**Chapter 1**

1. **Multiple Choice**
2. Under Statement of Financial Accounting Concepts No. 2, feedback value is an ingredient of the primary quality o

Relevance Reliability

* + - * 1. No No
        2. No Yes

c. Yes Yes

d. Yes No

Answer d

1. Under Statement of Financial Accounting Concepts No. 2, which of the following interacts with both relevance and reliability to contribute to the usefulness of information?
   1. Comparability
   2. Timeliness
   3. Neutrality
   4. Predictive value

Answer a

1. Which of the following hierarchy of qualities did Statement of Financial Accounting Concepts No. 2 indicate as being most important?
   1. Relevance
   2. Reliability
   3. Verifiability
   4. Decision usefulness

Answer d

1. Which of the following is considered a pervasive constraint by Statement of Financial Accounting Concepts No. 2
   1. Benefits>costs
   2. Conservatism
   3. Timeliness
   4. Verifiability

Answer a

1. Under Statement of Financial Accounting Concepts No. 2, which of the following is an ingredient of the primary quality of relevance?
   1. Predictive value
   2. Materiality
   3. Understandability
   4. Verifiability

Answer a

1. Under Statement of Financial Accounting Concepts No. 2, which of the following is an ingredient of the primary quality of reliability?
   1. Understandability
   2. Verifiability
   3. Predictive value
   4. Materiality

Answer b

1. Under Statement of Financial Accounting Concepts No. 2, the ability through consensus of measures to ensure that information represents what it purports to represent is an example of the concept of
   1. Relevance
   2. Verifiability
   3. Representational faithfulness
   4. Feedback value

Answer c

1. Under Statement of Financial Accounting Concepts No. 2, which of the following relates to both relevance and reliability?
   1. Timeliness
   2. Materiality
   3. Verifiability
   4. Neutrality

Answer b

1. Which of the following is **not** a qualitative characteristic associated with reliability?

a. Verifiable

b. Conservatism

c. Neutral

d. Faithful representation

Answer b

1. An item is considered material if

a. It doesn’t costs a lot of money.

b. It is of a tangible good.

c. It is likely to influence the decision of an investor or creditor.

d. The cost of reporting the item is greater than its benefits

Answer c

1. **Accounting concepts—identification.**

State the accounting assumption, principle, information characteristic, or constraint that is most applicable in the following cases.

1. All payments less than $25 are expensed as incurred. (Do not use conservatism.)

2. The company employs the same inventory valuation method from period to period.

3. A patent is capitalized and amortized over the periods benefited.

4. Assuming that dollars today will buy as much as ten years ago.

5. Rent paid in advance is recorded as prepaid rent.

6. Financial statements are prepared each year.

7. All significant post-balance sheet events are reported.

8. Personal transactions of the proprietor are distinguished from business transactions.

**Solution**

1. Materiality constraint.

2. Consistency characteristic.

3. Matching principle or going concern assumption.

4. Monetary unit assumption.

5. Matching principle or going concern assumption.

6. Periodicity assumption.

7. Full disclosure principle.

8. Economic entity assumption.

1. **Accounting concepts—identification.**

Presented below are a number of accounting procedures and practices in Sanchez Corp. For each of these items, list the assumption, principle, information characteristic, or modifying convention that is violated.

1. Because the company's income is low this year, a switch from accelerated depreciation to straight-line depreciation is made this year.

2. President of Sanchez Corp. believes it is foolish to report financial information on a yearly basis. Instead, the president believes that financial information should be disclosed only when significant new information is available related to the company's operations.

3. Sanchez Corp. decides to establish a large loss and related liability this year because of the possibility that it may lose a pending patent infringement lawsuit. The possibility of loss is considered remote by its attorneys.

4. An officer of Sanchez Corp. purchased a new home computer for personal use with company money, charging miscellaneous expense.

5. A machine, that cost $40,000, is reported at its current market value of $45,000.

**Solution**

1. Consistency.

2. Periodicity.

3. Matching (also, conservatism).

4. Economic entity.

5. Historical cost (also, revenue recognition)\*.

\*Reporting the asset at FMV of $45,000 implies the following entry:

Machine 5,000

Revenue 5,000

1. **Accounting concepts—matching.**

Listed below are several information characteristics and accounting principles and assumptions. Match the letter of each with the appropriate phrase that states its application. (Items a through k may be used more than once or not at all.)

a. Economic entity assumption g. Matching principle

b. Going concern assumption h. Full disclosure principle

c. Monetary unit assumption i. Relevance characteristic

d. Periodicity assumption j. Reliability characteristic

e. Historical cost principle k. Consistency characteristic

f. Revenue recognition principle

1. Stable-dollar assumption (do not use historical cost principle).

2. Earning process completed and realized or realizable.

3. Presentation of error-free information with representational faithfulness.

4. Yearly financial reports.

5. Accruals and deferrals in adjusting and closing process. (Do not use going

6. Useful standard measuring unit for business transactions.

7. Notes as part of necessary information to a fair presentation.

8. Affairs of the business distinguished from those of its owners.

9. Business enterprise assumed to have a long life.

10. Valuing assets at amounts originally paid for them.

11. Application of the same accounting principles as in the preceding year.

12. Summarizing significant accounting policies.

13. Presentation of timely information with predictive and feedback value.

**Solution**

1. c 4. d 7. h 10. e 13. i

2. f 5. g 8. a 11. k

3. j 6. c 9. b 12. h

1. **Accounting concepts—fill in the blanks.**

Fill in the blanks below with the accounting principle, assumption, or related item that best completes the sentence.

1. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ and \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ are the two primary qualities that make accounting information useful for decision making.

1. Information that helps users confirm or correct prior expectations has \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

3. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ enables users to identify the real similarities and differences in economic phenomena because the information has been measured and reported in a similar manner for different enterprises.

4. Some costs which give rise to future benefits cannot be directly associated with the revenues they generate. Such costs are allocated in a \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ and \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ manner to the periods expected to benefit from the cost.

5. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ would allow the expensing of all repair tools when purchased, even though they have an estimated life of 3 years.

6. The \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ characteristic requires that the same accounting method be used from one accounting period to the next, unless it becomes evident that an alternative method will bring about a better description of a firm's financial situation.

7. \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ guides accountants to select the accounting treatment that is least likely to overstate income and assets.

8. Parenthetical balance sheet disclosure of the inventory method utilized by a particular company is an application of the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ principle.

9. Corporations must prepare accounting reports at least yearly due to the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ assumption.

10. Recording and reporting inflows at the end of production is an allowable exception to the \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ principle.

**Solution**

1. Relevance; reliability 6. consistency

2. feedback value 7. Conservatism

3. Comparability 8. full disclosure

4. rational; systematic 9. periodicity

5. The materiality convention 10. revenue recognition

Chapter 3

Balance Sheet

PROBLEM 3-1

Airlines International

Balance Sheet

December 31, 2008

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| ASSETS |  |  |  |  |  |
| Current assets: |  |  |  |  |  |
| Cash |  |  |  | $ | 28,837 |
| Marketable securities |  |  |  |  | 10,042 |
| Accounts receivable | $ | 67,551 |  |  |  |
| Less: Allowance for doubtful accounts |  | 248 |  |  | 67,303 |
| Inventory |  |  |  |  | 16,643 |
| Prepaid expenses |  |  |  |  | 3,963 |
| Total current assets |  |  |  | $ | 126,788 |
| Long term Investments: |  |  |  |  |  |
| Investment and special funds |  |  |  |  | 11,901 |
| Property, plant, and equipment: |  |  |  |  |  |
| Property, plant and equipment | $ | 809,980 |  |  |  |
|  |  |  |  |  |  |
| Less: Accumulated depreciation |  | 220,541 |  |  | 589,439 |
|  |  |  |  |  |  |
| Other assets |  |  |  |  | 727 |
| Total assets |  |  |  | $ | 728,855 |
|  |  |  |  |  |  |
| LIABILITIES AND STOCKHOLDERS’ EQUITY: |  |  |  |  |  |
|  |  |  |  |  |  |
| Current Liabilities: |  |  |  |  |  |
| Accounts payable |  |  |  | $ | 77,916 |
| Accrued expenses |  |  |  |  | 23,952 |
| Unearned transportation revenue |  |  |  |  | 6,808 |
| Current installments of long-term debt |  |  |  |  | 36,875 |
|  |  |  |  |  |  |
| Total current liabilities |  |  |  | $ | 145,551 |
|  |  |  |  |  |  |
| Long-term debt, less current portion |  |  |  |  | 393,808 |
| Deferred income taxes |  |  |  |  | 42,070 |
|  |  |  |  |  |  |
| Stockholders’ equity: |  |  |  |  |  |
| Common stock (par $0.50) | $ | 7,152 |  |  |  |
| Capital in excess of par |  | 72,913 |  |  |  |
| Retained earnings |  | 67,361 |  |  |  |
| Total stockholders’ equity |  |  |  |  | 147,426 |
| Total liabilities and stockholders’ equity |  |  |  | $ | 728,855 |

# PROBLEM 3‑2

Lukes, Inc.

Balance Sheet

December 31, 2008

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| ASETS |  |  |  |  |  |
|  |  |  |  |  |  |
| Current assets: |  |  |  |  |  |
| Cash | $ | 3,000 |  |  |  |
| Receivables, less allowance of $3,000 |  | 58,000 |  |  |  |
| Inventories |  | 54,000 |  |  |  |
| Prepaid expenses |  | 2,000 |  |  |  |
| Total current assets |  |  |  | $ | 117,000 |
| Plant and equipment: |  |  |  |  |  |
| Buildings | $ | 75,000 |  |  |  |
| Machinery and equipment |  | 300,000 |  |  |  |
|  |  | 375,000 |  |  |  |
| Less: accumulated depreciation |  | 200,000 |  |  | 175,000 |
| Land |  |  |  |  | 11,000 |
| Other assets |  |  |  |  | 7,000 |
| Total assets |  |  |  | $ | 310,000 |
|  |  |  |  |  |  |
| LIABILITIES AND STOCKHOLDERS’ EQUITY |  |  |  |  |  |
|  |  |  |  |  |  |
| Current liabilities: |  |  |  |  |  |
| Accounts payable | $ | 35,000 |  |  |  |
| Accrued income taxes |  | 3,000 |  |  |  |
| Other accrued expenses |  | 8,000 |  |  |  |
| Current portion of long-term debt |  | 7,000 |  |  |  |
| Total current liabilities: |  |  |  | $ | 53,000 |
| Long-term liabilities: |  |  |  |  |  |
| Long-term debt, less current portion |  |  |  |  | 99,870 |
| Deferred income tax liability |  |  |  |  | 24,000 |
| Total long-term liabilities |  |  |  | $ | 123,870 |
|  |  |  |  |  |  |
| Stockholders’ equity: |  |  |  |  |  |
| Common stock, no par value 10,000 shares authorized, 5,724 shares issued |  |  |  |  | 3,180 |
| Retained earnings |  |  |  |  | 129,950 |
| Total stockholders’ equity |  |  |  | $ | 133,130 |
| Total liabilities and stockholders’ equity |  |  |  | $ | 310,000 |

PROBLEM 3‑3

Alleg, Inc.

Balance Sheet

December 31, 2008

|  |  |
| --- | --- |
| ASSETS  Current assets:  Cash  Marketable securities  Accounts receivable  Inventories  Total current assets  Plant and equipment:  Land and buildings  Machinery and equipment  Less: Accumulated depreciation  Total plant and equipment  Intangibles:  Goodwill  Patents  Other assets  Total assets  LIABILITIES AND STOCKHOLDERS’ EQUITY  Current liabilities:  Accounts payable  Current maturities of long-term debt  Total current liabilities  Long-term liabilities:  Mortgages payable  Bonds payable  Deferred income taxes  Total long-term liabilities  Stockholders’ equity:  Common stock, no par value  21,000 shares authorized at $1 par value,  10,000 shares issued  Additional paid-in capital  Retained earnings  Total stockholders’ equity  Total liabilities and stockholders’ equity | $ 13,000  17,000  26,000  30,000  86,000  57,000  125,000  182,000  61,000  121,000  8,000  10,000  18,000  50,000  $275,000  $ 15,000  11,000  26,000  80,000  70,000  18,000  168,000  10,000  38,000  33,000  81,000  $275,000 |

PROBLEM 3‑4

a. Restricted cash in sinking fund should be classified as long‑term investment.

b. Investment in Subsidiary Company is long‑term investment.

c. Measurement basis of marketable securities should be disclosed.

d. Preferable to show land and buildings separately, since land is not depreciable.

e. Treasury stock is not an asset, it should be deducted from stockholders' equity.

f. Discount on bonds payable is a contra liability and should be classified as a deduction from bonds payable.

g. Prepaid expenses should be classified as a current asset.

h. For most industries, liabilities should be classified as current and long-term.

i. Preferred and common stock should be separated, as should capital in excess of par.

PROBLEM 3‑5

a. Heading date is wrong. It should read December 31, 2008.

b. Preferable to disclose allowance for doubtful accounts on face of statement. Some firms disclose this account in a note.

c. Treasury stock is not an asset, it should be deducted from stockholders' equity.

d. Land and building are disclosed net. Accumulated depreciation should be disclosed.

* 1. Short‑term U.S. Notes should be classified under current assets.

* 1. Supplies should be classified under current assets.

* 1. For most industries, liabilities should be classified as current and long-term. Short-term bonds should be under current liabilities. Long-term bonds payable should be under long-term liabilities.
  2. Redeemable preferred stock should be presented before stockholders'

equity.