

CHAPTER 4

INCOME STATEMENT AND RELATED INFORMATION

IFRS questions are available at the end of this chapter.

TRUE-FALSE—Conceptual

Answer	No.	Description
T	1.	Usefulness of the income statement.
F	2.	Limitations of the income statement.
F	3.	Earnings management.
T	4.	Transaction approach of income measurement.
T	5.	Single-step income statement.
T	6.	Revenues and gains.
F	7.	Multiple-step vs. single-step income statement.
F	8.	Multiple-step income statement.
T	9.	Multiple-step vs. single-step income statement.
F	10.	Current operating performance approach.
T	11.	Reporting discontinued operations.
F	12.	Reporting extraordinary items.
F	13.	Irregular items.
T	14.	Intraperiod tax allocation.
F	15.	Reporting earnings per share.
F	16.	Computation of earnings per share.
T	17.	Prior period adjustments.
F	18.	Retained earnings restrictions.
F	19.	Comprehensive income definition.
T	20.	Reporting other comprehensive income.

MULTIPLE CHOICE—Conceptual

Answer	No.	Description
c	21.	Elements of the income statement.
d	22.	Usefulness of the income statement.
b	23.	Limitations of the income statement.
d	^s 24.	Use of an income statement.
d	^s 25.	Income statement reporting.
c	26.	Income statement information.
b	27.	Example of managing earnings down.
c	28.	Example of managing earnings up.
b	29.	Improving current net income.
a	30.	Decreasing current net income.
d	31.	Single-step income statement advantage.
b	32.	Single-step income statement.
d	33.	Methods of preparing income statements.
a	34.	Income statement presentation.
b	35.	Event with no income statement effect.
c	^s 36.	Net income effect.

MULTIPLE CHOICE—Conceptual (cont.)

Answer	No.	Description
b	^P 37.	Selling expenses.
b	^P 38.	Reporting merchandise inventory.
a	39.	Definition of an extraordinary item.
d	40.	Classification of an extraordinary item.
d	41.	Identification of an extraordinary item.
a	42.	Identification of an extraordinary item.
d	43.	Identification of an extraordinary item.
a	44.	Presentation of unusual or infrequent items.
d	45.	Identification of a change in accounting principle.
d	46.	Classification of extraordinary items.
c	47.	EPS disclosures on income statement.
c	48.	Reporting discontinued operations.
c	^S 49.	Reporting unusual or infrequent items.
d	50.	Intraperiod tax allocation.
d	51.	Purpose of intraperiod tax allocation.
c	52.	Intraperiod tax allocation.
d	53.	Reporting items net of tax.
d	54.	Reporting items at gross amount.
c	55.	Earnings per share disclosure.
d	56.	EPS disclosures on income statement.
d	57.	EPS disclosures on income statement.
c	^S 58.	Earnings per share disclosure.
d	^P 59.	Reporting correction of an error.
c	60.	Retained earnings statement.
d	61.	Prior period adjustment.
d	62.	Identification of a prior period adjustment.
b	63.	Reporting EPS amounts.
c	64.	Reporting EPS on financial statements.
b	65.	Comprehensive income inclusion.
a	66.	Displaying comprehensive income.
d	67.	Comprehensive income disclosure method.
c	68.	Comprehensive income items.
c	69.	Providing information about components of comprehensive income.

MULTIPLE CHOICE—Computational

Answer	No.	Description
a	70.	Calculate total revenues.
c	71.	Calculate total expenses.
a	72.	Single-step income statement.
c	73.	Multiple-step income statement.
c	74.	Multiple-step income statement.
c	75.	Calculation of net sales.
a	76.	Presentation of gain on sale of plant assets.
a	77.	Extraordinary items.
a	78.	Extraordinary items.
a	79.	Calculate income before extraordinary items.
c	80.	Calculate income before taxes and extraordinary items.

MULTIPLE CHOICE—Computational (cont.)

- | | | |
|---|------|--|
| b | 81. | Calculate extraordinary loss. |
| a | 82. | Events affecting income from continuing operations. |
| b | 83. | Calculation of events affecting net income. |
| c | 84. | Disposal of a major business component. |
| c | 85. | Tax effect on irregular items. |
| c | 86. | Tax effect on irregular items. |
| b | 87. | Calculate income tax expense. |
| a | 88. | Calculate income tax expense. |
| a | 89. | Calculate income tax expense. |
| b | 90. | Calculate earnings per share. |
| d | 91. | Calculate EPS for extraordinary loss. |
| d | 92. | Calculate earnings per share. |
| c | 93. | Earnings per share. |
| c | 94. | Earnings per share. |
| a | 95. | Retained earnings statement. |
| b | 96. | Retained earnings statement. |
| c | 97. | Retained earnings statement. |
| d | 98. | Retained earnings statement. |
| d | 99. | Calculate balance of retained earnings. |
| d | 100. | Calculate other comprehensive income. |
| a | 101. | Calculate comprehensive income. |
| c | 102. | Calculate ending Accumulated Other Comprehensive Income. |
| c | 103. | Calculate ending Retained Earnings balance. |
| a | 104. | Calculate total stockholders' equity. |

^P Note: these questions also appear in the Problem-Solving Survival Guide.

^S Note: these questions also appear in the Study Guide.

MULTIPLE CHOICE—CPA Adapted

Answer	No.	Description
d	105.	Calculate selling expenses.
a	106.	Calculate general and administrative expenses.
a	107.	Calculate selling expenses.
a	108.	Calculate general and administrative expenses.
d	109.	Calculate cost of goods manufactured.
c	110.	Calculate income before extraordinary item.
a	111.	Determine extraordinary loss.
b	112.	Determine infrequent gains not extraordinary.
a	113.	Determine infrequent losses not extraordinary.
b	114.	Identification of prior period adjustment.

EXERCISES

Item	Description
E4-115	Definitions.
E4-116	Terminology.
E4-117	Income statement disclosures.
E4-118	Calculate net income from change in stockholders' equity.
E4-119	Calculate net income from change in stockholders' equity.
E4-120	Income statement classifications.
E4-121	Income statement relationships.
E4-122	Multiple-step income statement.
E4-123	Classification of income and retained earnings statement items.

PROBLEMS

Item	Description
P4-124	Multiple-step income statement.
P4-125	Income statement form.
P4-126	Multiple-step income statement.
P4-127	Single-step income statement.
P4-128	Income statement and retained earnings statement.
P4-129	Irregular items and financial statements.

CHAPTER LEARNING OBJECTIVES

1. Understand the uses and limitations of an income statement.
2. Prepare a single-step income statement.
3. Prepare a multiple-step income statement.
4. Explain how to report irregular items.
5. Explain intraperiod tax allocation.
6. Identify where to report earnings per share information.
7. Prepare a retained earnings statement.
8. Explain how to report other comprehensive income.

SUMMARY OF LEARNING OBJECTIVES BY QUESTIONS

Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type	Item	Type
Learning Objective 1													
1.	TF	4.	TF	23.	MC	26.	MC	29.	MC	116.	E	119.	E
2.	TF	21.	MC	^S 24.	MC	27.	MC	30.	MC	117.	E		
3.	TF	22.	MC	^S 25.	MC	28.	MC	115.	E	118.	E		
Learning Objective 2													
5.	TF	31.	MC	70.	MC	72.	MC						
6.	TF	32.	MC	71.	MC	127.	P						
Learning Objective 3													
7.	TF	34.	MC	^P 38.	MC	76.	MC	108.	MC	121.	E	126.	P
8.	TF	35.	MC	73.	MC	105.	MC	109.	MC	122.	E	128.	P
9.	TF	^S 36.	MC	74.	MC	106.	MC	110.	MC	123.	E		
33.	MC	^P 37.	MC	75.	MC	107.	MC	120.	E	124.	P		
Learning Objective 4													
10.	TF	41.	MC	47.	MC	80.	MC	110.	MC	123.	E		
11.	TF	42.	MC	48.	MC	81.	MC	111.	MC	124.	P		
12.	TF	43.	MC	^S 49.	MC	82.	MC	112.	MC	125.	P		
13.	TF	44.	MC	77.	MC	83.	MC	113.	MC	126.	P		
39.	MC	45.	MC	78.	MC	84.	MC	115.	E	127.	P		
40.	MC	46.	MC	79.	MC	108.	MC	116.	E	128.	P		
Learning Objective 5													
14.	TF	52.	MC	85.	MC	88.	MC	124.	P	127.	P		
50.	MC	53.	MC	86.	MC	89.	MC	125.	P	128.	P		
51.	MC	54.	MC	87.	MC	116.	E	126.	P				
Learning Objective 6													
15.	TF	55.	MC	^S 58.	MC	92.	MC	115.	E	127.	P		
16.	TF	56.	MC	90.	MC	93.	MC	124.	P	128.	P		
47.	MC	57.	MC	91.	MC	94.	MC	126.	P				
Learning Objective 7													
17.	TF	60.	MC	63.	MC	96.	MC	99.	MC	116.	E	128.	P
18.	TF	61.	MC	64.	MC	97.	MC	114.	MC	123.	E		
^P 59.	MC	62.	MC	95.	MC	98.	MC	115.	E	127.	P		
Learning Objective 8													
19.	TF	65.	MC	67.	MC	69.	MC	101.	MC	103.	MC		
20.	TF	66.	MC	68.	MC	100.	MC	102.	MC	104.	MC		

Note: TF = True-False
MC = Multiple Choice

E = Exercise
P = Problem

TRUE-FALSE—Conceptual

1. The income statement is useful for helping to assess the risk or uncertainty of achieving future cash flows.
2. A strength of the income statement as compared to the balance sheet is that items that cannot be measured reliably can be reported in the income statement.
3. Earnings management generally makes income statement information more useful for predicting future earnings and cash flows.
4. The transaction approach of income measurement focuses on the income-related activities that have occurred during the period.
5. Companies frequently report income tax expense as the last item before net income on a single-step income statement.
6. Both revenues and gains increase both net income and owners' equity.
7. Use of a multiple-step income statement will result in the company reporting a higher net income than if they used a single-step income statement.
8. The primary advantage of the multiple-step format lies in the simplicity of presentation and the absence of any implication that one type of revenue or expense item has priority over another.
9. Gross profit and income from operations are reported on a multiple-step but not a single-step income statement.
10. The accounting profession has adopted a current operating performance approach to income reporting.
11. Companies report the results of operations of a component of a business that will be disposed of separately from continuing operations.
12. Gains or losses from exchange or translation of foreign currencies are reported as extraordinary items.
13. Discontinued operations, extraordinary items, and unusual gains and losses are all reported net of tax in the income statement.
14. Intraperiod tax allocation relates the income tax expense of the period to the specific items that give rise to the amount of the tax provision.
15. A company that reports a discontinued operation or an extraordinary item has the option of reporting per share amounts for these items.
16. Dividends declared on common and preferred stock are subtracted from net income in the computation of earnings per share.

17. Prior period adjustments can either be added or subtracted in the Retained Earnings Statement.
18. Companies only restrict retained earnings to comply with contractual requirements or current necessity.
19. Comprehensive income includes all changes in equity during a period except those resulting from distributions to owners.
20. The components of other comprehensive income can be reported in a statement of stockholders' equity.

True False Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
1.	T	6.	T	11.	T	16.	F
2.	F	7.	F	12.	F	17.	T
3.	F	8.	F	13.	F	18.	F
4.	T	9.	T	14.	T	19.	F
5.	T	10.	F	15.	F	20.	T

MULTIPLE CHOICE—Conceptual

21. The major elements of the income statement are
- revenue, cost of goods sold, selling expenses, and general expense.
 - operating section, nonoperating section, discontinued operations, extraordinary items, and cumulative effect.
 - revenues, expenses, gains, and losses.
 - all of these.
22. Information in the income statement helps users to
- evaluate the past performance of the enterprise.
 - provide a basis for predicting future performance.
 - help assess the risk or uncertainty of achieving future cash flows.
 - all of these.
23. Limitations of the income statement include all of the following *except*
- items that cannot be measured reliably are not reported.
 - only actual amounts are reported in determining net income.
 - income measurement involves judgment.
 - income numbers are affected by the accounting methods employed.
- ^S24. Which of the following would represent the least likely use of an income statement prepared for a business enterprise?
- Use by customers to determine a company's ability to provide needed goods and services.
 - Use by labor unions to examine earnings closely as a basis for salary discussions.
 - Use by government agencies to formulate tax and economic policy.
 - Use by investors interested in the financial position of the entity.

25. The income statement reveals
- resources and equities of a firm at a point in time.
 - resources and equities of a firm for a period of time.
 - net earnings (net income) of a firm at a point in time.
 - net earnings (net income) of a firm for a period of time.
26. The income statement information would help in which of the following tasks?
- Evaluate the liquidity of a company.
 - Evaluate the solvency of a company
 - Estimate future cash flows
 - Estimate future financial flexibility
27. Which of the following is an example of managing earnings down?
- Changing estimated bad debts from 3 percent to 2.5 percent of sales.
 - Revising the estimated life of equipment from 10 years to 8 years.
 - Not writing off obsolete inventory.
 - Reducing research and development expenditures.
28. Which of the following is an example of managing earnings up?
- Decreasing estimated salvage value of equipment.
 - Writing off obsolete inventory.
 - Underestimating warranty claims.
 - Accruing a contingent liability for an ongoing lawsuit.
29. What might a manager do during the last quarter of a fiscal year if she wanted to improve current annual net income?
- Increase research and development activities.
 - Relax credit policies for customers.
 - Delay shipments to customers until after the end of the fiscal year.
 - Delay purchases from suppliers until after the end of the fiscal year.
30. What might a manager do during the last quarter of a fiscal year if she wanted to decrease current annual net income?
- Delay shipments to customers until after the end of the fiscal year.
 - Relax credit policies for customers.
 - Pay suppliers all amounts owed.
 - Delay purchases from suppliers until after the end of the fiscal year.
31. Which of the following is an advantage of the single-step income statement over the multiple-step income statement?
- It reports gross profit for the year.
 - Expenses are classified by function.
 - It matches costs and expenses with related revenues.
 - It does not imply that one type of revenue or expense has priority over another.
32. The single-step income statement emphasizes
- the gross profit figure.
 - total revenues and total expenses.
 - extraordinary items and accounting changes more than these are emphasized in the multiple-step income statement.
 - the various components of income from continuing operations.

33. Which of the following is an acceptable method of presenting the income statement?
- A single-step income statement
 - A multiple-step income statement
 - A consolidated statement of income
 - All of these
34. Which of the following is *not* a generally practiced method of presenting the income statement?
- Including prior period adjustments in determining net income
 - The single-step income statement
 - The consolidated statement of income
 - Including gains and losses from discontinued operations of a component of a business in determining net income
35. The occurrence which most likely would have no effect on 2010 net income (assuming that all amounts involved are material) is the
- sale in 2010 of an office building contributed by a stockholder in 1983.
 - collection in 2010 of a receivable from a customer whose account was written off in 2009 by a charge to the allowance account.
 - settlement based on litigation in 2010 of previously unrecognized damages from a serious accident which occurred in 2008.
 - worthlessness determined in 2010 of stock purchased on a speculative basis in 2006.
- ^S36. The occurrence that most likely would have no effect on 2010 net income is the
- sale in 2010 of an office building contributed by a stockholder in 1961.
 - collection in 2010 of a dividend from an investment.
 - correction of an error in the financial statements of a prior period discovered subsequent to their issuance.
 - stock purchased in 1996 deemed worthless in 2010.
- ^P37. Which of the following is *not* a selling expense?
- Advertising expense
 - Office salaries expense
 - Freight-out
 - Store supplies consumed
- ^P38. The accountant for the Lintz Sales Company is preparing the income statement for 2010 and the balance sheet at December 31, 2010. The January 1, 2010 merchandise inventory balance will appear
- only as an asset on the balance sheet.
 - only in the cost of goods sold section of the income statement.
 - as a deduction in the cost of goods sold section of the income statement and as a current asset on the balance sheet.
 - as an addition in the cost of goods sold section of the income statement and as a current asset on the balance sheet.
39. In order to be classified as an extraordinary item in the income statement, an event or transaction should be
- unusual in nature, infrequent, and material in amount.
 - unusual in nature and infrequent, but it need not be material.
 - infrequent and material in amount, but it need not be unusual in nature.
 - unusual in nature and material, but it need not be infrequent.

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40. Classification as an extraordinary item on the income statement would be appropriate for the
- gain or loss on disposal of a component of the business.
 - substantial write-off of obsolete inventories.
 - loss from a strike.
 - none of these.
41. Which of these is generally an example of an extraordinary item?
- Loss incurred because of a strike by employees.
 - Write-off of deferred marketing costs believed to have no future benefit.
 - Gain resulting from the devaluation of the U.S. dollar.
 - Gain resulting from the state exercising its right of eminent domain on a piece of land used as a parking lot.
42. Under which of the following conditions would material flood damage be considered an extraordinary item for financial reporting purposes?
- Only if floods in the geographical area are unusual in nature and occur infrequently.
 - Only if the flood damage is material in amount and could have been reduced by prudent management.
 - Under any circumstances as an extraordinary item.
 - Flood damage should never be classified as an extraordinary item.
43. An item that should be classified as an extraordinary item is
- write-off of goodwill.
 - gains from transactions involving foreign currencies.
 - losses from moving a plant to another city.
 - gains from a company selling the only investment it has ever owned.
44. How should an unusual event not meeting the criteria for an extraordinary item be disclosed in the financial statements?
- Shown as a separate item in operating revenues or expenses if material and supplemented by a footnote if deemed appropriate.
 - Shown in operating revenues or expenses if material but not shown as a separate item.
 - Shown net of income tax after ordinary net earnings but before extraordinary items.
 - Shown net of income tax after extraordinary items but before net earnings.
45. 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
46. Which of the following is never classified as an extraordinary item?
- Losses from a major casualty.
 - Losses from an expropriation of assets.
 - Gain on a sale of the only security investment a company has ever owned.
 - Losses from exchange or translation of foreign currencies.

47. Which of the following is a required disclosure in the income statement when reporting the disposal of a component of the business?
- The gain or loss on disposal should be reported as an extraordinary item.
 - Results of operations of a discontinued component 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.
48. When a company discontinues an operation and disposes of the discontinued operation (component), 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.
- ^s49. A material item which is unusual in nature or infrequent in occurrence, but not both should be shown in the income statement
- | | <u>Net of Tax</u> | <u>Disclosed Separately</u> |
|----|-------------------|-----------------------------|
| a. | No | No |
| b. | Yes | Yes |
| c. | No | Yes |
| d. | Yes | No |
50. Income taxes are allocated to
- extraordinary items.
 - discontinued operations.
 - prior period adjustments.
 - all of these.
51. 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.
52. Companies use intraperiod tax allocation for all of the following items except
- Discontinued operations.
 - Extraordinary items.
 - Changes in accounting estimates.
 - Income from continuing operations.

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53. Which of the following items would be reported net of tax on the face of the income statement?
- Prior period adjustment
 - Unusual gain
 - Cumulative effect of a change in an accounting principle
 - Discontinued operations
54. Which of the following items would be reported at its gross amount on the face of the income statement?
- Extraordinary loss
 - Prior period adjustment
 - Cumulative effect of a change in an accounting principle
 - Unusual gain
55. Where must earnings per share be disclosed in the financial statements to satisfy generally accepted accounting principles?
- On the face of the statement of retained earnings (or, statement of stockholders' equity.)
 - In the footnotes to the financial statements.
 - On the face of the income statement.
 - Either (a) or (c).
56. Which of the following earnings per share figures must be disclosed on the face of the income statement?
- EPS on income from continuing operations.
 - The effect on EPS from operations of a discontinued division, net of taxes.
 - The effect on EPS from an extraordinary item, net of taxes.
 - All of the above.
57. Which of the following earnings per share figures must be disclosed on the face of the income statement?
- EPS for income before taxes.
 - The effect on EPS from unusual items.
 - EPS for gross profit.
 - EPS for income from continuing operations.
- ^S58. Earnings per share should always be shown separately for
- net income and gross margin.
 - net income and pretax income.
 - income before extraordinary items.
 - extraordinary items and prior period adjustments.
- ^P59. A correction of an error in prior periods' income will be reported
- | | <u>In the income statement</u> | <u>Net of tax</u> |
|----|--------------------------------|-------------------|
| a. | Yes | Yes |
| b. | No | No |
| c. | Yes | No |
| d. | No | Yes |

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60. Which of the following items will *not* appear in the retained earnings statement?
- Net loss
 - Prior period adjustment
 - Discontinued operations
 - Dividends
61. 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.
62. Watts 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.
63. A company is not required to report a per share amount on the face of the income statement for which of the following items?
- Net income
 - Prior period adjustment
 - Extraordinary item
 - Discontinued operations
64. Earnings per share data are required on the face of which of the following financial statements?
- Statement of retained earnings
 - Statement of stockholders' equity
 - Income statement
 - Balance sheet
65. Which of the following is included in comprehensive income?
- Investments by owners.
 - Unrealized gains on available-for-sale securities.
 - Distributions to owners.
 - Changes in accounting principles.
66. Which of the following is not an acceptable way of displaying the components of other comprehensive income?
- Combined statement of retained earnings
 - Second income statement
 - Combined statement of comprehensive income
 - As part of the statement of stockholders' equity

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67. Which disclosure method do most companies use to display the components of other comprehensive income?
- Combined statement of retained earnings
 - Second income statement
 - Combined statement of comprehensive income
 - As part of the statement of stockholders' equity
68. Comprehensive income includes all of the following *except*
- dividend revenue.
 - losses on disposal of assets.
 - investments by owners.
 - unrealized holding gains.
69. The approach most companies 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.

Multiple Choice Answers—Conceptual

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
21.	c	28.	c	35.	b	42.	a	49.	c	56.	d	63.	b
22.	d	29.	b	36.	c	43.	d	50.	d	57.	d	64.	c
23.	d	30.	a	37.	b	44.	a	51.	d	58.	c	65.	b
24.	d	31.	d	38.	b	45.	d	52.	c	59.	d	66.	a
25.	d	32.	b	39.	a	46.	d	53.	d	60.	c	67.	d
26.	c	33.	d	40.	d	47.	c	54.	d	61.	d	68.	c
27.	b	34.	a	41.	d	48.	c	55.	c	62.	d	69.	c

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

40. Many answers are possible.

MULTIPLE CHOICE—Computational

70. Ortiz Co. had the following account balances:

Sales	\$ 120,000
Cost of goods sold	60,000
Salary expense	10,000
Depreciation expense	20,000
Dividend revenue	4,000
Utilities expense	8,000
Rental revenue	20,000
Interest expense	12,000
Sales returns	11,000
Advertising expense	13,000

What would Ortiz report as total revenues in a single-step income statement?

- a. \$133,000
 b. \$ 10,000
 c. \$144,000
 d. \$120,000
71. Ortiz Co. had the following account balances:

Sales	\$ 120,000
Cost of goods sold	60,000
Salary expense	10,000
Depreciation expense	20,000
Dividend revenue	4,000
Utilities expense	8,000
Rental revenue	20,000
Interest expense	12,000
Sales returns	11,000
Advertising expense	13,000

What would Ortiz report as total expenses in a single-step income statement?

- a. \$127,000
 b. \$134,000
 c. \$123,000
 d. \$ 63,000
72. For Mortenson Company, the following information is available:

Cost of goods sold	\$ 60,000
Dividend revenue	2,500
Income tax expense	6,000
Operating expenses	23,000
Sales	100,000

In Mortenson's single-step income statement, gross profit

- a. should not be reported.
 b. should be reported at \$13,500.
 c. should be reported at \$40,000.
 d. should be reported at \$42,500.

73. For Mortenson Company, the following information is available:

Cost of goods sold	\$ 60,000
Dividend revenue	2,500
Income tax expense	6,000
Operating expenses	23,000
Sales	100,000

In Mortenson's multiple-step income statement, gross profit

- should not be reported
- should be reported at \$13,500.
- should be reported at \$40,000.
- should be reported at \$42,500.

74. For Rondelli Company, the following information is available:

Cost of goods sold	\$ 90,000
Dividend revenue	4,000
Income tax expense	9,000
Operating expenses	35,000
Sales	150,000

In Rondelli's multiple-step income statement, gross profit

- should not be reported
- should be reported at \$20,000.
- should be reported at \$60,000.
- should be reported at \$64,000.

75. Gross billings for merchandise sold by Lang Company to its customers last year amounted to \$15,720,000; sales returns and allowances were \$370,000, sales discounts were \$175,000, and freight-out was \$140,000. Net sales last year for Lang Company were

- \$15,720,000.
- \$15,350,000.
- \$15,175,000.
- \$15,035,000.

76. If plant assets of a manufacturing company are sold at a gain of \$820,000 less related taxes of \$250,000, and the gain is not considered unusual or infrequent, the income statement for the period would disclose these effects as

- a gain of \$820,000 and an increase in income tax expense of \$250,000.
- operating income net of applicable taxes, \$570,000.
- a prior period adjustment net of applicable taxes, \$570,000.
- an extraordinary item net of applicable taxes, \$570,000.

77. Manning Company has the following items: write-down of inventories, \$120,000; loss on disposal of Sports Division, \$185,000; and loss due to strike, \$113,000. Ignoring income taxes, what total amount should Manning Company report as extraordinary losses?

- \$ -0-.
- \$185,000.
- \$233,000.
- \$298,000.

78. Garwood Company has the following items: write-down of inventories, \$240,000; loss on disposal of Sports Division, \$370,000; and loss due to an expropriation, \$226,000.

Ignoring income taxes, what total amount should Garwood Company report as extraordinary losses?

- a. \$226,000
- b. \$370,000.
- c. \$466,000.
- d. \$596,000.

79. An income statement shows "income before income taxes and extraordinary items" in the amount of \$2,055,000. The income taxes payable for the year are \$1,080,000, including \$360,000 that is applicable to an extraordinary gain. Thus, the "income before extraordinary items" is

- a. \$1,335,000.
- b. \$615,000.
- c. \$1,395,000.
- d. \$675,000.

80. Dole Company, with an applicable income tax rate of 30%, reported net income of \$210,000. Included in income for the period was an extraordinary loss from flood damage of \$30,000 before deducting the related tax effect. The company's income before income taxes and extraordinary items was

- a. \$240,000.
- b. \$300,000.
- c. \$330,000.
- d. \$231,000.

81. A review of the December 31, 2010, financial statements of Somer Corporation revealed that under the caption "extraordinary losses," Somer reported a total of \$515,000. Further analysis revealed that the \$515,000 in losses was comprised of the following items:

- (1) Somer 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 \$250,000 was sustained as a result of hurricane damage to a warehouse.
- (3) During 2010, 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 Somer report as extraordinary on its 2010 income statement?

- a. \$150,000.
- b. \$250,000.
- c. \$400,000.
- d. \$515,000.

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Use the following information for questions 82 and 83.

At Ruth Company, events and transactions during 2010 included the following. The tax rate for all items is 30%.

- (1) Depreciation for 2008 was found to be understated by \$30,000.
- (2) A strike by the employees of a supplier resulted in a loss of \$25,000.
- (3) The inventory at December 31, 2008 was overstated by \$40,000.
- (4) A flood destroyed a building that had a book value of \$500,000. Floods are very uncommon in that area.

82. The effect of these events and transactions on 2010 income from continuing operations net of tax would be
- a. \$17,500.
 - b. \$38,500.
 - c. \$66,500.
 - d. \$416,500.
83. The effect of these events and transactions on 2010 net income net of tax would be
- a. \$17,500.
 - b. \$367,500.
 - c. \$388,500.
 - d. \$416,500.
84. During 2010, Lopez Corporation disposed of Pine Division, a major component of its business. Lopez realized a gain of \$1,200,000, net of taxes, on the sale of Pine's assets. Pine's operating losses, net of taxes, were \$1,400,000 in 2010. How should these facts be reported in Lopez's income statement for 2010?

<u>Total Amount to be Included in</u>	
<u>Income from</u> <u>Continuing Operations</u>	<u>Results of</u> <u>Discontinued Operations</u>
a. \$1,400,000 loss	\$1,200,000 gain
b. 200,000 loss	0
c. 0	200,000 loss
d. 1,200,000 gain	1,400,000 loss

85. Sandstrom Corporation has an extraordinary loss of \$50,000, an unusual gain of \$35,000, and a tax rate of 40%. At what amount should Sandstrom report each item?

<u>Extraordinary loss</u>	<u>Unusual gain</u>
a. \$(50,000)	\$35,000
b. (50,000)	21,000
c. (30,000)	35,000
d. (30,000)	21,000

86. Prophet Corporation has an extraordinary loss of \$200,000, an unusual gain of \$140,000, and a tax rate of 40%. At what amount should Prophet report each item?

<u>Extraordinary loss</u>	<u>Unusual gain</u>
a. \$(200,000)	\$140,000
b. (200,000)	84,000
c. (120,000)	140,000
d. (120,000)	84,000

87. Arreaga Corp. has a tax rate of 40 percent and income before non-operating items of \$232,000. It also has the following items (gross amounts).

Unusual loss	\$ 37,000
Extraordinary loss	101,000
Gain on disposal of equipment	8,000
Change in accounting principle increasing prior year's income	53,000

What is the amount of income tax expense Arreaga would report on its income statement?

- a. \$92,800
b. \$81,200
c. \$99,200
d. \$62,000
88. Palomo Corp has a tax rate of 30 percent and income before non-operating items of \$357,000. It also has the following items (gross amounts).

Unusual gain	\$ 23,000
Loss from discontinued operations	183,000
Dividend revenue	6,000
Income increasing prior period adjustment	74,000

What is the amount of income tax expense Palomo would report on its income statement?

- a. \$115,800
b. \$ 60,900
c. \$ 83,100
d. \$108,900
89. Lantos Company had a 40 percent tax rate. Given the following pre-tax amounts, what would be the income tax expense reported on the face of the income statement?

Sales	\$ 100,000
Cost of goods sold	60,000
Salary expense	8,000
Depreciation expense	11,000
Dividend revenue	9,000
Utilities expense	1,000
Extraordinary loss	10,000
Interest expense	2,000

- a. \$10,800
b. \$ 6,800
c. \$ 7,200
d. \$ 3,200

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90. In 2010, Esther Corporation reported net income of \$1,000,000. It declared and paid preferred stock dividends of \$250,000 and common stock dividends of \$100,000. During 2010, Esther had a weighted average of 200,000 common shares outstanding. Compute Esther's 2010 earnings per share.
- a. \$3.25
 - b. \$3.75
 - c. \$5.00
 - d. \$6.25
91. In 2010, Linz Corporation reported an extraordinary loss of \$1,000,000, net of tax. It declared and paid preferred stock dividends of \$100,000 and common stock dividends of \$300,000. During 2010, Linz had a weighted average of 200,000 common shares outstanding. Compute the effect of the extraordinary loss, net of tax, on earnings per share.
- a. \$3.00
 - b. \$3.50
 - c. \$4.50
 - d. \$5.00
92. In 2010, Benfer Corporation reported net income of \$350,000. It declared and paid common stock dividends of \$40,000 and had a weighted average of 70,000 common shares outstanding. Compute the earnings per share to the nearest cent.
- a. \$4.43
 - b. \$3.50
 - c. \$4.50
 - d. \$5.00
93. Benedict Corporation reports the following information:
- | | |
|--|-----------|
| Net income | \$500,000 |
| Dividends on common stock | 140,000 |
| Dividends on preferred stock | 60,000 |
| Weighted average common shares outstanding | 100,000 |
- Benedict should report earnings per share of
- a. \$3.00.
 - b. \$3.60
 - c. \$4.40.
 - d. \$5.00.
94. Norling Corporation reports the following information:
- | | |
|--|-----------|
| Net income | \$500,000 |
| Dividends on common stock | 140,000 |
| Dividends on preferred stock | 60,000 |
| Weighted average common shares outstanding | 200,000 |
- Norling should report earnings per share of
- a. \$1.50.
 - b. \$1.80
 - c. \$2.20.
 - d. \$2.50.

95. Moorman Corporation reports the following information:

Correction of understatement of depreciation expense	
in prior years, net of tax	\$ 430,000
Dividends declared	320,000
Net income	1,000,000
Retained earnings, 1/1/10, as reported	2,000,000

Moorman should report retained earnings, 1/1/10, as adjusted at

- a. \$1,570,000.
b. \$2,000,000.
c. \$2,430,000.
d. \$3,110,000.
96. Moorman Corporation reports the following information:

Correction of understatement of depreciation expense	
in prior years, net of tax	\$ 430,000
Dividends declared	320,000
Net income	1,000,000
Retained earnings, 1/1/10, as reported	2,000,000

Moorman should report retained earnings, 12/31/10, as adjusted at

- a. \$1,570,000.
b. \$2,250,000.
c. \$2,680,000.
d. \$3,110,000.
97. Leonard Corporation reports the following information:

Correction of overstatement of depreciation expense	
in prior years, net of tax	\$ 215,000
Dividends declared	160,000
Net income	500,000
Retained earnings, 1/1/10, as reported	1,000,000

Leonard should report retained earnings, 1/1/10, as adjusted at

- a. \$785,000.
b. \$1,000,000.
c. \$1,215,000.
d. \$1,555,000.
98. Leonard Corporation reports the following information:

Correction of overstatement of depreciation expense	
in prior years, net of tax	\$ 215,000
Dividends declared	160,000
Net income	500,000
Retained earnings, 1/1/10, as reported	1,000,000

Leonard should report retained earnings, 12/31/10, at

- a. \$785,000.
b. \$1,125,000.
c. \$1,340,000.
d. \$1,555,000.

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99. The following information was extracted from the accounts of Essex Corporation at December 31, 2010:

	<u>CR(DR)</u>
Total reported income since incorporation	\$1,700,000
Total cash dividends paid	(800,000)
Unrealized holding loss	(120,000)
Total stock dividends distributed	(200,000)
Prior period adjustment, recorded January 1, 2010	75,000

What should be the balance of retained earnings at December 31, 2010?

- a. \$655,000.
 - b. \$700,000.
 - c. \$580,000.
 - d. \$775,000.
100. Madsen Company reported the following information for 2010:

Sales revenue	\$510,000
Cost of goods sold	350,000
Operating expenses	55,000
Unrealized holding gain on available-for-sale securities	40,000
Cash dividends received on the securities	2,000

For 2010, Madsen would report other comprehensive income of

- a. \$137,000.
 - b. \$135,000.
 - c. \$42,000.
 - d. \$40,000.
101. Korte Company reported the following information for 2010:

Sales revenue	\$500,000
Cost of goods sold	350,000
Operating expenses	55,000
Unrealized holding gain on available-for-sale securities	20,000
Cash dividends received on the securities	2,000

For 2010, Korte would report comprehensive income of

- a. \$117,000.
- b. \$115,000.
- c. \$97,000.
- d. \$20,000.

102. For the year ended December 31, 2010, Transformers Inc. reported the following:

Net income	\$ 60,000
Preferred dividends declared	10,000
Common dividend declared	2,000
Unrealized holding loss, net of tax	1,000
Retained earnings	80,000
Common stock	40,000
Accumulated Other Comprehensive Income, Beginning Balance	5,000

What would Transformers report as its ending balance of Accumulated Other Comprehensive Income?

- a. \$6,000
- b. \$5,000
- c. \$4,000
- d. \$1,000

103. For the year ended December 31, 2010, Transformers Inc. reported the following:

Net income	\$ 60,000
Preferred dividends declared	10,000
Common dividend declared	2,000
Unrealized holding loss, net of tax	1,000
Retained earnings, beginning balance	80,000
Common stock	40,000
Accumulated Other Comprehensive Income, Beginning Balance	5,000

What would Transformers report as the ending balance of Retained Earnings?

- a. \$139,000
- b. \$133,000
- c. \$128,000
- d. \$127,000

104. For the year ended December 31, 2010, Transformers Inc. reported the following:

Net income	\$ 60,000
Preferred dividends declared	10,000
Common dividend declared	2,000
Unrealized holding loss, net of tax	1,000
Retained earnings, beginning balance	80,000
Common stock	40,000
Accumulated Other Comprehensive Income, Beginning Balance	5,000

What would Transformers report as total stockholders' equity?

- a. \$172,000
- b. \$168,000
- c. \$128,000
- d. \$120,000

Multiple Choice Answers—Computational

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
70.	a	76.	a	82.	a	88.	a	94.	c	100.	d
71.	c	77.	a	83.	b	89.	a	95.	a	101.	a
72.	a	78.	a	84.	c	90.	b	96.	b	102.	c
73.	c	79.	a	85.	c	91.	d	97.	c	103.	c
74.	c	80.	c	86.	c	92.	d	98.	d	104.	a
75.	c	81.	b	87.	b	93.	c	99.	d		

MULTIPLE CHOICE—CPA Adapted

Use the following information for questions 105 and 106.

Perry Corp. reports operating expenses in two categories: (1) selling and (2) general and administrative. The adjusted trial balance at December 31, 2010, included the following expense accounts:

Accounting and legal fees	\$140,000
Advertising	120,000
Freight-out	75,000
Interest	60,000
Loss on sale of long-term investments	30,000
Officers' salaries	180,000
Rent for office space	180,000
Sales salaries and commissions	110,000

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

105. How much of the expenses listed above should be included in Perry's selling expenses for 2010?
- \$230,000.
 - \$305,000.
 - \$320,000.
 - \$395,000.
106. How much of the expenses listed above should be included in Perry's general and administrative expenses for 2010?
- \$410,000.
 - \$440,000.
 - \$470,000.
 - \$500,000.

107. Didde Corp. reports operating expenses in two categories: (1) selling and (2) general and administrative. The adjusted trial balance at December 31, 2010 included the following expense and loss accounts:

Accounting and legal fees	\$140,000
Advertising	180,000
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	170,000

One-half of the rented premises is occupied by the sales department. Didde's total selling expenses for 2010 are

- a. \$540,000.
 - b. \$460,000.
 - c. \$430,000.
 - d. \$370,000.
108. The following items were among those that were reported on Dye Co.'s income statement for the year ended December 31, 2010:

Legal and audit fees	\$130,000
Rent for office space	180,000
Interest on inventory floor plan	210,000
Loss on abandoned equipment used in operations	35,000

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

- a. \$220,000.
- b. \$255,000.
- c. \$310,000.
- d. \$430,000.

Use the following information for questions 109 through 111.

Logan Corp.'s trial balance of income statement accounts for the year ended December 31, 2010 included the following:

	Debit	Credit
Sales		\$140,000
Cost of sales	\$ 50,000	
Administrative expenses	25,000	
Loss on sale of equipment	9,000	
Commissions to salespersons	8,000	
Interest revenue		5,000
Freight-out	3,000	
Loss due to earthquake damage	12,000	
Bad debt expense	3,000	
Totals	\$110,000	\$145,000

Other information:

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

January 1, 2010	\$80,000
December 31, 2010	70,000

On Logan's multiple-step income statement for 2010,

109. Cost of goods manufactured is
- a. \$63,000.
 - b. \$60,000.
 - c. \$43,000.
 - d. \$40,000.
110. Income before extraordinary item is
- a. \$64,000.
 - b. \$47,000.
 - c. \$32,900.
 - d. \$24,500.
111. Extraordinary loss is
- a. \$8,400.
 - b. \$12,000.
 - c. \$14,700.
 - d. \$21,000.
112. Chase Corp. had the following infrequent transactions during 2010:
- A \$150,000 gain from selling the only investment Chase has ever owned.
 - A \$210,000 gain on the sale of equipment.
 - A \$70,000 loss on the write-down of inventories.
- In its 2010 income statement, what amount should Chase report as total infrequent net gains that are not considered extraordinary?
- a. \$80,000.
 - b. \$140,000.
 - c. \$290,000.
 - d. \$360,000.
113. James, Inc. incurred the following infrequent losses during 2010:
- A \$70,000 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 2010 income statement, what amount should James report as total infrequent losses that are not considered extraordinary?
- a. \$170,000.
 - b. \$130,000.
 - c. \$110,000.
 - d. \$100,000.

114. 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	Yes
b.	No	No	Yes
c.	Yes	Yes	No
d.	No	No	No

Multiple Choice Answers—CPA Adapted

Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.	Item	Ans.
105.	d	107.	a	109.	d	111.	a	113.	a
106.	a	108.	a	110.	c	112.	b	114.	b

DERIVATIONS — Computational

No.	Answer	Derivation
70.	a	$\$120,000 + \$4,000 + \$20,000 - \$11,000 = \$133,000.$
71.	c	$\$60,000 + \$10,000 + \$20,000 + \$8,000 + \$12,000 + \$13,000 = \$123,000.$
72.	a	
73.	c	$\$100,000 - \$60,000 = \$40,000.$
74.	c	$\$150,000 - \$90,000 = \$60,000.$
75.	c	$\$15,720,000 - \$370,000 - \$175,000 = \$15,175,000.$
76.	a	
77.	a	
78.	a	
79.	a.	$\$2,055,000 - (\$1,080,000 - \$360,000) = \$1,335,000.$
80.	c	$\$210,000 + (\$30,000 \times .7) = \$231,000$ $\$231,000 \div .7 = \$330,000.$
81.	b	$\$515,000 - \$150,000 - \$85,000 - \$30,000 = \$250,000.$
82.	a	$\$25,000 - \$7,500 = \$17,500.$
83.	b	$\$17,500 + (\$500,000 \times .7) = \$367,500.$
84.	c	$\$1,400,000 - \$1,200,000 = \$200,000.$

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No.	Answer	Derivation
85.	c	$\$50,000 \times .60 = \$30,000.$
86.	c	$\$200,000 \times .60 = \$120,000.$
87.	b	$(\$232,000 - \$37,000 + \$8,000) \times .40 = \$81,200.$
88.	a	$(\$357,000 + \$23,000 + \$6,000) \times .30 = \$115,800.$
89.	a	$(\$100,000 - \$60,000 - \$8,000 - \$11,000 + \$9,000 - \$1,000 - \$2,000) \times .40 = \$10,800.$
90.	b	$(\$1,000,000 - \$250,000) \div 200,000 \text{ sh.} = \$3.75.$
91.	d	$\$1,000,000 \div 200,000 \text{ sh.} = \$5.00.$
92.	d	$(\$350,000) \div 70,000 \text{ sh.} = \$5.00.$
93.	c	$(\$500,000 - \$60,000) \div 100,000 = \$4.40.$
94.	c	$(\$500,000 - \$60,000) \div 200,000 = \$2.20.$
95.	a	$\$2,000,000 - \$430,000 = \$1,570,000.$
96.	b	$\$2,000,000 - \$430,000 + \$1,000,000 - \$320,000 = \$2,250,000.$
97.	c	$\$1,000,000 + \$215,000 = \$1,215,000.$
98.	d	$\$1,000,000 + \$215,000 + \$500,000 - \$160,000 = \$1,555,000.$
99.	d	$\$1,700,000 - \$800,000 - \$200,000 + \$75,000 = \$775,000.$
100.	d	Other comprehensive income = \$40,000.
101.	a	$\$500,000 - \$350,000 - \$55,000 + \$20,000 + \$2,000 = \$117,000.$
102.	c	$\$5,000 - \$1,000 = \$4,000.$
103.	c	$\$80,000 + \$60,000 - \$10,000 - \$2,000 = \$128,000.$
104.	a	$(\$80,000 + \$60,000 - \$10,000 - \$2,000) + \$40,000 + (\$5,000 - \$1,000) = \$172,000.$

DERIVATIONS — CPA Adapted

No.	Answer	Derivation
105.	d	$\$120,000 + \$75,000 + \$110,000 + \$90,000 = \$395,000.$
106.	a	$\$140,000 + \$180,000 + \$90,000 = \$410,000.$
107.	a	$\$180,000 + \$80,000 + \$110,000 + \$170,000 = \$540,000.$
108.	a	$\$130,000 + \$90,000 = \$220,000.$
109.	d	$\$50,000 + \$70,000 - \$80,000 = \$40,000.$
110.	c	$\$140,000 - \$50,000 - \$25,000 - \$9,000 - \$8,000 - \$3,000 - \$3,000 + \$5,000 - \$14,100 = \$32,900.$
111.	a	$\$12,000 \times 0.7 = \$8,400.$
112.	b	$\$210,000 - \$70,000 = \$140,000.$
113.	a	$\$70,000 + \$40,000 + \$60,000 = \$170,000.$
114.	b	Conceptual.

EXERCISES

Ex. 4-115—Definitions.

Provide clear, concise answers for the following.

1. What are revenues?
2. What are expenses?
3. What are gains?
4. What are losses?
5. What are the criteria (in addition to materiality) that must be met to classify an event or transaction as extraordinary?
6. When does a discontinued operation occur?
7. Indicate how earnings per share is computed.
8. State the primary category of prior period adjustments and indicate how they are reported in the financial statements.

Solution 4-115

1. Revenues are increases in net assets during a period from delivering goods or services that constitute the entity's major or central operations.
2. Expenses are the using-up of assets or other decreases in net assets during a period from delivering goods or services that constitute the entity's major or central operations.
3. Gains are increases in net assets from peripheral transactions, events, or circumstances affecting the entity except those resulting from revenues or investments by owners.
4. Losses are decreases in net assets from peripheral transactions, events, or circumstances affecting the entity except those resulting from expenses or distributions to owners.
5. Both of the following criteria should be met to classify an item as extraordinary: (1) Unusual nature, considering the environment, and (2) infrequent in occurrence, considering the environment.
6. A discontinued operation occurs when (a) the results of operations and cash flows of a component of a company have been eliminated from the ongoing operations, and (b) there is no significant continuing involvement in that component after the disposal transaction.
7. The computation of earnings per share is: Net income minus preferred dividends divided by the weighted average of common shares outstanding.
8. Prior period adjustments include correction of an error in the financial statements of a prior period. Prior period adjustments (net of tax) should be charged or credited to the opening balance of retained earnings.

Ex. 4-116—Terminology.

In the space provided, write the word or phrase that is defined or indicated.

1. Net income minus preferred dividends divided by the weighted average of shares outstanding. 1. _____
2. All changes in equity during a period except those resulting from investments by owners and distributions to owners. 2. _____
3. A correction of an error is reported as a 3. _____
4. An event or transaction which is unusual in nature and infrequent in occurrence. 4. _____
5. The income statement category for a disposal of a component of a business. 5. _____
6. Relating tax expense to specific items on the income statement. 6. _____

Solution 4-116

1. Earnings per share.
2. Comprehensive income.
3. Prior period adjustment.
4. Extraordinary item.
5. Discontinued operations.
6. Intraproduct tax allocation.

Ex. 4-117—Income statement disclosures.

What is disclosed in an income statement? Be specific.

Solution 4-117

An income statement discloses revenues, expenses, gains, and losses. It discloses the net income (loss) for a period and earnings per share data. The income statement may also include discontinued operations (net of tax) and extraordinary items (net of tax).

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Ex. 4-118—Calculation of net income from the change in stockholders' equity.

Presented below is certain information pertaining to Edson Company.

Assets, January 1	\$240,000
Assets, December 31	230,000
Liabilities, January 1	150,000
Common stock, December 31	80,000
Retained earnings, December 31	31,000
Common stock sold during the year	10,000
Dividends declared during the year	13,000

Compute the net income for the year.

Solution 4-118

	<u>January 1</u>	<u>December 31</u>
Assets	\$240,000	
Liabilities	<u>150,000</u>	
Stockholders' equity	<u>\$ 90,000</u>	<u>\$111,000*</u>

Computation of net income:

Stockholders' equity December 31	\$111,000
Stockholders' equity January 1	<u>90,000</u>
Increase	21,000
Add: Dividend declared	13,000
Less: Common stock sold	<u>(10,000)</u>
Net income	<u>\$ 24,000</u>

*\$80,000 + \$31,000

Ex. 4-119—Calculation of net income from the change in stockholders' equity.

Presented below are changes in the account balances of Wenn Company during the year, except for retained earnings.

	Increase <u>(Decrease)</u>		Increase <u>(Decrease)</u>
Cash	\$29,000	Accounts payable	\$34,000
Accounts receivable (net)	(13,000)	Bonds payable	(20,000)
Inventory	52,000	Common stock	72,000
Plant Assets (net)	37,000	Paid-in capital	16,000

The only entries in Retained Earnings were for net income and a dividend declaration of \$12,000.

Compute the net income for the current year.

Solution 4-119

Computation of net income

Change in assets (\$118,000 – \$13,000)	\$105,000	Increase
Change in liabilities (\$34,000 – \$20,000)	<u>14,000</u>	Increase
Change in stockholders' equity	91,000	Increase
Add: Dividend declared	12,000	
Less: Investment by stockholders	<u>(88,000)</u>	
Net income	<u>\$ 15,000</u>	

Ex. 4-120—Income statement classifications.

Indicate the major section or subsection of a multiple-step income statement in which each of the following items would usually appear:

- Advertising
- Depletion
- Dividend revenue
- Freight-in
- Loss on disposal of a component of the business, net of tax
- Income taxes on income
- Major casualty loss, net of tax
- Purchase discounts
- Sales discounts
- Officers' salaries
- Freight-out
- Sinking fund income

Solution 4-120

- Selling expense.
- Cost of goods sold.
- Other revenue.
- Cost of goods sold as an addition to purchases.
- Discontinued operations.
- Income taxes; subtracted from income before income taxes in arriving at net income.
- Extraordinary items.
- Cost of goods sold as a subtraction from purchases.
- Subtracted from gross revenues.
- Administrative or general expenses.
- Selling expense.
- Other revenue.

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Ex. 4-121—Income statement relationships.

Fill in the appropriate blanks for each of the independent situations below.

	<u>Company A</u>	<u>Company B</u>	<u>Company C</u>
Sales	(a) \$ _____	\$343,400	\$540,000
Beginning inventory	52,600	(d) _____	90,000
Net purchases	175,300	255,600	(g) _____
Ending inventory	52,200	108,000	63,000
Cost of goods sold	(b) _____	(e) _____	407,000
Gross profit	85,300	98,000	(h) _____
Operating expenses	(c) _____	50,000	48,000
Income before taxes	6,000	(f) _____	(i) _____

Solution 4-121

(a) \$261,000	(d) \$97,800	(g) \$380,000
(b) \$175,700	(e) \$245,400	(h) \$133,000
(c) \$79,300	(f) \$48,000	(i) \$85,000

Ex. 4-122—Multiple-step income statement.

Listed below in scrambled order are 13 income statement categories. Use the numerals 1 through 13 to indicate the order in which these categories should appear on a multiple-step income statement.

- () Discontinued operations.
- () Cost of goods sold.
- () Other revenues and gains.
- () Net income.
- () Income taxes.
- () Sales.
- () Gross profit on sales.
- () Income from operations.
- () Income from continuing operations before income taxes.
- () Operating expenses.
- () Extraordinary item.
- () Income before extraordinary items.
- () Income from continuing operations.

Solution 4-122

10, 2, 6, 13, 8, 1, 3, 5, 7, 4, 12, 11, 9

Ex. 4-123—Classification of income statement and retained earnings statement items.

For each of the items listed below, indicate how it should be treated in the financial statements. Use the following letter code for your selections:

- a. Ordinary or unusual (but not extraordinary) item on the income statement
- b. Discontinued operations
- c. Extraordinary item on the income statement
- d. Prior period adjustment

- _____ 1. The bad debt rate was increased from 1% to 2%, thus increasing bad debt expense.
- _____ 2. Obsolete inventory was written off. This was the first loss of this type in the company's history.
- _____ 3. An uninsured casualty loss was incurred by the company. This was the first loss of this type in the company's 50-year history.
- _____ 4. Recognition of income earned last year which was inadvertently omitted from last year's income statement.
- _____ 5. The company sold one of its warehouses at a loss.
- _____ 6. Settlement of litigation with federal government related to income taxes of three years ago. The company is continually involved in various adjustments with the federal government related to its taxes.
- _____ 7. A loss incurred from expropriation (the company owned resources in South America which were taken over by a dictator unsympathetic to American business).
- _____ 8. The company neglected to record its depreciation in the previous year.
- _____ 9. Discontinuance of all production in the United States. The manufacturing operations were relocated in Mexico.
- _____ 10. Loss on sale of investments. The company last sold some of its investments two years ago.
- _____ 11. Loss on the disposal of a component of the business.

Solution 4-123

- | | | | |
|------|------|------|-------|
| 1. a | 4. d | 7. c | 10. a |
| 2. a | 5. a | 8. d | 11. b |
| 3. c | 6. a | 9. a | |

PROBLEMS

Pr. 4-124—Multiple-step income statement.

Presented below is information related to Farr Company.

Retained earnings, December 31, 2010	\$ 650,000
Sales	1,400,000
Selling and administrative expenses	240,000
Hurricane loss (pre-tax) on plant (extraordinary item)	290,000
Cash dividends declared on common stock	33,600
Cost of goods sold	780,000
Gain resulting from computation error on depreciation charge in 2009 (pre-tax)	520,000
Other revenue	120,000
Other expenses	100,000

Instructions

Prepare in good form a multiple-step income statement for the year 2011. Assume a 30% tax rate and that 80,000 shares of common stock were outstanding during the year.

Solution 4-124

Farr Company
INCOME STATEMENT
For the Year Ended December 31, 2011

Sales	\$1,400,000
Cost of goods sold	<u>780,000</u>
Gross profit	620,000
Selling and administrative expenses	<u>240,000</u>
Income from operations	380,000
Other revenue	120,000
Other expenses	<u>(100,000)</u>
Income before taxes	400,000
Income taxes	<u>(120,000)</u>
Income before extraordinary item	280,000
Extraordinary loss, net of applicable income taxes of \$87,000	<u>(203,000)</u>
Net income	<u><u>\$ 77,000</u></u>

Per share of common stock—

Income before extraordinary item	\$3.50
Extraordinary item, net of tax	<u>(2.54)</u>
Net income	<u><u>\$.96</u></u>

Pr. 4-125—Income statement form.

Wilcox Corporation had income from continuing operations of \$800,000 (after taxes) in 2010. In addition, the following information, which has not been considered, is as follows.

1. In 2010, Wilcox experienced an uninsured earthquake loss in the amount of \$200,000.
2. A machine was sold for \$140,000 cash during the year at a time when its book value was \$110,000. (Depreciation has been properly recorded.) The company often sells machinery of this type.
3. Wilcox decided to discontinue its stereo division in 2010. During the current year, the loss on the disposal of this component of the business was \$150,000 less applicable taxes.

Instructions

Present in good form the income statement of Wilcox Corporation for 2010 starting with "income from continuing operations." Assume that Wilcox's tax rate is 30% and 200,000 shares of common stock were outstanding during the year.

Solution 4-125

Wilcox Corporation
Partial Income Statement
For the Year Ended December 31, 2010

Income from continuing operations		\$821,000*
Discontinued operations		
Loss on disposal of a component of a business, \$150,000, less applicable income taxes, \$45,000		(105,000)
Income before extraordinary item		716,000
Extraordinary loss, net of applicable income taxes of \$60,000		(140,000)
Net income		<u>\$576,000</u>
Per share of common stock—Income from cont. operations	\$4.11	
Discontinued operations, net of tax	<u>(.53)</u>	
Income before extraordinary item	3.58	
Extraordinary loss, net of tax	<u>(.70)</u>	
Net income	<u>\$2.88</u>	
*Income from cont. operations (unadjusted)	\$800,000	
Gain on sale of machinery (after tax)	<u>21,000</u>	
Income from cont. operations (adjusted)	<u>\$821,000</u>	

Pr. 4-126—Multiple-step income statement.

Shown below is an income statement for 2010 that was prepared by a poorly trained bookkeeper of Howell Corporation.

Howell Corporation	
INCOME STATEMENT	
December 31, 2010	
Sales revenue	\$945,000
Investment revenue	19,500
Cost of merchandise sold	(408,500)
Selling expenses	(145,000)
Administrative expense	(215,000)
Interest expense	<u>(13,000)</u>
Income before special items	183,000
Special items	
Loss on disposal of a component of the business	(30,000)
Major casualty loss (extraordinary item)	(70,000)
Net federal income tax liability	<u>(24,900)</u>
Net income	<u>\$ 58,100</u>

Instructions

Prepare a multiple-step income statement for 2010 for Howell Corporation that is presented in accordance with generally accepted accounting principles (including format and terminology). Howell Corporation has 50,000 shares of common stock outstanding and has a 30% federal income tax rate on all tax related items. Round all earnings per share figures to the nearest cent.

Solution 4-126

Howell Corporation	
INCOME STATEMENT	
For the Year Ended December 31, 2010	
Sales	\$945,000
Cost of goods sold	<u>408,500</u>
Gross profit	536,500
Selling expenses	\$145,000
Administrative expenses	<u>215,000</u>
Income from operations	<u>360,000</u>
Other revenue: Investment revenue	176,500
	<u>19,500</u>
	196,000
Other expenses: Interest expense	<u>13,000</u>
Income from continuing operations before taxes	183,000
Income taxes	<u>54,900</u>
Income from continuing operations	128,100
Loss from discontinued operations, net of applicable income tax of \$9,000	<u>21,000</u>
Income before extraordinary item	107,100
Extraordinary casualty loss, net of applicable income tax of \$21,000	<u>49,000</u>
Net income	<u>\$ 58,100</u>

Solution 4-126 (cont.)

Per share of common stock—

Income from continuing operations	\$2.56
Discontinued operations loss net of tax	<u>(.42)</u>
Income before extraordinary item	2.14
Extraordinary item, net of tax	<u>(.98)</u>
Net income	<u>\$1.16</u>

Pr. 4-127—Single-step income statement.

Presented below is an income statement for Kinder Company for the year ended December 31, 2010.

Kinder Company
Income Statement
For the Year Ended December 31, 2010

Net sales	\$800,000
Costs and expenses:	
Cost of goods sold	640,000
Selling, general, and administrative expenses	70,000
Other, net	<u>20,000</u>
Total costs and expenses	<u>730,000</u>
Income before income taxes	70,000
Income taxes	<u>21,000</u>
Net income	<u>\$ 49,000</u>

Additional information:

- "Selling, general, and administrative expenses" included a usual but infrequent charge of \$7,000 due to a loss on the sale of investments.
- "Other, net" consisted of interest expense, \$10,000, and an extraordinary loss of \$10,000 before taxes due to earthquake damage. If the extraordinary loss had not occurred, income taxes for 2010 would have been \$24,000 instead of \$21,000.
- Kinder had 20,000 shares of common stock outstanding during 2010.

Instructions

Using the single-step format, prepare a corrected income statement, including the appropriate per share disclosures.

Solution 4-127

Kinder Company
Income Statement
For the Year Ended December 31, 2010

Net sales		\$800,000
Costs and expenses:		
Cost of goods sold	\$640,000	
Selling, general, and administrative expenses	63,000	
Interest expense	10,000	
Infrequent charge—loss on sale of investments	<u>7,000</u>	
Total costs and expenses		<u>720,000</u>
Income before taxes and extraordinary item		80,000
Income taxes		<u>24,000</u>
Income before extraordinary item		56,000
Extraordinary loss		
Earthquake damage	10,000	
Less applicable taxes	<u>3,000</u>	<u>(7,000)</u>
Net income		<u>\$ 49,000</u>
Per share of common stock—		
Income before extraordinary item	\$2.80	
Extraordinary loss, net of tax	<u>(.35)</u>	
Net income	<u>\$2.45</u>	

Pr. 4-128—Income statement and retained earnings statement.

Porter Corporation's capital structure consists of 50,000 shares of common stock. At December 31, 2010 an analysis of the accounts and discussions with company officials revealed the following information:

Sales	\$1,100,000
Purchase discounts	18,000
Purchases	642,000
Earthquake loss (net of tax) (extraordinary item)	42,000
Selling expenses	128,000
Cash	60,000
Accounts receivable	90,000
Common stock	200,000
Accumulated depreciation	180,000
Dividend revenue	8,000
Inventory, January 1, 2010	152,000
Inventory, December 31, 2010	125,000
Unearned service revenue	4,400
Accrued interest payable	1,000
Land	370,000
Patents	100,000
Retained earnings, January 1, 2010	290,000
Interest expense	17,000
General and administrative expenses	150,000
Dividends declared	29,000
Allowance for doubtful accounts	5,000
Notes payable (maturity 7/1/13)	200,000
Machinery and equipment	450,000
Materials and supplies	40,000
Accounts payable	60,000

The amount of income taxes applicable to ordinary income was \$48,600, excluding the tax effect of the earthquake loss which amounted to \$18,000.

Instructions

- (a) Prepare a multiple-step income statement.
- (b) Prepare a retained earnings statement.

Solution 4-128

Porter Corporation
INCOME STATEMENT
 For the Year Ended December 31, 2010

Sales		\$1,100,000
Cost of goods sold:		
Merchandise inventory, Jan. 1	\$152,000	
Purchases	\$642,000	
Less purchase discounts	<u>18,000</u>	
Net purchases		<u>624,000</u>
Merchandise available for sale		776,000
Less merchandise inv., Dec. 31		<u>125,000</u>
Cost of goods sold		<u>651,000</u>
Gross profit on sales		449,000
Operating expenses:		
Selling expenses	128,000	
General and administrative expenses	<u>150,000</u>	
Total operating expenses		<u>278,000</u>
Operating income		171,000
Other revenue and expense:		
Dividend revenue	8,000	
Interest expense	<u>(17,000)</u>	<u>(9,000)</u>
Income before taxes		162,000
Income taxes		<u>48,600</u>
Income before extraordinary item		113,400
Extraordinary loss due to earthquake, net of applicable taxes of \$18,000		<u>(42,000)</u>
Net income		<u>\$ 71,400</u>
Per share of common stock—		
Income before extraordinary item	\$2.27	
Extraordinary loss, net of tax	<u>(.84)</u>	
Net income		<u>\$1.43</u>

Porter Corporation
RETAINED EARNINGS STATEMENT
 For the Year Ended December 31, 2010

Retained earnings, January 1, 2010		\$290,000
Add: Net income	\$71,400	
Deduct: Dividends declared	<u>29,000</u>	<u>42,400</u>
Retained earnings, December 31, 2010		<u>\$332,400</u>

Pr. 4-129—Irregular items and financial statements.

The accountant preparing the income statement for Bakersfield, Inc. had some doubts about the appropriate accounting treatment of the seven items listed below during the fiscal year ending December 31, 2010. Assume a tax rate of 40 percent.

1. The corporation experienced an uninsured flood loss of \$50,000 before taxes. While this loss meets the criteria of an extraordinary item, it has not been recorded.
2. The corporation disposed of its sporting goods division during 2010. This disposal meets the criteria for discontinued operations. The division correctly calculated income from operating this division of \$100,000 before taxes and a loss of \$12,000 before taxes on the disposal of the division. All of these events occurred in 2010 and have not been recorded.
3. The company recorded advances of \$10,000 to employees made December 31, 2010 as Salary Expense.
4. Dividends of \$10,000 during 2010 were recorded as an operating expense.
5. In 2010, Bakersfield changed its method of accounting for inventory from the first-in-first-out method to the average cost method. Inventory in 2010 was correctly recorded using the average cost method. The new inventory method would have resulted in an additional \$125,000 of cost of goods sold (before taxes) being reported on prior years' income statement.
6. Office equipment purchased January 1, 2010 for \$45,000 was incorrectly charged to Office Supplies Expense at the time of purchase. The office equipment has an estimated three-year service life with no expected salvage value. Bakersfield uses the straight-line method to depreciate office equipment for financial reporting purposes. This error has not been recorded.
7. On January 1, 2006, Bakersfield bought a building that cost \$85,000, had an estimated useful life of ten years, and had a salvage value of \$5,000. Bakersfield uses the straight-line depreciation method to depreciate the building. In 2010, it was estimated that the remaining useful life was eight years and the salvage value was zero. Depreciation expense reported on the 2010 income statement was correctly calculated based on the new estimates. No adjustment for prior years' depreciation estimates was made.

Part A. For each item, record corrections to income from continuing operations before taxes, if any. **Denote any negative numbers by using brackets < >.**

Solution 4-129

Number Item	Description	Increase <Decrease> to Income from Continuing Operations
1	Extraordinary items reported after Income from Continuing Operations (ICO)	No Effect
2	Discontinued Items reported after ICO	No Effect
3	Correct with Dr: Prepaid Salary Cr: Salary Expense	\$10,000
4	Dividends are not reported on the Income Statement; should be on Statement of R/E.	\$10,000
5	Change in inventory method: Current year reported correctly on income statement, need to adjust beginning R/E.	No Effect
6	To correct, need to put back all \$45,000 of equipment into Equipment account and take out of Supplies Expense account. Also take depreciation of \$15,000 for the year. Net effect is to increase income by \$30,000.	\$30,000
7	Current year is correct. Change in estimate does not need retroactive action.	No Effect

Part B. At January 1, 2010, Bakersfield, Inc.'s retained earnings balance was \$200,000. Assume that income from continuing operations (before taxes) and after correctly considering any of the seven additional items was \$1,000,000. Prepare the income statement and statement of retained earnings. **Denote negative numbers by using brackets < >. Do not disclose earnings per share data.**

Bakersfield Incorporated	
Partial Income Statement	
For the Year Ending December 31, 2010	
Income from Continuing Operations before Taxes	1,000,000
Less: Income tax expense ($\$1,000,000 \times 40\%$)	<400,000>
Income from Continuing Operation after tax	600,000
Discontinued Operations	
Add: Income from discontinued operations net of tax ($\$100,000 \times .6$)	60,000
Less: Loss on disposal of discontinued operation net of tax ($\$12,000 \times .6$)	<7,200>
Income before extraordinary items	652,800
Less: Loss due to extraordinary item net of tax ($\$50,000 \times .6$)	<30,000>
Net income	622,800

Bakersfield Incorporated	
Statement of Retained Earnings	
For the Year Ending December 31, 2010	
Beginning Retained earnings as of January 1, 2010	200,000
Adjustment for change in inventory method ($\$125,000 \times .6$)	<75,000>
Beginning Retained earnings restated	125,000
Add: Net Income	622,800
Less: Dividends	<10,000>
Ending Retained earnings	737,800

IFRS QUESTIONS

True/False

1. Both U.S. GAAP and iGAAP discuss income statement presentation using either a single-step or multi-step approach.
2. iGAAP does not allow gains or losses to be classified as extraordinary items.
3. iGAAP allows for revaluation of long-term tangible and intangible assets with the differences impacting equity but not net income.
4. Both iGAAP and U.S. GAAP allow for comprehensive income to be reported in either a Statement of Stockholders' Equity or a Statement of Recognized Income and Expense.
5. Under iGAAP, a company may classify expenses by function, but must also disclose the classification of expenses by nature.

Answers to True/False:

1. False
2. True
3. True
4. False
5. True

Multiple Choice:

1. The iGAAP income statement classification of expenses by nature results in descriptions which include all of the following except
 - a. salaries
 - b. depreciation
 - c. distribution
 - d. utilities
2. U.S. GAAP allows all of the following statement formats to be used for reporting comprehensive income except
 - a. Statement of Recognized Income and Expense
 - b. Single Income Statement
 - c. Combined Income Statement of Comprehensive Income
 - d. Statement of Stockholders' Equity
3. An iGAAP SoRIE statement might include all of the following except
 - a. net income or loss
 - b. unrealized gains or losses on the revaluation of long-term assets
 - c. cumulative effect of a change in accounting principle
 - d. extraordinary gain or loss

Answers to Multiple Choice:

1. c
2. a
3. d

Short Answer:

1. What are the iGAAP requirements with respect to expense classification?
 1. Under iGAAP expenses must be classified by either nature or function. Classification by nature leads to descriptions such as the following: salaries, depreciation expense, utilities expense and so on. Classification by function leads to descriptions like administration, distribution, and manufacturing. Disclosure by nature is required in the notes to the financial statements if the functional expense method is used on the income statement. There is no U.S. GAAP in this area, except the SEC does require public companies to report their expenses by function.
 2. Bradshaw Company experienced a loss that was deemed to be both unusual in nature and infrequent in occurrence. How should Bradshaw report this item in accordance with iGAAP?
 2. Bradshaw should report this item similar to other unusual gains and losses. While under U.S. GAAP, companies are required to report an item as extraordinary if it is unusual in nature and infrequent in occurrence, extraordinary item reporting is prohibited under iGAAP.