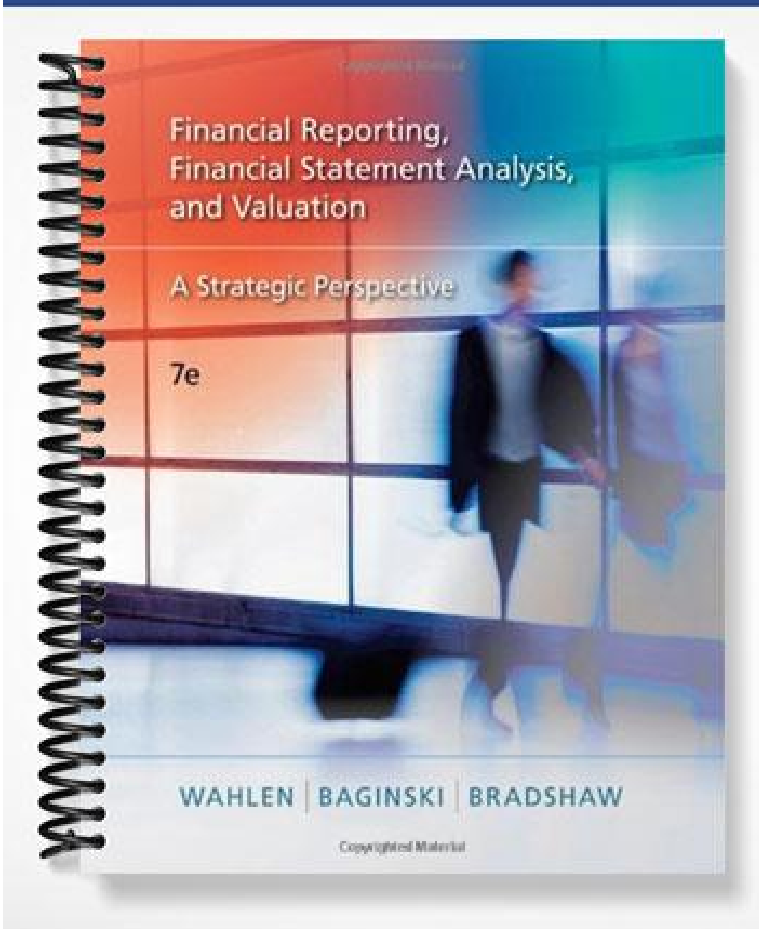
TEST BANK


Financial Reporting,
Financial Statement Analysis,
and Valuation
A Strategic Perspective
7e
WAHLEN | BAGINSKI | BRADSHAW

Chapter 2--Asset and Liability Valuation and Income Measurement

Student: ____

1. Which of the following assets appears on the balance sheet at fair value?
A. Equipment
B. Land
C. Investments in Marketable Securities
D. Intangible Assets

2. Why might income tax expense on the income statement differ from actual income taxes paid to the government?
A. There are timing differences to when income is recognized and there are items that may or may not be subject to taxation.
B. The IRS uses the accrual method of calculating income.
C. Financial statement preparers can use an estimated tax rate.
D. The IRS requires deferral of most expenses.

3. Shareholders' equity consists of what three components:
A. Assets, liabilities, and contributed capital.
B. Contributed capital, accumulated other comprehensive income, and retained earnings.
C. Liabilities, contributed capital, and retained earnings.
D. Liabilities, contributed capital, and accumulated other comprehensive income.

4. Which of the following valuation methods reflects current values?
A. acquisition cost
B. present value of cash flows using historical interest rates
C. net realizable value
D. adjusted acquisition cost

5. The use of acquisition cost as a valuation method is justified on the basis that acquisition cost
A. timely
B. relevant
C. subjective
D. objective

6. Firms use acquisition cost valuations and adjusted acquisition cost valuations for which of the following types of assets?
A. Assets that do not have fixed amounts of future cash flows.
B. Assets that have fixed amounts of future cash flows.
C. Assets with certain future economic benefits.
D. monetary

7. The net amount a firm would receive if it sold an asset or the net amount it would pay to settle a liability is referred to as
A. current replacement cost
B. net realizable value
C. current cost
D. acquisition cost

8. Disregarding cash flows with owners, over sufficiently long periods of time, net income equals?
A. revenues minus dividends and expenses
B. assets minus liabilities
C. stockholders’ equity
D. cash inflows minus cash outflows

9. When income tax expense for a period is greater than income tax payable the difference will be reported how and on which financial statement?
A. Deferred tax asset and Statement of Cash Flows
B. Deferred tax asset and Balance Sheet
C. Deferred tax liability and Statement of Cash Flows
D. Deferred tax liability and Balance Sheet

10. Permanent tax differences are revenues and expenses
A. that firms include in income tax returns, but do not appear in the income statement.
B. that are included in both the tax return and income statement, but in different accounting periods.
C. that firms include in the income statement, but do not appear in income tax returns.
D. that are not included in either the tax return or the income statement.

11. The traditional accounting model delays the recognition of value changes of assets and liabilities until what event occurs?
A. A change in value.
B. A market transaction.
C. A balance sheet date.
D. Cash is received or cash is paid.

12. Fish Farm Corporation purchases a new tract of land on which it is going to build new growing and holding tanks in order to expand its business, which of the following costs would not be part of the cost of the land?
A. costs to run a title search
B. costs of grading to level the land
C. costs of tearing down an existing structure
D. cost of the new holding tanks

13. Current replacement cost represents
A. the amount a firm would have to pay currently to acquire an asset it now holds
B. the amount a firm would have to pay currently to acquire an asset it does not now hold
C. the amount a firm would have to pay in the future to acquire an asset it now holds
D. the amount a firm would have to pay to purchase a comparably depreciated version of the asset it now holds

14. Which of the following is not one of methods used by GAAP for treating value changes
A. Recognize value changes on the balance sheet and income statement when they are realized in a market transaction
B. Recognize value changes in the income statement when the value changes occur over time, but recognize them on the balance sheet when they are realized in a market transaction
C. Recognize value changes on the balance sheet when the value changes occur over time, but recognize them in the income statement when they are realized in a market transaction
D. Recognize value changes on the balance sheet and income statement when they occur over time, even though they are not realized in a market transaction

15. Which of the following transactions is consistent with recognizing value changes on the balance sheet and income statement when they are realized in a market transaction
A. Selling land at a cost greater than its original purchase price.
B. Recording an increase in the fair value of investments at year end.
C. Translating foreign operations accounted for in Yen back to U.S. dollars in order to prepare consolidated financial statements.
D. Writing down the value of an asset due to obsolescent.

16. At origination which of the following temporary differences would create a deferred tax asset
A. Tax basis of an asset exceeds its financial reporting basis.
B. Tax basis of a liability exceeds its financial reporting basis.
C. Financial reporting basis of an asset is equal to its tax basis.
D. Financial reporting basis of an asset exceeds its tax basis.

17. Plaxo Corporation has a tax rate of 35% and uses the straight-line method of depreciation for its equipment, which has a useful life of four years. Tax legislation requires the company to depreciate its equipment using the following schedule: year 1- 50%, year 2 - 30%, year 3 - 15% and year 4 - 5%. In 2006 Plaxo purchases a piece of equipment with a four year life and an original cost of $100,000. What amount will Plaxo record as a deferred tax asset or liability in 2006?
A. Deferred tax asset of $25,000.
B. Deferred tax liability of $25,000.
C. Deferred tax asset of $8,750.
D. Deferred tax liability of $8,750.

18. The amount initially paid to acquire an asset is called ______________________________.

____

19. Firms recognize the reduction in service potential of assets such as building and equipment using the process of ____________________.

____

20. The amount that a company would have to pay today to acquire an asset it now holds is called ____.

____

21. The difference between income tax payable and income tax expense is reported on the balance sheet as either ___________________________________ or a ___________________________________.

____

22. Items, such as interest revenue on municipal bond holdings, that do not affect taxable income or income taxes paid in any year are referred to as ____.

____

23. Revenues and expenses that firms include in both net income to shareholders and in taxable income, but in different periods are referred to as ____.

____

24. Stockholders' equity can be expanded into the following three accounts: contributed capital, retained earnings and ____.

---

25. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation**. If ORP Corporation sells $25,000 of its product on account, it will see an increase in non-cash assets and ________________________________.

---

26. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation**. To recognize the cost of goods sold ORP Corporation will reduce retained earnings and reduce ___________________________.

---

27. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation.** ORP Corporation sells land with a book value of $12,000 for $9,000. This transaction results in ORP recording an increase in cash of $9,000, a decrease in non-cash assets of $12,000 and a decrease in ______________________________ of $3,000.

---

28. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation.** JCP Company purchased marketable securities for $5,000 during the year, at the end of the year the company revalues the securities to $5,700. This revaluation would result in an increase to non-cash assets and ____.

____

29. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation.** The payment of dividends by a firm reduces cash and ______________________________.

____

30. Acquisition costs includes all costs necessary to get an asset ready for its ___________________________.

____

31. ______________________ assets and liabilities represent amounts of cash a firm can expect to receive or pay in the future.

____

32. ____ is the net amount that a firm would receive if it sold an asset or the net amount it would have to pay to settle a liability.

____

33. A change in the ___________________________ or ___________________________ will not change a preset series of cash flows, however it will change the present value of those cash flows.

____

34. Net income equals revenues plus ______________________ minus expenses and ______________________.

____

35. The application of GAAP requires firms to write down assets whose fair values decrease below their book values, but does not allow firms to revalue upward the values of assets whose fair values have increased. This asymmetric treatment rests on the ____.
____

36. What valuation methods reflect historical cost? Discuss the advantages and disadvantages of valuing assets and liabilities using historical valuations.

37. What valuation methods reflect current values? Discuss the advantage(s) and disadvantage(s) of valuing assets and liabilities using current values.

38. Discuss the three ways in which GAAP allows value changes to be treated in the financial statements. Provide an example of each value change treatment.

39. When income tax expense differs from income taxes currently payable on taxable income companies recognize deferred tax assets and deferred tax liabilities. What type of event would create a deferred tax asset and deferred tax liability?

40. Discuss the two principal reasons income before taxes for financial reporting differs from taxable income.

41. The analytical framework used to evaluate transactions is reproduced below:

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Using this analytical framework indicate the effect of each of the following transactions for TX Corporation:

1. TX Corporation purchased marketable securities for $150,000 for cash.
2. At the end of the period TX Corporation revalued the securities to $125,000.
3. During the next period TX Corporation sells the securities for $165,000.

42. The analytical framework used to evaluate transactions is reproduced below:

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Using this analytical framework indicate the effect of each of the following transactions for CX Corporation:

1. CX Corporation purchases land for $450,000 cash.
2. At the end of the period CX Corporation receives an appraisal that values the land at $540,000.
3. During the next period CX Corporation sells the land for $665,000.
4. CX pays taxes at a rate of 40%.

43. Plaxo Corporation has a tax rate of 35% and uses the straight-line method of depreciation for its equipment, which has a useful life of four years. Tax legislation requires the company to depreciate this type of equipment using the following schedule: year 1- 50%, year 2 - 30%, year 3 - 15% and year 4 - 5%. In 2006 Plaxo purchases a piece of equipment with a four year life and an original cost of $100,000. Discuss how this transaction will effect Plaxo's income taxes in 2006.

44. For some transactions GAAP requires that value changes are recognized on the balance sheet and the income statement when they occur, even if not realized. Discuss what types of transactions get this type of treatment and the logic behind this accounting.

45. Deferred tax assets and liabilities are created due to temporary differences between the tax and financial reporting basis of certain assets and liabilities. Discuss which scenarios result in a deferred tax asset and which result in deferred tax liabilities.

46. H. Solo Company purchased a new piece of equipment with a list price of $175,000 and subject to a 5 percent discount if paid within 45 days. H. Solo paid within the discount period. The company also paid $1,500 to obtain title to the equipment and $600 as the license fee for the first year of operation. It paid $2,500 to level the area in which the equipment would be located and $12,500 to relocate other equipment that would have interfered with the proper operation of the new equipment. H. Solo paid $400 for property and liability insurance for the first year of operation. What is the acquisition cost of this equipment that H. Solo should record in its accounting records? Indicate the treatment of any amount not included in acquisition cost.

47. Accord Inc. income tax return shows taxes currently payable for 2006 of $85,000. The company reported deferred tax assets of $35,000 at the end of 2005 and $24,000 at the end of 2006. Accord reported deferred tax liabilities of $48,000 at the end of 2006 and $54,000 at the end of 2006.

Determine the amount of income tax expense reported by Accord for 2006.

48. There are three valuation methods that reflect historical values: acquisition cost, adjusted acquisition cost, and present value of cash flows using historical interest rates. For each of three methods discuss what the valuation represents and provide an example of a balance sheet item that is valued using the method. In addition, for each of the three methods valuation methods explain its advantages and disadvantages.

49. The analytical framework used to evaluate transactions is reproduced below:

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Using this analytical framework indicate the effect of each of the following transactions for Wisco Corporation:

1. Wisco sold merchandise for $225,000 on account which cost $170,000 to manufacture.
2. Wisco purchased for cash $110,000 of raw material inventory.
3. The company paid $25,000 in advance for an advertising campaign that would be aired next year.
4. Wisco paid its employees $15,000 for the month.
5. The company purchased $7,000 of supplies on account.
6. Wisco issued $25,000 of long-term debt.
7. The company used $10,000 of excess cash to purchase marketable securities.
8. Wisco purchased a machine for $22,000 in cash.
9. At the end of the year Wisco paid dividends of $5,000.
10. At the end of the year the marketable securities that Wisco purchased in transaction 7 were now worth $11,500.
11. Depreciation for the period was $1,500.

50. The analytical framework used to evaluate transactions is reproduced below:

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Using this analytical framework indicate the effect of each of the following transactions for Staples Corporation:

1. Staples recorded cash sales of $25,000. The merchandise had cost $19,000 to manufacture.
2. Staples purchased $8,500 of raw material inventory on account.
3. The company paid $2,500 for property insurance for the next 12 months.
4. Staples paid its employees $5,000 for the month.
5. The company purchased $1,000 of supplies on account.
6. Staples issued $25,000 of long-term debt.
7. The company used $10,000 of excess cash to purchase marketable securities.
8. Staples purchased a machine for $16,000 using $8,000 cash with the balance on account.
9. Staples paid $2,500 for interest expense on the long-term debt.
10. At the end of the year the marketable securities that Staples purchased in transaction 7 were now worth $14,500.
11. Depreciation for the period was $1,500.
12. Staples examined the equipment and determined that its fair value was $10,000.

51. The following problem requires present value information:

Biotech sold a patent on a new blood analyzer to Pharma. The sales agreement which was signed on January 1, 2006 requires Pharma to pay Biotech $1 million immediately. In addition, Pharma is required to pay $600,000 each December 31 for 20 years starting with December 31, 2006. Pharma and Biotech judge that a 10 percent is an appropriate interest rate for this arrangement.

a. Compute the present value of the receivable on Biotech's books on January 1, 2006 immediately after receiving the $1 million down payment.
b. Compute the present value of the receivable on Biotech's books on December 31, 2006.
c. Compute the present value of the receivable on Biotech's books on December 31, 2007.

Chapter 2--Asset and Liability Valuation and Income Measurement Key

1. Which of the following assets appears on the balance sheet at fair value?
A. Equipment
B. Land
C. Investments in Marketable Securities
D. Intangible Assets

2. Why might income tax expense on the income statement differ from actual income taxes paid to the government?
A. There are timing differences to when income is recognized and there are items that may or may not be subject to taxation.
B. The IRS uses the accrual method of calculating income.
C. Financial statement preparers can use an estimated tax rate.
D. The IRS requires deferral of most expenses.

3. Shareholders' equity consists of what three components:
A. Assets, liabilities, and contributed capital.
B. Contributed capital, accumulated other comprehensive income, and retained earnings.
C. Liabilities, contributed capital, and retained earnings.
D. Liabilities, contributed capital, and accumulated other comprehensive income.

4. Which of the following valuation methods reflects current values?
A. acquisition cost
B. present value of cash flows using historical interest rates
C. net realizable value
D. adjusted acquisition cost

5. The use of acquisition cost as a valuation method is justified on the basis that acquisition cost
A. timely
B. relevant
C. subjective
D. objective

6. Firms use acquisition cost valuations and adjusted acquisition cost valuations for which of the following types of assets?
A. Assets that do not have fixed amounts of future cash flows.
B. Assets that have fixed amounts of future cash flows.
C. Assets with certain future economic benefits.
D. monetary

7. The net amount a firm would receive if it sold an asset or the net amount it would pay to settle a liability is referred to as
A. current replacement cost
B. net realizable value
C. current cost
D. acquisition cost

8. Disregarding cash flows with owners, over sufficiently long periods of time, net income equals?
A. revenues minus dividends and expenses
B. assets minus liabilities
C. stockholders' equity
D. cash inflows minus cash outflows

9. When income tax expense for a period is greater than income tax payable the difference will be reported how and on which financial statement?
A. Deferred tax asset and Statement of Cash Flows
B. Deferred tax asset and Balance Sheet
C. Deferred tax liability and Statement of Cash Flows
D. Deferred tax liability and Balance Sheet

10. Permanent tax differences are revenues and expenses
A. that firms include in income tax returns, but do not appear in the income statement.
B. that are included in both the tax return and income statement, but in different accounting periods.
C. that firms include in the income statement, but do not appear in income tax returns.
D. that are not included in either the tax return or the income statement.

11. The traditional accounting model delays the recognition of value changes of assets and liabilities until what event occurs?
A. A change in value.
B. A market transaction.
C. A balance sheet date.
D. Cash is received or cash is paid.

12. Fish Farm Corporation purchases a new tract of land on which it is going to build new growing and holding tanks in order to expand its business, which of the following costs would not be part of the cost of the land?
A. costs to run a title search
B. costs of grading to level the land
C. costs of tearing down an existing structure
D. cost of the new holding tanks

13. Current replacement cost represents
A. the amount a firm would have to pay currently to acquire an asset it now holds
B. the amount a firm would have to pay currently to acquire an asset it does not now hold
C. the amount a firm would have to pay in the future to acquire an asset it now holds
D. the amount a firm would have to pay to purchase a comparably depreciated version of the asset it now holds

14. Which of the following is not one of methods used by GAAP for treating value changes
A. Recognize value changes on the balance sheet and income statement when they are realized in a market transaction
B. Recognize value changes in the income statement when the value changes occur over time, but recognize them on the balance sheet when they are realized in a market transaction
C. Recognize value changes on the balance sheet when the value changes occur over time, but recognize them in the income statement when they are realized in a market transaction
D. Recognize value changes on the balance sheet and income statement when they occur over time, even though they are not realized in a market transaction

15. Which of the following transactions is consistent with recognizing value changes on the balance sheet and income statement when they are realized in a market transaction
A. Selling land at a cost greater than its original purchase price.
B. Recording an increase in the fair value of investments at year end.
C. Translating foreign operations accounted for in Yen back to U.S. dollars in order to prepare consolidated financial statements.
D. Writing down the value of an asset due to obsolescent.

16. At origination which of the following temporary differences would create a deferred tax asset
A. Tax basis of an asset exceeds its financial reporting basis.
B. Tax basis of a liability exceeds its financial reporting basis.
C. Financial reporting basis of an asset is equal to its tax basis.
D. Financial reporting basis of an asset exceeds its tax basis.

17. Plaxo Corporation has a tax rate of 35% and uses the straight-line method of depreciation for its equipment, which has a useful life of four years. Tax legislation requires the company to depreciate its equipment using the following schedule: year 1- 50%, year 2 - 30%, year 3 - 15% and year 4 - 5%. In 2006 Plaxo purchases a piece of equipment with a four year life and an original cost of $100,000. What amount will Plaxo record as a deferred tax asset or liability in 2006?
A. Deferred tax asset of $25,000.
B. Deferred tax liability of $25,000.
C. Deferred tax asset of $8,750.
D. Deferred tax liability of $8,750.

18. The amount initially paid to acquire an asset is called ________________________________.
acquisition cost

19. Firms recognize the reduction in service potential of assets such as building and equipment using the process of _____________________.
depreciation

20. The amount that a company would have to pay today to acquire an asset it now holds is called ____.
current replacement cost

21. The difference between income tax payable and income tax expense is reported on the balance sheet as either _____________________________________ or a _____________________________________.
deferred tax asset, deferred tax liability

22. Items, such as interest revenue on municipal bond holdings, that do not affect taxable income or income taxes paid in any year are referred to as ____.
permanent differences

23. Revenues and expenses that firms include in both net income to shareholders and in taxable income, but in different periods are referred to as ____.
temporary differences

24. Stockholders' equity can be expanded into the following three accounts: contributed capital, retained earnings and ____.
accumulated other comprehensive income

25. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation**. If ORP Corporation sells $25,000 of its product on account, it will see an increase in non-cash assets and _________________________________.
retained earnings

26. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation**. To recognize the cost of goods sold ORP Corporation will reduce retained earnings and reduce ____________________________.
non-cash assets *or*
non cash assets

27. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation.** ORP Corporation sells land with a book value of $12,000 for $9,000. This transaction results in ORP recording an increase in cash of $9,000, a decrease in non-cash assets of $12,000 and a decrease in ______________________________ of $3,000.
retained earnings

28. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation.** JCP Company purchased marketable securities for $5,000 during the year, at the end of the year the company revalues the securities to $5,700. This revaluation would result in an increase to non-cash assets and

____.

accumulated other comprehensive income

29. **Balance Sheet Equation**

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Refer to **Balance Sheet Equation.** The payment of dividends by a firm reduces cash and ___________________________.

retained earnings

30. Acquisition costs includes all costs necessary to get an asset ready for its ___________________________.

intended use

31. _____________________ assets and liabilities represent amounts of cash a firm can expect to receive or pay in the future.

Monetary

32. ____ is the net amount that a firm would receive if it sold an asset or the net amount it would have to pay to settle a liability.

Net realizable value

33. A change in the ___________________________ or ___________________________ will not change a preset series of cash flows, however it will change the present value of those cash flows.

interest rate, discount rate

34. Net income equals revenues plus _____________________ minus expenses and _____________________.

gains, losses

35. The application of GAAP requires firms to write down assets whose fair values decrease below their book values, but does not allow firms to revalue upward the values of assets whose fair values have increased. This asymmetric treatment rests on the ____.
conservatism convention.

36. What valuation methods reflect historical cost? Discuss the advantages and disadvantages of valuing assets and liabilities using historical valuations.

Valuation methods reflecting historical cost include:

1. acquisition cost
2. adjusted acquisition cost
3. present value of cash flows using historical interest rates

The main advantages of using historical valuations are simplicity, less subjectivity and reliability. The disadvantages include lack of relevance.

37. What valuation methods reflect current values? Discuss the advantage(s) and disadvantage(s) of valuing assets and liabilities using current values.

Valuation methods reflecting current values include:

1. current replacement cost
2. net realizable value
3. present value of cash flows using current interest rates

The main advantage of using current values is increased relevance for financial statement users. The disadvantages include greater subjectivity.

38. Discuss the three ways in which GAAP allows value changes to be treated in the financial statements. Provide an example of each value change treatment.

1. Value changes recognized on the balance sheet and the income statement when realized in a market transaction. Examples include selling inventory or land.
2. Value changes recognized on the balance sheet when they occur, but recognized on the income statement when realized. Examples include marketable securities.
3. Value changes recognized on the balance sheet and the income statement when they occur. Examples include impairment losses.

39. When income tax expense differs from income taxes currently payable on taxable income companies recognize deferred tax assets and deferred tax liabilities. What type of event would create a deferred tax asset and deferred tax liability?

Deferred tax assets arise when taxable income exceeds book income. An example would be warranty expense. Deferred tax liabilities arise when book income exceeds taxable income. An example would be recognized more depreciation expense for tax purposes than for book purposes.

40. Discuss the two principal reasons income before taxes for financial reporting differs from taxable income.

1. Permanent Differences--Revenues and expenses that firms include in net income to shareholders, but which never appear in the income tax return.
2. Temporary Differences--Revenues and expenses that firms include in both net income to shareholders and in taxable income but in different periods.

41. The analytical framework used to evaluate transactions is reproduced below:

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Using this analytical framework indicate the effect of each of the following transactions for TX Corporation:

1. TX Corporation purchased marketable securities for $150,000 for cash.
2. At the end of the period TX Corporation revalued the securities to $125,000.
3. During the next period TX Corporation sells the securities for $165,000.

	Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings
1.	-150,000		+150,000								
2.			-25,000						-25,000		
3.	+165,000		-125,000						+25,000		+15,000

42. The analytical framework used to evaluate transactions is reproduced below:

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Using this analytical framework indicate the effect of each of the following transactions for CX Corporation:
1. CX Corporation purchases land for $450,000 cash.
2. At the end of the period CX Corporation receives an appraisal that values the land at $540,000.
3. During the next period CX Corporation sells the land for $665,000.
4. CX pays taxes at a rate of 40%.

	Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings
1.	-450,000		+450,000								
2.	No Entry										
3.	+665,000		-450,000								+215,000
4.	-86,000										-86,000

43. Plaxo Corporation has a tax rate of 35% and uses the straight-line method of depreciation for its equipment, which has a useful life of four years. Tax legislation requires the company to depreciate this type of equipment using the following schedule: year 1- 50%, year 2 - 30%, year 3 - 15% and year 4 - 5%. In 2006 Plaxo purchases a piece of equipment with a four year life and an original cost of $100,000. Discuss how this transaction will effect Plaxo's income taxes in 2006.

The difference in depreciation rates results in Plaxo recording a deferred tax liability in 2006 equal to the difference in the tax and financial depreciation expense multiplied by the firm's tax rate.

Plaxo's tax depreciation expense in 2006 will be (50% *$100,000) $50,000, while its financial reporting depreciation expense will be (25% * $100,000) $25,000.

The $25,000 difference is multiplied by Plaxo's 35% tax rate to result in a deferred tax liability of $8,750.

44. For some transactions GAAP requires that value changes are recognized on the balance sheet and the income statement when they occur, even if not realized. Discuss what types of transactions get this type of treatment and the logic behind this accounting.

The application of GAAP requires firms to write down assets whose fair values decrease below their book values. For example, GAAP requires that firms recognize a loss on equipment in which its fair value has decreased below its book value due to obsolescence or other permanent valuation effect.

GAAP does not allow firms to revalue upward the values of assets whose fair values have increased. Firms must await the validation of the value increase through a market transaction to justify this type of gain.

45. Deferred tax assets and liabilities are created due to temporary differences between the tax and financial reporting basis of certain assets and liabilities. Discuss which scenarios result in a deferred tax asset and which result in deferred tax liabilities.

Deferred tax assets result from the following two scenarios:

1. The tax basis of assets exceeds the financial reporting basis
2. The tax basis of liabilities is less than the financial reporting basis

Deferred tax liabilities result from the following two scenarios:

1. The tax basis of assets is less than the financial reporting basis
2. The tax basis of liabilities exceeds the financial reporting basis

46. H. Solo Company purchased a new piece of equipment with a list price of $175,000 and subject to a 5 percent discount if paid within 45 days. H. Solo paid within the discount period. The company also paid $1,500 to obtain title to the equipment and $600 as the license fee for the first year of operation. It paid $2,500 to level the area in which the equipment would be located and $12,500 to relocate other equipment that would have interfered with the proper operation of the new equipment. H. Solo paid $400 for property and liability insurance for the first year of operation. What is the acquisition cost of this equipment that H. Solo should record in its accounting records? Indicate the treatment of any amount not included in acquisition cost.

H. Solo should record the equipment at the following cost:

Purchase price	=	$175,000 less 5% discount = $166,250
title	=	$1,500
leveling	=	$2,500
relocation	=	$12,500
TOTAL COST	=	$182,750

The $600 license for the first year of operations is a period expense, $400 should be treated as insurance expense for the period.

47. Accord Inc. income tax return shows taxes currently payable for 2006 of $85,000. The company reported deferred tax assets of $35,000 at the end of 2005 and $24,000 at the end of 2006. Accord reported deferred tax liabilities of $48,000 at the end of 2006 and $54,000 at the end of 2006.

Determine the amount of income tax expense reported by Accord for 2006.

Accord’s income tax expense for 2006 can be determined by this journal entry:

Income tax expense	$102,000	
	Deferred Tax Asset	$11,000
	Deferred Tax Liability	$6,000
	Income taxes payable	$85,000

48. There are three valuation methods that reflect historical values: acquisition cost, adjusted acquisition cost, and present value of cash flows using historical interest rates. For each of three methods discuss what the valuation represents and provide an example of a balance sheet item that is valued using the method. In addition, for each of the three methods valuation methods explain its advantages and disadvantages.

1. Acquisition cost is the amount paid initially to acquire the asset, examples include prepayments, land, and intangibles with indefinite lives. The advantage is simplicity and reliability, the disadvantage is lack of relevance.
2. Adjusted acquisition cost is the amount paid initially to acquire an asset less accumulated depreciation and amortization, examples include equipment and intangible assets with limited lives. The advantage is simplicity and reliability, the disadvantage is lack of relevance and subjectivity due to not being able to observe the actual consumption of the asset.
3. Present value of cash flows using historical interest rates is an item in which cash receipts or cash payments will occur over time, these future cash flows are then discounted at the interest rate in effect at the time of the initial transaction. Balance sheet examples include notes receivable and notes payable. The advantage is simplicity and reliability, the disadvantage is subjectivity due to not updating the interest rate as time elapses.

49. The analytical framework used to evaluate transactions is reproduced below:

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Using this analytical framework indicate the effect of each of the following transactions for Wisco Corporation:

1. Wisco sold merchandise for $225,000 on account which cost $170,000 to manufacture.
2. Wisco purchased for cash $110,000 of raw material inventory.
3. The company paid $25,000 in advance for an advertising campaign that would be aired next year.
4. Wisco paid its employees $15,000 for the month.
5. The company purchased $7,000 of supplies on account.
6. Wisco issued $25,000 of long-term debt.
7. The company used $10,000 of excess cash to purchase marketable securities.
8. Wisco purchased a machine for $22,000 in cash.
9. At the end of the year Wisco paid dividends of $5,000.
10. At the end of the year the marketable securities that Wisco purchased in transaction 7 were now worth $11,500.
11. Depreciation for the period was $1,500.

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

1. Wisco sold for merchandise for $225,000 on account which cost $170,000 to manufacture.

Cash	+	Non-Cash Assets	= Liabilities	Contributed Capital	Accumulated Other Comprehensive Income	Retained Earnings
	+	225,000				225,000
	-	170,000				-170,000

2. Wisco purchased for cash $110,000 of raw material inventory.

	Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings
-	110,000	+	110,000								

3. The company paid $25,000 in advance for an advertising campaign that would be aired next year.

	Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings
-	25,000	+	25,000								

4. Wisco paid its employees $15,000 for the month.

	Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings
-	15,000										-15,000

5. The company purchased $7,000 of supplies on account.

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings
	+	7,000	+	7,000						

6. Wisco issued $25,000 of long-term debt.

Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings
+ 25,000				+ 25,000						

7. The company used $10,000 of excess cash to purchase marketable securities.

Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings

-	10,000	+	10,000	

8. Wisco purchased a machine for $22,000 in cash.

	Cash	+	Non-Cash Assets	=	Liabilities	Contributed Capital	Accumulated Other Comprehensive Income	Retained Earnings
-	22,000	+	22,000					

9. At the end of the year Wisco paid dividends of $5,000.

	Cash	+ Non-Cash Assets	= Liabilities	+ Contributed Capital	+ Accumulated Other Comprehensive Income	+ Retained Earnings
-	5,000				-	5,000
10.	At the end of the year the marketable securities that Wisco purchased in transaction 7 were now worth $11,500.					

	Cash		Non-Cash Assets		Liabilities		Contributed Capital		Accumulated Other Comprehensive Income		Retained Earnings
		+	N on-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings
		+	1,500					+	1,500		
11.	Depreciation for the period was $1,500.										

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings
	-	1,500							-	1,500

50. The analytical framework used to evaluate transactions is reproduced below:

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

Using this analytical framework indicate the effect of each of the following transactions for Staples Corporation:

1. Staples recorded cash sales of $25,000. The merchandise had cost $19,000 to manufacture.
2. Staples purchased $8,500 of raw material inventory on account.
3. The company paid $2,500 for property insurance for the next 12 months.
4. Staples paid its employees $5,000 for the month.
5. The company purchased $1,000 of supplies on account.
6. Staples issued $25,000 of long-term debt.
7. The company used $10,000 of excess cash to purchase marketable securities.
8. Staples purchased a machine for $16,000 using $8,000 cash with the balance on account.
9. Staples paid $2,500 for interest expense on the long-term debt.
10. At the end of the year the marketable securities that Staples purchased in transaction 7 were now worth $14,500.
11. Depreciation for the period was $1,500.
12. Staples examined the equipment and determined that its fair value was $10,000.

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings

1. Staples recorded cash sales of $25,000. The merchandise had cost $19,000 to manufacture.

	Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings
+	25,000									-	25,000
		-	19,000								-19,000
2.	Staples purchased $8,500 of raw material inventory on account.										

Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings
	+	8,500	+	8,500						

3. The company paid $2,500 for property insurance for the next 12 months.

	Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings
-	2,500	+	2,500								

4. Staples paid its employees $5,000 for the month.

	Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings
-	5,000										-5,000

5. The company purchased $1,000 of supplies on account.

Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings
	+	1,000	+	1,000						

6. Staples issued $25,000 of long-term debt.

Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings
+ 25,000				+ 25,000						

7. The company used $10,000 of excess cash to purchase marketable securities.

Cash	+	Non-Cash Assets	=	Liabilities	-	Contributed Capital	-	Accumulated Other Comprehensive Income	-	Retained Earnings

- 10,000 + 10,000

8. Staples purchased a machine for $16,000 using $8,000 cash with the balance on account.

	Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings
-	8,000	+	16,000	+	8,000						

9. Staples paid $2,500 for interest expense on the long-term debt.

	Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income		Retained Earnings
-	2,500									-	2,500

10. At the end of the year the marketable securities that Staples purchased in transaction 7 were now worth $145000.

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income		Retained Earnings
	+	4,500					+	4,500		

11. Depreciation for the period was $1,500.

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings
-		1,500						-		1,500

12. Staples examined the equipment and determined that its fair value was $10,000.

Cash	+	Non-Cash Assets	=	Liabilities	+	Contributed Capital	+	Accumulated Other Comprehensive Income	+	Retained Earnings
-		4,500						-		4,500

51. The following problem requires present value information:

Biotech sold a patent on a new blood analyzer to Pharma. The sales agreement which was signed on January 1, 2006 requires Pharma to pay Biotech $1 million immediately. In addition, Pharma is required to pay $600,000 each December 31 for 20 years starting with December 31, 2006. Pharma and Biotech judge that a 10 percent is an appropriate interest rate for this arrangement.

a. Compute the present value of the receivable on Biotech's books on January 1, 2006 immediately after receiving the $1 million down payment.
b. Compute the present value of the receivable on Biotech's books on December 31, 2006.
c. Compute the present value of the receivable on Biotech's books on December 31, 2007.

Jan. 1 2006:
The present value of an ordinary annuity of $600,000 for 20 periods, at 10% equals ($600,000 * 8.5136) $5,108,160.

Dec. 31, 2006:
After receiving the first payment the present value of $600,000 for 19 periods, at 10% equals ($600,000 * 8.3649) $5,018,940.

Dec. 31, 2007:
After receiving the second payment the present value of $600,000 for 18 periods, at 10% equals ($600,000 * 8.2014) $4,920,840.