

SELF STUDY QUESTIONS

Section 4

Fill in the Blank

Module 1

In the space provided, write the word or words to either replace the question mark or answer the question.

1. A(n) ? expenditure relates to the acquirement of a benefit that extends over one or more accounting periods beyond the current period, hence it is recorded in an appropriate asset account.

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2. A(n) ? expenditure relates to the acquirement of a benefit that does not extend beyond the current accounting period, hence it is recorded in an appropriate expense account for the current period.

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SELF STUDY QUESTIONS

Fill in the Blank

Section 4

Module 2

In the space provided, write the word or words to either replace the question mark or answer the question.

1. With the exception of ?, all fixed assets are assumed to have a limited economic life. \_\_\_\_\_
2. The ? value is an estimate of the disposal value of an asset at the end of its economic life. \_\_\_\_\_
3. The depreciation method that results in equal charges to expense is the ? method. \_\_\_\_\_
4. A method of accelerated depreciation is ?. \_\_\_\_\_
5. The cost of a fixed asset less its accumulated depreciation is equal to the ?. \_\_\_\_\_

In the space provided, write the word or words to either replace the question mark or answer the question.

1. A lease is a contractual arrangement by which the holder of property (the ?) permits its use by another party (the ?) for a contracted period of time.  

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2. ? leases are leases in which the lessee simply uses the property for a specific period of time, paying rent to the lessor, who retains all the risks and obligations of ownership and who also retains title to the property.  

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3. A(n) ? lease is a lease in which the lessor, in substance, provides financing for the lessee's acquisition of the property, or use of the property for most of its economic life.  

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Circle the letter of the best answer.

1. Which of the following is not a major characteristic of a plant asset?
  - A. possess physical substance
  - B. acquired for use in operations
  - C. yield services over a number of years
  - D. all of the above are major characteristics of a plant asset
  
2. An expenditure that will benefit several accounting periods is considered to be
  - A. a prepaid revenue
  - B. a contra asset
  - C. a capital expenditure
  - D. a revenue expenditure
  - E. a collateral expenditure
  
3. The debit for a sales tax properly levied and paid on the purchase of machinery preferably would be charged to
  - A. the machinery account
  - B. a separate deferred charge account
  - C. miscellaneous tax expense (which includes all taxes other than those on income)
  - D. accumulated depreciation - machinery
  
4. An operational asset which could have been bought for \$17,000 cash actually cost \$17,500 because it was bought on long-term credit terms. The additional \$500 should be accounted for as
  - A. part of the cost of the asset acquired
  - B. interest expense on the acquisition date
  - C. interest expense over the period of payment
  - D. prepaid interest expense on the acquisition date
  
5. Company B acquired an operational asset, terms 2% discount if paid within 30 days. The invoice cost was \$10,000. The asset should be recorded by Company B at
  - A. \$10,000 regardless of whether the discount is taken
  - B. \$10,000 if this is the amount of cash paid
  - C. \$ 9,800 if this is the amount of cash paid
  - D. \$ 9,800 regardless of whether the discount is taken
  - E. none of the above

SELF STUDY QUESTIONS

Section 4

Multiple Choice

Module 1

6. Henderson Company purchased a piece of machinery by paying \$5,000 cash. In addition to the purchase price, the company incurred \$100 freight charges and \$75 to have the machine balanced, greased, and tested. The machine has an estimated useful life of 5 years and will require maintenance costs of \$25 per year. Henderson Company would record the cost of the machine at
- A. \$5,000
  - B. \$5,100
  - C. \$5,175
  - D. \$5,300

Circle the letter of the best answer.

1. As generally used in accounting, what is depreciation?
  - A. it is a process of asset valuation for balance sheet purposes
  - B. it applies only to long-lived intangible assets
  - C. it is used to indicate a decline in market value of a long-lived asset
  - D. it is an accounting process which allocates long-lived asset cost to accounting periods
  
2. Why are certain costs of doing business capitalized when incurred and then depreciated or amortized over subsequent accounting cycles?
  - A. to reduce the federal income tax liability
  - B. to aid management in the decision-making process
  - C. to match the costs of production with revenues as earned
  - D. to adhere to the accounting concept of conservatism
  
3. Depreciation can best be described as a method of
  - A. accumulating funds for the replacement of assets
  - B. reducing the carrying cost of assets to current market values
  - C. deriving tax benefits
  - D. allocating the costs of assets over their useful lives
  
4. Accumulated depreciation, as used in accounting, represents
  - A. funds (or cash) set aside to replace the operational asset being depreciated
  - B. earnings retained in the business that will be used to purchase another operational asset when the present asset becomes fully depreciated
  - C. an expense on the income statement
  - D. the portion of the cost of an operational asset written off as expense since asset acquisition date
  - E. none of the above
  
5. Which of the following statements is not true?
  - A. at acquisition, tangible operational assets are recorded at cost on the basis of the cost principle
  - B. subsequent to acquisition, those tangible operational assets that have a limited life are reported at the cost recognized at acquisition less accumulated allocations of such costs
  - C. depreciation accounting is a process of valuation, not of allocation
  - D. periodic allocations of acquisition cost, made on a systematic and rational basis, are recognized as current expense in conformance with the matching principle
  - E. all are true

6. The book value of an asset is the
  - A. original cost of the asset
  - B. market value of the asset
  - C. total of all expenses associated with the asset
  - D. acquisition cost of the asset less any accumulated depreciation on the asset
  
7. When the cost of equipment is divided by its estimated useful life, the result is referred to as the asset's
  - A. book value
  - B. accumulated depreciation
  - C. carrying value
  - D. none of the above
  
8. The straight-line depreciation method usually provides a higher amount of depreciation expense than does the declining balance method
  - A. during all year's of an asset's life
  - B. during the first year of an asset's life
  - C. during the last year of an asset's life
  - D. answer cannot be determined based on the information provided
  
9. Which depreciation method usually allows for the higher amount of net income during the first year an asset is owned?
  - A. straight line method
  - B. double declining balance method
  - C. answers A and B
  - D. answer cannot be determined based on the information provided
  
10. If an industrial firm uses the units of production method for computing depreciation on its only plant asset, factory machinery, the credit to accumulated depreciation from period to period during the life of the firm will
  - A. be constant
  - B. vary with unit sales
  - C. vary with sales revenue
  - D. vary with production
  - E. none of the above
  
11. The net effect of using this depreciation method is an increasing charge in successively later periods
  - A. double declining balance
  - B. fixed percentage on declining base
  - C. straight line
  - D. none of the above

12. A graph is set up with “depreciation expense on the vertical axis and “time” on the horizontal axis. Assuming linear relationships, how would the graphs for straight line and declining balance depreciation, respectively, be drawn?
- vertically and sloping down to the right
  - vertically and sloping up to the right
  - horizontally and sloping down to the right
  - horizontally and sloping up to the right
  - none of the above
13. Which method of depreciation results in periodic depreciation expense that fluctuates from one period to the next, but not necessarily in a steadily upward or downward direction?
- straight line method
  - units of production method
  - declining balance method
  - none of the above
14. In which of the following methods is salvage value not considered in the calculation of the first-year’s depreciation on fixed assets?
- straight line
  - double declining balance
  - units of production
  - salvage value is considered in all of the methods listed above
15. In January 20x7 Action Corporation entered into a contract to acquire a new machine for its factory. The machine, which had a cash price of \$150,000, was paid for as follows:

Down payment .....	\$ 15,000
Notes payable in 10 equal monthly installments .....	120,000
500 shares of Action common stock with an agreed value of \$50 per share .....	<u>25,000</u>
	\$160,000

Prior to the machine’s use, installation costs of \$4,000 were incurred. The machine has an estimated useful life of 10 years and an estimated salvage value of \$5,000. What should Action record as depreciation expense for 20x7 under the straight line method?

- \$15,900
- \$15,500
- \$15,000
- \$14,900

16. AB Management Company wishes to depreciate a new building that cost \$400,000 using double declining balance depreciation. The estimated residual value of the building is \$50,000 and it has an expected useful life of 25 years. Assuming the first year's depreciation expense was recorded properly, what should be the amount of depreciation expense for the second year?
- A. \$32,000
  - B. \$29,440
  - C. \$28,160
  - D. \$28,000
  - E. \$25,100

Circle the letter of the best answer.

1. A lease in which the lessee simply uses the property for a specific period of time, paying rent to the lessor, who retains all the risks and obligations of ownership and who also retains title to the property is referred to as
  - A. a sale and leaseback
  - B. an operating lease
  - C. a capital lease
  - D. an executory lease
  
2. Generally accepted accounting principles require that certain lease agreements be accounted for as purchases. The theoretical basis for this treatment is that a lease of this type
  - A. effectively conveys all of the benefits and risks incident to the ownership of property
  - B. is an example of form over substance
  - C. provides the use of the leased asset to the lessee for a limited period of time
  - D. must be recorded in accordance with the concept of cause and effect
  
3. Lease Y contains a bargain purchase option and the lease term is equal to 75 percent of the estimated economic life of the leased property. Lease Z contains a bargain purchase option and the lease term is equal to less than 75 percent of the estimated economic life of the leased property. How should the lessee classify these leases?

Lease Y	Lease Z
A. operating lease	operating lease
B. operating lease	capital lease
C. capital lease	capital lease
D. capital lease	operating lease
  
4. What is the cost basis of an asset acquired by a lease which is in substance an installment purchase?
  - A. the net realizable value of the asset determined at the date of the lease agreement plus the sum of the future minimum lease payments under the lease
  - B. the sum of the future minimum lease payments under the lease
  - C. the present value of the amount of future minimum lease payments under the lease (exclusive of executory costs and any profit thereon) discounted at an appropriate rate
  - D. the present value of the market price of the asset discounted at an appropriate rate as an amount to be received at the end of the lease

5. When a lessee measures the present value of future rentals to be capitalized under a capital lease, identifiable payments expected to be paid by the lessee to cover taxes, insurance, and maintenance should be
- A. included in the present value of the future rentals to be capitalized
  - B. excluded from the present value of the future rentals to be capitalized
  - C. capitalized, but at a different discount rate and reported in a different account than the present value of the future rental payments
  - D. capitalized, but at a different discount rate and for a relevant period that usually is different than for the future rental payments
  - E. none of the above
6. For a capital lease, an amount equal to the present value at the beginning of the lease term of minimum lease payments during the lease term, excluding that portion of the payments representing executory costs such as insurance, maintenance, and property taxes to be paid by the lessor, together with any profit thereon, should be recorded by the lessee as a(n)
- A. Expense
  - B. liability but not an asset
  - C. asset but not a liability
  - D. asset and a liability
7. In a lease that is recorded as an operating lease by the lessee, the equal monthly rental payments should be
- A. allocated between interest expense and depreciation expense
  - B. allocated between a reduction in the liability for leased assets and interest expense
  - C. recorded as a reduction in the liability for leased assets
  - D. recorded as rental expense
8. When the lessee accounts for a capital lease
- A. the account leasehold (or leased property under capital lease) should be reported as an asset on lessee's balance sheet
  - B. a liability reflecting the lease obligation should be reported on the lessee's balance sheet
  - C. both A and B are true
  - D. neither A nor B is true

9. Equal monthly rental payments for a particular lease should be charged to rental expense by the lessee for which of the following?

	Capital lease	Operating lease
A.	yes	no
B.	yes	yes
C.	no	no
D.	no	yes

10. The appropriate valuation of an operating lease on the statement of financial position of a lessee is

- A. zero
- B. the absolute sum of the lease payments
- C. the present value of the sum of the lease payments discounted at an appropriate rate
- D. the market value of the asset at the date of the inception of the lease

11. On December 31, 19x2, T Co. entered into an agreement to lease a piece of machinery from Y Co. Lease payments are \$1,000 per month for 10 years (120 months).

The lease is in substance an installment purchase of the machinery by T Co., and so the machinery and related lease obligation must be shown on the balance sheet of T Co.

This means that on T Co.'s balance sheet as of December 31, 19x2, the leased machinery will be carried at

- A. some amount less than \$120,000
- B. exactly \$120,000
- C. some amount greater than \$120,000
- D. cannot be determined whether the amount should be more or less than \$120,000 from the information given

1. What are the characteristics of an asset classified as a plant asset?
2. What costs, in general, should be included in the cost of a plant asset?
3. In what general circumstances would it be appropriate to treat a cost as an asset instead of as an expense? Explain.
4. Property, plant, and equipment (plant assets) generally represent a material portion of the total assets of most companies. Accounting for the acquisition and usage of such assets is, therefore, an important part of the financial reporting process. Distinguish between revenue and capital expenditures and explain why this distinction is important.
5. Presented below is a statement that appeared about Weyerhaeuser Company in a financial magazine:

The land and timber holdings are now carried on the company's books at a mere \$422 million. The value of the timber alone is variously estimated at from \$3 billion to \$7 billion and is rising all the time. "The understatement of the company is pretty severe," conceded Charles W. Bingham, a senior vice-president. Adds Robert L. Schuyler, another senior vice-president: "We have a whole stream of profit nobody sees and there is no way to show it on our books."

What does Schuyler mean when he says that "we have a whole stream of profit nobody sees and there is no way to show it on our books?"<sup>1</sup> How should one describe liabilities?

## SELF STUDY QUESTIONS

Section 4

Essay

Module 2

1. As used in accounting, what is the meaning of the term depreciation?
2. What are the five factors that could cause a decline in the usefulness of a plant asset?

1. What are some of the major advantages of leasing to a lessee?
2. What are the four criteria established by the FASB to determine whether a lease is to be treated as an operating lease or a capital lease?
3. What are the executory costs associated with leases?
4. What is meant by a bargain purchase option in a lease agreement?
5. What is meant by a bargain renewal option in a lease agreement?
6. Capital leases and operating leases are the two classifications of leases described in FASB pronouncements, from the standpoint of the lessee.
  - a. Describe how a capital lease would be accounted for by the lessee both at the inception of the lease and during the first year of the lease, assuming the lease transfers ownership of the property to the lessee by the end of the lease.
  - b. Describe how an operating lease would be accounted for by the lessee both at the inception of the lease and during the first year of the lease, assuming equal monthly payments are made by the lessee at the beginning of each month of the lease.
7. Jerry Moluf, M.D. (lessee) has a noncancellable 20-year lease with E. T. Elsner Realty, Inc., (lessor) for the use of a medical building. Taxes, insurance, and maintenance are paid by the lessee in addition to the fixed annual payments, of which the present value is equal to the fair market value of the leased property. At the end of the lease period, title becomes the lessee's at a nominal price.

Considering the terms of the lease described above, comment on the nature of the lease transaction and the accounting treatment that should be accorded it by the lessee.
8. What are the basic financial statement disclosure requirements for a lessee pertaining to leases?