Examination: Financial Accounting, Summer 2002
Examiner: Prof. Dr. Michael Hommel
The following aids can be used: calculator

Question 1 (30 points)

Presented below are three models for setting accounting standards.

1. The purely political approach, where national legislative action decrees accounting standards.
2. The private, professional approach, where financial accounting standards are set and enforced by private professional actions only.
3. The public / private mixed approach, where standards are basically set by private sector bodies that behave as though they were public agencies and whose standards to a great extent are enforced through governmental agencies.

Instructions:

a) Which of the three models best describes standard setting in the United States? Comment on your answer.
b) Why do companies, financial analysts, labor unions, industry trade associations, and others take such an active interest in standard setting?
c) Cite an example of a group other than the FASB that attempts to establish accounting standards. Speculate as to why another group might wish to set its own standards.

Question 2 (30 points)

a) Describe the cost flow assumptions used in average cost, FIFO, and LIFO methods of inventory valuation.
b) Discuss the ways and conditions under which the FIFO and LIFO inventory costing methods produce different inventory valuations. Identify the effects on both the balance sheet and the income statement.
c) What is the dollar-value method of LIFO inventory valuation? What advantage does the dollar-value method have over the specific goods approach of LIFO inventory valuation?
d) On December 31, 1999, the inventory of EOC Company amounts to $ 800,000. During 2000, the company decides to use the dollar-value LIFO method of costing inventories. On December 31, 2000, the inventory is $ 1,020,000 at December 31, 2000 prices. Using the December 31, 1999, price level of 100 and the December 31, 2000, price level of 108, compute the inventory value at December 31, 2000, under the dollar-value LIFO method.

Question 3 (30 points)

a) What is the meaning of the term „contingency“ as used in accounting? Distinguish between accounting for a gain contingency and accounting for a loss contingency.
b) How are the terms „probable“, „reasonably possible“ and „remote“ related to contingent liabilities? Which influence do they have on accounting for loss contingencies?
c) Determine the proper accounting treatment (including book entries) for the following situation: As result of uninsured accidents during the year, personal injury suits for $ 350,000 and $ 60,000 have been filed against the Clark Corporation. It is the judgement of

Clark's legal counsel that an unfavorable outcome is unlikely in the $ 60,000 case but that an unfavorable verdict approximating $ 200,000 will probably result in the $ 350,000 case.

Question 4 (30 points)

Revenue is usually recognized at the point of sale. Under special circumstances, however, bases other than the point of sale are used for the timing of revenue recognition.

a) Why is the point of sale usually used as the basis for the timing of revenue recognition?
b) Revenue may also be recognized (1) during production and (2) when cash is received. For each of these two bases of timing of revenue recognition, give an example of the circumstances in which it is properly used and discuss the accounting merits of its use in lieu of the sales basis.
c) What are the two types of losses that can become evident in accounting for long-term contracts? What is the nature of each type of loss? How is each type accounted for?