

Problem-Solving Survival Guide

INTERMEDIATE ACCOUNTING

Eleventh Edition

VOLUME I
CHAPTERS 1-14

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VOLUME 1: CHAPTERS 1-14

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ACCOUNTING
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ISBN 0-471-22640-8

Printed in the United States of America

11 12 13 14

Printed and bound by Courier Kendallville, Inc.

PREFACE: To the Student

The purpose of this problem solving tutorial is to help you to improve your success rate in solving accounting homework assignments and in answering accounting exam questions. For each chapter we provide you with:

OVERVIEW	To briefly introduce the chapter topics and their importance.
STUDY OBJECTIVES	To provide you with a learning framework. Explanations of these objectives also provide you with a summary of the major points covered in the chapter.
TIPS	To alert you to common pitfalls and misconceptions and to remind you of important terminology, concepts, and relationships that are relevant to answering specific questions or solving certain problems. To help you to understand the intricacies of a problematic situation and to tell you what to do in similar circumstances.
EXERCISES	To provide you with a selection of problems which are representative of homework assignments which an intermediate accounting student may encounter.
MULTIPLE CHOICE	To provide you with a selection of multiple-choice questions which are representative of common exam questions covering topics in the chapter.
PURPOSES	To identify the essence of each question or exercise and to link them to learning objectives.
SOLUTIONS	To show you the appropriate solution for each exercise and multiple-choice question presented.
EXPLANATIONS	To give you the details of how selected solutions were derived and to explain why things are done as shown.
APPROACHES	To coach you on the particular model, computational format, or other strategy to be used to solve particular problems. To teach you how to analyze and solve multiple-choice questions.

This book will be a welcome teaching/learning aid because it provides you with the opportunity to solve accounting problems in addition to the ones assigned by your instructor without having to rely on your teacher for solutions. Many of the exercises and questions contained herein are very similar to items in your intermediate accounting textbook; the difference is, the ones in this book are accompanied with detailed clearly-laid out solutions.

The use of the multiple choice questions in this volume and the related suggestions on how to approach them can easily increase your ability (and confidence in your ability) to deal with exam questions of this variety.

We are grateful to Jennifer Laudermilch, Senior Manager, Global Assurance Methodology, PricewaterhouseCoopers LLP, Jersey City, New Jersey, for her constructive suggestions and editorial comments. Also thanks to Chelsea Hunt, James S. Hunt, Annabelle Specie, M.F. Specie, and Diane Henry for their assistance and support. Our appreciation to Mary Ann Benson who skillfully prepared the manuscript and performed the composition of this book.

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HOW TO STUDY ACCOUNTING

The successful study of accounting requires a different approach than most other subjects. In addition to reading a chapter, applying the material through the completion of exercises or problems is necessary to develop a true and lasting understanding of the concepts introduced in the text chapter. The study of accounting principles is a combination of theory and practice; theory describes what to do and why, and practice is the application of guidelines to actual situations. We use illustrations (practice) to demonstrate how theory works and we use theory to explain why something is done in practice. Therefore, it is impossible to separate the two in the study of accounting.

Learning accounting is a cumulative process. It is difficult to master Chapter 4 until you are thoroughly familiar with Chapters 1-3, and so on. Therefore, it is imperative that you keep up with class assignments. And because accounting is a technical subject, you must pay particular attention to terminology.

Accounting is the language of business. It is an exciting subject that provides a challenge for most business majors. Your ultimate success in life may well depend on your ability to grasp financial data. The effort you expend now will provide rewards for years to come.

We encourage you to follow the four steps for study outlined below to give yourself the best possible chance for a successful learning experience and to make the most efficient use of your time. These steps provide a system of study for each new chapter in your text.

- Step 1**
- Scan the study objectives in the text.
 - Scan the chapter (or chapter section) rather quickly.
 - Glance over the questions at the end of the chapter.

This first step will give you an overview of the material to be mastered.

- Step 2**
- Read the assigned pages slowly.
 - Use the marginal notes to review and to locate topics within each chapter.
 - Study carefully and mark for later attention any portions not clearly understood.
 - Pay particular attention to examples and illustrations.
 - Try to formulate tentative answers to end-of-chapter questions.

During this phase, you will be filling in the "outline" you formed in Step 1. Most of the details will fall into place during this part of your study. The remaining steps are necessary, however, for a keen understanding of the subject.

- Step 3**
- Carefully read the **Overview, Learning Objectives, and Tips** sections of this *Problem Solving Survival Guide* volume.
 - Do the **Exercises and Cases** in the *Problem Solving Survival Guide* that pertain to the same learning objectives as your homework assignments. Review the relevant **Illustrations** in this book.
 - Do the **Multiple-Choice Type Questions** in the *Problem Solving Survival Guide* that pertain to the same study objectives as your homework assignments.
 - Refer back to the sections of the chapter in the text that you marked as unclear if any. It is likely that any confusion or questions on your part will have been cleared up through your work in the *Problem Solving Survival Guide*. If a section remains unclear, carefully reread it and rework relevant pages of the *Problem Solving Survival Guide*.
 - Repeat this process for each assigned topic area.

Step 4 • Write out formal answers to homework assignments in the text.

This step is crucial because you find out whether you can independently **apply** the material you have been studying to fresh situations. You may find it necessary to go back to the text and/or the *Problem Solving Survival Guide* to restudy certain sections. This is common and merely shows that the study assignments are working for you.

Additional comments pertaining to Step 3 and your usage of this *Problem Solving Survival Guide* volume are as follows:

- The **Learning Objectives** and **Tips** sections, along with **Illustrations** will aid your understanding and retention of the material. **Exercises** provide examples of application of the text material. These should be very valuable in giving you guidance in completing homework assignments which are often similar in nature and content.
- The **Approach** stated for an exercise or question is likely the most valuable feature of this *Problem Solving Survival Guide* volume because it tells you how to **think** through the situation at hand. This thought process can then be used for similar situations. It is impossible to illustrate every situation you may encounter. You can, however, handle new situations by simply applying what you know and making modifications where appropriate. Many students make the mistake of attempting to memorize their way through an accounting book. That too is an impossible feat. **Do not rely on memorization.** If this material is going to be useful to you, you must **think** about what you are reading and always be thinking of **why** things are as they are. If you know the reasoning for a particular accounting treatment, it will be much easier to remember that treatment and reconstruct it even weeks after your initial study of it.
- **Explanations** are provided for exercise and questions. These are very detailed so that you will thoroughly understand what is being done and why. These details will serve you well when you complete your homework assignments.
- Always make an honest effort to solve the exercises and answer the questions contained in this *Problem Solving Survival Guide* volume **before** you look at the solutions. Answering the questions on your own will maximize the benefits you can expect to reap from this book.
- The **Multiple-Choice Type Questions** are self-tests to give you immediate feedback on how well you understand the material. Study the **Approaches** suggested for answering these questions in the *Problem Solving Survival Guide*. Practice them when answering the multiple choice questions in the text. Apply them when taking examinations. By doing so, you will learn to calmly, methodically, and successfully process examination questions. This will definitely improve your exam scores.

- When you work an **Exercise** or **Case** in the *Problem Solving Survival Guide* or in the text, always read the instructions **before** you read all of the given data. This allows you to determine what you are to accomplish. Therefore, as you now read through the data, you can begin to process it because you can determine its significance and relevance. If you read the data before the instructions, you are likely to waste your time because you will have to reread the facts once you find out what you are to do with them. Also, more importantly, you are likely to begin to anticipate what the problem is about, which will often cause you to do things other than what is requested in the question.

Good luck and best wishes for a positive learning experience!

HOW TO APPROACH A MULTIPLE CHOICE EXAMINATION

1. Work questions in the order in which they appear on the exam. If a question looks too long or difficult and you choose to skip over it, put a big question mark in the margin to remind yourself to return to that question after others are completed. Also put a mark in the margin for any question meriting additional review at the end of the exam period.
2. Do not look at the answer choices until you have thoroughly processed the question stem (see 3 and 4 below). The wrong answers are called "distracters". The manner in which these "distracters" are developed causes them to likely mislead you or cause you to misinterpret the question if you read them too early in the process.
3. Read each question very carefully. Start with the requirement or essence of the question first (this is usually the last sentence or last phrase of the stem of the question) so that you immediately focus on the question's intent. Now as you read through the rest of the stem and encounter data, you can tell which data are relevant. Underline keywords and important facts. Be especially careful to note exception words such as **not**. Prepare intermediary solutions as you read the question. Identify pertinent information with notations in the margin of the exam. If a set of data is the basis for two or more questions, read the requirements of each of the questions **before** reading the data and before beginning to work on the first question (sometimes the questions can be worked simultaneously or you may find it easier to work them out of order).
4. Anticipate the answer before looking at the alternative solutions. Recall the applicable definition, concept, principle, rule, model, or format. If the question deals with a computation, perform the computation. Use abbreviations to describe each component of your computation; this will greatly aid you in following your work and staying on target with the question.
5. Read the answers and select the best answer choice. For computational questions, if the answer you have computed is not among the choices, check your math and the logic of your solution.
6. When you have completed all questions, review each question again to verify your choices. Reread the question requirement, scan the data, look at your selected answer, scan your work, and determine the reasonableness of your choice.

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CHAPTER 1

FINANCIAL ACCOUNTING AND ACCOUNTING STANDARDS

OVERVIEW

Accounting is the language of business. As such, accountants collect and communicate economic information about business enterprises or other entities to a wide variety of persons. To be useful, financial statements must be clearly understandable and comparable so that users may compare the performance of one business with the performance of the same business for a prior period or with the performance of another similar business. Therefore, all general purpose financial statements should be prepared in accordance with the same uniform guidelines. In this chapter, we will examine the history and sources of current financial accounting standards (generally accepted accounting principles).

SUMMARY OF LEARNING OBJECTIVES

1. **Identify the major financial statements and other means of financial reporting.** The financial statements most frequently provided are (1) the balance sheet, (2) the income statement, (3) the statement of cash flows, and (4) the statement of owners' or stockholders' equity. Financial reporting other than financial statements may take various forms. Examples include the president's letter and supplementary schedules in the corporate annual report, prospectuses, reports filed with government agencies, news releases, management's forecasts, and descriptions of an enterprise's social or environmental impact.
2. **Explain how accounting assists in the efficient use of scarce resources.** Accounting provides reliable, relevant, and timely information to managers, investors, and creditors so that resources are allocated to the most efficient enterprises. Accounting also provides measurements of efficiency (profitability) and financial soundness.
3. **Identify some of the challenges facing accounting.** Financial reports fail to provide (1) some key performance measures widely used by management, (2) forward-looking information needed by investors and creditors, (3) sufficient information about a company's soft assets (intangibles) and (4) real-time financial information.
4. **Identify the objectives of financial reporting.** The objectives of financial reporting are to provide (1) information that is useful in investment and credit decisions, (2) information that is useful in assessing cash flow prospects, and (3) information about enterprise resources, claims to those resources, and changes in the resources and claims to resources.

5. **Explain the need for accounting standards.** In preparing financial statements, accountants are confronted with the potential dangers of bias, misinterpretation, inexactness, and ambiguity. In order to minimize these dangers, the accounting profession has attempted to develop a set of standards that is generally accepted and universally practiced. Without this set of standards, each accountant or enterprise would have to develop its own standards, and readers of financial statements would have to familiarize themselves with every company's peculiar accounting and reporting practices. As a result, it would be almost impossible to prepare statements that could be compared.
6. **Identify the major policy-setting bodies and their role in the standard-setting process.** The **Securities and Exchange Commission (SEC)** is an agency of the federal government that has the broad powers to prescribe, in whatever detail it desires, the accounting standards to be employed by companies that fall within its jurisdiction. The **American Institute of Certified Public Accountants (AICPA)** issued standards through its Committee on Accounting Procedure (CAP) and Accounting Principles Board (APB). The **Financial Accounting Standards Board (FASB)** establishes and improves standards of financial accounting and reporting for the guidance and education of the public, which includes issuers, auditors, and users of financial information. The **Governmental Accounting Standards Board (GASB)** establishes and improves standards of financial accounting for state and local governments.
7. **Explain the meaning of "generally accepted accounting principles."** Generally accepted accounting principles are those principles that have substantial authoritative support, such as FASB Standards and Interpretations, APB Opinions and Interpretations, AICPA Accounting Research Bulletins, and other authoritative pronouncements.
8. **Describe the impact of user groups on the standard-setting process.** User groups may want particular economic events accounted for or reported in a particular way, and they fight hard to get what they want. The FASB has become the target of many pressures and efforts to influence changes in the existing standards and the development of new ones. Because of the accelerated rate of change and the increased complexity of our economy, these pressures have been multiplying. Accounting standards are as much a product of political action as they are of careful logic or empirical findings.
9. **Understand issues related to ethics and financial accounting.** Financial accountants are called on for moral discernment and ethical decision making. Decisions are more difficult because a public consensus has not emerged to formulate a comprehensive ethical system that provides guidelines in making ethical judgments.

TIPS ON CHAPTER TOPICS

- | | |
|-------------|---|
| TIP: | The accounting profession has adopted a common set of standards and procedures called generally accepted accounting principles (often referred to as GAAP). The term "generally accepted" can mean either that an authoritative accounting rule-making body has established a principle of reporting in a given area or that over time a given practice has been accepted as appropriate because of its universal application. |
| TIP: | Because most business owners (stockholders of corporations) are not involved with the operation of the business, the stewardship function —measuring and reporting data to absentee owners—has emerged as a critical role for accounting. This situation greatly increases the need for accounting standards. |

- TIP:** The financial statements most frequently provided by an entity (often called the **basic financial statements** or **general purpose financial statements**) are: (1) the income statement, (2) the statement of owners' equity (or statement of stockholders' equity), (3) the balance sheet, and (4) the statement of cash flows. In addition, note disclosures are an integral part of the financial statements.
- TIP:** The primary focus of this textbook concerns the development of two types of financial information which are governed by generally accepted accounting principles: (1) the basic financial statements and (2) the related note disclosures.
- TIP:** The terms **principles** and **standards** are used interchangeably in practice and throughout this book.
- TIP:** The **accrual basis of accounting** is used in preparing the basic financial statements. The accrual basis provides for (1) reporting revenues in the period they are earned (which may not be the same period in which the related cash is received), and (2) reporting expenses in the period they are incurred (which may not be the same period in which the related cash is paid).

CASE 1-1

Purpose: (L.O.6) This case will identify the organizations responsible for various accounting documents.

Instructions

Presented below are a number of accounting organizations and the type of documents they have issued. Match the appropriate document to the organization involved. Note that more than one document may be issued by the same organization.

Organization		Document
1. _____	Accounting Principles Board	(a) Practice Bulletins (b) Accounting Research Bulletins (c) Opinions
2. _____	AICPA Committee on Accounting Procedure	(d) Invitations to Comment (e) Financial Reporting Releases (f) Statements of Financial Accounting Standards
3. _____	Financial Accounting Standards Board	(g) Technical Bulletins (h) Statements of Position
4. _____	Securities and Exchange Commission	(i) Regulations S-X (j) Industry Accounting and Auditing Guides
5. _____	Accounting Standards Executive Committee of the AICPA	(k) Statements of Financial Accounting Concepts

Solution to Case 1-1

- | | | |
|----------|-------------------|----------------|
| 1. c | 3. d, f, g, k | 5. a, h, j |
| 2. b | 4. e, i | |

CASE 1-2

Purpose: (L.O.7) This case will review the meaning of generally accepted accounting principles and their significance.

All publicly-held companies must have their annual financial statements audited by an independent CPA. In accordance with generally accepted auditing standards (which you will study in an auditing class), the auditor expresses an opinion regarding the fairness of the financial statements which are to be in conformity with generally accepted accounting principles.

Instructions

- Define generally accepted accounting principles and explain their significance to an auditor of financial statements.
- Reconstruct the "House of GAAP" which displays the hierarchy of sources of generally accepted accounting principles.

Solution to Case 1-2

- (a) The accounting profession has adopted a common set of standards and procedures called **generally accepted accounting principles** (often referred to as GAAP). The word "principles" refers to methods or procedures or standards. The phrase "generally accepted" means having "substantial authoritative support." A method has substantial authoritative support if it has been approved by a rule-making body or if it has gained acceptance over time because of its universal application.

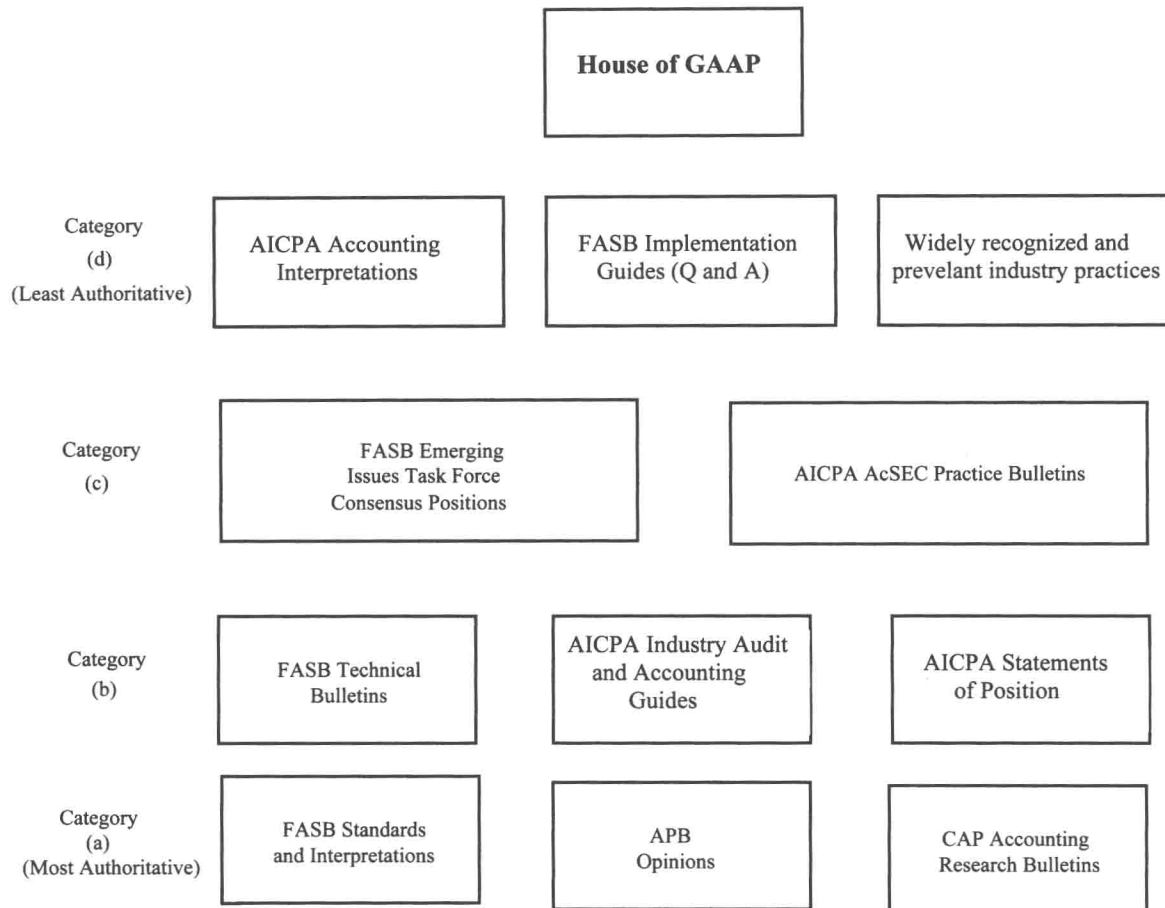
The AICPA's Code of Professional Conduct requires that members prepare financial statements in accordance with generally accepted accounting principles. Specifically, Rule 203 of this Code prohibits a member from expressing an opinion that financial statements conform with GAAP if those statements contain a material departure from a generally accepted accounting principle, unless the member can demonstrate that because of unusual circumstances the financial statements would otherwise have been misleading. Failure to follow Rule 203 can lead to loss of a CPA's license to practice.

The meaning of generally accepted accounting principles is defined by *Statement on Auditing Standards (SAS) No. 69*, "The Meaning of 'Present Fairly in Conformity With Generally Accepted Accounting Principles' in the Independent Auditor's Report." Under this standard, generally accepted accounting principles covered by Rule 203 are construed to be FASB Standards and Interpretations, APB Opinions, and AICPA (CAP) Accounting Research Bulletins.

Oftentimes, however, a specific accounting transaction that occurs is not covered by any of these documents. In this case, other authoritative literature is used. Major examples are: FASB Technical Bulletins, AICPA Industry Audit and Accounting Guides, and Statements of Position that have been "cleared" by the FASB (these are assumed to be cleared—approved—by the FASB unless the pronouncement states otherwise). These documents are considered to have substantial authoritative support because the recognized professional bodies, after giving interested and affected parties the opportunity to react to exposure drafts and respond at public hearings, have voted their issuance. If these pronouncements are lacking in guidance, then other sources might be considered. The hierarchy of these sources is presented in the House of GAAP [see part (b) of this Solution]. If the accounting treatment of an event is not specified by a category (a) pronouncement, then categories (b) through (d) should be investigated. If there is a conflict between pronouncements in (b) through (d), the higher category [for example (b) is higher than (c)] is to be followed.

In the event that none of these pronouncements addresses the transaction, the accountant should seek support from other accounting literature. Examples of other accounting literature include FASB Concepts Statements; International Accounting Standards Board Statements; AICPA Issues Papers; and accounting textbooks, handbooks, and articles.

(b)



ANALYSIS OF MULTIPLE-CHOICE TYPE QUESTIONS

QUESTION

1. (L.O. 1) The process of identifying, measuring, analyzing, and communicating financial information needed by management to plan, evaluate, and control an organization's operations is called
 - a. financial accounting.
 - b. managerial accounting.
 - c. tax accounting.
 - d. auditing.

Approach and Explanation: Define each answer selection. Select the answer item for which your definition matches the stem of the question. **Financial accounting** is the process that culminates in the preparation of financial reports on the enterprise as a whole for use by parties both internal and external to the enterprise. (Users of these financial reports include investors, creditors, managers, unions, and government agencies.) **Managerial accounting** is the process of identifying, measuring, analyzing, and communicating financial information needed by management to plan, evaluate, and control an organization's operations. (These reports are only for the use of parties internal to the enterprise.) **Tax accounting** usually refers to tax planning, advising on tax matters, and/or preparing tax returns. **Auditing** refers to the

examination of financial statements by a certified public accountant in order to express an opinion on their fairness. An auditor attests to the fairness of financial statements and their conformity to generally accepted accounting principles. (Solution = b.)

QUESTION

2. (L.O. 4) One objective of financial reporting is to provide:
- information about the investors in the business entity.
 - information about the liquidation values of the resources held by the enterprise.
 - information that is useful in assessing cash flow prospects.
 - information that will attract new investors.

Approach and Explanation: Before you read the possible answers, mentally list the objectives of financial reporting or write down the key words of each objective. Then carefully read the suggested answers. As you read an answer choice, note whether it is a match to an item in your list or not. The objectives of financial reporting are to provide (1) information that is useful in investment and credit decisions, (2) information that is useful in assessing cash flow prospects, and (3) information about enterprise resources, claims to those resources, and changes in the resources and claims to resources. (Solution = c.)

QUESTION

3. (L.O. 6) The most significant current source of generally accepted accounting principles is the:
- NYSE.
 - SEC.
 - APB.
 - FASB.

Explanation: The mission of the Financial Accounting Standards Board (FASB) is to establish and improve standards of financial accounting and reporting. The Accounting Principles Board (APB) was the predecessor of the FASB. The New York Stock Exchange (NYSE) has nothing to do with the development of generally accepted accounting principles. Generally, the Securities and Exchange Commission (SEC) has relied on the AICPA and the FASB to develop and enforce accounting standards. (Solution = d.)

QUESTION

4. (L.O. 6) Members of the Financial Accounting Standards Board are:
- employed by the American Institute of Certified Public Accountants (AICPA).
 - part-time employees.
 - required to hold a CPA certificate.
 - independent of any other organization.

Explanation: The members of the FASB are well-paid, full-time members. The FASB is not affiliated with the AICPA; it is not associated with any single professional organization. The FASB is answerable only to the Financial Accounting Foundation. It is not necessary to be a CPA or a member of the AICPA to be a member of the FASB. FASB members must sever all ties with CPA firms, companies, or institutions. (Solution = d.)