26. **JOURNAL ENTRIES:** For each item below, record the appropriate journal entry:

A. Sell goods on credit for $100,000 excluding sales taxes, and also cash sales where you collected $54,500 including sales taxes. The sales tax rate is 9%.

B. Pay $200,000 to an outside consultant for expert scientific analysis in connection with the research and development of a vaccine.

C. Purchase an expensive $250,000 piece of equipment for use in the lab in connection with ongoing research and development.

D. Relative to the equipment in (C) above, if the equipment is to be used for 10 years and will have no salvage value, what (if any) journal entry is required at the end of the first year?

E. A lawsuit has been filed against the company which seeks to recover $500,000 in damages. The attorneys indicate that although the amount of the loss could reach the $500,000 mark, the likelihood is remote.

F. Same as C above, except the attorneys indicate that a loss is probable and they estimate the loss could be anywhere between $50,000 and $200,000.

G. Same as C above, except the attorneys indicate that a loss is probable for an estimated $25,000.

H. We are suing a competitor for infringement upon our patented technology. Our attorneys indicate that it is probable that we will recover $1,000,000 from the lawsuit.

I. Once we have completed our research and development, we pay an attorney $200,000 to secure a patent on the resulting process which we plan to begin immediate production.
27. Acquiror, Inc. purchased Bought, Inc. for: $ 2,500,000

As a result of the acquisition, Acquiror obtained all of the assets and assumed all of the liabilities of Bought, Inc. The following represents the balance sheet of Bought, Inc., at cost and fair value, on the date of the acquisition:

<table>
<thead>
<tr>
<th></th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>25,000</td>
<td>25,000</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>40,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>1,000,000</td>
<td>1,250,000</td>
</tr>
<tr>
<td>Intangible- customer lists</td>
<td>-</td>
<td>1,500,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>400,000</td>
<td>400,000</td>
</tr>
<tr>
<td>Debt</td>
<td>600,000</td>
<td>600,000</td>
</tr>
</tbody>
</table>

I. Compute any goodwill resulting from the transaction.

II. Present the journal entry to record the purchase by Acquiror, Inc.

III. Indicate the proper means of amortizing the goodwill under GAAP.

28. Acquiror, Inc. purchased Bought, Inc. in a prior year and they track Bought as a separate reporting unit. In connection with their impairment testing, they have estimated the following:

- Estimated value of the reporting unit is $5,000,000
- The net book value of the reporting unit is: $5,200,000
- Goodwill on the books of the reporting unit $1,000,000

Ignoring goodwill, the fair market value of the reporting units net assets exceeds cost by $200,000.

I. Based upon the information above, is there any impairment of goodwill? Briefly support this assertion.

II. If you believe there is an impairment, compute that impairment.

III. If you believe there is an impairment, record that impairment in a journal entry.

IV. How would your answer to each of the above questions differ if the estimated fair value of the reporting unit were $5,500,000 instead of $5,000,000?
26. Solution:

<table>
<thead>
<tr>
<th></th>
<th>Description</th>
<th>Amount</th>
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</thead>
<tbody>
<tr>
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<td>Accounts receivable</td>
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<td>Sales</td>
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<td>Sales tax payable</td>
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<td>Cash</td>
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<td>Sales</td>
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<td></td>
<td>Sales tax payable</td>
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<tr>
<td>B</td>
<td>R&amp;D expense</td>
<td>200,000</td>
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<tr>
<td></td>
<td>Cash</td>
<td>200,000</td>
</tr>
<tr>
<td>C</td>
<td>R&amp;D equipment</td>
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</tr>
<tr>
<td></td>
<td>Cash</td>
<td>250,000</td>
</tr>
<tr>
<td>D</td>
<td>R&amp;D expense</td>
<td>25,000</td>
</tr>
<tr>
<td></td>
<td>Accumulated depreciation</td>
<td>25,000</td>
</tr>
<tr>
<td>E</td>
<td>No entry</td>
<td></td>
</tr>
<tr>
<td>F</td>
<td>Lawsuit expense</td>
<td>50,000</td>
</tr>
<tr>
<td></td>
<td>Accrued lawsuit liability</td>
<td>50,000</td>
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<tr>
<td>G</td>
<td>Lawsuit expense</td>
<td>25,000</td>
</tr>
<tr>
<td></td>
<td>Accrued lawsuit liability</td>
<td>25,000</td>
</tr>
<tr>
<td>H</td>
<td>No entry</td>
<td></td>
</tr>
<tr>
<td>I</td>
<td>Intangible asset</td>
<td>200,000</td>
</tr>
<tr>
<td></td>
<td>Cash</td>
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</tr>
</tbody>
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<td>Debt</td>
<td>600,000</td>
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</tr>
</tbody>
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**Take note:**

**I. Compute any goodwill resulting from the transaction.**

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<thead>
<tr>
<th>Description</th>
<th>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Purchase price</td>
<td>$ 2,500,000</td>
<td></td>
</tr>
<tr>
<td>Fair value of identifiable assets</td>
<td>1,815,000</td>
<td></td>
</tr>
<tr>
<td><strong>GOODWILL</strong></td>
<td><strong>$ 685,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

**II. Present the journal entry to record the purchase by Acquiror, Inc.**

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
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<td>1,500,000</td>
<td></td>
</tr>
<tr>
<td>Goodwill</td>
<td></td>
<td>$ 685,000</td>
</tr>
<tr>
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<td></td>
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</tr>
<tr>
<td>Debt</td>
<td></td>
<td>600,000</td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>$ 2,500,000</td>
</tr>
</tbody>
</table>

**III. Indicate the proper means of amortizing the goodwill under GAAP.**

We do NOT amortize goodwill.
I. YES, because the estimated value of the reporting unit < its NBV.

II. NBV of reporting unit $5,200,000
    Exclude goodwill $ (1,000,000)
    Adjust for fair value 200,000
    Fair value of net assets excluding goodwill $4,400,000
    Fair value of reporting unit $5,000,000
    Implied value of goodwill $600,000
    Goodwill on books $1,000,000
    Goodwill impairment $400,000

III. Impairment expense $400,000
     Goodwill $400,000

IV. If fair value of $5.5 million, then the first answer would be NO as the FMV of reporting unit would be greater than its NBV and thus would pass the impairment test. Consequently there would be no computation or recordation of impairment.
1. When a patent is amortized, the credit is usually made to
   a. the Patent account.
   b. an Accumulated Amortization account.
   c. a Deferred Credit account.
   d. an expense account.

2. Which of the following contingencies need NOT be disclosed in the
   financial statements or the notes thereto?
   a. Probable losses not reasonably estimable
   b. Environmental liabilities that cannot be reasonably estimated
   c. Guarantees of indebtedness of others
   d. All of these must be disclosed.

3. The ability to consummate the refinancing of a short-term obligation
   may be demonstrated by
   a. actually refinancing the obligation by issuing a long-term
      obligation after the date of the balance sheet but before it is
      issued.
   b. entering into a financing agreement that permits the enterprise
      to refinance the debt on a long-term basis.
   c. actually refinancing the obligation by issuing equity securities
      after the date of the balance sheet but before it is issued.
   d. all of these.

4. Which of the following research and development related costs should
   be capitalized and amortized over current and future periods?
   a. Research and development general laboratory building which can be
      put to alternative uses in the future
   b. Inventory used for a specific research project
   c. Administrative salaries allocated to research and development
   d. Research findings purchased from another company to aid a
      particular research project currently in process

5. Liabilities are
   a. any accounts having credit balances after closing entries are
      made.
   b. deferred credits that are recognized and measured in conformity
      with generally accepted accounting principles.
   c. obligations to transfer ownership shares to other entities in the
      future.
   d. obligations arising from past transactions and payable in assets
      or services in the future.
6. SOP 98-5 requires the immediate expensing of:
   a. Customer mailing lists
   b. Indefinite life intangible assets
   c. Organizational costs
   d. Fines and penalties

7. Wriglee, Inc. went to court this year and successfully defended its patent from infringement by a competitor. The cost of this defense should be charged to
   a. patents and amortized over the legal life of the patent.
   b. legal fees and amortized over 5 years or less.
   c. expenses of the period.
   d. patents and amortized over the remaining useful life of the patent.

8. XYZ, Inc. has purchased an intangible asset which expires in 2 years, but may be automatically renewed at that time for an additional 10 years. XYZ fully expects to renew the intangible upon the two year initial expiration. What period should this intangible be amortized over?
   a. Do not amortize
   b. 2 years
   c. 10 years
   d. 12 years

9. An indefinite life intangible asset should be amortized:
   a. Over a period not to exceed 40 years.
   b. Over a period not to exceed 100 years.
   c. Over a period of the creator's life plus 40 years.
   d. Never.

10. When a business is acquired for a purchase price which is less than the fair value of all identifiable assets of a business, this should result in:
    a. Goodwill
    b. Badwill
    c. Extraordinary gain
    d. A non amortizing intangible asset

11. Accrued liabilities are disclosed in financial statements by
    a. a footnote to the statements.
    b. showing the amount among the liabilities but not extending it to the liability total.
    c. an appropriation of retained earnings.
    d. appropriately classifying them as regular liabilities in the balance sheet.
12. The intangible asset goodwill may be
   a. capitalized only when purchased.
   b. capitalized either when purchased or created internally.
   c. capitalized only when created internally.
   d. written off directly to retained earnings.

13. A liability for compensated absences such as vacations, for which it
    is expected that employees will be paid, should
   a. be accrued during the period when the compensated time is
      expected to be used by employees.
   b. be accrued during the period following vesting.
   c. be accrued during the period when earned by the employee.
   d. not be accrued unless a written contractual obligation exists.

14. Indefinite lived intangible assets should be tested for impairment:
   a. At least annually.
   b. Only if there has been an event or change in circumstance
      indicating an impairment.
   c. Only if the undiscounted cash flows are less than net book
      value.
   d. Only if the discounted cash flows are less than net book value.

15. Stock dividends distributable should be classified on the
    a. income statement as an expense.
    b. balance sheet as an asset.
    c. balance sheet as a liability.
    d. balance sheet as an item of stockholders' equity.

16. Which of the following is not an intangible asset?
   a. Trade name
   b. Research and development costs
   c. Franchise
   d. Copyrights

17. Which of the following is the proper way to report a gain
    contingency?
   a. As an accrued amount
   b. As deferred revenue
   c. As an account receivable with additional disclosure explaining
      the nature of the contingency
   d. As a disclosure only

18. If an intangible asset is being amortized over a definite life, the
    following is true:
   a. Impairment testing is never required.
   b. Impairment testing is required whenever there is an event or
      change in circumstances indicating a possible impairment.
   c. Impairment testing is required to be performed on an annual
      basis.
   d. Impairment testing is required only if the auditor deems it to be
      necessary.
19. Which of the following sets of conditions would give rise to the accrual of a contingency under current generally accepted accounting principles?
   a. Amount of loss is reasonably estimable and event occurs infrequently.
   b. Amount of loss is reasonably estimable and occurrence of event is probable.
   c. Event is unusual in nature and occurrence of event is probable.
   d. Event is unusual in nature and event occurs infrequently.

20. Costs incurred internally to create intangibles are
   a. capitalized.
   b. capitalized if they have an indefinite life.
   c. expensed as incurred.
   d. expensed only if they have a limited life.

21. Which of the following statements is FALSE?
   a. A company may exclude a short-term obligation from current liabilities if the firm intends to refinance the obligation on a long-term basis and demonstrates an ability to complete the refinancing.
   b. Cash dividends should be recorded as a liability when they are declared by the board of directors.
   c. Under the cash basis method, warranty costs are charged to expense as they are paid.
   d. FICA taxes withheld from employees' payroll checks should never be recorded as a liability since the employer will eventually remit the amounts withheld to the appropriate taxing authority.

22. If a company constructs a laboratory building to be used as a research and development facility, the cost of the laboratory building is matched against earnings as
   a. research and development expense in the period(s) of construction.
   b. depreciation deducted as part of research and development costs.
   c. depreciation or immediate write-off depending on company policy.
   d. an expense at such time as productive research and development has been obtained from the facility.
23. A company has provided its employees a bonus plan which provides for distribution of 50% of all net income in excess of the amount budgeted for the applicable year. If the budgeted income was $10,000,000 and the amount of net income actually recorded for the year was $10,800,000:

a. The Company should accrue a bonus expense and payable to the employees in the amount of $400,000.
b. The Company should accrue a bonus expense and payable to the employees in the amount of $800,000.
c. The Company should disclose in the notes that there is a $400,000 payable to employees under the bonus plan which will be paid in the subsequent year.
d. The Company should disclose in the notes that there is a $800,000 payable to employees under the bonus plan which will be paid in the subsequent year.

24. Which of the following statements is correct?
   a. A company may exclude a short-term obligation from current liabilities if the firm intends to refinance the obligation on a long-term basis.
   b. A company may exclude a short-term obligation from current liabilities if the firm can demonstrate an ability to consummate a refinancing.
   c. A company may exclude a short-term obligation from current liabilities if they can demonstrate an intent and ability to consummate a refinancing.
   d. None of these.

25. Lopez Corporation, a manufacturer of household paints, is preparing annual financial statements at December 31, 2004. Because of a recently proven health hazard in one of its paints, the government has clearly indicated its intention of having Lopez recall all cans of this paint sold in the last six months. The management of Lopez estimates that this recall would cost $800,000. What accounting recognition, if any, should be accorded this situation?
   a. No recognition
   b. Note disclosure only
   c. Operating expense of $800,000 and liability of $800,000
   d. Appropriation of retained earnings of $800,000
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<th>Bank</th>
<th>Exam</th>
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<th>Diff</th>
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<td>c</td>
<td>MChoice</td>
<td>C</td>
<td>5</td>
</tr>
</tbody>
</table>

* Test Questions are Scrambled
Answer questions 1-25 (multiple choice) on green scantron and the rest in your blue-book please.

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   c. Under the cash basis method, warranty costs are charged to expense as they are paid.
   d. FICA taxes withheld from employees' payroll checks should never be recorded as a liability since the employer will eventually remit the amounts withheld to the appropriate taxing authority.

8. An indefinite life intangible asset should be amortized:
   a. Over a period not to exceed 40 years.
   b. Over a period not to exceed 100 years.
   c. Over a period of the creator's life plus 40 years.
   d. Never.

9. When a patent is amortized, the credit is usually made to
   a. the Patent account.
   b. an Accumulated Amortization account.
   c. a Deferred Credit account.
   d. an expense account.

10. The intangible asset goodwill may be
    a. capitalized only when purchased.
    b. capitalized either when purchased or created internally.
    c. capitalized only when created internally.
    d. written off directly to retained earnings.

11. A company has provided its employees a bonus plan which provides for distribution of 50% of all net income in excess of the amount budgeted for the applicable year. If the budgeted income was $10,000,000 and the amount of net income actually recorded for the year was $10,800,000:
    a. The Company should accrue a bonus expense and payable to the employees in the amount of $400,000.
    b. The Company should accrue a bonus expense and payable to the employees in the amount of $800,000.
    c. The Company should disclose in the notes that there is a $400,000 payable to employees under the bonus plan which will be paid in the subsequent year.
    d. The Company should disclose in the notes that there is a $800,000 payable to employees under the bonus plan which will be paid in the subsequent year.
12. Which of the following is the proper way to report a gain contingency?
   a. As an accrued amount
   b. As deferred revenue
   c. As an account receivable with additional disclosure explaining the nature of the contingency
   d. As a disclosure only

13. Which of the following contingencies need NOT be disclosed in the financial statements or the notes thereto?
   a. Probable losses not reasonably estimable
   b. Environmental liabilities that cannot be reasonably estimated
   c. Guarantees of indebtedness of others
   d. All of these must be disclosed.

14. Which of the following sets of conditions would give rise to the accrual of a contingency under current generally accepted accounting principles?
   a. Amount of loss is reasonably estimable and event occurs infrequently.
   b. Amount of loss is reasonably estimable and occurrence of event is probable.
   c. Event is unusual in nature and occurrence of event is probable.
   d. Event is unusual in nature and event occurs infrequently.

15. When a business is acquired for a purchase price which is less than the fair value of all identifiable assets of a business, this should result in:
   a. Goodwill
   b. Badwill
   c. Extraordinary gain
   d. A non amortizing intangible asset

16. Which of the following statements is correct?
   a. A company may exclude a short-term obligation from current liabilities if the firm intends to refinance the obligation on a long-term basis.
   b. A company may exclude a short-term obligation from current liabilities if the firm can demonstrate an ability to consummate a refinancing.
   c. A company may exclude a short-term obligation from current liabilities if they can demonstrate an intent and ability to consummate a refinancing.
   d. None of these.
17. Lopez Corporation, a manufacturer of household paints, is preparing annual financial statements at December 31, 2004. Because of a recently proven health hazard in one of its paints, the government has clearly indicated its intention of having Lopez recall all cans of this paint sold in the last six months. The management of Lopez estimates that this recall would cost $800,000. What accounting recognition, if any, should be accorded this situation?
   a. No recognition
   b. Note disclosure only
   c. Operating expense of $800,000 and liability of $800,000
   d. Appropriation of retained earnings of $800,000

18. Accrued liabilities are disclosed in financial statements by
   a. a footnote to the statements.
   b. showing the amount among the liabilities but not extending it to the liability total.
   c. an appropriation of retained earnings.
   d. appropriately classifying them as regular liabilities in the balance sheet.

19. If an intangible asset is being amortized over a definite life, the following is true:
   a. Impairment testing is never required.
   b. Impairment testing is required whenever there is an event or change in circumstances indicating a possible impairment.
   c. Impairment testing is required to be performed on an annual basis.
   d. Impairment testing is required only if the auditor deems it to be necessary.

20. SOP 98-5 requires the immediate expensing of:
   a. Customer mailing lists
   b. Indefinite life intangible assets
   c. Organizational costs
   d. Fines and penalties

21. Which of the following research and development related costs should be capitalized and amortized over current and future periods?
   a. Research and development general laboratory building which can be put to alternative uses in the future
   b. Inventory used for a specific research project
   c. Administrative salaries allocated to research and development
   d. Research findings purchased from another company to aid a particular research project currently in process
22. XYZ, Inc. has purchased an intangible asset which expires in 2 years, but may be automatically renewed at that time for an additional 10 years. XYZ fully expects to renew the intangible upon the two year initial expiration. What period should this intangible be amortized over?

a. Do not amortize  
b. 2 years  
c. 10 years  
d. 12 years

23. Liabilities are
a. any accounts having credit balances after closing entries are made.  
b. deferred credits that are recognized and measured in conformity with generally accepted accounting principles.  
c. obligations to transfer ownership shares to other entities in the future.  
d. obligations arising from past transactions and payable in assets or services in the future.

24. The ability to consummate the refinancing of a short-term obligation may be demonstrated by
a. actually refinancing the obligation by issuing a long-term obligation after the date of the balance sheet but before it is issued.  
b. entering into a financing agreement that permits the enterprise to refinance the debt on a long-term basis.  
c. actually refinancing the obligation by issuing equity securities after the date of the balance sheet but before it is issued.  
d. all of these.

25. Which of the following is not an intangible asset?
a. Trade name  
b. Research and development costs  
c. Franchise  
d. Copyrights
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* Test Questions are Scrambled