Multiple Choice Questions (1 point each, 25% of exam total)

Choose the best answer for each of the questions below and record your response on the Scantron sheet.

1. What is the focus of the “Norwalk Agreement” (Memorandum of Understanding) between the IASB and the FASB?
   A) To make U.S. GAAP conform with existing IASB standards
   B) To ensure that IASB standards reflect existing U.S. GAAP
   C) To make U.S. GAAP and IASB standards compatible
   D) To highlight the differences between U.S. GAAP and the IASB standards

   A) Measurement
   B) Alternatives available
   C) Disclosure
   D) All of the above may be different between IFRS and U.S. GAAP

3. Which of the following is generally true about the differences between U.S. GAAP and IASB standards?
   A) U.S. GAAP is generally more flexible than IASB standards.
   B) U.S. GAAP tends to be more rule-based and the IASB standards tend to be principles-based.
   C) More professional judgment is required to apply U.S. GAAP than is required for implementing IASB standards.
   D) In all cases, U.S. GAAP is more detailed than the IASB standards.

4. Which of the following inventory valuation methods commonly used in the U.S. is NOT allowed under IAS 2 (Inventories)?
   A) LIFO
   B) FIFO
   C) Weighted Average
   D) Retail inventory method

5. What is the basis for choosing depreciation methods for fixed assets under IAS 16 (Property, Plant, & Equipment)?
   A) Tax minimization
   B) Profit maximization
   C) Useful life of the fixed asset
   D) Pattern of economic benefits to be derived from the asset
6. According to IAS 16 (Property, Plant & Equipment), what is the term used to indicate the amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction?
   A) Replacement cost
   B) Net realizable value
   C) Fair market value
   D) Historical cost

7. In what way does IAS 16 (Property, Plant, & Equipment) differ from U.S. GAAP concerning fixed asset measurement subsequent to initial recognition?
   A) IAS 16 allows for upward revaluation of the asset based on fair value.
   B) IAS 16 does not allow accumulated depreciation to be shown on the balance sheet.
   C) IAS 16 requires that fixed assets be carried at fair value less accumulated impairment losses.
   D) IAS 16 allows both upward and downward revaluation of fixed assets, whereas U.S. GAAP only allows upward revaluation.

8. If a company chooses the revaluation model permitted in IAS 16 for fixed asset measurement:
   A) annual revaluations must be performed on each class of assets.
   B) it must update the valuation so that the balance sheet represents fair value on the balance sheet date.
   C) appraisals must be performed by an official of the IASB.
   D) the depreciated replacement cost must be used as the fair value of the fixed asset.

9. As defined by IAS 38, how are intangible assets unlike other assets?
   A) They must have arisen from past events.
   B) Their value cannot be reasonably measured.
   C) They must be controlled by the enterprise.
   D) They are non-monetary and lack physical substance.

10. How does IAS 38 (Intangible Assets) differ from U.S. GAAP with respect to development costs?
    A) U.S. GAAP does not allow capitalization of development costs, whereas IAS 38 allows capitalization of these costs.
    B) U.S. GAAP requires capitalization of development costs, whereas IAS 38 makes capitalization of these costs optional.
    C) U.S. GAAP treats development costs as part of “Goodwill” whereas IAS 38 treats these costs as an intangible asset.
    D) U.S. GAAP requires expensing of all development costs and IAS 38 requires capitalizing all development costs.
11. Agro-World Technologies Inc. incurred $1,000,000 to construct a pilot plant to study the feasibility of building agricultural machinery more inexpensively for emerging economies. How would this cost be classified under IAS 38 (Intangible Assets)?
   A) Research
   B) Development
   C) Neither research nor development
   D) It could be either research or development, depending on management's wishes.

12. Under U.S. GAAP, interest on loans secured to acquire fixed assets must be:
   A) expensed in the period they are incurred.
   B) capitalized as part of the fixed asset cost.
   C) either expensed currently or capitalized as part of the fixed asset cost.
   D) charged against revenue in the year the asset is put into service.

13. In what way does the IASB standard on Leases (IAS 17) differ from U.S. GAAP?
   A) It is less specific than U.S. GAAP in terms of defining what constitutes a finance lease.
   B) U.S. GAAP requires more professional judgment in accounting for leases than does IAS 17.
   C) IAS 17 is more specific than U.S. GAAP in defining an operating lease.
   D) Operating leases are capitalized under IAS 17 but are not capitalized under U.S. GAAP.

14. Under IAS 37, inflows of resources that are “virtually certain” to be received should be:
   A) disclosed as contingent assets in the notes to the financial statements.
   B) recognized as assets.
   C) undisclosed until management is absolutely certain that resources will be received.
   D) reported only in the cash flow statement.

15. Under IAS 16 (Property, Plant, and Equipment), subsequent revaluation decreases are:
   A) never recognized.
   B) credited to a revaluation surplus account.
   C) recognized as an expense on the Income Statement.
   D) first recognized as a reduction in any related revaluation surplus.
Problem (45 points, 75% of the exam total)

In 2009, its first year of operations, Color Fusion Ltd. (CFL) prepared its financial statements in accordance with U.S. GAAP (as audited by the company’s auditors). Pre-tax Operating Income amounted to $250,000 and Shareholders’ Equity reported at $1,300,000.

Color Fusion is interested in attracting additional external investors to help finance a major expansion. Several of the targeted investors are based in Europe and have asked the company’s auditors (you) to prepare a reconciliation to IAS for the Income statement and the Shareholders’ Equity portion of the Balance Sheet.

You have identified the following items as having potentially material impact for the reconciliation process.

1. The 12/31/2009 balance sheet shows inventory with a balance of $600,000. Records indicate historical cost of $620,000 and replacement cost of $600,000. Through additional analysis you determined that the current estimated selling price is 630,000 and $25,000 cost to sell. The normal profit margin is 15%.

2. The balance sheet shows property, plant, & equipment, all acquired in 2009, with historical cost of $1,500,000 and accumulated depreciation of $100,000. Your analysis indicates the fair market value as of December is $1,600,000.

3. In 2009 CFL entered into a 5-year lease agreement for a small fleet of delivery vehicles with five annual lease payments of $33,289 each. The present value of the minimum lease payments at the time of executing the lease was $120,000. The useful life of the vehicles is 5 years. The fair market value of the vehicles at the time of signing the lease was $140,000. CFL’s 12/31 balance sheet showed leased assets $96,000 ($120,000 basis less $24,000 accumulated depreciation) and Lease Liabilities at $101,111. Interest expense related to the lease amortization on the income statement amounted to $18,889

4. CFL owns a 5-acre plot of land that is currently not in use and being held as investment property. The historical cost of the land is $350,000. A real estate broker conducted a comparative analysis in December and determined the fair market value of the tract is $325,000.

5. CFL established a contributory defined contribution plan in 2009 for all employees. In accordance with the terms of the plan, CFL made contributions in the amount of $45,000 and employees collectively contributed $65,000. CFL has no post-retirement obligations beyond that of the contributions actually made.
<table>
<thead>
<tr>
<th>Item</th>
<th>Adjustment</th>
<th>Explanation</th>
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<td>Pre-tax Operating Income (U.S. GAAP)</td>
<td>$250,000</td>
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<td>Pre-tax Operating Income (IFRS)</td>
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<td>Shareholders' Equity (U.S. GAAP)</td>
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## Case

### AACSB Assessment – Analytic and Synthesis

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<tr>
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</table>
| Pre-tax Operating Income            | $250,000   | U.S. GAAP: Inventory write-off of $20,000 (historical cost of $620,000 vs. replacement cost of $600,000).  
IAS 2: Inventory write-off of $15,000 (historical cost of $620,000 vs. NRV of $605,000).  
Thus, the write-off is $5,000 less under IAS compared with U.S. GAAP. |
| Inventory write-off                 | -5,000     | U.S. GAAP: balance sheet will report PP&E at depreciated historical cost of $1,400,000.  
IAS 16: FMV is estimated at $1,600,000 so the firm can recognize a write-up of $200,000 through a "revaluation surplus" in shareholders’ equity NOT through the income statement. |
| PP&E                                | 0          | U.S. GAAP: The lease is accounted for as a capital lease as it meets one criteria – lease term >= 75% of the useful life of the asset.  
IAS 17: Professional judgment is needed to determine whether the lease is an operating lease or a finance lease. The lease appears to meet the conditions of a finance lease and therefore the accounting would be the same under U.S. GAAP and IAS. |
| Leases                              | 0          | U.S. GAAP: Gains and losses on investment property are not recognized until realized (assets sold).  
IAS 40: Gains and losses on investment property are recognized in current income.  
The $25,000 loss is recognized in the current income statement. |
| Investment Property                 | -25,000    | U.S. GAAP: Contributions to defined contribution plans are expensed as incurred.  
IAS 19: Contributions to defined contribution plans are expensed as incurred.  
No adjustment to income is required. |
| Post-retirement Defined Contribution Plan | 0        | U.S. GAAP: Contributions to defined contribution plans are expensed as incurred.  
IAS 19: Contributions to defined contribution plans are expensed as incurred.  
No adjustment to income is required. |
| Pre-tax Operating Income (IFRS)     | $230,000   | |

**Comment [AJW1]:** An indication of the dollar amount and direction of the adjustment is required here. While some of the issues require no adjustment, your solution needs to indicate clearly that no adjustment is needed – not simple left blank.

**Comment [AJW2]:** Each adjustment is worth 5 points maximum, with partial credit provided where appropriate.

**Comment [AJW3]:** A total is needed here to complete the reconciliation.
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<tbody>
<tr>
<td>Shareholders’ Equity (U.S. GAAP)</td>
<td>$1,300,000</td>
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<tr>
<td>Inventory write-off</td>
<td>-$5,000</td>
<td>As a result of the additional $5,000 recognized in the income statement, shareholders’ equity, through retained earnings, is adjusted upward by $5,000.</td>
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<td>PP&amp;E</td>
<td>+200,000</td>
<td>The firm can recognize a write-up of $200,000 through a “Revaluation Surplus” in shareholders’ equity.</td>
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<td>Leases</td>
<td>0</td>
<td>There is no difference in treatment between U.S. GAAP and IAS under these conditions.</td>
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<tr>
<td>Investment Property</td>
<td>-25,000</td>
<td>The loss of $25,000 is recognized in shareholders’ equity through retained earnings.</td>
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<tr>
<td>Post-retirement Defined Contribution Plan</td>
<td>0</td>
<td>No adjustment is necessary as U.S. GAAP and IFRS treatment is the same.</td>
</tr>
<tr>
<td>Shareholders’ Equity (IFRS)</td>
<td>$1,480,000</td>
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