," Carey reported a total of \$615,000. Further analysis revealed that the \$615,000 in losses was comprised of the following items:
- (1) Carey recorded a loss of \$150,000 incurred in the abandonment of equipment formerly used in the business.
 - (2) In an unusual and infrequent occurrence, a loss of \$350,000 was sustained as a result of hurricane damage to a warehouse.
 - (3) During 2001, several factories were shut down during a major strike by employees, resulting in a loss of \$85,000.
 - (4) Uncollectible accounts receivable of \$30,000 were written off as uncollectible.

Ignoring income taxes, what amount of loss should Carey report as extraordinary on its 2001 income statement?

- a. \$150,000.
- b. \$350,000.
- c. \$500,000.
- d. \$615,000.

Use the following information for questions 31 and 32.

The financial statements of Block, Inc. for 2000 and 2001 contained the following errors:

	2000	2001
Ending inventory	\$5,000 overstated	\$8,000 understated
Insurance expense	2,400 understated	1,300 overstated

31. Assuming that none of the errors was detected or corrected, by what amount will 2000 income before taxes be overstated or understated?
- a. \$2,600 understated
 - b. \$2,600 overstated
 - c. \$7,400 overstated
 - d. \$7,400 understated
32. Assuming that none of the errors was detected or corrected, by what amount will 2001 income before taxes be overstated or understated?
- a. \$14,300 understated
 - b. \$11,900 understated
 - c. \$6,700 understated
 - d. \$6,700 overstated

Use the following information for questions 33 through 35. Ignore taxes.

Marco, Inc. is a calendar-year corporation. Its financial statements for the years 2000 and 2001 contained errors as follows:

	2000	2001
Ending Inventory	\$ 6,000 understated	\$10,000 overstated
Depreciation Expense	11,000 overstated	7,000 overstated

33. Assuming that the errors made in 2000 were corrected, but that the errors made in 2001 were not detected, by what amount will 2001 income before taxes be overstated or understated?
- \$3,000 overstated
 - \$10,000 overstated
 - \$17,000 overstated
 - \$3,000 understated
34. Assuming that *none* of the errors was detected or corrected, by what amount will retained earnings at December 31, 2001 be overstated or understated?
- \$23,000 understated
 - \$17,000 understated
 - \$8,000 understated
 - \$10,000 overstated
35. Assuming that *none* of the errors was detected or corrected, and that no additional errors were made in 2002, by what amount will current assets at December 31, 2002 be overstated or understated?
- \$10,000 overstated
 - \$0
 - \$4,000 overstated
 - \$10,000 understated
36. In 2001 Rowe Company changed from straight-line to double-declining balance depreciation. The total difference in depreciation for all years through 2000 was \$52,000 and for 2001 the difference was \$5,000. The tax rate is 30%. The amount that should be reported in the income statement for 2001 as a change in accounting principle is
- \$36,400 debit.
 - \$36,400 credit.
 - \$39,900 debit.
 - \$39,900 credit.

Use the following information for questions 37 and 38.

At Ivan Company events and transactions during 2001 included the following. The tax rate for all items is 30%.

- Depreciation for 1999 was found to be understated by \$30,000.
 - A strike by the employees of a supplier resulted in a loss of \$20,000.
 - The inventory at December 31, 1999 was overstated by \$40,000.
 - A flood destroyed a building that had a book value of \$400,000. Floods are very uncommon in that area.
37. The effect of these events and transactions on 2001 income from continuing operations net of tax would be
- \$14,000.
 - \$35,000.
 - \$63,000.
 - \$343,000.
38. The effect of these events and transactions on 2001 net income net of tax would be
- \$14,000.
 - \$294,000.
 - \$315,000.
 - \$343,000.
39. The following information was extracted from the accounts of Colaw Corporation at December 31, 2001:
- | | CR(DR) |
|--|-------------|
| Total reported income since incorporation | \$1,500,000 |
| Total cash dividends paid | (800,000) |
| Cumulative effect of changes in accounting principle | (120,000) |
| Total stock dividends distributed | (200,000) |
| Prior period adjustment, recorded January 1, 2001 | 66,000 |
- What should be the balance of retained earnings at December 31, 2001?
- \$446,000.
 - \$500,000.
 - \$380,000.
 - \$566,000.

40. During 2001, Perez Corporation disposed of Rush Division, a major segment of its business. Perez realized a gain of \$1,500,000, net of taxes, on the sale of Rush's assets. Rush's operating losses, net of taxes, were \$1,800,000 in 2001. How should these facts be reported in Perez's income statement for 2001?

	Total Amount to be Included in	
	Income from	Results of
	<u>Continuing Operations</u>	<u>Discontinued Operations</u>
a.	\$1,800,000 loss	\$1,500,000 gain
b.	300,000 loss	0
c.	0	300,000 loss
d.	1,500,000 gain	1,800,000 loss

41. Quinn Company reported the following information for 2001:

Sales revenue	\$520,000
Cost of goods sold	350,000
Operating expenses	55,000
Unrealized holding gain on available-for-sale securities	50,000
Cash dividends received on the securities	2,000

For 2001, Quinn would report other comprehensive income of

- a. \$167,000.
 b. \$165,000.
 c. \$52,000.
 d. \$50,000.
- *42. Stine, Inc. decided on January 1, 2001 to discontinue its plastic making division. The division, considered a reportable segment, was sold on June 1, 2001. Division assets with a carrying value of \$650,000 were sold for \$500,000. Operating income from January 1, to May 30, 2001 for the division amounted to \$80,000. Ignoring taxes, what amount should be reported on Stine's income statement for the year ended December 31, 2001, under the caption "discontinued operations"?
- a. \$230,000 gain
 b. \$80,000 gain
 c. \$150,000 loss
 d. \$70,000 loss

Use the following information for questions 43 and 44.

Norton Motors operates a division which sells farm equipment. At a meeting on April 1, 2001 the Board of Directors adopted a plan for disposal of the division on December 1, 2001. The following data relate to the division during 2001:

	<u>1st Quarter</u>	<u>2nd Quarter</u>	<u>3rd Quarter</u>	<u>4th Quarter</u>
Income (loss) before taxes	\$400,000	\$(100,000)	\$(400,000)	\$(200,000)

The division was sold for \$20,000,000 when the book value was \$18,800,000. The income tax rate is 30%.

- *43. The amount that should be reported as income (loss) from operation of the division is
- a. \$400,000.
 b. \$280,000.
 c. \$210,000.
 d. \$70,000.
- *44. The amount that should be reported as gain (loss) on disposal of the division is
- a. \$1,200,000.
 b. \$840,000.
 c. \$770,000.
 d. \$350,000.

Multiple Choice Answers—Computational

- | | | | | | |
|-------|-------|-------|-------|-------|--------|
| 27. c | 30. b | 33. a | 36. a | 39. d | *42. d |
| 28. a | 31. c | 34. c | 37. a | 40. c | *43. b |
| 29. c | 32. a | 35. b | 38. b | 41. d | *44. d |

MULTIPLE CHOICE—CPA Adapted

Use the following information for questions 45 and 46.

Olson Corp. reports operating expenses in two categories: (1) selling and (2) general and administrative. The adjusted trial balance at December 31, 2001, included the following expense accounts:

Accounting and legal fees	\$120,000
Advertising	150,000
Freight-out	75,000
Interest	60,000
Loss on sale of long-term investments	30,000
Officers' salaries	180,000
Rent for office space	160,000
Sales salaries and commissions	110,000

One-half of the rented premises is occupied by the sales department.

45. How much of the expenses listed above should be included in Olson's selling expenses for 2001?
- \$260,000.
 - \$335,000.
 - \$340,000.
 - \$415,000.
46. How much of the expenses listed above should be included in Olson's general and administrative expenses for 2001?
- \$380,000.
 - \$410,000.
 - \$440,000.
 - \$470,000.
47. Crane Corp. reports operating expenses in two categories: (1) selling and (2) general and administrative. The adjusted trial balance at December 31, 2001 included the following expense and loss accounts:

Accounting and legal fees	\$140,000
Advertising	160,000
Freight-out	80,000
Interest	70,000
Loss on sale of long-term investment	30,000
Officers' salaries	225,000
Rent for office space	220,000
Sales salaries and commissions	150,000

One-half of the rented premises is occupied by the sales department. Crane's total selling expenses for 2001 are

- \$500,000.
 - \$420,000.
 - \$390,000.
 - \$350,000.
48. The following items were among those that were reported on Otto Co.'s income statement for the year ended December 31, 2001:
- | | |
|--|-----------|
| Legal and audit fees | \$110,000 |
| Rent for office space | 160,000 |
| Interest on inventory floor plan | 210,000 |
| Loss on abandoned equipment used in operations | 35,000 |

The office space is used equally by Otto's sales and accounting departments. What amount of the above-listed items should be classified as general and administrative expenses in Otto's multiple-step income statement?

- \$190,000.
- \$225,000.
- \$270,000.
- \$400,000.

Use the following information for questions 49 through 51.

Garber Corp.'s trial balance of income statement accounts for the year ended December 31, 2001 included the following:

	<u>Debit</u>	<u>Credit</u>
Sales	\$140,000	
Cost of sales	\$ 60,000	
Administrative expenses	25,000	
Loss on sale of equipment	9,000	
Commissions to salespersons	10,000	
Interest revenue		5,000
Freight-out 3,000		
Loss on early retirement of long-term debt	15,000	
Bad debt expense	3,000	
Totals	<u>\$125,000</u>	<u>\$145,000</u>

Other information:

Garber's income tax rate is 30%. Finished goods inventory:

January 1, 2001	\$80,000
December 31, 2001	70,000

On Garber's multiple-step income statement for 2001,

49. Cost of goods manufactured is
- \$73,000.
 - \$70,000.
 - \$53,000.
 - \$50,000.
50. Income before extraordinary item is
- \$35,000.
 - \$20,000.
 - \$24,500.
 - \$14,000.
51. Extraordinary loss is
- \$10,500.
 - \$15,000.
 - \$16,800.
 - \$24,000.

52. Beal Corp. had the following infrequent transactions during 2001:

A \$150,000 gain on reacquisition and retirement of bonds.

A \$240,000 gain on the disposal of a segment of a business. Beal continued similar

operations at another location.

A \$70,000 loss on the abandonment of equipment.

In its 2001 income statement, what amount should Beal report as total infrequent net gains that are not considered extraordinary?

- a. \$80,000.
- b. \$170,000.
- c. \$320,000.
- d. \$390,000.

53. Ross, Inc. incurred the following infrequent losses during 2001:

A \$90,000 write-down of equipment leased to others.

A \$40,000 adjustment of accruals on long-term contracts.

A \$60,000 write-off of obsolete inventory.

In its 2001 income statement, what amount should Ross report as total infrequent losses that are not considered extraordinary?

- a. \$190,000.
- b. \$150,000.
- c. \$130,000.
- d. \$100,000.

54. Which of the following should be reported as a prior period adjustment?

	<u>Change in Estimated Lives of Depreciable Assets</u>	<u>Change from Unaccepted Principle to Accepted Principle</u>
a.	Yes	Yes
b.	No	Yes
c.	Yes	No
d.	No	No

*55. On September 30, 2001, a commitment was made to dispose of a business segment in early 2002. The segment operating loss for the period October 1 to December 31, 2001, should be included in the 2001 income statement as part of

- a. loss on disposal of the discontinued segment.

Multiple Choice Answers—CPA Adapted

45. d 47. a 49. d 51. a 53. a *55. a
46. a 48. a 50. c 52. b 54. b