Complete the multiple choice on a green scantron and the problems in your blue-book.

1. 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.

2. The cost of an intangible asset includes all of the following except
   a. purchase price.
   b. legal fees.
   c. other incidental expenses.
   d. All of these are included.

3. 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.

4. If a definite-life intangible asset has been subject to an event or circumstance indicating possible impairment:
   a. An undiscounted cash flow analysis should be performed in connection with the first step of impairment testing.
   b. A discounted cash flow analysis should be performed in connection with the first step of impairment testing.
   c. If an undiscounted cash flow analysis indicates that the undiscounted cash flows are less than the net book value of the subject asset, then an impairment has been deemed to have occurred.
   d. Both (a) and (c).
5. Management acquired a business in 2003, resulting in the recordation of $1,000,000 of goodwill. The Company's management continues to monitor the operations of the acquired business separately, however the balance sheet is no longer separately tracked. Which of the following is true regarding the acquired business?

a. The acquired business represents a "reporting unit" for purposes of impairment testing.
b. The acquired business does not represent a "reporting unit" for purposes of impairment testing.
c. The associated goodwill should be written-off as the acquired business does not represent a "reporting unit"
d. The associated goodwill can not be measured for impairment.

6. 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.

7. A definite life intangible 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.

8. 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.

9. Easton Company and Lofton Company were combined in a purchase transaction. Easton was able to acquire Lofton at a bargain price. The sum of the market or appraised values of identifiable assets acquired less the fair value of liabilities assumed exceeded the cost to Easton. After revaluing noncurrent assets to zero, there was still some "negative goodwill." Proper accounting treatment by Easton is to report the amount as

a. an extraordinary gain.
b. part of current income in the year of combination.
c. a deferred credit and amortize it.
d. paid-in capital.
10. Purchased goodwill should
   a. be written off as soon as possible against retained earnings.
   b. be written off as soon as possible as an extraordinary item.
   c. be written off by systematic charges as a regular operating expense over the period benefited.
   d. not be amortized.

11. 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.

12. 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

13. 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.

14. 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.

15. 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.
16. 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. 

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. 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. 

19. Information available prior to the issuance of the financial 
   statements indicates that it is probable that, at the date of the 
   financial statements, a liability has been incurred for obligations 
   related to product warranties. The amount of the loss involved can 
   be reasonably estimated. Based on the above facts, an estimated 
   loss contingency should be 
   a. accrued. 
   b. disclosed but NOT accrued. 
   c. NEITHER accrued NOR disclosed. 
   d. classified as an appropriation of retained earnings. 

20. 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.
21. On December 31, 2004, Frye Co. has $6,000,000 of short-term notes payable due on February 14, 2005. On January 10, 2005, Frye arranged a line of credit with County Bank which allows Frye to borrow up to $4,500,000 at one percent above the prime rate for three years. On February 2, 2005, Frye borrowed $3,600,000 from County Bank and used $1,500,000 additional cash to liquidate $5,100,000 of the short-term notes payable. The amount of the short-term notes payable that should be reported as current liabilities on the December 31, 2004 balance sheet which is issued on March 5, 2005 is
   a. $0.
   b. $900,000.
   c. $1,500,000.
   d. $2,400,000.

22. Unruh Co. is being sued for illness caused to local residents as a result of negligence on the company's part in permitting the local residents to be exposed to highly toxic chemicals from its plant. Unruh's lawyer states that it is probable that Unruh will lose the suit and be found liable for a judgment costing Unruh anywhere from $800,000 to $4,000,000. However, the lawyer states that the most probable cost is $2,400,000. As a result of the above facts, Unruh should accrue
   a. a loss contingency of $800,000 and disclose an additional contingency of up to $3,200,000.
   b. a loss contingency of $2,400,000 and disclose an additional contingency of up to $1,600,000.
   c. a loss contingency of $2,400,000 but NOT disclose any additional contingency.
   d. no loss contingency but disclose a contingency of $800,000 to $4,000,000.

23. 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.

24. Operating losses incurred during the start-up years of a new business should be
   a. accounted for and reported like the operating losses of any other business.
   b. written off directly against retained earnings.
   c. capitalized as a deferred charge and amortized over five years.
   d. capitalized as an intangible asset and amortized over a period not to exceed 20 years.
25. The general ledger of Waner Corporation as of December 31, 2004, includes the following accounts:

<table>
<thead>
<tr>
<th>Account</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Copyrights</td>
<td>$40,000</td>
</tr>
<tr>
<td>Deposits with advertising agency (will be used to promote goodwill)</td>
<td>$27,000</td>
</tr>
<tr>
<td>Discount on bonds payable</td>
<td>$67,500</td>
</tr>
<tr>
<td>Excess of cost over fair value of identifiable net assets of acquired subsidiary</td>
<td>$490,000</td>
</tr>
<tr>
<td>Trademarks</td>
<td>$90,000</td>
</tr>
</tbody>
</table>

In the preparation of Waner's balance sheet as of December 31, 2004, what should be reported as total intangible assets?

- a. $714,500.
- b. $647,000.
- c. $620,000.
- d. $580,000.

ANSWER IN YOUR BLUE BOOK.

26. An employer has paid its employee all amounts due for the employee's base compensation through the end of the year. At the end of the year, there is 1 week of payroll which has not been paid. The employee makes $2,000 per month for base compensation. The employment agreement grants the employee 10% of all net income in excess of $1,000,000 and net income for the applicable period was $1,200,000. The employee withholding is 15% for federal income taxes, 5% for state taxes, and 7.5% for other federal withholding. The employer also pays an additional 7.5% for other federal withholding, and $25 per weekly payroll for health benefits. Present the journal entry required to record the one week payroll. To ensure full credit, record the entire expense to the employer in one account called "wage expense" and any amounts payable for the other federal withholding (combined employer and employee) as "Other federal withholding payable" any other expenses or payables should each be presented as a separate account in the journal entry.

27. AAA, Inc. purchased a piece of equipment on February 1, 2004 by paying $500,000 in cash and issuing a $250,000 2 year, 0% note payable. AAA, Inc.'s effective borrowing rate is 10% per year. The present value of 1 at 10% for 2 periods is .826.

   (a) Record the entry necessary to reflect the purchase on February 1, 2004

   (b) Record any entry required as of December 31, 2004.

   (c) Record any entry required as of December 31, 2005.
28. PeopleINshape, Inc. is a gym. They sell gym memberships requiring the new member to pay an initial "membership" fee, which is good for as long as the member maintains their gym membership. They have performed a study of the usual life of a gym membership and found that the estimated life of a membership lasts for 3 years.

During October 2004, PeopleINshape, Inc. sold 100 new memberships and received $12,500 in associated new membership fees on October 31, 2004.

INSTRUCTIONS:
Based on the above facts, prepare the journal entries necessary for PeopleINshape, Inc. for the October membership sales and any adjusting entries necessary in connection with those new memberships as of December 31, 2004.
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>Accounts receivable</td>
<td>50,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>350,000</td>
<td>367,500</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>600,000</td>
<td>750,000</td>
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<tr>
<td>Intangible- customer lists</td>
<td>-</td>
<td>600,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>375,000</td>
<td>375,000</td>
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<tr>
<td>Debt</td>
<td>550,000</td>
<td>550,000</td>
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<tr>
<td>Equity</td>
<td>75,000</td>
<td>842,500</td>
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</tbody>
</table>

I. Compute any goodwill resulting from the transaction.

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

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

IV. Assume that the business is a "reporting unit". Management has estimated the fair
value of the reporting unit to be $1,300,000 and is testing for impairment. The balance sheet
at net book value is as follows on the date of the impairment test:

<table>
<thead>
<tr>
<th></th>
<th>NBV</th>
<th>Fair Value</th>
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<tr>
<td>Accounts receivable</td>
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<tr>
<td>Equity</td>
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Is there an impairment? If yes, compute the amount of the impairment and show the
associated journal entry.

V. Assume that the fair value in IV above is $1,000,000. Is there an impairment, if
yes, compute the amount of the impairment and show the associated journal entry.
<table>
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<th>Question</th>
<th>Answer</th>
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<td>Exercise</td>
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</tbody>
</table>
14. The company must both intend to refinance the obligation on a long-term basis and demonstrate the ability to consummate the refinancing to exclude a short-term obligation from current liabilities.

21. $6,000,000 - $3,600,000 = $2,400,000.

22. $2,400,000 and $1,600,000.

25. $40,000 + $490,000 + $90,000 = $620,000.

26. Wages expense  
   Wages payable  22,063
   Federal withholding payable  14,862
   State withholding payable  3,075
   Other Fed. withholding payable  1,025
   Health ben. payable  25

27. (A) PV of note is $250,000 * .826 = $206,500
   PV of cash = $500,000
   PV of purchase = $706,500

   Equipment  706,500
   Cash  500,000
   Note payable  206,500

   (B) Note balance 206,500 * 10% rate *11/12 = 18,929
   Interest expense  18,929
   Accrued interest (or note payable)  18,929

   (C) Note balance (206,500+18,929) * 10% rate (full year) = 22,543
   Interest expense  22,543
   Accrued interest (or note payable)  22,543

28. OCTOBER ENTRY:
   Cash  $12,500
   Unearned membership income  $12,500

   DECEMBER 31, 2004 ADJUSTING ENTRY:
   Unearned membership income  $694
   Membership revenue  $694
   ($12,500/36 months=$347.22/ month X 2 months= $694.
SOLUTION

29. Acquiror, Inc. purchased Bought, Inc. for: $1,250,000

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>Cost</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>50,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>350,000</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>600,000</td>
</tr>
<tr>
<td>Intangible- customer lists</td>
<td>-</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>375,000</td>
</tr>
<tr>
<td>Debt</td>
<td>550,000</td>
</tr>
<tr>
<td>Equity</td>
<td>75,000</td>
</tr>
</tbody>
</table>

| Purchase price | $1,250,000 |
| FV acquired | 842,500 |
| Goodwill | $407,500 |

I. Compute any goodwill resulting from the transaction.

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

| Accounts receivable | 50,000 |
| Inventory | 367,500 |
| Fixed assets, net | 750,000 |
| Intangible- customer lists | 600,000 |
| Accounts payable | 375,000 |
| Debt | 550,000 |
| Cash | $1,250,000 |
| Goodwill | $407,500 |

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

WE DO NOT AMORTIZE GOODWILL. $0.00

IV. Assume that the business is a "reporting unit". Management has estimated the fair value of the reporting unit to be $1,300,000 and is testing for impairment. The balance sheet at net book value is as follows on the date of the impairment test:

<table>
<thead>
<tr>
<th>NBV</th>
<th>FAIR VALUE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>49,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>385,875</td>
</tr>
<tr>
<td>Fixed assets, net</td>
<td>735,000</td>
</tr>
<tr>
<td>Intangible- customer lists</td>
<td>588,000</td>
</tr>
<tr>
<td>Goodwill</td>
<td>407,500</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>412,500</td>
</tr>
<tr>
<td>Debt</td>
<td>550,000</td>
</tr>
<tr>
<td>Equity</td>
<td>1,202,875</td>
</tr>
</tbody>
</table>

Is there an impairment? If yes, compute the amount of the impairment and show the associated journal entry.

No impairment as FAIR VALUE exceeds NBV of reporting unit.

V. Assume that the fair value in IV above is $1,000,000. Is there an impairment, if yes, compute the amount of the impairment and show the associated journal entry.

THERE IS AN IMPAIRMENT AS NBV< FAIR VALUE:

| Reporting Unit value | 1,000,000 |
| Fair value of identifiable net assets, excl. gw will | (783,983) |
| Implied goodwill value | 216,018 |
| Goodwill recorded | 407,500 |
| Goodwill impairment | 191,483 |

Impairment expense | 191,483 |

Goodwill impairment | 191,483 |