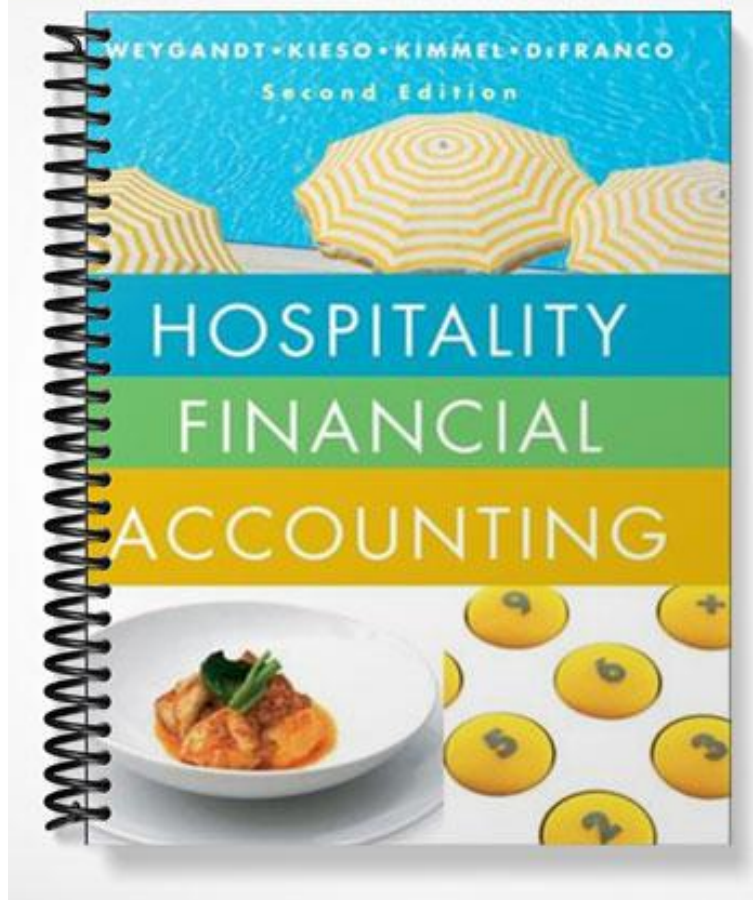


# SOLUTIONS MANUAL



# CHAPTER 2

## ACCOUNTING PRINCIPLES

### SOLUTIONS TO EXERCISES

#### EXERCISE 2-1

- (a) False
- (b) True
- (c) False

#### EXERCISE 2-2

- (a) No
- (b) Yes
- (c) No

#### EXERCISE 2-3

- (a) No
- (b) No
- (c) Yes

#### EXERCISE 2-4

- (a) Comparability
- (b) Consistency
- (c) Relevance
- (d) Reliability

#### EXERCISE 2-5

- (A) Going concern
- (A) Time period
- (C) Materiality
- (P) Revenue recognition
- (C) Conservatism
- (P) Matching

### EXERCISE 2-6

|     | <u>Assets</u> | <u>Liabilities</u> | <u>Stockholders' Equity</u> |
|-----|---------------|--------------------|-----------------------------|
| (a) | +             | +                  | NE                          |
| (b) | +             | NE                 | +                           |
| (c) | +             | NE                 | +                           |
| (d) | -             | -                  | NE                          |
| (e) | +             | NE                 | +                           |
| (f) | -             | -                  | NE                          |

### EXERCISE 2-7

1. Increase in assets and increase in stockholders' equity.
2. Decrease in assets and decrease in stockholders' equity.
3. Increase in assets and increase in liabilities.
4. Increase in assets and increase in stockholders' equity.
5. Decrease in assets and decrease in stockholders' equity.
6. Decrease in assets and decrease in liabilities.
7. Increase in liabilities and increase in assets.
8. Increase in assets and increase in liabilities.
9. Decrease in assets and decrease in liabilities.

### EXERCISE 2-8

- |        |        |
|--------|--------|
| 1. (c) | 5. (d) |
| 2. (d) | 6. (b) |
| 3. (a) | 7. (e) |
| 4. (b) | 8. (f) |

EXCERSICE 2-9

(a)

MAUI TRAVEL AGENCY, INC.

|     | <u>Cash</u>       | + | <u>Accounts<br/>Receivable</u> | + | <u>Supplies</u> | + | <u>Office<br/>Equipment</u> | = | <u>Accounts<br/>Payable</u> | + | <u>Common<br/>Stock</u> | + | <u>Retained<br/>Earnings</u> |
|-----|-------------------|---|--------------------------------|---|-----------------|---|-----------------------------|---|-----------------------------|---|-------------------------|---|------------------------------|
| 1.  | <u>+\$40,000</u>  |   |                                |   |                 |   |                             |   |                             |   | <u>+\$40,000</u>        |   |                              |
|     | 40,000            |   |                                |   |                 |   |                             | = |                             |   | 40,000                  |   |                              |
| 2.  | <u>-1,000</u>     |   |                                |   |                 |   |                             |   |                             |   |                         |   | <u>\$ -1,000</u> (a)         |
|     | 39,000            |   |                                |   |                 |   |                             | = |                             |   | 40,000                  | + | (1,000)                      |
| 3.  | <u>-5,000</u>     |   |                                |   |                 |   | <u>+\$5,000</u>             |   |                             |   |                         |   |                              |
|     | 34,000            |   |                                |   |                 | + | 5,000                       | = |                             |   | 40,000                  | + | (1,000)                      |
| 4.  | <u>1,000</u>      |   |                                |   | <u>+\$1,000</u> |   |                             |   |                             |   |                         |   |                              |
|     | 33,000            |   |                                |   | 1,000           | + | 5,000                       | = |                             | + | 40,000                  | + | (1,000)                      |
| 5.  | <u>          </u> |   |                                |   |                 |   |                             |   | <u>+\$500</u>               |   |                         |   | <u>-500</u> (b)              |
|     | 33,000            |   |                                | + | 1,000           | + | 5,000                       | = | 500                         | + | 40,000                  | + | (500)                        |
| 6.  | <u>+12,000</u>    |   | <u>+\$13,000</u>               |   |                 |   |                             |   |                             |   |                         |   | <u>+25,000</u> (c)           |
|     | 45,000            | + | 13,000                         | + | 1,000           | + | 5,000                       | = | 500                         | + | 40,000                  | + | 24,500                       |
| 7.  | <u>-750</u>       |   |                                |   |                 |   |                             |   |                             |   |                         |   | <u>-750</u> (d)              |
|     | 44,250            | + | 13,000                         | + | 1,000           | + | 5,000                       | = | 500                         | + | 40,000                  | + | 23,750                       |
| 8.  | <u>-500</u>       |   |                                |   |                 |   |                             |   | <u>-500</u>                 |   |                         |   |                              |
|     | 43,750            | + | 13,000                         | + | 1,000           | + | 5,000                       | = | 0                           | + | 40,000                  | + | 23,750                       |
| 9.  | <u>-2,500</u>     |   |                                |   |                 |   |                             |   |                             |   |                         |   | <u>-2,500</u> (e)            |
|     | 41,250            | + | 13,000                         | + | 1,000           | + | 5,000                       | = | 0                           | + | 40,000                  | + | 21,250                       |
| 10. | <u>+10,000</u>    |   | <u>-10,000</u>                 |   |                 |   |                             |   |                             |   |                         |   |                              |
|     | <u>\$51,250</u>   | + | <u>\$3,000</u>                 | + | <u>\$1,000</u>  | + | <u>\$5,000</u>              | = | <u>\$ 0</u>                 | + | <u>\$40,000</u>         | + | <u>\$21,250</u>              |

Key to Retained Earnings column on previous page.

- (a) Rent Expense
- (b) Advertising Expense
- (c) Service Revenue
- (d) Dividends
- (e) Salaries Expense

|                           |            |                  |
|---------------------------|------------|------------------|
| (b) Service revenue ..... |            | \$25,000         |
| Expenses                  |            |                  |
| Salaries .....            | \$2,500    |                  |
| Rent .....                | 1,000      |                  |
| Advertising.....          | <u>500</u> | <u>4,000</u>     |
| Net income .....          |            | <u>\$ 21,000</u> |

EXERCISE 2-10

(a)

**KIKI'S FAMOUS DESERTS CORPORATION**

|      | <u>Cash</u>    | + | <u>Accounts<br/>Receivable</u> | + | <u>Supplies</u> | + | <u>Office<br/>Equipment</u> | = | <u>Notes<br/>Payable</u> | + | <u>Accounts<br/>Payable</u> | + | <u>Common<br/>Stock</u> | + | <u>Retained<br/>Earnings</u> |
|------|----------------|---|--------------------------------|---|-----------------|---|-----------------------------|---|--------------------------|---|-----------------------------|---|-------------------------|---|------------------------------|
| Bal. | \$7,000        | + | \$2,000                        | + | \$500           | + | \$5,000                     | = |                          | + | \$5,500                     | + | \$ 7,500                | + | \$1,500                      |
| 1.   | <u>+1,000</u>  |   | <u>-1,000</u>                  |   | _____           |   | _____                       |   |                          |   | _____                       |   | _____                   |   | _____                        |
|      | 8,000          | + | 1,000                          | + | 500             | + | 5,000                       | = |                          | + | 5,500                       | + | 7,500                   | + | 1,500                        |
| 2.   | <u>-1,200</u>  |   | _____                          |   | _____           |   | _____                       |   |                          |   | <u>-1,200</u>               |   | _____                   |   | _____                        |
|      | 6,800          | + | 1,000                          | + | 500             | + | 5,000                       | = |                          | + | 4,300                       | + | 7,500                   | + | 1,500                        |
| 3.   | <u>+3,000</u>  |   | <u>+7,000</u>                  |   | _____           |   | _____                       |   |                          |   | _____                       |   | _____                   |   | <u>+10,000</u> (a)           |
|      | 9,800          | + | 8,000                          | + | 500             | + | 5,000                       | = |                          | + | 4,300                       | + | 7,500                   | + | 11,500                       |
| 4.   | <u>-250</u>    |   | _____                          |   | _____           |   | <u>+2,000</u>               |   |                          |   | <u>+1,750</u>               |   | _____                   |   | _____                        |
|      | 9,550          | + | 8,000                          | + | 500             | + | 7,000                       | = |                          | + | 6,050                       | + | 7,500                   | + | 11,500                       |
| 5.   | <u>-3,950</u>  |   | _____                          |   | _____           |   | _____                       |   |                          |   | _____                       |   | _____                   |   | <u>-2,000</u> (b)            |
|      | _____          |   | _____                          |   | _____           |   | _____                       |   |                          |   | _____                       |   | _____                   |   | <u>-1,500</u> (c)            |
|      | 5,600          | + | 8,000                          | + | 500             | + | 7,000                       | = |                          | + | 6,050                       | + | 7,500                   | + | 7,550                        |
| 6.   | <u>-550</u>    |   | _____                          |   | _____           |   | _____                       |   |                          |   | _____                       |   | _____                   |   | <u>-550</u> (e)              |
|      | 5,050          | + | 8,000                          | + | 500             | + | 7,000                       | = |                          | + | 6,050                       | + | 7,500                   | + | 7,000                        |
| 7.   | <u>+1,000</u>  |   | _____                          |   | _____           |   | _____                       |   | <u>+\$1,000</u>          |   | _____                       |   | _____                   |   | _____                        |
|      | 6,050          | + | 8,000                          | + | 500             | + | 7,000                       | = | 1,000                    | + | 6,050                       | + | 7,500                   | + | 7,000                        |
| 8.   | _____          |   | _____                          |   | _____           |   | _____                       |   | _____                    |   | <u>+500</u>                 |   | _____                   |   | <u>-500</u> (f)              |
|      | <u>\$6,050</u> | + | <u>\$8,000</u>                 | + | <u>\$500</u>    | + | <u>\$7,000</u>              | = | <u>\$1,000</u>           | + | <u>\$6,550</u>              | + | <u>\$ 7,500</u>         | + | <u>\$6,500</u>               |

Key to Retained Earnings column on previous page.

- (a) Service Revenue
- (b) Salaries Expense
- (c) Rent Expense
- (d) Advertising Expense
- (e) Dividends
- (f) Utilities Expense

(b) **KIKI'S FAMOUS DESERTS CORPORATION**  
**Income Statement**  
**For the Month Ended August 31, 2007**

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|                           |                |              |
|---------------------------|----------------|--------------|
| Revenues                  |                |              |
| Service revenue .....     |                | \$10,000     |
| Expenses                  |                |              |
| Salaries expense .....    | \$2,000        |              |
| Rent expense .....        | 1,500          |              |
| Advertising expense ..... | 450            |              |
| Utilities expense .....   | 500            |              |
| Total expenses .....      |                | <u>4,450</u> |
| Net income .....          | <u>\$5,550</u> |              |

**KIKI'S FAMOUS DESERTS CORPORATION**  
**Retained Earnings Statement**  
**For the Month Ended August 31, 2007**

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|                                    |                |
|------------------------------------|----------------|
| Retained Earnings, August 1 .....  | \$ 1,500       |
| Add: Net income .....              | <u>5,550</u>   |
|                                    | 7,050          |
| Less: Dividends .....              | <u>550</u>     |
| Retained Earnings, August 31 ..... | <u>\$6,500</u> |

**KIKI'S FAMOUS DESERTS CORPORATION**  
**Balance Sheet**  
**August 31, 2007**

| Assets  |              |                 |
|---|--------------|-----------------|
| Cash .....                                      |              | \$ 6,050        |
| Accounts receivable .....                       |              | 8,000           |
| Supplies.....                                   |              | 500             |
| Office equipment .....                          |              | <u>7,000</u>    |
| Total assets.....                               |              | <u>\$21,550</u> |
| Liabilities and Stockholders' Equity            |              |                 |
| Liabilities                                     |              |                 |
| Notes payable.....                              |              | \$ 1,000        |
| Accounts payable .....                          |              | <u>6,550</u>    |
| Total liabilities .....                         |              | 6,550           |
| Stockholders' equity                            |              |                 |
| Common stock .....                              | \$7,500      |                 |
| Retained earnings.....                          | <u>6,500</u> |                 |
| Total stockholders' equity.....                 |              | <u>14,000</u>   |
| Total liabilities and stockholders' equity..... |              | <u>\$21,550</u> |

**EXERCISE 2-11**

- (a) The mission of the Financial Accounting Standards Board is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information.
- (b) The FASB receives many requests for action on various financial accounting and reporting topics from all segments of a diverse constituency, including the SEC. The auditing profession is sensitive to emerging trends in practice, and consequently it is a frequent source of requests. Overall, requests for action include both new topics and suggested review or reconsideration of existing pronouncements.
- (c) For each major project on its technical agenda, the Board appoints an advisory task force of outside experts, studies existing literature on the subject and conducts or commissions such additional research as may be necessary, publishes a discussion document setting forth the issues and possible solutions as the basis for public comment, conducts a public hearing, and gives broad distribution to an Exposure Draft of the proposed Statement for public comment.

Significant steps in the process are announced publicly. The Board's meetings are open to public observation and a public record is maintained.



## EXERCISE 2-12

- (a) The stakeholders in this situation are:
- Richard Keith, accountant.
  - Financial vice-president of Manchester Corporation.
  - All readers and users of Manchester Corporation's financial statements.
- (b) It is neither illegal nor professionally unethical to continue to use an acceptable accounting method or standard when an option to change exists. What is brought into question is whether Richard's proposal for early implementation of a standard that results in a much fairer presentation of Manchester's financial condition and earnings is more ethical than the financial vice-president's proposal to delay implementation.
- (c) Richard appears to have little to gain except the satisfaction of issuing a set of financial statements that apparently results in a much fairer presentation of the company's financial condition and earnings.

Early implementation, because it adversely affects reported net income, primarily affects the stockholders.