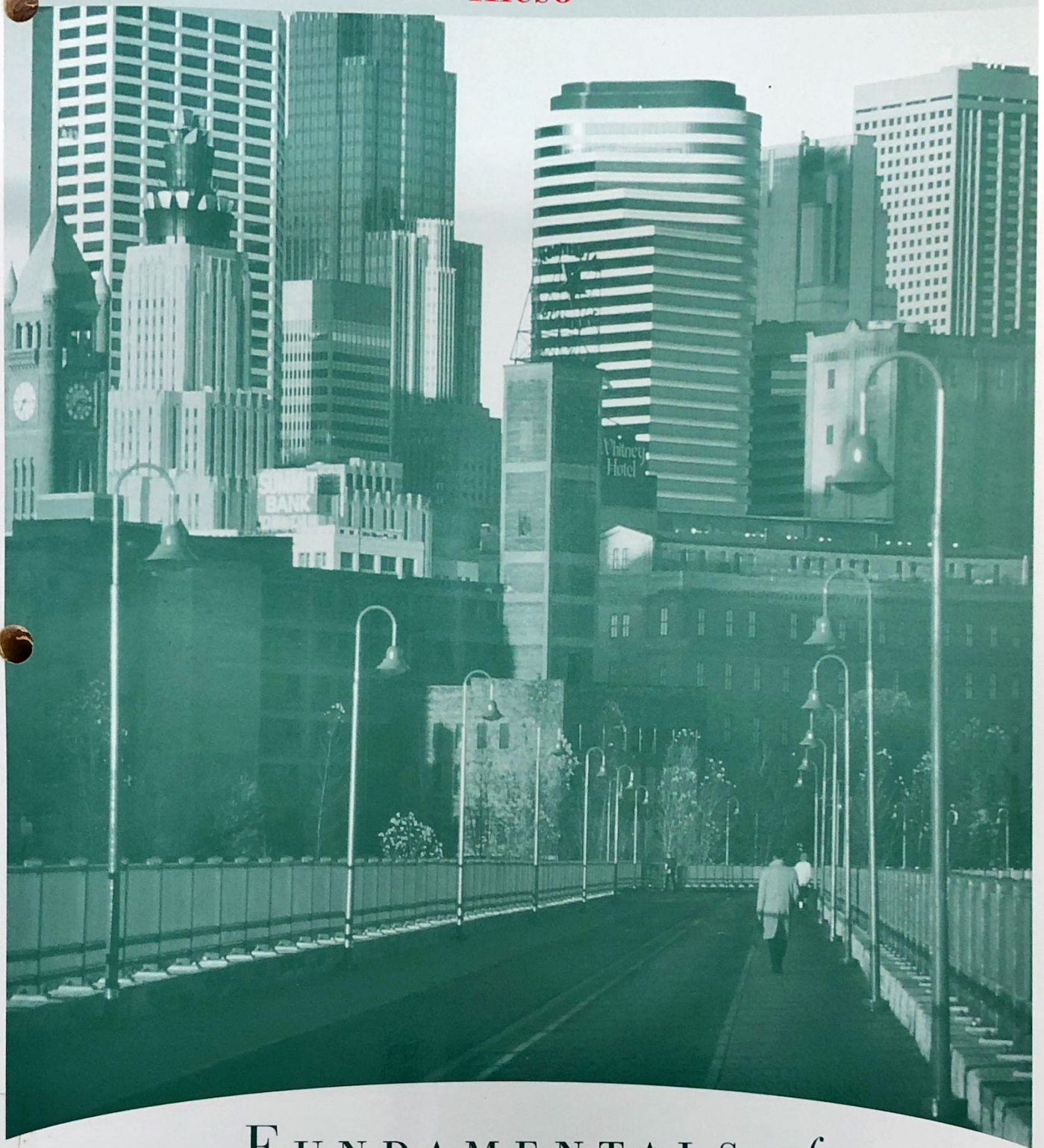


STUDY GUIDE

Kieso



FUNDAMENTALS *of* **INTERMEDIATE ACCOUNTING**

KIESO | WEYGANDT | WARFIELD

STUDY GUIDE

FUNDAMENTALS OF INTERMEDIATE ACCOUNTING

Douglas W. Kieso, J.D., M.A.S., C.P.A.

University of California—Irvine
Irvine, California

Donald E. Kieso, Ph.D., C.P.A.

KPMG Peat Marwick Emeritus Professor of Accountancy
Northern Illinois University
DeKalb, Illinois

Jerry J. Weygandt, Ph.D., C.P.A.

Arthur Andersen Alumni Professor of Accounting
University of Wisconsin
Madison, Wisconsin

Terry D. Warfield, Ph.D.

PricewaterhouseCoopers Research Scholar
University of Wisconsin
Madison, Wisconsin



GIFT OF THE ASIA FOUNDATION
NOT FOR RE-SALE

QUÀ TẶNG CỦA QUỸ CHÂU Á
KHÔNG ĐƯỢC BÁN LẠI



JOHN WILEY & SONS, INC.

COVER PHOTO © Sally Beyer/Stone/Getty Images.

To order books or for customer service call 1-800-CALL-WILEY (225-5945).

Copyright © 2003 John Wiley & Sons, Inc. All rights reserved.

No part of this publication may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, scanning or otherwise, except as permitted under Sections 107 or 108 of the 1976 United States Copyright Act, without either the prior written permission of the Publisher, or authorization through payment of the appropriate per-copy fee to the Copyright Clearance Center, 222 Rosewood Drive, Danvers, MA 01923, (978) 750-8400, fax (978) 750-4470. Requests to the Publisher for permission should be addressed to the Permissions Department, John Wiley & Sons, Inc, 111 River Street, Hoboken, NJ, 07030, (201) 748-6011, fax (201) 748-6008, E-Mail: PERMREQ@WILEY.COM.

ISBN 0-471-22233-X

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

Printed and bound by Courier Kendallville, Inc.

CONTENTS

- Chapter 1: Financial Accounting and Accounting Standards
- Chapter 2: Conceptual Framework Underlying Financial Accounting
- Chapter 3: The Accounting Information System
- Chapter 4: Balance Sheet
- Chapter 5: Income Statement and Related Information
- Chapter 6: Revenues and Cash Flows
- Chapter 7: Cash and Receivables
- Chapter 8: Accounting for Inventories
- Chapter 9: Accounting for Property, Plant and Equipment
- Chapter 10: Intangible Assets
- Chapter 11: Accounting for Liabilities
- Chapter 12: Stockholders' Equity
- Chapter 13: Investments
- Chapter 14: Accounting for Income Taxes
- Chapter 15: Accounting for Compensation
- Chapter 16: Accounting for Leases
- Chapter 17: Disclosure Issues (including Accounting Changes Earnings Per Share)
- Appendix A & B: Accounting and the Time Value of Money
- Appendix C, D, E, & F: Various Accounting Issues
- Appendix G: Accounting for Derivative Instruments

NOTE TO STUDENTS

This Study Guide is provided as an aid to your study of *Fundamentals of Intermediate Accounting*, by Donald E. Kieso and Jerry J. Weygandt, and Terry D. Warfield. If used wisely, it can supplement and reinforce your understanding of the concepts and techniques presented in the textbook. **Never rely on the Study Guide as a substitute for a thorough reading of the textbook material.** This Study Guide merely highlights the in-depth presentation in the textbook.

An approach that combines use of the Study Guide and textbook material is suggested below.

1. Read the textbook presentation of the chapter.
2. Read the chapter review paragraphs in the Study Guide.
3. Answer the questions and review exercises appearing at the end of the chapter review paragraphs and compare your answers with those found at the end of each chapter. The extent of your success in answering these questions and exercises will indicate your understanding of the chapter. If you were unsuccessful in answering a large percentage of these questions correctly, you should read the textbook again.
4. Work the problems assigned from the textbook.

Solutions to the review questions and exercises are found at the end of each chapter. In addition to identifying the correct answer to each true-false and multiple choice question, an explanation is provided indicating why the answer is false and why a particular alternative (for multiple choice questions) is correct. This approach is designed to aid you in gaining a complete understanding of the material in each chapter.

When preparing for examinations, the Study Guide material may be used to determine your recall of the information presented in specific chapters. Once you have identified those subject areas in need of further review, return to the textbook material for a complete discussion of the subject matter involved. Remember, the Study Guide merely highlights the textbook material; it cannot be relied upon as a comprehensive treatment of a subject area.

In the study of accounting, there is no substitute for hard work and a desire to learn. A proper attitude and a willingness to work will go a long way toward ensuring your success in accounting.

ACKNOWLEDGEMENTS

The authors (Donald E. Kieso, Douglas W. Kieso, Jerry J. Weygandt, and Terry D. Warfield) wish to acknowledge the following individuals for their assistance in this study guide: Mary Ann Benson, compositor; Ed Brislin of John Wiley & Sons, Inc., supplements editor; and Professor Dick D. Wasson, Southwestern College, reviewer and proofer.

Douglas W. Kieso

Financial Accounting and Accounting Standards

CHAPTER STUDY OBJECTIVES

1. Identify the major financial statements and other means of financial reporting.
2. Explain how accounting assists in the efficient use of scarce resources.
3. Identify some of the challenges facing accounting.
4. Identify the objectives of financial reporting.
5. Explain the need for accounting standards.
6. Identify the major policy-setting bodies and their role in the standards-setting process.
7. Explain the meaning of generally accepted accounting principles.
8. Describe the impact of user groups on the standards-setting process.
9. Understand issues related to ethics and financial accounting.

CHAPTER REVIEW

1. Chapter 1 describes the environment that has influenced both the development and use of the financial accounting process. The chapter traces the development of financial accounting standards, focusing on the groups that have had or currently have the responsibility for developing such standards. Certain groups other than those with direct responsibility for developing financial accounting standards have significantly influenced the standard-setting process. These various pressure groups are also discussed in Chapter 1.

Nature of Financial Accounting

2. (S.O. 1) **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.

3. **Financial statements** are the principal means through which financial information is communicated to those outside an enterprise. 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. Other means of financial reporting include the president's letter or supplementary schedules in the corporate annual report, prospectuses, and reports filed with government agencies.

4. (S.O. 2) Accounting is important for markets, free enterprise, and competition because it assists in providing information that leads to capital allocation. The better the information, the more effective the process of capital allocation and then the healthier the economy.

5. (S.O. 3) The challenges facing financial accounting are the following:

- a. **Non-financial measurements** such as customer satisfaction indexes, backlog information, and reject rates on goods purchased.
- b. **Forward-looking information.**

- c. **Soft assets.**
 - d. **Timeliness.**
6. (S.O. 4) The objectives of financial accounting are to provide information that:
- a. is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions;
 - b. helps present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of perspective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans; and
 - c. clearly portrays the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events, and circumstances that change its resources and claims to those resources.
7. (S.O. 5) The accounting profession has developed a common set of standards and procedures known as **generally accepted accounting principles (GAAP)**. These principles serve as a general guide to the accounting practitioner in accumulating and reporting the financial information of a business enterprise. Although the adoption of some generally accepted accounting principles has caused controversy among accountants as well as members of the financial community, a majority of the members in each group recognize the ultimate benefit an accepted set of accounting principles can bring to the financial reporting process.

Accounting Organizations

8. (S.O. 6) Financial accounting standards in use at this time in the United States are primarily a result of the accounting profession's efforts during the past 75 years. Prior to that time accounting practices were relatively unsophisticated owing to the lack of extensive economic development in the United States. The **American Institute of Certified Public Accountants (AICPA)**, the national professional organization of practicing Certified Public Accountants (CPAs), has been a catalyst in the development of GAAP in the United States. Although the responsibility for setting accounting standards now rests with the FASB, the Securities and Exchange Commission (SEC), the Governmental Accounting Standards Board (GASB), and other organizations can and do influence the standards-setting process.

9. The **SEC** takes a great deal of interest in the standards developed by the accounting profession. The SEC is an agency of the federal government that monitors the activities of corporate enterprises whose stock is publicly held. The SEC requires each corporate entity under its jurisdiction to **file a set of annual audited financial statements**. The SEC has the mandate to establish accounting principles; however, the SEC's involvement in the development of accounting standards has varied. In general, the SEC has supported the development of accounting standards by the private sector; however, there have been times when they have stepped in and prodded the private sector into a different direction.

10. The first group appointed by the AICPA to address the issue of uniformity in accounting practice was the **Committee on Accounting Procedure (CAP)**. This group served the accounting profession from 1939 to 1959. During that period it issued 51 **Accounting Research Bulletins (ARBs)** that narrowed the wide range of alternative accounting practices then in existence. Even though the work of the Committee on Accounting Procedure was a valuable aid to accounting practitioners, the authority for its pronouncements rested solely on general acceptance by the accounting profession.

11. In 1959, the AICPA created the **Accounting Principles Board (APB)**. The major purposes of this group were (a) to advance the written expression of accounting principles, (b) to determine appropriate practices, and (c) to narrow the areas of difference and inconsistency in practice. The APB was designated as the AICPA's sole authority for public pronouncements on accounting principles. Its pronouncements, known as **APB Opinions**, were intended to be based mainly on research studies and be supported by reasons and analysis. The APB Opinions constituted GAAP until superseded by subsequent pronouncements of the body designated by the accounting profession to issue such pronouncements. Although the AICPA recognized other sources as providing substantial authoritative support for

accounting practices, the burden for justifying a departure from financial accounting standards rests with the reporting member.

The FASB

12. The APB operated in a somewhat hostile environment for 13 years. Early in its existence it was criticized for overreacting to certain issues. A committee, known as the **Study Group on Establishment of Accounting Principles (Wheat Committee)**, was set up to study the APB and recommend changes in its structure and operation. The result of the Study Group's findings was the demise of the APB and the creation of the Financial Accounting Standards Board (FASB). The FASB represents the current rule-making body within the accounting profession.

13. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, which includes issuers, auditors, and users of financial information. The FASB differs from the predecessor APB in the following ways:

- a. Smaller membership (7 versus 18 on the APB).
- b. Full-time remunerated membership (APB members were unpaid and part-time).
- c. Greater autonomy (APB was a senior committee of the AICPA).
- d. Increased independence (FASB members must sever all ties with firms, companies, or institutions).
- e. Broader representation (it is not necessary to be a CPA to be a member of the FASB).

Two basic premises of the FASB are that in establishing financial accounting standards: (a) it should be responsive to the needs and viewpoints of the entire economic community, not just the public accounting profession, and (b) it should operate in full view of the public through a "due process" system that gives interested persons ample opportunity to make their views known.

14. The FASB issues **Statements of Financial Accounting Standards and Interpretations**. Both the Standards and the Interpretations are considered GAAP and must be followed in practice in the same manner as APB Opinions. The FASB also issues **Statements of Financial Accounting Concepts (SFAC)** and **Technical Bulletins**. The SFAC represent an attempt to move away from the problem-by-problem approach to standard setting that has been characteristic of the accounting profession. The Concept Statements are intended to form a cohesive set of interrelated concepts, a body of theory, or conceptual framework, that will serve as a tool for solving existing and emerging problems in a consistent, sound manner. Unlike FASB Statements, the Concept Statements do not establish GAAP. Technical Bulletins provide answers to specific questions related to the application and implementation of FASB Statement or Interpretations, APB Opinions, and ARBs. Technical Bulletins do not alter GAAP; they merely provide guidance on questions related to existing GAAP.

15. In 1984, the FASB created the **Emerging Issues Task Force (EITF)**. The purpose of the Task Force is to reach a consensus (15 of 17 members must agree) on how to account for new and unusual financial transactions that have the potential for creating diversity in financial reporting practices. The EITF can deal with short-term accounting issues by reaching a consensus and thus avoiding the need for deliberation by the FASB and the issuance of an FASB Statement. The Governmental Accounting Standards Board (GASB) was created in 1984 to address state and local governmental reporting issues. The operational structure of the GASB is similar to that of the FASB.

16. (S.O. 7) Generally accepted accounting principles (GAAP) are those principles that have **substantial authoritative support**. Accounting principles that have substantial authoritative support are those found in FASB Statements and Interpretations, APB Opinions, and Accounting Research Bulletins (ARBs). If an accounting transaction is not covered in any of these documents, the accountant may look to other authoritative accounting literature for guidance.

17. (S.O. 8) Although accounting standards are developed by using careful logic and empirical findings, a certain amount of pressure and influence is brought to bear by groups interested in or affected by accounting standards. The FASB does not exist in a vacuum, and politics and special-interest pressures remain a part of the standard-setting process.

18. Most countries have recognized the need for more global standards. In 1973, the **International Accounting Standards Committee (IASC)** was formed to narrow the areas of divergence between standards of different countries. Recently, the IASC has been restructured and renamed the **International Accounting Standards Board (IASB)**.

19. (S.O. 9) In accounting ethical dilemmas are encountered frequently. The whole process of ethical sensitivity and selection among alternatives can be complicated by pressures that may take the form of time pressures, job pressures, client pressures, personal pressures, and peer pressures. Throughout the textbook, ethical considerations are presented to sensitize you to the type of situations you may encounter in your profession.