# Assignment 1

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## E1-8

The conceptual framework indicates the desired fundamental and enhancing qualitative characteristics of accounting information. Several constraints impede achieving these desired characteristics. Answer each of the following questions related to these characteristics and constraints.

1.Which component would allow a large company to record the purchase of a $120 printer as an expense rather than capitalizing the printer as an asset?

~~Representational faithfulness also is enhanced if information is~~ **~~free from error~~**~~, meaning that there are no errors or omissions in the description of the amount or the process used to report the amount.~~

Materiality

2. Donald Kirk, former chairman of the FASB, once noted that “. . . there must be public confidence that the standard-setting system is credible, that selection of board members is based on merit and not the influence of special interests . . .” Which characteristic is implicit in Mr. Kirk’s statement?

A financial accounting standard, and the standard-setting process, is **neutral** if it is free from bias. In other words, it should try not be intended to achieve particular social outcomes or favor particular groups or companies.

3. Allied Appliances, Inc., changed its revenue recognition policies. Which characteristic is jeopardized by this change?

**Consistency** refers to the same accounting practices being used over time to permit valid comparisons between reporting periods.

4. National Bancorp, a publicly traded company, files quarterly and annual financial statements with the SEC. Which characteristic is relevant to the timing of these periodic filings?

**Timeliness** indicates that information is available to users early enough to allow them to use it in their decision process.

5. In general, relevant information possesses which qualities?

**Relevance** in the context of financial reporting means that information has **predictive value** and/or **confirmatory value**, typically both. For example, current-period net income has predictive value if it helps users predict a company’s future cash flows, and it has confirmatory value if it helps investors confirm or change their prior assessments regarding a company’s cash-flow generating ability. Financial information is **material** if omitting it or misstating it could affect users’ decisions. The threshold for materiality has been left to the subjective judgment of the company preparing the financial statements and its auditors.

Predictive value and/or confirmatory value

6. When there is agreement between a measure or description and the phenomenon it purports to represent information possesses which characteristic?

~~A depiction of an economic phenomenon is~~ **~~complete~~** ~~if it includes all the information necessary for faithful representation of the economic phenomenon that it purports to represent.~~

Faithful representation

7. Jeff Brown is evaluating two companies for future investment potential. Jeff’s task is made easier because both companies use the same accounting methods when preparing their financial statements. Which characteristic does the information Jeff will be using possess?

**~~Understandability~~** ~~means that users can comprehend the information within the context of the decision being made.~~

Comparability (Consistency)

8. A company should disclose information only if the perceived benefits of the disclosure exceed the costs of providing the information. Which constraint does this statement describe?

underlying all of this framework is a **cost effectiveness** constraint. The benefits of providing information must outweigh the cost.

## E1-9

Listed below are several terms and phrases associated with the accounting concepts. Pair each item from List A (by letter) with the item from List B that is most appropriately associated with it.

|  |  |  |
| --- | --- | --- |
| Pair | List A | List B |
| D | 1.Expense recognition  **exact cause-and-effect relationship**  **associating expense with revenues**  **systematic and rational allocation**  **In the period incurred** | a. The enterprise is separate from its owners and other entities. |
| G | 2. Periodicity  **life of a company to be divided into artificial time periods to provide timely information.** | b. A common denominator is the dollar. |
| E | 3. Historical cost principle  **original transaction value adjusted for depreciation and amortization** | c. The entity will continue indefinitely. |
| I | 4. Materiality  **Financial information is material if omitting it or misstating it could affect users’ decisions.** | d. Record expenses in the period the related revenue is recognized.  Matching principle:  matches revenues and expenses that arise from the same transactions or other events |
| H | 5. Revenue recognition  **Inflows of assets or settlements of liabilities resulting from providing a product or service to a customer** | e. The original transaction value upon acquisition. |
| C | 6. Going concern assumption  **business entity will continue to operate indefinitely** | f. All information that could affect decisions should be reported. |
| B | 7. Monetary unit assumption  **used in U.S. financial statements is the U.S. dollar.** | g. The life of an enterprise can be divided into artificial time periods. |
| A | 8. Economic entity assumption  **economic events can be identified specifically with an economic entity.** | h. Criteria usually satisfied for products at point of sale.  Realization principle  Earnings process is judged to be complete or virtually complete  Reasonable certainty as to the collectibility of the asset to be received (usually cash) |
| F | 9. Full-disclosure principle  **financial reports should include any information that could affect the decisions made by external users** | i. Concerns the relative size of an item and its effect on decisions. |
|  |  |  |

## E1-10

Listed below are several statements that relate to financial accounting and reporting. Identify the accounting concept that applies to each statement.

1. Jim Marley is the sole owner of Marley’s Appliances. Jim borrowed $100,000 to buy a new home to be used as his personal residence. This liability was not recorded in the records of Marley’s Appliances.

~~Materiality~~

**~~Financial information is material if omitting it or misstating it could affect users’ decisions.~~**

Economic entity assumption

**economic events can be identified specifically with an economic entity.**

Jim is the identity in this transaction

2. Apple Inc. distributes an annual report to its shareholders.

~~Full-disclosure principle~~

**~~financial reports should include any information that could affect the decisions made by external users~~**

Periodicity

**life of a company to be divided into artificial time periods to provide timely information.**

“Annual” report

3. Hewlett-Packard Corporation depreciates machinery and equipment over their useful lives.

~~Historical cost principle~~

**~~original transaction value adjusted for depreciation and amortization~~**

The going concern assumption

**In the absence of information to the contrary, it is anticipated that a business entity will continue to operate indefinitely**

“Over their useful life” means the company was immortal.

4. Crosby Company lists land on its balance sheet at $120,000, its original purchase price, even though the land has a current fair value of $200,000.

Historical cost principle

The land was not sell now, there is no exchange for that

5. Honeywell Corporation records revenue when products are delivered to customers, even though the cash has not yet been received.

Revenue Recognition (or realization principle)

**Reasonable certainty as to the collectibility of the asset to be received**

6. Liquidation values are not normally reported in financial statements even though many companies do go out of business.

The going concern assumption

**In the absence of information to the contrary, it is anticipated that a business entity will continue to operate indefinitely**

7. IBM Corporation, a multibillion dollar company, purchased some small tools at a cost of $800. Even though the tools will be used for a number of years, the company recorded the purchase as an expense.

Materiality

The threshold for materiality often depends on the relative dollar amount of the transaction,

Since the amount of $800 is too small relatively to the IBM, it can be ignored.

## E1-11

Identify the accounting concept that was violated in each of the following situations.

1.Pastel Paint Company purchased land two years ago at a price of $250,000. Because the value of the land has appreciated to $400,000, the company has valued the land at $400,000 in its most recent balance sheet.

Disagree

2. Atwell Corporation has not prepared financial statements for external users for over three years. 3. The Klingon Company sells farm machinery. Revenue from a large order of machinery from a new buyer was recorded the day the order was received.

4. Don Smith is the sole owner of a company called Hardware City. The company recently paid a $150 utility bill for Smith’s personal residence and recorded a $150 expense.

5. Golden Book Company purchased a large printing machine for $1,000,000 (a material amount) and recorded the purchase as an expense.

6. Ace Appliance Company is involved in a major lawsuit involving injuries sustained by some of its employees in the manufacturing plant. The company is being sued for $2,000,000, a material amount, and is not insured. The suit was not disclosed in the most recent financial statements because no settlement had been reached.

## E 1-12

For each of the following situations, indicate whether you agree or disagree with the financial reporting practice employed and state the accounting concept that is applied (if you agree) or violated (if you disagree).

1. Wagner Corporation adjusted the valuation of all assets and liabilities to reflect changes in the purchasing power of the dollar.

Disagree. The **monetary unit** or measurement scale used in financial statements is nominal units of money, without any adjustment for changes in purchasing power

2. Spooner Oil Company changed its method of accounting for oil and gas exploration costs from successful efforts to full cost. No mention of the change was included in the financial statements. The change had a material effect on Spooner’s financial statements.

Disagree. No mention of change disagreed with full **disclosure principle**

3. Cypress Manufacturing Company purchased machinery having a five-year life. The cost of the machinery is being expensed over the life of the machinery.

Agree, systematic and rational allocation to specific time periods is one of the 4 approaches for **expense recognition**.

4. Rudeen Corporation purchased equipment for $180,000 at a liquidation sale of a competitor. Because the equipment was worth $230,000, Rudeen valued the equipment in its subsequent balance sheet at $230,000.

Disagree, **Historical price principle** decide that it won’t affect the original value except depreciation and amortization.

5. Davis Bicycle Company received a large order for the sale of 1,000 bicycles at $100 each. The customer paid Davis the entire amount of $100,000 on March 15. However, Davis did not record any revenue until April 17, the date the bicycles were delivered to the customer.

Agree, according to realization principle in **revenue recognition**, there is no reasonable certainty as to the collectability of the asset to be received until April 17.

6. Gigantic Corporation purchased two small calculators at a cost of $32.00. The cost of the calculators was expensed even though they had a three-year estimated useful life.

Agree, $32.00 is too small to the Gigantic Corporation, and can be taken as expense by **materiality**.

7. Esquire Company provides financial statements to external users every three years.

Disagree, according to **periodicity assumption**, Esquire need to provide information annually.

## E 2-2

Prepare journal entries to record each of the transactions listed in E2–1(below).

The following transactions occurred during March 2016 for the Wainwright Corporation. The company owns and operates a wholesale warehouse.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Asset | liabilities | Paid-In Capital | Retained Earnings |
| 1 | + 300,000(cash) |  | +300,000(common stock) |  |
| 2 | -10,000(cash)  -30,000(note payable)  +40,000(equipment) |  |  |  |
| 3 | +90,000(inventory) | -90,000(account payable) |  |  |
| 4 | +120,000(account receivable)  -700,000(inventory) |  |  | +120,000(revenue)  -70,000(expense) |
| 5 | -5,000(cash) |  |  | -5,000(expense) |
| 6 | -6,000(cash)  +6,000(insurance expense) |  |  |  |
| 7 | -70,000(cash) | -700,000(account payable) |  |  |
| 8 | +55,000(cash)  -55,000(account receivable) |  |  |  |
| 9 | -1,000(depreciation) |  |  | -1,000(expense) |

1. Issued 30,000 shares of common stock in exchange for $300,000 in cash.

2. Purchased equipment at a cost of $40,000. $10,000 cash was paid and a note payable was signed for the balance owed.

3. Purchased inventory on account at a cost of $90,000. The company uses the perpetual inventory system.

4. Credit sales for the month totaled $120,000. The cost of the goods sold was $70,000.

5. Paid $5,000 in rent on the warehouse building for the month of March.

6. Paid $6,000 to an insurance company for fire and liability insurance for a one-year period beginning April 1, 2016.

7. Paid $70,000 on account for the merchandise purchased in 3.

8. Collected $55,000 from customers on account.

9. Recorded depreciation expense of $1,000 for the month on the equipment.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1 | Cash | Common Stock | 300,000 | 300,000 |
| 2 | Equipment | Cash  Note payable | 40,000 | 10,000  30,000 |
| 3 | Inventory | Account payable | 90,000 | 90,000 |
| 4 | Account receivable  Expense | Revenue  Inventory | 120,000  70,000 | 120,000  70,000 |
| 5 | Expense | Cash | 5,000 | 5,000 |
| 6 | Insurance expense | Cash |  | 6,000 |
| 7 | Account payable | Cash | 70,000 | 70,000 |
| 8 | Cash | Account receivable | 55,000 | 55,000 |
| 9 | Expense | Depreciation | 1,000 | 1,000 |

## E 2-3

Post the journal entries prepared in E2–2 to T-accounts. Assume that the opening balances in each of the accounts is zero. Prepare a trial balance from the ending account balances.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1 | Cash | Common Stock | 300,000 | 300,000 |
| 2 | Equipment | Cash  Note payable | 40,000 | 10,000  30,000 |
| 3 | Inventory | Account payable | 90,000 | 90,000 |
| 4 | Account receivable  COGS | Revenue  Inventory | 120,000  70,000 | 120,000  70,000 |
| 5 | Rent expense | Cash | 5,000 | 5,000 |
| 6 | Insurance expense | Cash | 6,000 | 6,000 |
| 7 | Account payable | Cash | 70,000 | 70,000 |
| 8 | Cash | Account receivable | 55,000 | 55,000 |
| 9 | Depreciation expense | Accumulated depreciation | 1,000 | 1,000 |