Intermediate Accounting 14th edition Kieso, Weygandt, Warfield Solutions Manual

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CHAPTER 1

Financial Accounting and Accounting Standards

ASSIGNMENT CLASSIFICATION TABLE

Topics	Questions	Cases
1. Subject matter of accounting.	1	4
2. Environment of accounting.	2, 3, 29	6, 7
3. Role of principles, objectives, standards, and accounting theory.	4, 5, 6, 7	1, 2, 3, 5
4. Historical development of GAAP.	8, 9, 10, 11	8
5. Authoritative pronouncements and rule-making bodies.	12, 13, 14, 15, 16, 17, 18, 19, 20, 21, 22, 23	3, 9, 11, 12, 13, 14, 16, 17
6. Role of pressure groups.	23, 24, 25, 26, 27, 28	10, 19, 20
7. Ethical issues.	30	15, 18

ASSIGNMENT CHARACTERISTICS TABLE

Item	Description	Level of Difficulty	Time (minutes)
CA1-1	FASB and standard-setting.	Simple	15–20
CA1-2	GAAP and standard-setting.	Simple	15–20
CA1-3	Financial reporting and accounting standards.	Simple	15–20
CA1-4	Financial accounting.	Simple	15–20
CA1-5	Objective of financial reporting.	Moderate	20–25
CA1-6	Accounting numbers and the environment.	Simple	10–15
CA1-7	Need for GAAP.	Simple	15–20
CA1-8	AICPA’s role in rule-making.	Simple	20–25
CA1-9	FASB role in rule-making.	Simple	20–25
CA1-10	Politicalization of GAAP.	Complex	30–40
CA1-11	Models for setting GAAP.	Simple	15–20
CA1-12	GAAP terminology.	Moderate	30–40
CA1-13	Accounting organizations and documents issued.	Simple	15–20
CA1-14	Accounting pronouncements.	Simple	10–15
CA1-15	Rule-making Issues.	Complex	20–25
CA1-16	Securities and Exchange Commission.	Moderate	30–40
CA1-17	Rule-making process.	Moderate	25–35
CA1-18	Financial reporting pressures.	Moderate	25–35
CA1-19	Economic consequences.	Moderate	25–35
CA1-20	GAAP and economic consequences.	Moderate	25–35

SOLUTIONS TO CODIFICATION EXERCISES

CE1-1

There is no answer to this requirement as it asks the student to register to use the Codification.

CE1-2

(a) The Codification Overview module illustrates three items (1) the topic structure (2) different methods of accessing and viewing content, and (3) a summary of the unique features of the Codification Research System.

(b) The Codification is intended to (1) become the single source of U.S. accounting standards and (2) supersede all of the non-SEC documents used to populate the Codification.

CE1-3

The "What's New" page provides links to Codification content that has been recently issued. During the verification phase, updates may result from either the issuance of Codification update instructions that accompany new Standards or from changes to the Codification due to incorporation of constituent feedback.

ANSWERS TO QUESTIONS

1. Financial accounting measures, classifies, and summarizes in report form those activities and that information which relate to the enterprise as a whole for use by parties both internal and external to a business enterprise. Managerial accounting also measures, classifies, and summarizes in report form enterprise activities, but the communication is for the use of internal, managerial parties, and relates more to subsystems of the entity. Managerial accounting is management decision oriented and directed more toward product line, division, and profit center reporting.

2. Financial statements generally refer to the four basic financial statements: balance sheet, income statement, statement of cash flows, and statement of changes in owners' or stockholders' equity. Financial reporting is a broader concept; it includes the basic financial statements and any other means of communicating financial and economic data to interested external parties. Examples of financial reporting other than financial statements are annual reports, prospectuses, reports filed with the government, news releases, management forecasts or plans, and descriptions of an enterprise's social or environmental impact.

3. If a company's financial performance is measured accurately, fairly, and on a timely basis, the right managers and companies are able to attract investment capital. To provide unreliable and irrelevant information leads to poor capital allocation which adversely affects the securities market.

4. The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in decisions about providing resources to the entity through equity investments and loans or other forms of credit. Information that is decision-useful to capital providers (investors) may also be useful to other users of financial reporting who are not investors.

5. Investors are interested in financial reporting because it provides information that is useful for making decisions (referred to as the decision-usefulness approach). When making these decisions, investors are interested in assessing the company's (1) ability to generate net cash inflows and (2) management's ability to protect and enhance the capital providers' investments.
Financial reporting should therefore help investors assess the amounts, timing, and uncertainty of prospective cash inflows from dividends or interest, and the proceeds from the sale, redemption, or maturity of securities or loans. In order for investors to make these assessments, the economic resources of an enterprise, the claims to those resources, and the changes in them must be understood.

6. A common set of standards applied by all businesses and entities provides financial statements which are reasonably comparable. Without a common set of standards, each enterprise could, and would, develop its own theory structure and set of practices, resulting in noncomparability among enterprises.

7. General-purpose financial statements are not likely to satisfy the specific needs of all interested parties. Since the needs of interested parties such as creditors, managers, owners, governmental agencies, and financial analysts vary considerably, it is unlikely that one set of financial statements is equally appropriate for these varied uses.

8. The SEC has the power to prescribe, in whatever detail it desires, the accounting practices and principles to be employed by the companies that fall within its jurisdiction. Because the SEC receives audited financial statements from nearly all companies that issue securities to the public or are listed on the stock exchanges, it is greatly interested in the content, accuracy, and credibility of the statements. For many years the SEC relied on the AICPA to regulate the profession and develop and enforce accounting principles. Lately, the SEC has assumed a more active role in the develop-ment of accounting standards, especially in the area of disclosure requirements. In December 1973, in ASR No. 150, the SEC said the FASB's statements would be presumed to carry substantial authoritative support and anything contrary to them to lack such support. It thereby supports the development of accounting principles in the private sector.

9. The Committee on Accounting Procedure was a special committee of the American Institute of CPAs that, between the years of 1939 and 1959, issued 51 **Accounting Research Bulletins** dealing with a wide variety of timely accounting problems. These bulletins provided solutions to immediate problems and narrowed the range of alternative practices. But, the Committee's problem-by-problem approach failed to provide a well-defined and well-structured body of accounting theory that was so badly needed. The Committee on Accounting Procedure was replaced in 1959 by the Accounting Principles Board.

10. The creation of the Accounting Principles Board was intended to advance the written expression of accounting principles, to determine appropriate practices, and to narrow the differences and inconsistencies in practice. To achieve its basic objectives, its mission was to develop an overall conceptual framework to assist in the resolution of problems as they became evident and to do substantive research on individual issues before pronouncements were issued.

11. **Accounting Research Bulletins** were pronouncements on accounting practice issued by the Committee on Accounting Procedure between 1939 and 1959; since 1964 they have been recognized as accepted accounting practice unless superseded in part or in whole by an opinion of the APB or an FASB standard. **APB Opinions** were issued by the Accounting Principles Board during the years 1959 through 1973 and, unless superseded by FASB Statements, are recognized as accepted practice and constitute the requirements to be followed by all business enterprises. **FASB Statements** are pronouncements of the Financial Accounting Standards Board and currently represent the accounting profession's authoritative pronouncements on financial accounting and reporting practices.

12. The explanation should note that generally accepted accounting principles or standards have "substantial authoritative support." They consist of accounting practices, procedures, theories, concepts, and methods which are recognized by a large majority of practicing accountants as well as other members of the business and financial community. Bulletins issued by the Committee on Accounting Procedure, opinions rendered by the Accounting Principles Board, and statements issued by the Financial Accounting Standards Board constitute "substantial authoritative support."

13. It was believed that FASB Statements would carry greater weight than APB Opinions because of significant differences between the FASB and the APB, namely: (1) The FASB has a smaller mem-bership, (2) full-time compensated members; (3) the FASB has greater autonomy, (4) increased independence; (5) the FASB has broader representation than the APB.

14. The technical staff of the FASB conducts research on an identified accounting topic and prepares a "preliminary views" that is released by the Board for public reaction. The Board analyzes and evaluates the public response to the preliminary views, deliberates on the issues, and issues an "exposure draft" for public comment. The preliminary views merely present all facts and alternatives related to a specific topic or problem, whereas the exposure draft is a tentative "statement." After studying the public's reaction to the exposure draft, the Board may reevaluate its position, revise the draft, and vote on the issuance of a final statement.

15. Statements of financial accounting **standards** constitute generally accepted accounting principles and dictate acceptable financial accounting and reporting practices as promulgated by the FASB. The first standards statement was issued by the FASB in 1973.

Statements of financial accounting **concepts** do not establish generally accepted accounting principles. Rather, the concepts statements set forth fundamental objectives and concepts that the FASB intends to use as a basis for developing future standards. The concepts serve as guidelines in solving existing and emerging accounting problems in a consistent, sound manner. Both the standards statements and the concepts statements may develop through the same process from discussion memorandum, to exposure draft, to a final approved statement.

16. Rule 203 of the Code of Professional Conduct prohibits a member of the AICPA from expressing an opinion that financial statements conform with GAAP if those statements contain a material departure from an accounting principle promulgated by the FASB, or its predecessors, the APB and the CAP, 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 a loss of a CPA's license to practice. This rule is extremely important because it requires auditors to follow FASB standards.

17. FASB Standards, FASB Technical Bulletins, AICPA Practice Bulletins.

18. The chairman of the FASB was indicating that too much attention is put on the bottom line and not enough on the development of quality products. Managers should be less concerned with short-term results and be more concerned with the long-term results. In addition, short-term tax benefits often lead to long-term problems.

The second part of his comment relates to accountants being overly concerned with following a set of rules, so that if litigation ensues, they will be able to argue that they followed the rules exactly. The problem with this approach is that accountants want more and more rules with less reliance on professional judgment. Less professional judgment leads to inappropriate use of accounting procedures in difficult situations.

In the accountants' defense, recent legal decisions have imposed vast new liability on accountants. The concept of accountant's liability that has emerged in these cases is broad and expansive; the number of classes of people to whom the accountant is held responsible are almost limitless.

19. FASB Staff Positions (FSP) are used to provide interpretive guidance and to make minor amend - ments to existing standards. The due process used to issue a FSP is the same used to issue a new standard.

20. The Emerging Issues Task Force often arrives at consensus conclusions on certain financial report-ing issues. These consensus conclusions are then looked upon as GAAP by practitioners because the SEC has indicated that it will view consensus solutions as preferred accounting and will require persuasive justification for departing from them. Thus, at least for public companies which are sub-ject to SEC oversight, consensus solutions developed by the Emerging Issues Task Force are followed unless subsequently overturned by the FASB. It should be noted that the FASB took greater direct ownership of GAAP established by the EITF by requiring that consensus positions be ratified by the FASB.

21. The Financial Accounting Standards Board Accounting Standards Codification (Codifications) is a compilation of all GAAP in one place. Its purpose is to integrate and synthesize existing GAAP and not to create new GAAP. It creates one level of GAAP which is considered authoritative. The FASB Codification Research Systems (CRS) is an-on-line real time data base which provides easy access to the Codification. The Codification and the related CRS provide a topically organized structure which is subdivided into topic, subtopics, sections, and paragraphs.

22. Hopefully, the codification will help users to better understand what GAAP is. If this occurs, companies will be more likely to comply with GAAP and the time to research accounting issues will be substantially reduced. In addition, through the electronic web-based format, GAAP can be easily updated which will help users stay current.

23. The sources of pressure are innumerable, but the most intense and continuous pressure to change or influence accounting principles or standards come from individual companies, industry associations, governmental agencies, practicing accountants, academicians, professional accoun - ting organizations, and public opinion.

24. Economic consequences means the impact of accounting reports on the wealth positions of issuers and users of financial information and the decision-making behavior resulting from that impact. In other words, accounting information impacts various users in many different ways which leads to wealth transfers among these various groups.

If politics plays an important role in the development of accounting rules, the rules will be subject to manipulation for the purpose of furthering whatever policy prevails at the moment. No matter how well intentioned the rule maker may be, if information is designed to indicate that investing in a particular enterprise involves less risk than it actually does, or is designed to encourage invest - ment in a particular segment of the economy, financial reporting will suffer an irreplaceable loss of credibility.

25. No one particular proposal is expected in answer to this question. The students' proposals, however, should be defensible relative to the following criteria:
(1) The method must be efficient, responsive, and expeditious.
(2) The method must be free of bias and be above or insulated from pressure groups.
(3) The method must command widespread support if it does not have legislative authority.
(4) The method must produce sound yet practical accounting principles or standards.
The students' proposals might take the form of alterations of the existing methodology, an accoun - ting court (as proposed by Leonard Spacek), or governmental device.

26. Concern exists about fraudulent financial reporting because it can undermine the entire financial reporting process. Failure to provide information to users that is accurate can lead to inappropriate allocations of resources in our economy. In addition, failure to detect massive fraud can lead to additional governmental oversight of the accounting profession.

27. The expectations gap is the difference between what people think accountants should be doing and what accountants think they can do. It is a difficult gap to close. The accounting profession recognizes it must play an important role in narrowing this gap. To meet the needs of society, the profession is continuing its efforts in developing accounting standards, such as numerous pronouncements issued by the FASB, to serve as guidelines for recording and processing business transactions in the changing economic environment.

Questions Chapter 1 (Continued)

28. The following are some of the key provisions of the Sarbanes-Oxley Act:

- Establishes an oversight board for accounting practices. The Public Company Accounting Over-sight Board (PCAOB) has oversight and enforcement authority and establishes auditing, quality control, and independence standards and rules.
- Implements stronger independence rules for auditors. Audit partners, for example, are required to rotate every five years and auditors are prohibited from offering certain types of consulting services to corporate clients.
- Requires CEOs and CFOs to personally certify that financial statements and disclosures are accurate and complete and requires CEOs and CFOs to forfeit bonuses and profits when there is an accounting restatement.
- Requires audit committees to be comprised of independent members and members with finan - cial expertise.
- Requires codes of ethics for senior financial officers.

In addition, Section 404 of the Sarbanes-Oxley Act requires public companies to attest to the effectiveness of their internal controls over financial reporting.

29. Some major challenges facing the accounting profession relate to the following items: Nonfinancial measurement—how to report significant key performance measurements such as customer satisfaction indexes, backlog information and reject rates on goods purchased. Forward-looking information—how to report more future oriented information.
Soft assets—how to report on intangible assets, such as market know-how, market dominance, and well-trained employees.
Timeliness—how to report more real-time information.

30. Accountants must perceive the moral dimensions of some situations because GAAP does not define or cover all specific features that are to be reported in financial statements. In these instances accountants must choose among alternatives. These accounting choices influence whether par-ticular stakeholders may be harmed or benefited. Moral decision-making involves awareness of potential harm or benefit and taking responsibility for the choices.

TIME AND PURPOSE OF CONCEPTS FOR ANALYSIS

CA 1-1 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to answer questions about FASB and standard setting.

CA 1-2 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to answer questions about FASB and standard setting.

CA 1-3 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to answer questions about financial reporting and accounting standards topics.

CA 1-4 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to distinguish between financial accounting and managerial accounting, identify major financial statements, and differentiate financial statements and financial reporting.

CA 1-5 (Time 20–25 minutes)
Purpose—to provide the student with an opportunity to explain the basic objective of financial reporting.

CA 1-6 (Time 10–15 minutes)
Purpose—to provide the student with an opportunity to describe how reported accounting numbers might affect an individual's perceptions and actions.

CA 1-7 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to evaluate the viewpoint of removing mandatory accounting rules and allowing each company to voluntarily disclose the information it desired.

CA 1-8 (Time 20–25 minutes)
Purpose—to provide the student with an opportunity to explain the evolution of accounting rule-making organizations and the role of the AICPA in the rule making environment.

CA 1-9 (Time 20–25 minutes)
Purpose—to provide the student with an opportunity to identify the sponsoring organization of the FASB, the method by which the FASB arrives at a decision, and the types and the purposes of docu-ments issued by the FASB.

CA 1-10 (Time 30–40 minutes)
Purpose—to provide the student with an opportunity to focus on the types of organizations involved in the rule making process, what impact accounting has on the environment, and the environment's influence on accounting.

CA 1-11 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to focus on what type of rule-making environment exists in the United States. In addition, this CA explores why user groups are interested in the nature of GAAP and why some groups wish to issue their own rules.

CA 1-12 (Time 30–40 minutes)
Purpose—to provide the student with an opportunity to identify and define acronyms appearing in the first chapter. Some are self-evident, others are not so.

Time and Purpose of Concepts for Analysis (Continued)

CA 1-13 (Time 15–20 minutes)
Purpose—to provide the student with an opportunity to identify the various documents issued by different accounting organizations. This CA should help the student to better focus on the more important documents issued in the financial reporting area.

CA 1-14 (Time 10–15 minutes)
Purpose—to provide the student with an opportunity to match the descriptions of a number of authoritative pronouncements issued by rule-making bodies to the pronouncements.

CA 1-15 (Time 20–25 minutes)
Purpose—to provide the student with an opportunity to consider the ethical dimensions of implementation of a new accounting pronouncement.

CA 1-16 (Time 30–40 minutes)
Purpose—to provide the student with an assignment that explores the role and function of the Securities and Exchange Commission.

CA 1-17 (Time 25–35 minutes)
Purpose—to provide the student with an assignment that explores the role of the FASB and the rule-making process.

CA 1-18 (Time 25–35 minutes)
Purpose—to provide the student with a writing assignment concerning the ethical issues related to meeting earnings targets.

CA 1-19 (Time 25–35 minutes)
Purpose—to provide the student with the opportunity to discuss the role of Congress in accounting rule-making.

CA 1-20 (Time 25–35 minutes)
Purpose—to provide the student with an opportunity to comment on a letter sent by business executives to the FASB and Congress on the accounting for derivatives.

SOLUTIONS TO CONCEPTS FOR ANALYSIS

CA 1-1

1. True
2. False. Any company claiming compliance with GAAP must comply with all standards and interpretations, including disclosure requirements.
3. True
4. False. In establishing financial accounting standards, the FASB relies on two basic premises: (1) the FASB should be responsive to the needs and viewpoints of the entire economic community, not just the public accounting profession, and (2) it should operate in full view of the public through a "due process" system that gives interested people ample opportunities to make their view known.

CA 1-2

1. False. In addition to providing decision-useful information about future cash flows, management also is accountable to investors for the custody and safekeeping of the company's economic resources and for their efficient and profitable use; however, this is not considered an objective.
2. False. The objective of financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers.
3. False. The FASB follows the same due process procedures for interpretations and standards.
4. True

CA 1-3

1. (d)
2. (d)
3. (d)
4. (a)
5. (a)
6. (b)
7. (d)
8. (b)

CA 1-4

(a) Financial accounting is the process that culminates in the preparation of financial reports relative to the enterprise as a whole for use by parties both internal and external to the enterprise. In contrast, managerial accounting is the process of identification, measurement, accumulation, analysis, prepa-ration, interpretation, and communication of financial information used by the management to plan, evaluate, and control within an organization and to assure appropriate use of, and accountability for, its resources.

(b) The financial statements most frequently provided are the balance sheet, the income statement, the statement of cash flows, and the statement of changes in owners' or stockholders' equity.

CA 1-4 (Continued)

(c) Financial statements are the principal means through which financial information is communicated to those outside an enterprise. As indicated in (b), there are four major financial statements. However, some financial information is better provided, or can be provided only, by means of financial reporting other than formal financial statements. Financial reporting (other than financial statements and related notes) may take various forms. Examples include the company president's letter or supplementary schedules in the corporate annual reports, prospectuses, reports filed with govern-ment agencies, news releases, management's forecasts, and descriptions of an enterprise's social or environmental impact.

CA 1-5

(a) In accordance with **Statement of Financial Accounting Concepts No. 1,** "Objectives of Financial Reporting by Business Enterprises," the objectives of financial reporting are to provide information to investors, creditors, and others

1. that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.
2. to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. Since investors' and creditors' cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the related enterprise.
3. about the economic resources of an enterprise, the claims to those resources (obligations of the enterprise to transfer resources to other entities and owners' equity), and the effects of trans-actions, events, and circumstances that change its resources and claims to those resources.

(b) **Statement of Financial Accounting Concepts No. 1** established standards to meet the information needs of large groups of external users such as investors, creditors, and their representatives. Although the level of sophistication related to business and financial accounting matters varies both within and between these user groups, users are expected to possess a reasonable understanding of accounting concepts, financial statements, and business and economic activities and are expected to be willing to study and interpret the information with reasonable diligence.

CA 1-6

Accounting numbers affect investing decisions. Investors, for example, use the financial statements of different companies to enhance their understanding of each company's financial strength and operating results. Because these statements follow generally accepted accounting principles, investors can make meaningful comparisons of different financial statements to assist their investment decisions.

Accounting numbers also influence creditors' decisions. A commercial bank usually looks into a company's financial statements and past credit history before deciding whether to grant a loan and in what amount. The financial statements provide a fair picture of the company's financial strength (for
example, short-term liquidity and long-term solvency) and operating performance for the current period and over a period of time. The information is essential for the bank to ensure that the loan is safe and sound