

MOSICH

STUDY GUIDE FOR USE WITH

INTERMEDIATE ACCOUNTING

REVISED SIXTH EDITION



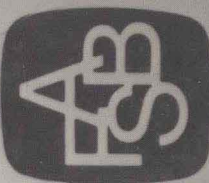
MOSICH

INTERMEDIATE ACCOUNTING



ACCOUNTING STANDARDS

Statements of Financial Accounting Standards



ACCOUNTING STANDARDS

Current General Standards

**STUDY GUIDE
FOR USE WITH**

Intermediate Accounting

Revised Sixth Edition

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for Use with
Intermediate Accounting**

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STUDY GUIDE
FOR USE WITH

Intermediate Accounting

To the Student

This *Study Guide* is prepared to accompany *Intermediate Accounting*, revised sixth edition, by A. N. Mosich. However, it may be used effectively with other intermediate accounting texts. The summary of each chapter includes the highlights of the chapter, true-or-false questions, completion statements, multiple-choice questions, and short exercises. Solutions for all questions and short exercises appear at the end of each *Study Guide* chapter, and check figures for selected exercises at the end of each chapter in the text appear in the Appendix of the *Study Guide*. The three major objectives of this *Study Guide* are:

- To help you master the material as you initially study each chapter of the text.
- To summarize the essential points in each chapter of the text and to test your knowledge with a series of objective questions and short exercises, thus making it possible for you to review the material quickly from time to time, particularly before examinations.
- To make the study of accounting more enjoyable and less tedious for you. This is accomplished by the presentation of an informal and concise summary of each chapter, followed by three groups of objective questions and a number of short exercises. The answers to the questions and short exercises give you immediate feedback and point out the concepts that require your attention.

The manner in which you use this *Study Guide* is entirely up to you. However, the following approach has been found to be efficient by many of our students in recent years:

- 1 Study the assigned chapter in the text.
- 2 Read the “Highlights of the Chapter” section of the *Study Guide*. If you encounter any points that you do not understand, refer to the text for a detailed discussion or illustration of the topic or the specific point covered.
- 3 Answer the questions and short exercises and compare your answers with those we have developed. This will indicate how well you understand the material contained in the related chapter in the text. Again, if you find something you do not understand, refer to the text for a more complete discussion or illustration of the subject.
- 4 Prepare solutions for the exercises, cases, and problems in the text assigned as homework by your instructor.

Once you have mastered the material in this manner, rereading the “Highlights of the Chapter” section in the *Study Guide* offers a quick and effective way of reviewing the material before an examination. Of course, no study technique is equally effective for all students; thus, you may wish to depart from the approach suggested here to suit your needs and study habits.

Acknowledgment

The material for the revised sixth edition was prepared by Charles J. Davis of California State University–Sacramento. Without his help, this edition would not have come out as timely, up-to-date, and as comprehensive as it is. His assistance was invaluable and much appreciated.

A. N. MOSICH

**STUDY GUIDE
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Intermediate Accounting

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Accounting Principles and Professional Practice

HIGHLIGHTS OF THE CHAPTER

- 1 The basic assumptions that underlie current accounting practice have evolved in response to the needs of users of financial statements and other accounting reports. These users of financial information may be classified as internal users (management personnel) and external users (investors, creditors, etc.).
- 2 **Financial accounting** is related directly to external reporting, that is, providing investors and other outsiders with the information they need for decision making.
- 3 Organizations and institutions that have influenced the development of a body of accounting theory include the Financial Accounting Standards Board (FASB), American Institute of Certified Public Accountants (AICPA), American Accounting Association (AAA), Securities and Exchange Commission (SEC), Cost Accounting Standards Board (CASB), Financial Executives Institute (FEI), and the income tax laws and regulations.
- 4 From 1959 to 1973, the Accounting Principles Board (APB) was the unit of the AICPA responsible for formulating accounting principles. CPA firms did not give approval to financial statements that depart from **APB Opinions**, unless they were willing to assume the considerable risk and legal liability of defending “unauthorized practices.”
- 5 Subsequent to the establishment of the Financial Accounting Standards Board, the AICPA’s Accounting Standards Division began to issue **Statements of Position** to propose revisions of AICPA-published **Industry Audit Guides** and **Accounting Guides**. In addition, the **Accounting Standards Division** prepared **Issue Papers** for consideration by the FASB.
- 6 In 1973, the Financial Accounting Standards Board replaced the APB as the unit responsible for developing and issuing standards of financial reporting. The FASB is a smaller, full-time group of seven members, of whom only four are CPAs from public practice.
- 7 The FASB issues **Statements of Financial Accounting Standards** as a guide for the preparation of financial statements. Before a **Statement** is issued, the FASB utilizes **Discussion Memoranda**, public hearings, and **Exposure Drafts** to encourage wide participation by all interested parties.
- 8 The Securities and Exchange Commission was established by Congress in 1934 to regulate the interstate issuance of securities to the public, and the trading of securities listed on stock exchanges and over the counter. The principal goal of the SEC is adequate **disclosure** of all relevant information about publicly owned companies. In recent years the SEC has played an increasingly active role and has exerted great influence on the development of accounting principles by the FASB.
- 9 The **attest function** is performed by certified public accountants. A CPA firm, after performing an audit, attests to the reliability of financial statements. A **conflict of interest** may exist between a business enterprise preparing financial statements and the external users of those statements. When an **independent** CPA firm conducts an audit and expresses its opinion on the fairness of financial statements, more reliability may be placed on the statements.
- 10 A major undertaking of the FASB has been the development of a conceptual framework for financial accounting and reporting. The FASB has issued **Statements of Financial Accounting Concepts** in the following areas:

Objectives of financial reporting by business enterprises
 Qualitative characteristics of accounting information
 Elements of financial statements of business enterprises
 Recognition and measurement in financial statements of business enterprises

- 11 **Statements of Financial Accounting Concepts** establish the objectives and concepts that the FASB uses to establish financial accounting and reporting standards; they do not establish generally accepted accounting principles.
- 12 In **Statement of Financial Accounting Concepts No. 1**, the FASB identified eight objectives of financial reporting. The primary emphasis was placed on information regarding the earnings of business enterprises.
- 13 In **Statement of Financial Accounting Concepts No. 2**, the FASB identified **usefulness for decision making** as the most important qualitative characteristic of accounting information. Other major qualitative characteristics were **relevance** and **reliability**. **Cost-benefit considerations** and **materiality** were recognized as constraints on the qualitative characteristics.
- 14 The cost of producing the extensive information demanded by users of financial statements has become a significant factor. The FASB has undertaken to apply **cost-benefit considerations** in its standard-setting activities.
- 15 **Relevant** accounting information helps users of the information to evaluate events or to confirm or correct expectations regarding a business enterprise. Accounting information is not relevant unless it is timely.
- 16 **Reliable** accounting information is reasonably free from error or bias. To be reliable, information must be verifiable and must have validity. However, financial statements are not completely factual because estimates are inherent in the accounting process.
- 17 The concept of **conservatism** means that when reasonable support exists for alternative methods and different estimates, accountants should select the alternative with the least favorable effect on net income and financial position in the current accounting period. Conservatism is considered a safeguard against the dangers of overstatement of earnings or financial position. Business enterprises that issue securities to the public have an incentive to report increasing earnings, and sometimes ignore conservatism in an effort to acquire a "growth image."
- 18 The **consistency** concept recognizes that acceptable alternative accounting methods exist, but insists that a method adopted by a business enterprise must be used consistently in order that financial statements of the enterprise be **comparable**. Frequent switching of methods could cause reported net income to rise or fall as a result of accounting changes, and thus obscure the trend of underlying business activity. **APB Opinion No. 20**, "Accounting Changes," stated that a business enterprise should not change from one accounting principle or method to another unless the new principle or method is **preferable**.
- 19 The **materiality** of an item means its relative importance. A loss of \$10,000 might be material for a small business enterprise, but not for a large enterprise. The qualitative aspects of a transaction, as well as the dollar amount, must be considered in judging materiality. If a conflict of interest exists, even a small item is material and should be disclosed.
- 20 In **Statement of Financial Accounting Concepts No. 3**, the FASB identified 10 interrelated elements of financial statements of business enterprises: Assets, liabilities, equity, investments by owners, distributions to owners, comprehensive income, revenue, expenses, gains, and losses. Except for "comprehensive income," the FASB's definitions of the elements do not differ markedly from traditional concepts. The FASB defined **comprehensive income** as the change in net assets of a business enterprise during an accounting period from nonowner sources.
- 21 In **Statement of Financial Accounting Concepts No. 5**, the FASB provided guidance on what information is to be included in the financial statements and the timing of its inclusion (**recognition**) and on the quantification of that information (**measurement**).
- 22 The term **generally accepted accounting principles** (GAAP) is used by CPA firms in their audit reports to indicate whether the business enterprise being audited has prepared its financial statements in an acceptable manner so that these statements may be compared with the statements of prior years and to some extent with financial statements of other enterprises.
- 23 **Accounting principles** are not rooted in the laws of nature as are principles in the physical sciences, but must be developed in relation to stated objectives of financial reporting. The sources of accounting principles include accounting literature as a whole, but especially the official pronouncements of the FASB and the APB.

- 24** The **business entity principle** means that for accounting purposes a business enterprise, whether incorporated or not, is an entity separate from its owners. Business transactions and events are interpreted and recorded from the viewpoint of the entity, and financial statements are prepared to show the financial position and operating results of the entity.
- 25** The **continuity or going-concern principle** means that accountants assume that a business enterprise will continue and will therefore be able to carry out its plans. This justifies carrying assets such as equipment and goods in process at cost rather than at liquidation value.
- 26** The **revenue realization principle**. Revenue for an accounting period is equal to the inflow of cash or receivables from the sale of goods and services during that period. Although each step in the process of producing and distributing goods or performing services is essential to earning revenue, accountants usually consider revenue to be **realized** at the point of sale. Objective evidence of the realization of revenue exists in an arm's-length transaction in which title to goods passes to customers.
- 27** The **valuation principle** distinguishes between **monetary assets**, which are carried in the balance sheet at amounts closely approximating **present value**, and **nonmonetary assets** or **productive resources**, which are reported in the balance sheet at **cost**. Liabilities are reported in the balance sheet at the amount of cash (or cash equivalent) necessary to discharge the obligations.
- 28** The **matching principle** means that after the revenue for an accounting period has been measured, the **expenses (expired costs) associated with that revenue** must be recognized to measure net income.
- 29** The **monetary principle** is an assumption that money is a useful standard measuring unit for reporting business transactions. The validity and usefulness of financial reporting in terms of **nominal dollars** is threatened by rapid and substantial changes in the price level, as, for example, by severe inflation. This has led to recommendations that nominal dollars be replaced with **constant purchasing power** in financial statements.
- 30** The **disclosure principle** requires that financial statements include **all** information necessary to keep the statements from being misleading. Disclosure may be made not only in the financial statements, but also in notes to the financial statements. The use of notes to the financial statements is a common means of describing significant accounting policies and disclosing stock option plans, pension plans, pending litigation, and loss contingencies.
- 31** In recent years, the rapid acceleration in pronouncements on accounting principles has resulted in a **standards overload** and in complaints about the unforeseen **economic consequences** of accounting standards when they have been applied in practice.
- 32** Cash inflows are related to revenue recognition, but the cash inflow and the related revenue may not be recorded in the same accounting period. Similarly, cash outflows are related to expenses, but the cash outflow and the expense may not be recorded in the same period.
- 33** The **accrual basis of accounting** is assumed throughout the textbook. The accrual basis requires that revenue be recognized when it is **realized** and that expenses be recognized when they are **incurred**. This approach makes possible the matching of expired costs and revenue to measure net income.
- 34** Under the **cash basis of accounting**, revenue is recognized only when cash is received; expenses are recognized only when they are paid in cash. The cash basis of accounting is **not** in conformity with GAAP, because it violates the matching principle. A **modified cash basis of accounting** is acceptable for income tax returns of individuals, professional firms, and service-type enterprises, but not of business enterprises with inventories.
- 35** Assume that Steiger Company had wages expense of \$100,000 and interest revenue of \$10,000 for Year 2. The balance sheets on December 21, Year 1 and Year 2, included the following:

	Year 1	Year 2
Wages payable	\$7,000	\$5,000
Interest receivable	1,000	2,000

Compute the cash payments for wages and the cash received as interest during Year 2.

Cash payments for wages consisted of \$100,000 wages expense plus \$2,000 paid to reduce the liability for wages payable (\$7,000 – \$5,000 = \$2,000), or a total **cash outflow** of \$102,000.

Cash receipts of interest consisted of \$10,000 of interest revenue minus the \$1,000 increase in the interest receivable (interest realized but not collected), or a total **cash inflow** of \$9,000.

QUESTIONS AND SHORT EXERCISES**True or False**

For each of the following statements, circle the T or the F to indicate whether the statement is true or false:

- T F 1** **Financial accounting** is related to external reporting, whereas **managerial accounting** relates to internal reporting to various levels of management.
- T F 2** Because the information needs of the various users of financial statements differ, corporations generally prepare separate special-purpose financial statements for each external group of users, such as bankers, bondholders, and common stockholders.
- T F 3** The Financial Accounting Standards Board (FASB), just as its predecessor the Accounting Principles Board (APB), is comprised entirely of CPAs from public practice.
- T F 4** The Securities and Exchange Commission (SEC) has broad authority to prescribe accounting principles.
- T F 5** Both **Statements of Financial Accounting Concepts** and **Statements of Financial Accounting Standards** are issued by the FASB to establish generally accepted accounting principles.
- T F 6** The FASB's objectives of financial reporting place primary emphasis on information regarding the financial position of a business enterprise.
- T F 7** The FASB identified **usefulness for decision making** as the most important qualitative characteristic of accounting information.
- T F 8** A balance sheet is more reliable than an earnings forecast, but it may be less relevant as a basis for business decisions.
- T F 9** Once a business enterprise has adopted an accounting method (such as the straight-line method of depreciation), the method should not be changed unless an alternative method is justified as preferable and the effect of the change on net income is disclosed.
- T F 10** The FASB has established specific standards of materiality for financial accounting.
- T F 11** **Comprehensive income**, as defined by the FASB, differs from the traditional concept of **net income**.
- T F 12** According to the FASB, disclosure is a substitute for items that should be included in financial statements.
- T F 13** Generally accepted accounting principles are of equal significance in the fields of financial accounting and managerial accounting.
- T F 14** The most important sources of generally accepted accounting principles are the SEC and the Internal Revenue Service.
- T F 15** The **business entity principle** is applicable to single proprietorships and partnerships as well as to incorporated enterprises.
- T F 16** The business activity of Wagers Company was rendered illegal by legislation passed on December 1, Year 10, to become effective on March 1, Year 11. In preparing its December 31, Year 10, financial statements, Wagers should **not** follow the going-concern principle.
- T F 17** In most business enterprises with adequate accounting systems, revenue generally is considered realized at the point when cash is received.
- T F 18** Nonmonetary assets are reported in the balance sheet at amounts closely approximating present value.
- T F 19** If balance sheets were expressed in constant purchasing power, the two categories most affected would be nonmonetary assets and owner's equity.
- T F 20** Because of the standards overload, the FASB has undertaken to provide "Big GAAP" for large publicly owned companies and "Little GAAP" for small, nonpublic companies.
- T F 21** If Wolford Company has \$10,000 of accrued interest on notes payable at the end of Year 1 and \$8,000 at the end of Year 2, and made cash payments for interest of \$35,000 during Year 2, the interest expense for Year 2 is \$33,000.
- T F 22** Financial statements prepared on the cash basis of accounting do not present the financial position or operating results of a business enterprise in accordance with generally accepted accounting principles.

Completion Statements

Fill in the necessary words to complete the following statements:

- 1** A business enterprise that recognizes _____ when it is realized and recognizes _____ when they are incurred is following the _____ basis of accounting.

- 2 The valuation of inventories at the lower of cost or market is an example of the concept of _____.
- 3 The concept concerned with the question of whether a specific item or event is sufficiently important to be disclosed in the financial statements is called _____.
- 4 The idea that the affairs of a business enterprise should be accounted for separately from the affairs of the owner or owners of the enterprise is called the _____ principle.
- 5 If a business enterprise were to prepare a balance sheet with all assets stated at their liquidation values, the enterprise would be departing from the _____ (or _____) principle.
- 6 Among the several organizations that have contributed to the development of accounting theory and practice, the one most concerned with a normative approach to accounting (that is, “what should be,” as opposed to “what is”) is the _____.
- 7 The Financial Accounting Standards Board (FASB) replaced the _____ as the authority for accounting principles.
- 8 The FASB’s _____ project includes objectives, qualitative characteristics, and needs of users of accounting information.
- 9 The unforeseen _____ of accounting standards have been an area of concern to accountants.

Multiple Choice

Choose the best answer for each of the following questions and enter the identifying letter in the space provided:

_____ 1 **Statements of Financial Accounting Concepts** issued by the FASB:

- a Identify objectives used by the FASB to establish financial accounting and reporting standards
- b Are the same as **Statements of Financial Accounting Standards**
- c Are a source of generally accepted accounting principles
- d Must be approved by the SEC before they are effective

_____ 2 Notes to the financial statements of a business enterprise should include:

- a Disclosure of general risks or uncertainties, such as the possibility of earthquakes
- b Information needed to correct any misleading presentations in the financial statements
- c An evaluation of the system of internal control
- d A summary of significant accounting policies

_____ 3 A business enterprise that uses straight-line depreciation for some plant assets and accelerated depreciation for other plant assets is:

- a Not violating generally accepted accounting principles
- b Violating the accounting principle of consistency
- c Unable to obtain a clear opinion on its financial statements from a CPA firm
- d Violating the matching principle of accounting

_____ 4 Which of the following is the most important objective of the consistency concept of accounting?

- a Comparability of financial statements of a specific business enterprise
- b Full disclosure of all information necessary to make the financial statements not misleading
- c Prevention and detection of fraud
- d Timeliness of accounting information needed to make business decisions

_____ 5 In financial accounting the **disclosure principle**:

- a Applies to all material transactions and events occurring during the accounting period covered by the financial statements, but not to any transactions and events occurring after the period
- b Applies to material transactions and events occurring subsequent to the balance sheet date but prior to the release of the financial statements
- c Requires that the names and titles of all officers and directors of a corporation be included in a note to the financial statements
- d Requires inclusion in the financial statements of all information that might be of interest to users of the statements

_____ 6 Which of the following accounting principles is **least** threatened or invalidated by severe monetary inflation?

- a Monetary principle
- b Business-entity principle
- c Matching principle
- d Violation principle

_____ 7 In which of the following types of business enterprises is management most likely to emphasize the concept of conservatism in its accounting policies?

- a An enterprise with a strong working capital position and no need for outside financing

- b A corporation with common stock listed on a stock exchange that is in a weak current position and faces decreasing demand for its products
- c A “growth” company listed on the New York Stock Exchange that has reported increased earnings per share for each of the last 10 years
- d An enterprise seeking to be acquired by another enterprise

_____ 8 Which of the following is **least** deserving of inclusion in a list of **generally accepted accounting principles**?

- a Use of historical cost in the accounting records and financial statements
- b Matching of costs and revenue
- c Use of reliable evidence
- d Use of controlling ledger accounts and subsidiary ledgers

_____ 9 When a corporation issues shares of its common stock in exchange for land and buildings, the cost of the assets acquired should be based on:

- a The cash equivalent or current fair value of the assets acquired or the common stock issued, whichever is more clearly evident
- b The present value of the future revenue expected from use of the assets acquired
- c The par or stated value of the common stock issued
- d The equity (book value) of the common stock issued

_____ 10 Allworth Company borrowed \$300,000 from its largest stockholder by issuing a noninterest-bearing promissory note payable calling for repayment of \$336,000 one year later. If the loan had been obtained from a bank, the interest rate would have been 15%. Which of the following should appear as the liability in Allworth’s balance sheet prepared immediately after it obtained the loan?

- a \$300,000
- b \$336,000
- c \$345,000
- d Some other amount

_____ 11 Generally, revenue is recognized by a merchandising enterprise when:

- a Management of the enterprise decides that it is appropriate to do so
- b The merchandise is available for sale to customers
- c An exchange has taken place and the earning process is virtually complete
- d An order for merchandise has been received

_____ 12 **Comprehensive income**, as defined by the Financial Accounting Standards Board, includes all changes in equity during a period except:

- a Extraordinary items
- b Income or loss from a discontinued business segment
- c Investments by owners and distributions to owners

- d Cumulative effect of a change in accounting principle

Short Exercises

- 1 Listed below is a group of accounting principles, qualitative characteristics, or concepts. Beneath this list is a series of phrases, each of which is closely related to one of the principles, characteristics, or concepts. Identify the principle, characteristic, or concept most closely related to each phrase by entering the identifying letter in the space provided next to each phrase.

Accounting Principles, Characteristics, or Concepts

- A Business entity principle
- B Continuity or going-concern principle
- C Monetary principle
- D Valuation principle
- E Revenue realization principle
- F Matching principle
- G Reliability characteristic
- H Comparability characteristic
- I Disclosure principle
- J Materiality concept
- K Conservatism concept

- _____ 1 Valuation of inventories at lower of cost or market
- _____ 2 Establishment of a minimum dollar amount for expenditures for plant assets to be capitalized; lesser amounts to be recognized as expenses
- _____ 3 Comparability of successive annual financial statements of a specific business enterprise
- _____ 4 Provision for doubtful accounts expense as a percentage of credit sales
- _____ 5 Consolidated financial statements
- _____ 6 Elimination of the “liquidation concept” in viewing business enterprises
- _____ 7 Anticipate no profits and provide for all possible losses
- _____ 8 Summary of significant accounting policies
- _____ 9 Affairs of a business enterprise as distinguished from those of its owner or owners

- _____ 10 Useful standard measuring unit for business transactions and events
- _____ 11 Replacing cost of goods produced with a higher valuation representing their current fair value
- _____ 12 Material subsequent events
- _____ 13 Basis of valuation of assets and liabilities
- _____ 14 Stable-dollar assumption
- _____ 15 Accruals and deferrals to achieve necessary cutoffs for the preparation of financial statements
- _____ 16 Critical event justifying the recognition of an increase in net assets
- _____ 17 Business documents showing details of completed business transactions
- _____ 18 Interim (quarterly and monthly) reports
- _____ 19 Financial reporting susceptible to independent verification
- _____ 20 All information necessary for an adequate presentation of financial position and results of operations

- 2 All insurance premiums paid by Krug Company are recorded in the Unexpired Insurance ledger account. At the year-end, the amount of expired insurance is transferred to the Insurance Expense account. The income statement for Year 2 included insurance expense of \$4,625. Unexpired insurance was \$2,770 at the end of Year 1 and \$2,160 at the end of Year 2. On the basis of this information, the amount of Krug Company's cash payments for insurance premiums during Year 2 was \$ _____.

Computations

- 3 **Features Magazine** records all cash received for magazine subscriptions by debiting Cash and crediting a liability ledger account, Unearned Subscriptions. As revenue is realized by delivery of magazines to subscribers, a transfer is made from the Unearned Subscriptions account to the Subscriptions Revenue account.

Unearned subscriptions amounted to \$223,100 at the end of Year 1 and \$230,700 at the end of Year 2. Subscriptions revenue of \$900,000 appeared in the income statement of Year 2. The

amount of **Features Magazine's** cash receipts from subscriptions in Year 2 was \$ _____.

Computations

- 4 The income statement of Providence Company for Year 2 included the following items: interest revenue, \$60,500; salaries expense, \$93,200; office supplies expense, \$3,100.

Comparative balance sheets accompanying the income statement for Year 2 included the following:

	Year 1	Year 2
Interest receivable	\$8,400	\$7,100
Salaries payable	5,800	6,700
Inventory of office supplies	1,400	1,150

From the above information, compute the following amounts:

- a Cash received for interest: \$ _____.
- b Cash paid for salaries: \$ _____.
- c Cash paid for office supplies: \$ _____.

Computations

Note to Student: If you have difficulty with this exercise, you may find it helpful to devise some simpler situations for practice. For example, how much cash is paid for salaries if salaries expense for Year 2 is \$100,000; salaries payable at the end of Year 1 was zero; and salaries payable at the end of Year 2 is \$1,000? The answer is \$99,000, because \$1,000 of the \$100,000 salaries earned by employees was not paid in cash but was owed to them at the end of Year 2. This computation is equivalent to saying that salaries expense minus the increase in the liability (salaries payable) equals cash paid for salaries. $\$100,000 - (\$1,000 - \$0) = \$99,000$.

- 5 Linda Robin, proprietor of Robin Company, had capital account balances of \$31,200 on November 30, Year 6, and \$39,000 on December 31, Year 6. Net income of Robin Company for the month of December, Year 6, was \$6,800, and Linda Robin withdrew \$3,000 cash from the proprietorship dur-

ing that month. Robin also made a cash investment in the proprietorship on December 5, Year 6.

Compute the amount of Linda Robin's investment in Robin Company on December 5, Year 6.
\$ _____.

Computations

SOLUTIONS TO QUESTIONS AND SHORT EXERCISES: CHAPTER 1

True or False

- 1 T 2 F 3 F 4 T 5 F 6 F 7 T 8 T 9 T
10 F 11 T 12 F 13 F 14 F 15 T 16 T 17 F
18 F 19 T 20 F 21 T (\$8,000 + \$35,000 - \$10,000 = \$33,000) 22 T

Completion Statements

- 1 Revenue, expenses, accrual. 2 Conservatism. 3 Materiality.
4 Business entity. 5 Continuity (going-concern). 6 American Accounting Association. 7 Accounting Principles Board.
8 Conceptual framework. 9 Economic consequences.

Multiple Choice

- 1 a 2 d 3 a 4 a 5 b 6 b 7 a 8 d 9 a 10 a
11 c 12 c

Short Exercises

- 1 1 K 2 J 3 H 4 F 5 A 6 B 7 K 8 I 9 A
10 C 11 E 12 I 13 D 14 C 15 F 16 E 17 G
18 I 19 G 20 I

- 2 \$4,015. The insurance expense for Year 2 minus the decrease in unexpired insurance equals the cash payments for insurance during Year 2: $\$4,625 - (\$2,770 - \$2,160) = \$4,015$.
- 3 \$907,600. The subscriptions revenue for the year plus the increase in the liability for unearned subscriptions equals the cash receipts from subscriptions during Year 2: $\$900,000 + (\$230,700 - \$223,100) = \$907,600$.
- 4 a \$61,800. The cash received for interest may be computed by adding the decrease in interest receivable to the interest revenue: $\$60,500 + (\$8,400 - \$7,100) = \$61,800$.
- b \$92,300. The cash paid for salaries during Year 2 may be computed by deducting the increase in salaries payable from the salaries expense for Year 2: $\$93,200 - (\$6,700 - \$5,800) = \$92,300$.
- c \$2,850. The cash paid for office supplies may be computed by deducting the decrease in the inventory of office supplies from the office supplies expense: $\$3,100 - (\$1,400 - \$1,150) = \$2,850$. To state the analysis another way, the cash payment of \$2,850 for office supplies plus the \$250 of office supplies consumed from the amount on hand at the beginning of the year equaled the year's expense of \$3,100.
- 5 \$4,000. The December 31 capital account balance plus the withdrawals during December, minus the November 30 capital account balance plus net income, equals the amount of the December 5 investment: $(\$39,000 + \$3,000) - (\$31,200 + \$6,800) = \$4,000$.

Information Processing and the Accounting Cycle

HIGHLIGHTS OF THE CHAPTER

- 1 The recording phase of accounting consists of interpreting and recording **business transactions** and **events** as they occur. Business transactions and other events cause changes in the assets, liabilities, or owners' equity of a business enterprise.
- 2 A **supporting document** or **business paper** (such as a check, invoice, or cash register tape) is the first record made of a transaction. It generally shows the date, dollar amount, and nature of the transaction. Serial numbers are used for each type of supporting document or business paper to prevent any omissions.
- 3 The processing of accounting information utilizes the same accounting principles, regardless of whether a business enterprise uses a manual system with traditional journals and ledgers or an electronic data processing system with information stored on magnetic tapes or discs. Manual recording methods are stressed in the textbook because this is the simplest and clearest means of illustrating the application of accounting principles to business transactions and events.
- 4 The **double-entry system** is almost universally used because of the built-in controls it provides against many types of errors.
- 5 The normal **accounting period** is one year in length. Financial statements for shorter periods, such as a quarter of a year, are called **interim reports** and generally are reviewed by independent CPAs. A **natural business year** ends when operations are at a low point to simplify year-end procedures.
- 6 The **accounting cycle** is the series of accounting procedures repeated in the same order each accounting period. These procedures include the maintenance of journals and ledgers and the preparation of financial statements.
- 7 **Journals** are chronological records in which transactions are expressed in terms of debits and credits to the appropriate ledger accounts. The number and design of journals vary with the size and nature of operations. A widely used system illustrated in Chapter 2 of the textbook consists of four special journals and a general journal. The special journals are the sales journal, voucher register (or purchases journal), cash receipts journal, and cash payments journal.
- 8 Most business transactions fall into one of four types: (a) sales on credit, (b) purchases on credit, (c) receipts of cash, and (d) payments of cash. A special journal generally is used for each of these four types of transactions. All other transactions are recorded in the **general journal**.
- 9 The total or totals accumulated in a special journal are posted at the end of each accounting period to the appropriate ledger accounts, such as Cash, Sales, Purchases, Accounts Receivable, Accounts Payable, etc. Special journals reduce the amount of posting work by permitting the posting of totals for a larger number of individual transactions. They also strengthen internal control by providing for division of duties among employees.
- 10 The information contained in supporting documents is first entered in journals and then posted to ledger accounts. The **nominal accounts** (that is, revenue and expense accounts) are closed at the end of each accounting period. The **real accounts** (balance sheet accounts) remain open when the accounting records are closed at the end of each period.