CH 22 Textbook Self-Study Questions

2. Which of the following is accounted for as a change in accounting principle?
   A. A change in the residual value of plant assets.
   B. A change from the cash basis of accounting to the accrual basis of accounting.
   C. A change from double-declining balance method to the straight line method of calculating depreciation.
   D. A change in inventory valuation from average cost to FIFO.

3. On December 31, 2012, Goldewait, Inc. appropriately changed its inventory valuation method to FIFO cost from weighted-average cost for financial statement and income tax purposes. The change will result in a $1,950,000 increase in the beginning inventory at January 1, 2012. Assume a 30% income tax rate. The cumulative effect of this accounting change on beginning retained earnings is
   A. $0.
   B. $585,000.
   C. $1,365,000.
   D. $1,950,000.

4. A change to LIFO inventory valuation from any other acceptable inventory valuation method
   A. requires the use of the retrospective approach.
   B. is accounted for as an adjustment to beginning retained earnings.
   C. is not allowed by the FASB.
   D. requires no restatement of prior years' net income.

5. Which type of accounting change should always be accounted for in current and future periods?
   A. Change in accounting principle
   B. Change in reporting entity
   C. Change in accounting estimate
   D. Correction of an error

6. Presenting consolidated financial statements this year when statements of individual companies were presented last year is
   A. a correction of an error.
   B. an accounting change that should be reported prospectively.
   C. an accounting change that should be reported by restating the financial statements of all prior periods presented.
   D. not an accounting change.

7. Mazzeo Inc. is a calendar-year corporation. Its financial statements for the years ended 12/31/12 and 12/31/13 contained the following errors:

<table>
<thead>
<tr>
<th></th>
<th>2012</th>
<th>2013</th>
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</thead>
<tbody>
<tr>
<td>Ending inventory</td>
<td>$23,000 overstatement</td>
<td>$31,000 understatement</td>
</tr>
<tr>
<td>Depreciation expense</td>
<td>19,000 understatement</td>
<td>11,000 overstatement</td>
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</tbody>
</table>

Assume that the 2012 errors were not corrected and that no errors occurred in 2011. By what amount will 2012 income before income taxes be overstated or understated?
   A. $42,000 overstatement
   B. $4,000 overstatement
   C. $23,000 understatement
   D. $19,000 understatement
8. Which of the following is not a reason why companies prefer certain accounting methods?
   A. Bonus payments.
   B. Asset structure.
   C. Political costs.
   D. Smooth earnings.

9. Which of the following is not a counterbalancing error?
   A. Failure to record accrued wages.
   B. Failure to record depreciation.
   C. Failure to record prepaid expenses.
   D. Understatement of unearned revenue.

10. Accounting changes are often made and the monetary impact is reflected in the financial statements of a company even though, in theory, this may be a violation of the accounting concept of
    A. materiality.
    B. consistency.
    C. faithful representation.
    D. objectivity.

11. What approach does the FASB generally require when accounting for changes in accounting principle?
    A. Cumulative.
    B. Retrospective.
    C. Prospective.
    D. Current.

12. On January 1, 2012, Key Corp. changed its inventory method to FIFO from LIFO for both financial and income tax reporting purposes. The change resulted in a $2,320,000 increase in the January 1, 2012 inventory. Assume that the income tax rate for all years is 27.5%. How should the cumulative effect of the accounting change be reported by Key in its 2012 financial statements?
    A. retained earnings statement as a $1,682,000 addition to the beginning balance.
    B. income statement as a $2,320,000 cumulative effect of accounting change.
    C. retained earnings statement as an $638,000 addition to the beginning balance.
    D. income statement as an $1,682,000 cumulative effect of accounting change.

13. If retrospective application of a change in accounting principle requires assumptions about management's intent in a prior period, then what approach should be used to account for the change?
    A. Retrospective.
    B. Cumulative.
    C. Prior period adjustment.
    D. Prospective.

14. When a company changes from an accelerated method to the straight-line method of depreciation, this change should be handled as a
    A. change in accounting principle.
    B. change in accounting estimate.
    C. prior period adjustment.
    D. correction of an error.
15. Which of the following describes a change in reporting entity?
   A. A company acquires a subsidiary that is to be accounted for as a purchase.
   B. A manufacturing company expands its market from regional to nationwide.
   C. A company divests itself of a European branch sales office.
   D. Changing the companies included in combined financial statements.

16. On July 1, 2011, Kelly Corp. acquired equipment at a cost of $720,000. It is to be depreciated on the straight-line method over a four-year period with no residual value. Because of a bookkeeping error, no depreciation was recognized in Kelly's 2011 financial statements. The oversight was discovered during the preparation of Kelly's 2012 financial statements. Which of the following accounts will not be affected by correcting the error that occurred in 2011, assuming comparative financial statements are not prepared?
   A. Depreciation Expense.
   B. Accumulated Depreciation.
   C. Retained Earnings.
   D. All of these accounts will be affected.

18. All of the following involve counterbalancing errors except the
   A. failure to record prepaid expenses.
   B. failure to adjust for bad debts.
   C. understatement of inventory.
   D. overstatement of purchases.

19. A change that occurs as the result of new information or as additional experience is acquired is a:
   A. change in accounting principle.
   B. change in accounting estimate.
   C. change in reporting entity.
   D. correction of an error.

20. All of the following are examples of a change in accounting principle except a change from:
   A. average cost to LIFO inventory pricing.
   B. FIFO to average cost.
   C. the completed-contract to percentage-of-completion method of accounting for construction contracts.
   D. the double-declining balance method to the straight-line method of depreciation.

21. A switch from the cash basis of accounting to the accrual basis is considered a:
   A. change in accounting principle.
   B. change in accounting estimate.
   C. change in reporting entity.
   D. correction of an error.

23. The cumulative effect of a change in accounting principle is reported:
   A. on the income statement as an extraordinary item.
   B. on the income statement as part of discontinued operations.
   C. on the retained earnings statement as an adjustment to the beginning balance of the current year.
   D. on the retained earnings statement as an adjustment to the beginning balance of the earliest year presented.
25. Corrections of errors from prior periods are reported:
   A. as an extraordinary item.
   B. between extraordinary items and net income on the income statement.
   C. as adjustments to the current year's beginning retained earnings.
   D. as adjustments of beginning retained earnings of the earliest year presented.

26. The cumulative effect of an accounting change is not computed for a change:
   A. from the LIFO method to the FIFO method.
   B. to the percentage-of-completion method from the completed-contract method.
   C. to the LIFO method from the FIFO method.
   D. All of the options require computation of the cumulative effect of the change.

27. Changes in estimates must be accounted for:
   A. consistently.
   B. currently.
   C. prospectively.
   D. retrospectively.

Additional Self-Study Questions

1. Which of the following statements related to changes in estimates is not correct?
   A. Financial statements of prior periods are not restated.
   B. Opening balances are not adjusted for the change.
   C. Pro forma amounts for prior periods are reported.
   D. These changes are viewed as normal recurring corrections and adjustments.

2. A change in reporting entity is accounted for:
   A. prospectively.
   B. currently.
   C. retrospectively.
   D. consistently.

3. Foster Inc. is a calendar-year corporation. Its financial statements for the years ended 12/31/12 and 12/31/13 contained the following errors:
   Ending inventory $11,500 understatement 2012; $13,000 overstatement 2013
   Depreciation expense 9,500 overstatement 2012; 10,500 understatement 2013

   Assume that the 2012 errors were not corrected and that no errors occurred in 2011. By what amount will 2012 income before income taxes be overstated or understated?
   A. $21,000 understatement
   B. $2,000 understatement
   C. $9,500 overstatement
   D. $1,000 overstatement
4. Failure to record depreciation expense in a given year must be accounted for:
   A. currently.
   B. by showing pro forma data.
   C. as a prior period adjustment.
   D. prospectively.

8. A switch from the cash basis of accounting to the accrual basis is correction of an error.
   A. True
   B. False

9. A change in from an accelerated method to the straight-line method of depreciation requires an adjustment to the beginning balance of retained earnings.
   A. True
   B. False

10. A change in the useful life and salvage value of a depreciable asset is handled retrospectively.
    A. True
    B. False

11. Changes due to an error result in a restatement of the beginning retained earnings balance.
    A. True
    B. False

12. Recording a depreciable asset as an expense is an example of a noncounterbalancing error.
    A. True
    B. False

13. Failure to record depreciation expense in a prior year would be accounted for as a prospective change.
    A. True
    B. False

15. Understating ending inventory will understate the current year's net income.
    A. True
    B. False

17. Inventory errors are counterbalancing errors.
    A. True
    B. False

19. Which of the following is not one of the three types of accounting changes?
    A. Change in accounting principle.
    B. Change in reporting entity.
    C. Change in accounting estimate.
    D. Correction of an error.
20. A company fails to record accrued wages for the current year. Which of the following statement is true?
   A. Net income for the current year is understated.
   B. Net income for the current year is correct.
   C. Retained earnings for the current year is overstated.
   D. Retained earnings for the current year is understated.

21. A change in depreciation method used is which type of accounting change?
   A. Cumulative-effect type.
   B. Retrospective-effect type.
   C. Prospective-effect type.
   D. Counterbalancing-effect type.

22. A change from LIFO inventory valuation to another inventory valuation method is an example of a:
   A. cumulative-effect type of accounting change.
   B. retrospective-effect type of accounting change.
   C. prospective-effect type of accounting change.
   D. current-effect type of accounting change.

24. At December 31, 2010, Grambling Inc. estimated bad debts as 3% of the outstanding balance of Accounts Receivable. At December 31, 2011, Grambling determined that it had underestimated bad debts in the prior period and increased its estimate to 6.5%. This change is handled on a:
   A. retrospective basis.
   B. cumulative basis.
   C. prospective basis.
   D. speculative basis.

25. Whenever it is impossible to determine whether a change in principle or a change in estimate has occurred, the change should be considered a:
   A. change in principle.
   B. correction of an error.
   C. change in estimate.
   D. counterbalancing error.

26. Which of the following is an example of a change in reporting entity?
   A. Presenting consolidated statements in place of statements for individual companies.
   B. Changing the companies included in combined financial statements.
   C. Changing specific subsidiaries that constitute the group of companies for which the entity presents consolidated financial statements.
   D. All of the above.

27. In 2011, Friends Company failed to record depreciation expense on some of its assets. When the error is discovered in 2012, it will be accounted for:
   A. using pro forma data.
   B. prospectively.
   C. as a prior period adjustment.
   D. All of the above.
## SOLUTIONS

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<tr>
<th>Self-study</th>
<th>Additional self-study</th>
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<tbody>
<tr>
<td>12. A</td>
<td>27. C</td>
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<td>13. D</td>
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