1. A partnership is formed by two individuals who were previously sole proprietors. Property other than cash which is part of the initial investment in the partnership would be recorded for financial accounting purposes at the
A. Proprietor's book values or the fair value of the property at the date of the investment, whichever is higher.
B. Proprietor's book values or the fair value of the property at the date of the investment, whichever is lower.
C. Fair value of the property at the date of the investment.
D. Proprietors' book values of the property at the date of the investment.
ANSWER: C
This answer is correct. The investment in the capital of a partnership should be measured at the fair market value of the assets contributed. This is necessary to achieve equity between the partners. Remember that the partnership is a separate reporting entity; any gains (losses) reported by the partnership should result solely from the activities of the partnership. If the property were recorded by the partnership at the proprietors' book value, a gain (loss) may ultimately become recognized by the partnership which is actually attributable to the time period prior to when the property was acquired by the partnership.

2. Jaden Co. produces expensive equipment for sale on installment contracts. When there is doubt about eventual collectibility, the income recognition method least likely to overstate income is
A. At the time of delivery.
B. The cost recovery method.
C. The installment method.
D. At the time the equipment is completed.
ANSWER: B
This answer is correct. Profit is deemed to be realized when a sale in the ordinary course of business is effected, unless the circumstances are such that the collection of the sale price is not reasonably assured. The most conservative accounting treatment in such instances is the cost recovery method, which defers the recognition of any profit until the full cost of the item sold has been collected. Subsequent collections are then considered to be all profit.

3. Cole Co. had the following balances at December 31, year 1:

Cash in checking account $350,000
Cash in money-market account 250,000
US Treasury bill, purchased 12/1/Y1, maturing 2/28/Y2 800,000
US Treasury bond, purchased 3/1/Y1, maturing 2/28/Y2 500,000

Cole's policy is to treat as cash equivalents all highly-liquid investments with a maturity of 3 months or less when purchased. What amount should Cole report as cash and cash equivalents in its December 31, year 1 balance sheet?

A. $1,400,000
B. $1,150,000
C. $ 600,000
D. $1,900,000
ANSWER: A
This answer is correct. If no restrictions apply, cash in checking accounts ($350,000) is always included in cash. Per ASC Topic 305, cash equivalents are short-term, highly liquid investments which are readily convertible into cash and have maturities of 3 months or less from the date of purchase by the entity. Common examples are

treasury bills, commercial paper, and money-market funds. In this case, the cash equivalents are the money-market account ($250,000) and the treasury bill ($800,000). Therefore, total cash and cash equivalents is $1,400,000 ($350,000 + $250,000 + $800,000). The maturity of the treasury bond was at least 12 months (3/1/Y1 to 2/28/Y2) from the date of purchase, therefore, it should not be reported in cash and cash equivalents.

4. A flash flood swept through Max, Inc.'s warehouse on May 1. After the flood, Max's accounting records showed the following:

Inventory, January 1 $ 35,000
Purchases, January 1 through May 1 200,000
Sales, January 1 through May 1 250,000
Inventory not damaged by flood 30,000
Gross profit percentage on sales 40%

What amount of inventory was lost in the flood?

A. $ 85,000
B. $150,000
C. $120,000
D. $ 55,000
ANSWER: D
This answer is correct. The requirement is to determine the amount of lost inventory. The gross profit method should be used to estimate the cost of goods sold and the amount lost in the flood. If the gross profit percentage is 40%, the cost of sales percentage is 60% and cost of goods sold can be estimated to be $150,000 ($250,000 × 60%). Beginning inventory plus purchases equals goods available for sale or $235,000 ($35,000 + $200,000). Goods available for sale of $235,000 less cost of goods sold of $150,000 equals $85,000 (estimated ending inventory). A count of inventory not lost in the flood resulted in $30,000; therefore, the amount lost in the flood equals $55,000 ($85,000 – $30,000), and this is correct.

5. Under IFRS, interest and dividends received may be reported on the statement of cash flows as
A. Investing activities only.
B. Either operating or investing activities.
C. Operating activities only.
D. Neither operating nor investing activities.
ANSWER: B
This answer is correct because under IFRS, interest and dividends received may be reported on the statement of cash flows as either operating or investing activities. Although an entity has reporting discretion, it must be reported consistently.

6. Which of the following transactions would require the use of the present value of an annuity due concept in order to calculate the present value of the asset obtained or liability owed at the date of incurrence?
A. A 10-year 8% bond is issued on January 2 with interest payable semiannually on July 1 and January 1 yielding 7%.
B. A 10-year 8% bond is issued on January 2 with interest payable semiannually on July 1 and January 1 yielding 9%.
C. A capital lease is entered into with the initial lease payment due 1 month subsequent to the signing of the

B. $0 $330,000
C. $190,000 $150,000
D. $190,000 $0

A. D
B. B
C. A
D. C
ANSWER: A
This answer is correct. The current liability for pensions at 12/31/Y5 consists of the year 5 net pension cost ($190,000), which will not be paid until 2 months after year-end. There is no noncurrent liability. A noncurrent liability would exist if the projected benefit obligation ($480,000) exceeds the fair value of plan assets ($500,000). ASC Topic 715 requires the recording of a liability when the projected benefit obligation is greater than the fair value of plan assets. The unrecognized prior service cost ($150,000) is not directly recorded as a liability. It is amortized to pension cost over future periods.

9. Under IFRS reporting, a prior period error includes all of the following except for:
A. Changing accounting policies.
B. Incorrect application of accounting policies.
C. Measurement mistakes.
D. Disclosure mistakes.
ANSWER: A
This answer is correct because under IFRS reporting, changes in accounting policies are not considered prior period errors. Prior period errors include arithmetic mistakes; accounting policy application mistakes; and recognition, measurement, presentation, and disclosure mistakes.

10. Justin owns 100% of the capital stock of both Blake Corp. and Sydney Corp. Blake purchases merchandise inventory from Sydney at 140% of Sydney's cost. During year 2, merchandise that cost Sydney $40,000 was sold to Blake. Blake sold all of this merchandise to unrelated customers for $81,200 during year 2. In preparing combined financial statements for year 2, Justin's bookkeeper disregarded the common ownership of Blake and Sydney. What amount should be eliminated from cost of goods sold in the combined income statement for year 2?
A. $16,000
B. $40,000
C. $24,000
D. $56,000
ANSWER: D
This answer is correct. When computing combined cost of goods sold (CGS), the objective is to restate the accounts as if the intercompany transactions had not occurred. Assuming that there was no sale between Blake and Sydney, the correct amount of consolidated CGS would be $40,000, the original cost of the merchandise to Sydney. However, Sydney recognized $40,000 for CGS and Blake recognized $56,000 ($40,000 × 140%) for a total of $96,000. Thus, $56,000 ($96,000 – $40,000) should be eliminated from CGS in the combined income statement for year 2.

11. Genesis Company reports under IFRS. At December 31, 20X1, Genesis classified a note payable as a current liability. Under what conditions could Genesis reclassify the note payable from current to noncurrent?