

Intermediate Accounting 2: Midterm Review

**Multiple Choice Bank**

1. Held-to-maturity investments are accounted for at
  - a. fair value.
  - b. lower of cost and fair value.
  - c. net present value.
  - d. **amortized cost.**
2. Available-for-sale investments are reported at
  - a. cost.
  - b. **fair value.**
  - c. lower of cost and fair value.
  - d. amortized cost.
3. Comprehensive income is included as part of
  - a. retained earnings.
  - b. net income.
  - c. **shareholders' equity.**
  - d. unearned revenue.
4. The equity method of accounting for equity securities is used for
  - a. available-for-sale equity investments.
  - b. trading securities.
  - c. investments without significant influence.
  - d. **investments with significant influence.**
5. Dane, Inc., owns 35% of Marin Corporation. During the calendar year 2006, Marin had net earnings of \$300,000 and paid dividends of \$30,000. Dane mistakenly recorded these transactions using the cost method rather than the equity method of accounting. What effect would this have on the investment account, net income, and retained earnings, respectively?
  - a. Understate, overstate, overstate
  - b. Overstate, understate, understate
  - c. Overstate, overstate, overstate
  - d. **Understate, understate, understate**
6. Long-term investments in equity securities should be written down if
  - a. it is probable that the investor will not be able to collect all amounts due.
  - b. there is a permanent decline in value.
  - c. **there is an other than temporary decline in value.**
  - d. the market value is less than the carrying value.
7. Companies using differential reporting may account for equity investments under significant influence by which alternative method to the one normally required?
  - a. Consolidation
  - b. Fair value
  - c. **Cost**
  - d. Any of these
8. Which of the following items is a current liability?
  - c. **Bonds (for which there is an adequate appropriation of retained earnings) due in eleven months.**

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10. Gomez Corporation, a manufacturer of household paints, is preparing annual financial statements at December 31, 2008. Because of a recently proven health hazard in one of its paints, the government has clearly indicated its intention of having Gomez recall all cans of this paint sold in the last six months. The management of Gomez estimates that this recall would cost \$800,000. What accounting recognition, if any, should be accorded this situation?

- a. No recognition
- b. Note disclosure only
- c. Operating expense of \$800,000 and liability of \$800,000
- d. Appropriation of retained earnings of \$800,000

11. When a company sets aside money in a trust such that the investment and any return will be sufficient to pay the principal and the interest to the creditor, but the creditor does not release the company from the primary obligation to settle the debt, this type of arrangement is known as

- a. substantive repayment.
- b. in-substance refunding.
- c. in-substance defeasance.
- d. legal defeasance.

12. Which of the following must be disclosed relative to long-term debt maturities and sinking fund requirements?

- a. The present value of future payments for sinking fund requirements and long-term debt maturities during each of the next five years.
- b. The present value of scheduled interest payments on long-term debt during each of the next five years.
- c. The amount of scheduled interest payments on long-term debt during each of the next five years.
- d. The amount of future payments for sinking fund requirements and long-term debt maturities during each of the next five years.

13. The pre-emptive right of a common shareholder is the right to

- a. share proportionately in corporate assets upon liquidation.
- b. share proportionately in any new issues of shares of the same class.
- c. receive cash dividends before they are distributed to preferred shareholders.
- d. exclude preferred shareholders from voting rights.

14. How should a "gain" from the sale of treasury shares be reflected in the financial statements?

- a. As ordinary earnings shown on the income statement
- b. As contributed surplus from treasury shares transactions
- c. As an increase in the amount shown for common shares
- d. As an extraordinary item shown on the income statement

15. According to the CBCA, when a company purchases its own shares on the market

- a. they are recorded with a debit to Treasury Shares.
- b. the amount is deducted from the share class to which they belong.
- c. they must be cancelled.
- d. the excess of purchase price over cost is a loss.

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16. At the date of the financial statements, common shares issued would exceed common shares outstanding as a result of the

- a. declaration of a stock split.
- b. declaration of a stock dividend.
- c. purchase of treasury shares.
- d. payment in full of subscribed shares.

17. Farmer Corporation owns 4,000,000 shares of shares in Baha Corporation. On December 31, 2008, Farmer distributed these shares as a dividend to its shareholders. This is an example of a

- a. property dividend.
- b. stock dividend.
- c. scrip dividend.
- d. cash dividend.

18. Declaration and issuance of a stock dividend

- a. increases the current ratio.
- b. decreases the amount of working capital.
- c. decreases total shareholders' equity.
- d. has no effect on total assets, liabilities, or shareholders' equity.

19. What effect does the issuance of a 2-for-1 stock split have on each of the following balance sheet accounts?

Common Shares	Retained Earnings
---------------	-------------------

- |              |           |
|--------------|-----------|
| a. No effect | No effect |
| b. Increase  | No effect |
| c. Decrease  | No effect |
| d. Decrease  | Decrease  |

20. A company wishes to raise funds by issuing either bonds or cumulative preferred shares. How will the annual interest or dividend affect total liabilities each year?

- a. Interest is a current liability each year (until paid).
- b. Undeclared cumulative preferred dividends are a current liability each year (until paid).
- c. Both interest and undeclared cumulative preferred dividends are current liabilities each year (until paid).
- d. Interest and cumulative preferred dividends in arrears are current liabilities each year (until paid).

1) Cash dividends declared out of current earnings are distributed to an investor. How will the investor's investment account be affected by those dividends under each of the following accounting methods?

<b>Cost Method</b>	<b>Equity Method</b>
--------------------	----------------------

- |             |           |
|-------------|-----------|
| 1 No effect | No effect |
| 2 No effect | Decrease  |
| 3 Decrease  | No effect |
| 4 Decrease  | Decrease  |

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- 2) A debt security is classified as held-to-maturity if the reporting entity has the
- a) positive intent to hold it to maturity.
  - b) positive intent to hold it to maturity and has held it for more than one year.
  - c) positive intent to hold it to maturity and has the ability to hold it to maturity.
  - d) intent to hold it for an indefinite period of time.
- 3) Held-to-maturity investments are accounted for at
- a) fair value.
  - b) lower of cost and fair value.
  - c) net present value.
  - d) amortized cost.
- 4) The premium or discount on available-for-sale investments in bonds is
- a) amortized over the life of the bond.
  - b) recorded as an expense or revenue.
  - c) not amortized.
  - d) amortized over the expected holding period.
- 5) When an investment changes its classification from available-for-sale to held-to-maturity the transfer takes place at:
- a) equity
  - b) fair value
  - c) carrying value
  - d) market value
- 6) Which of the following statements is *false*?
- a) A company may exclude a short-term obligation from current liabilities if the firm intends to refinance the obligation on a long-term basis and demonstrates an ability to complete the refinancing.
  - b) Cash dividends should be recorded as a liability when they are declared by the board of directors.
  - c) Under the cash basis method, warranty costs are charged to expense as they are paid.
  - d) Federal income taxes withheld from employees' payroll cheques should never be recorded as a liability since the employer will eventually remit the amounts withheld to the appropriate taxing authority.
- 7) Which of the following is the proper way to report a gain contingency?
- a) As an accrued amount
  - b) As deferred revenue
  - c) As an account receivable with additional disclosure explaining the nature of the contingency
  - d) As a disclosure only

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8) Assume that a manufacturing corporation has (1) good quality control, (2) a one-year operating cycle, (3) a relatively stable pattern of annual sales, and (4) a continuing policy of guaranteeing new products against defects for three years that has resulted in material but rather stable warranty repair and replacement costs. Any liability for the warranty

- a) should be reported as long-term.
- b) should be reported as current.
- c) should be reported as part current and part long-term.**
- d) need not be disclosed.

9) If bonds are initially sold at a discount and the straight-line method of amortization is used, interest expense in the earlier years will

- a) exceed what it would have been had the effective interest method of amortization been used.**
- b) be less than what it would have been had the effective interest method of amortization been used.
- c) be the same as what it would have been had the effective interest method of amortization been used.
- d) be less than the stated (nominal) rate of interest.

10) When a company sets aside money in a trust such that the investment and any return

will be sufficient to pay the principal and the interest to the creditor, but the creditor does not release the company from the primary obligation to settle the debt, this type of arrangement is known as

- a) substantive repayment.
- b) in-substance refunding.
- c) in-substance defeasance.**
- d) legal defeasance.

11) When shares are reacquired at a cost greater than their original issue price and cancelled, what account(s) should be debited?

- a) The share account for the total cost.
- b) The share account for the original issue price, the existing contributed capital account from prior retirements in this class of shares, if any, and any remaining balance to retained earnings.
- c) The share account for the average per share amount and retained earnings for the additional amount.
- d) The share account for the average per share amount and a loss account for the additional amount.
- e) None of the above.**

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12) Gahan Corp. purchased its own shares on January 1, 2008 for \$20,000 and debited the treasury shares account for the purchase price. The shares were subsequently sold for \$12,000. The \$8,000 difference between the cost and sales price should be recorded as a deduction from

- a) contributed surplus to the extent that previous net "gains" from sales or retirements of the same class of shares are included therein; otherwise, from retained earnings.
- b) contributed surplus without regard as to whether or not there have been previous net "gains" from sales or retirements of the same class of shares included therein.
- c) retained earnings.
- d) net income.

13) Which of the following statements about property dividends is *not* true?

- a) A property dividend is a nonreciprocal transfer of nonmonetary assets.
- b) A property dividend is also called a dividend in kind.
- c) The accounting for a property dividend should be based on the carrying value (book value) of the nonmonetary assets transferred.
- d) All of these statements are true.

14) The issuer of a 5% common stock dividend to common shareholders preferably should transfer from retained earnings to contributed capital an amount equal to the

- a) market value of the shares issued.
- b) book value of the shares issued.
- c) minimum legal requirements.
- d) par or stated value of the shares issued.

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- d) Interest and cumulative preferred dividends in arrears are current liabilities each year (until paid).