**What should a full set of financial statements include?**

- Statement of Financial Position (the balance sheet)
- Statement of Earnings (the income statement)
- Statement of Comprehensive Income
- Statement of Cash Flows
- Statement of Changes in Owners' Equity

**What is meant by a "classified" balance sheet?**

A classified balance sheet distinguishes *current* and *non-current* assets and liabilities.

**Name the expense that each of the following unexpired costs turn into as they expire:**

1. **Inventory**
2. **Unexpired (prepaid) cost of insurance**
3. **Net book value of fixed assets**
4. **Unexpired cost of patents**

1. Cost of goods sold
2. Insurance expense
3. Depreciation expense
4. Amortization expense

**Are gains and losses on the disposal of assets shown on a "gross basis" (i.e., where both the sale proceeds and the net book value of the disposed asset are reported) or on the "net basis" (i.e., where only the difference between the sale price and the net book value of the disposed asset is reported)?**

Gains and losses are reported at their *net* amounts (i.e., proceeds less net book value).

**How does a "multiple-step" income statement differ from a "single-step" income statement?**

- A multiple-step income statement reports operating revenues and expenses separately from nonoperating revenues and expenses and other gains and losses.
- On a single-step income statement's presentation of income from continuing operations, total expenses are subtracted from total revenues without separation between operating and nonoperating revenues and expenses.

**The gain (loss) from discontinued operations can consist of...**

An impairment loss, a gain (loss) from actual operations, and a gain (loss) on disposal.

**How do we account for subsequent increases in the fair value of a discontinued component?**

A gain is recognized for the subsequent increase in fair value minus costs to sell (but not in excess of the previously recognized cumulative loss). The gain is reported in the period of increase.

**What conditions must be present for a disposal to be reported in discontinued operations?**

A disposal of a component, group of components, business activity, or nonprofit activity is reported in discontinued operations if the disposal represents a *strategic shift* that has or will have a *major effect* on an entity's *operations* and *financial results*.

**State two types of *foreign currency transactions.***

- Operating transactions, such as importing, exporting, borrowing, lending, and investing transactions.
- Forward exchange contracts, which are agreements to exchange two different currencies at a specific future date and at a specific rate.

**Where are *foreign currency transaction* gains or losses reported in the financial statements?**

Foreign currency transaction gains or losses are included in determining net income for the period.

**For operating transactions in foreign currency, detail the recording process.**

- Record original transaction at exchange or spot rate on date of transaction.
- At balance sheet date, compute gain/loss on the transaction by recalculating using the current exchange or spot rate.
- On payment date, compute gain/loss on the transaction by using the exchange rate on payment date.

**Define *comprehensive income.***

Change in equity (net assets) that results from transactions and other events and circumstances from nonowner sources.

**List some disclosure requirements for *comprehensive income.***

- Tax effects of each component included in current "other comprehensive income"
- Changes in the accumulated balances of components of "other comprehensive income"
- Total accumulated other comprehensive income
- Reclassification adjustments between other comprehensive income and net income

**List the two formats acceptable for reporting *comprehensive income.***

- Statement of comprehensive income (single-statement approach)
- Statement of income followed by separate statement of comprehensive income (two-statement approach)

**Identify four items included in *other comprehensive income.***

**PUFI**

**P**ension adjustments
**U**nrealized gains and losses on available-for-sale debt securities and hedges
**F**oreign currency translation adjustments and gains/losses on certain foreign currency transactions
**I**nstrument-specific credit risk for liabilities (using FV) and their changes in FV

**What is the basic formula used for calculating EPS?**

$$\frac{\text{Income available to common shareholders}}{\text{Weighted average number of common shares outstanding}}$$

**Name the potentially dilutive securities or instruments.**

- Stock options and warrants and their equivalents
- Convertible securities (bonds or preferred stock)
- Contracts that may be settled in stock or cash
- Contingent issuable shares

**Compare *basic* and *diluted* EPS.**

**Basic**: Simple capital structure (only common stock outstanding):

$$\frac{\text{Income available to common shareholders}}{\text{Weighted average common shares outstanding}}$$

**Diluted**: Complex capital structure:

$$\frac{\text{Income available to common shareholders assuming conversion of all dilutive securities}}{\text{Weighted average common shares outstanding after conversion of all dilutive shares}}$$

**What is the *antidilution* rule?**

Any conversion, exercise, or contingent issuance that has an antidilutive effect (increases EPS or decreases loss per share) is **not** included in the calculation unless the shares have actually been converted, exercised, or satisfaction of the contingency met.

Each potential common share is considered separately in sequence from most to least dilutive, with in-the-money options and warrants generally included first.

**List the reporting requirements for EPS.**

Face of income statement, with equal prominence for basic and diluted per-share amounts, for both income from continuing operations and net income.

Per-share amounts for discontinued operations can be reported on the face of the income statement or in the notes to the financial statements.

**Describe Form 10-K and Form 10-Q. What level of assurance must be provided with the financial statements submitted in these forms?**

*Form 10-K:* Filed annually by U.S. registered companies. Includes a summary of financial data, MD&A, and *audited* financial statements prepared using U.S. GAAP.

*Form 10-Q:* Filed quarterly by U.S. registered companies. Includes unaudited financial statements, interim MD&A, and certain disclosures.

**Define *common stock* and list the basic properties.**

*Common stock*: Residual ownership interest

Basic rights include:

- Voting rights
- Dividend rights
- Rights to share in distribution of assets if corporation is liquidated, after satisfaction of creditor and preferred stockholders' claims

**List some common properties of *preferred stock.***

- Convertible, callable
- Redeemable
- Dividends can be cumulative and/or participating

**What are the two alternative methods of accounting for treasury stock?**

*Cost method*: Treasury stock is debited at cost of shares repurchased.

*Legal (par value method/stated value method):* Treasury stock is debited at par value of shares repurchased.

Remember, no gains/losses are recognized on the income statement; income and retained earnings may never increase by the transaction; *Additional Paid-in Capital–Treasury Stock* account used to record "gains" and absorb "losses."

Treasury stock is not an asset; cash and property dividends are not paid on treasury stock; stock dividends may be paid on

**Summarize the *cost* method of accounting for treasury stock.**

- Recorded, carried, and reissued at reacquisition cost
- Any "gain" is credited to *Paid-in Capital–Treasury Stock*
- Any "loss" is charged against previous "gains," then retained earnings
- Reported as a deduction from total stockholders' equity

**Summarize the *par value* method of accounting for treasury stock.**

- Recorded at par value with cost of stock that is in excess of par value recorded as a deduction to *Paid-in Capital–Treasury Stock* and then from retained earnings after *Paid-in Capital–Treasury Stock* is depleted.
- Reported as a deduction from capital stock.

**List the significant dates with respect to cash dividends.**

- *Date of Declaration*: Becomes a liability and reduces retained earnings
- *Date of Record*: No journal entry, memorandum entry only
- *Date of Payment*: Actually paid

**List five types of *dividends.***

*Cash*

*Liquidating:* Return of investment

*Property:* *FMV of assets given up, with gain/loss recognized*

*Scrip:* Promise to pay a dividend in future

*Stock:* Results in capitalizing part of *retained earnings*, increasing legal capital. Remember, if <20%–25%, record at market value; if >20%–25%, record at par value.

**What is the threshold for treating stock dividends as *large* vs. *small* stock dividends?**

Small stock dividend: <20%–25%
Large stock dividend: >20%–25%

The treatment of stock dividends depends on the percentage of the dividend in proportion to the total shares outstanding prior to the declaration of the dividend.

**What is the accounting treatment of *small* stock dividends?**

Fair value of additional shares issued at the date of declaration is transferred from retained earnings to capital stock and additional paid-in capital.

**What is the accounting treatment of *large* stock dividends?**

Par value of additional shares issued is transferred from retained earnings to capital stock.

**List the steps associated with the five-step approach to revenue recognition.**

- **Step 1**: Identify the contract with the customer.
- **Step 2**: Identify the separate performance obligations in the contract.
- **Step 3**: Determine the transaction price.
- **Step 4**: Allocate the transaction price to the separate performance obligations.
- **Step 5**: Recognize revenue when or as the entity satisfies each performance obligation.

**What criteria must be met in order for a performance obligation to be considered distinct?**

- The promise to transfer the good/service is separately identifiable from other goods or services in the contract.
- The customer can benefit from the good/service independently or when combined with the customer's own available resources.

**What criteria must be met in order to recognize revenue on a contract?**

- All the parties have approved the contract and are committed to performing their obligations.
- The rights of each party are identified.
- Payment terms can be identified.
- Future cash flows are expected to change as a result of the contract (commercial substance).
- It is probable that the entity will collect substantially all of the consideration.

**Define the transaction price when recognizing revenue.**

The transaction price is the amount of consideration an entity expects to receive in exchange for transferring goods/services to a customer.

**What factors should be accounted for when determining the transaction price?**

The price should take into account (if applicable):

- Variable consideration
- Significant financing
- Noncash considerations
- Consideration payable to the customer

**Describe how allocation works when a contract contains more than one performance obligation.**

For contracts with more than one performance obligation, the overall contract transaction price should be allocated among each obligation based on the stand-alone selling price expected for satisfying each unique obligation (along with applying any discounts and/or variable consideration).

**Describe how revenue recognition differs when performance is satisfied over time versus at a point in time.**

Revenue is recognized based on measuring progress toward completion using either output or input methods when the performance obligation is satisfied over time.
In order to recognize revenue when performance is satisfied at a point in time, the customer must obtain control of the asset.

**Identify two methods of revenue recognition for long-term construction-type contracts under U.S. GAAP.**

Long-term construction contracts may be recognized:

- Over time; or
- At a point in time.

**For long-term construction-type contracts, when are losses recognized?**

Immediately when discovered, regardless of the method used for revenue recognition.

**State the formula for recognizing the gain/loss on long-term construction-type contracts over time.**

$$\frac{\text{Total cost to date}}{\text{Total estimated cost of contract}} \times \text{Total estimated gross profit} - \text{Gross profit recognized to date}$$

**Distinguish between the treatment of costs incurred in obtaining a contract as assets or as expenses.**

If an entity expects to recover these costs through the performance of the contract, the entity will treat them as assets. If the costs are incurred regardless of whether the contract is obtained, they are treated as expenses.

**How do control and revenue recognition differ when an entity acts as a principal versus when it acts as an agent?**

A principal has control over the good/service prior to transfer, and revenue equal to expected gross consideration will be recognized. An agent does not have control, and revenue equal to the agent's fee/commission will be recognized.

**Describe the accounting treatment for forwards and call options related to repurchase agreements.**

**Forward or Call Option**

- Repurchase price < Original price (lease)
- Repurchase price ≥ Original selling price (financing arrangement)

**Describe the accounting treatment for put options related to repurchase agreements.**

**Put Option**

- Repurchase price < Original selling price
  - Customer has a significant economic incentive to exercise the right (lease)
  - Customer does not have significant economic incentive (sale with a right of return)
- Repurchase price ≥ Original selling price
  - Repurchase price > Expected market value of the asset (financing arrangement)
  - Repurchase price ≤ Expected market value of the asset and customer does not have a significant economic incentive to exercise the right (sale with a right of return)

**What criteria must be met in order for a customer to obtain control in a bill-and-hold arrangement?**

- There must be a substantive reason for the arrangement.
- The product is separately identified as belonging to the customer.
- The product is ready (in its current condition) for transfer to the customer.
- The entity (seller) cannot use the product or direct it to another customer.

**Define a consignment arrangement.**

A consignment arrangement exists when a dealer/distributor is tasked by an entity with selling the entity's products to customers.

**Identify indicators of a consignment arrangement.**

Indicators of a consignment arrangement include:

- The entity controls the product until a specified event occurs (such as a sale to a customer).
- The dealer/distributor does not have an unconditional obligation to pay the entity for the product.
- The entity has the authorization to require the return of the product or transfer the product to another party.

**When is a warranty considered a separate performance obligation within a contract?**

If a customer has the option to purchase a warranty separately or if the warranty provides a service that is beyond the assurance that the product will comply with agreed-upon specifications, the warranty will be treated as a separate performance obligation.
A portion of the overall transaction price should then be allocated to the warranty obligation.

**Describe refund liabilities and when it is appropriate to book them.**

A refund liability represents the amount of money an entity does not expect to be entitled to receive. Refund liabilities should be recognized in situations in which customers have a right to return and the entity anticipates having to return a portion of the consideration already received from customers.

**How is a *change in an accounting estimate* reported?**

Prospectively

**How is a *change in accounting principle* reported?**

- Cumulative effect of change is included in the retained earnings statement as an adjustment of the beginning retained earnings balance of the earliest year presented.
- Prior period financial statements are restated, if presented.

**What are the special exceptions to the general rule for the reporting of changes in an accounting principle?**

**How are these exceptions reported?**

Changes where it is impracticable to estimate the cumulative effect adjustment, e.g., a change to LIFO from another method of inventory pricing under U.S. GAAP or a change in depreciation methods.

Such exceptions are accounted for prospectively, like a change in accounting estimate.

**Name the three types of *accounting changes.***

- Change in an accounting principle
- Change in accounting estimate
- Change in accounting entity

**Under U.S. GAAP, how is a *change in the accounting entity* reported?**

All current and prior period financial statements presented are restated.

**How are *error corrections* reported?**

Reported as prior period adjustments to retained earnings and all comparative financial statements presented are restated.

**What four situations require adjusting journal entries in order to properly present financial statements on the accrual basis?**

1. Cash is received before the performance obligation is met (deferred revenues).
2. Cash is paid before the expense is incurred (prepaid expenses).
3. Cash is received after the performance obligation has been met (receivables).
4. Cash is paid after the expense has been incurred (accrued expenses).

**What is the journal entry to record the earning of deferred revenue?**

| | | | |
|---|---|---|---|
| DR | Deferred revenue | $XXX | |
| CR | Revenue | | $XXX |

**What are the three rules for recording adjusting journal entries?**

1. Adjusting journal entries must be recorded by the end of the entity's fiscal year, before the preparation of financial statements.
2. Adjusting journal entries *never* involve the cash account.
3. All adjusting entries will hit one income statement account and one balance sheet account.

**Identify the contents of the *Summary of Significant Accounting Policies* note to the financial statements.**

*Summary of Significant Accounting Policies*

Identify and describe:

- Measurement bases used in preparing the financial statements
- Specific accounting principles and methods used

**What are the U.S. GAAP disclosure requirements for risks and uncertainties?**

- Nature of operations.
- Use of estimates in preparing the financial statements.
- Significant estimates.
- Current vulnerability due to certain concentrations.

**What is a subsequent event and what are the two categories of subsequent events?**

An event or transaction that occurs after the balance sheet date but before the financial statements are issued or are available to be issued.

1. *Recognized subsequent events*–Provide additional information about conditions that existed at the balance sheet date.
2. *Nonrecognized subsequent events*–Provide information about conditions that occurred after the balance sheet date and did not exist on the balance sheet date.

**Define *fair value.***

Fair value is the price to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date.

**Describe the valuation techniques that can be used to measure the fair value of an asset or liability.**

1. *Market approach*–Uses prices and other relevant information from market transactions involving identical or comparable assets or liabilities to measure fair value.
2. *Income approach*–Converts future amounts, including cash flows or earnings, to a single discounted amount to measure the fair value of assets or liabilities.
3. *Cost approach*–Uses current replacement cost to measure the fair value of assets.

**Describe the hierarchy of fair value inputs. Which inputs have the highest priority?**

1. *Level 1 inputs*–Quoted prices in active markets for identical assets or liabilities.
2. *Level 2 inputs*–Inputs other than quoted market prices that are directly or indirectly observable for an asset or liability.
3. *Level 3 inputs*–Unobservable inputs for the asset or liability that reflect the entities' assumptions and are based on the best available information.

*Note*: Level 1 inputs have the highest priority.

**What are the general guidelines for OCBOA financial statement presentation?**

- Different titles from accrual basis financial statements.
- Required financial statements are the equivalent of the accrual basis balance sheet and income statement.
- Financial statements should explain changes in equity accounts.
- A statement of cash flows is not required.
- Disclosures should be similar to GAAP financial statement disclosures.

**Name two methods of accounting for the write-off of uncollectible accounts.**

*Direct Write-off*

Dr Bad debt expense
Cr Accounts receivable

*Weaknesses*: Bad debts are not matched to sales, and accounts receivable are overstated. Not GAAP.

*Allowance Method*

Dr Allowance for uncollectible accounts
Cr Accounts receivable

*Strengths*: Matches bad debts with credit sales. Accounts receivable fairly stated. Required by GAAP.

**Name two methods for estimating uncollectible accounts.**

- Percentage of accounts receivable at year-end
- Aging of accounts receivable at year-end

**Using the allowance method, give the two journal entries to provide for and then to write off an uncollectible account.**

*Provide For*

Dr Bad debt expense
Cr Allowance for uncollectible accounts

*Write-off*

Dr Allowance for uncollectible accounts
Cr Accounts receivable

**What is the difference between factoring *with* recourse and *without* recourse?**

*With Recourse*
The factor may return the account to the company if it proves to be uncollectible. Potential liability and risk of loss remains with the company.

*Without Recourse*
The factor assumes the risk of loss if the account is uncollectible.

**At what value should non-interest-bearing promissory notes be recorded?**

At the present value of all future payments required by the note. The payments should be discounted at the market interest rate.

**Notes receivable may be discounted "with" or "without" recourse. What is the difference?**

*Discounting With Recourse*
The holder remains contingently liable.

*Discounting Without Recourse*
The holder assumes no further liability after discounting.

**Describe the computational steps required in "discounting a note."**

1. Compute maturity value (remember to include interest to maturity).
2. Compute the "discount" (remember to use maturity value).
3. Get proceeds by subtracting discount from maturity value.
4. Compute interest income as the difference between proceeds and face of note.

**When does the title to goods pass for each of the following?**
**FOB destination**
**FOB shipping point**
**Consigned goods**

- *FOB destination*–When received by buyer.
- *FOB shipping point*–When given to a common carrier.
- *Consigned goods*–When sold to a third party by consignee.

**Describe an inventory consignment arrangement. Also, how are the consigned goods carried on the parties' balance sheets?**

Consignor gives goods to consignee for sale to third parties. Title to the goods remains with the consignor; therefore the consigned items stay on the balance sheet of the consignor.

**How is net realizable value calculated in the lower of cost and net realizable value method?**

Net realizable value is the net selling price less completion and disposal costs.

**Under U.S. GAAP, how is market calculated in the lower of cost or market method?**

In the lower of cost or market method, "market" generally means current replacement cost, provided the current replacement cost does not exceed the market ceiling or fall below the market floor.

- *Ceiling*–Net realizable value (estimated net selling price less completion and disposal costs).
- *Floor*–Net realizable value minus normal profit margin.

**Explain the difference between *periodic* and *perpetual* inventory methods.**

*Periodic*

- The quantity of inventory is determined only by physical count.
- Ending inventory is physically counted and priced.

*Perpetual*

- Inventory is updated for each purchase and for each sale.
- Keeps a running total of inventory balances.

**Name several cost flow methods for inventory.**

- Specific identification
- FIFO
- LIFO (unit and dollar value)
- Averaging
  - Weighted average (associated with periodic)
  - Moving average (associated with perpetual)

**During periods of rising prices, the use of LIFO versus FIFO has what effect on the valuation of ending inventory and reported net income?**

Both ending inventory and net income will be lower when LIFO is used during a period of rising prices.

**L**IFO = **L**owest

**When are losses on firm purchase commitments recognized?**

Losses are recognized in the period in which the price declines.

| | |
|---|---|
| Dr | Estimated loss on purchase commitment |
| Cr | Estimated liability on purchase commitment |

**How is fixed-asset carrying value computed under U.S. GAAP?**

Carrying value = Historical cost – Accumulated depreciation – Impairment

**Give examples of costs to be capitalized as *land.***

- Acquisition price
- Closing costs, such as real estate broker commissions, legal fees, escrow fees, title guarantee insurance
- Any mortgages, liens, or encumbrances on the land which the buyer assumes
- Preparation costs, such as surveying costs, leveling costs, tree removal
- Cost of razing an existing building, in getting land into condition for intended use
- Less: Proceeds from sale of assets on land

*Note:* Excavating costs for a building and cost of improvements with a definite life are not included in land.

**Give some examples of capitalizable costs for:**
**—Acquisition of equipment**
**—Acquisition of building**

*Acquisition of Equipment*
Purchase price, freight-in, installation, testing, taxes, less any cash discounts allowed.*

*Acquisition of Building*
Purchase price, deferred maintenance, alterations, improvements, architect's fees.*

*If equipment or building is constructed by company, capitalized cost could include construction period interest.

**Describe the proper accounting for *ordinary* versus *extraordinary* repairs.**

*Ordinary* repairs are expensed as repair and maintenance. They do not increase the life or utility of the asset.

*Extraordinary* repairs either increase the life or utility of the asset. If the extraordinary repair increases the life of the asset, it is recorded by reducing accumulated depreciation. If the extraordinary repair increases the utility of the asset, it is capitalized to the fixed asset account.

**State two rules concerning capitalizing interest.**

- Only capitalize interest on money actually spent, not on amount borrowed.
- The amount of capitalized interest is the lower of:
    - actual interest cost incurred; or
    - computed capitalized interest (avoidable interest).

**For capitalizing interest, when does the capitalization period begin?**

It begins when three conditions are met:
- Expenditures for the asset have been made.
- Activities that are necessary to get the asset ready for its intended use are in progress.
- Interest cost is being incurred.

Ends when the asset is substantially complete and ready for its intended use.

**Name the most common *depreciation* methods. Give the basic formula for calculating each method.**

*Straight-Line*
(Cost – Salvage) / Useful life

*Sum-of-the-Years' Digits*
Sum of years = n(n+1) / 2
(Cost – Salvage) × (Years remaining) / (Sum of years)

*Double-Declining Balance*
2 × Straight-line rate × Net book value of asset*
*No deduction for salvage to determine the depreciable base. Depreciate down to salvage value.

*Units of Production*
(Cost – Salvage) / Estimated hours × Actual hours for period

**State the rules for computing depletion on natural resources.**

**Remember it is REAL property.**

**R**esidual value (subtract)
**E**xtraction/development cost
**A**nticipated restoration cost
**L**and purchase price

$$\frac{\text{Cost of land} + \text{Extraction dev. costs} + \text{Anticipated restoration costs} - \text{Residual Value}}{\text{Estimated recoverable units}} \times \text{Units extracted} = \text{Depletion}$$

**What is the calculation for impairment losses for property, plant, and equipment under U.S. GAAP?**

The amount by which the carrying amount exceeds the fair value of the asset.

**Is restoration of impairment losses permitted under U.S. GAAP?**

Restoration (reversal of impairment losses) is permitted for assets held for sale. Restoration is prohibited for assets held for use.

**How are purchased intangible assets and internally developed intangible assets recorded under U.S. GAAP?**

*Purchased intangible assets:*
Recorded at cost, including legal and registration fees.

*Internally developed intangible assets:*

- Legal fees, costs of successful defense, registration fees, consulting fees, and design fees can be capitalized.
- Most research and development costs must be expensed.

**What is the maximum period over which an identifiable intangible asset (not goodwill) should be amortized?**

The shorter of its estimated useful economic life and its remaining legal life (as in a copyright, franchise, or patent).

**How are intangible assets reported under U.S. GAAP?**

Reported at cost less amortization (finite life intangibles only) and impairment.

**What is the two-step impairment test for the impairment of intangible assets with finite lives under U.S. GAAP?**

**Step 1:** The carrying amount of the asset is compared with the sum of the undiscounted cash flows expected to result from the use of the asset and it eventual disposition.
**Step 2:** If the carrying amount exceeds the total undiscounted future cash flows, then the asset is impaired and an impairment loss equal to the difference between the carrying amount of the asset and its fair value is recorded.

**What intangible assets with finite lives are subject to the impairment test?**

- Intangibles and fixed assets to be held and used.
- Intangibles and fixed assets slated for disposal.

*Note:* Intangible assets with finite useful lives are tested for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

**For intangible assets, how is the impairment loss reported in the financial statements?**

As a component of income from continuing operations before income taxes.

The carrying amount of the asset is reduced.

**How should the contractual amounts of future services to be performed under a franchise agreement be accounted for by the franchisee?**

They should be recorded at their present value as an intangible asset.

**Define *start-up costs.* What is the accounting treatment of start-up costs?**

- Costs incurred for one-time activities to start a new operation. Start-up costs include costs incurred in the formation of a corporation.
- Start-up costs are expensed in the period incurred.

**Explain the difference between the net method and gross method of recording accounts payable.**

*Gross Method*

The gross method records a purchase without regard to the discount. When invoices are paid within the discount period, a purchase discount is credited.

*Net Method*

Under the net method, purchases and accounts payable are recorded net of the discount. If payment is made within the discount period, no adjustment is necessary. If payment is made after the discount period, a purchase discount lost account is debited.

**What types of costs are associated with exit and disposal activities?**

- Involuntary employee termination benefits
- Costs to terminate a contract that is not a capital lease
- Costs to consolidate facilities
- Costs to relocate employees

**Define an asset retirement obligation (ARO).**

A legal obligation associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, development, and/or normal operation of a long-lived asset.

**How is an ARO initially measured?**

At fair value (present value of the future obligation) as an asset (asset retirement cost) and a liability (asset retirement obligation).

**How is an ARO accounted for in periods after initial measurement?**

The ARO liability is adjusted for accretion expense and the ARO asset is depreciated.

**What is the accounting treatment of *gain contingencies*?**

Gain contingencies are not reflected on the balance sheet but are disclosed as to their nature and amount if likelihood is probable and to do so would not be misleading.

**Identify the three ranges of likelihood that a future event will confirm a contingent liability.**

- Probable
- Reasonably possible
- Remote

**When are *contingent liabilities* accrued?**

- When the loss is both probable and can be reasonably estimated, then record and disclose.
- Financial statement disclosure only for reasonably possible contingent losses.
- Remote contingent losses are not disclosed, unless they are "guarantee-type" contingent losses, which must be disclosed.

**Premiums, warranties, and service contracts are examples of estimated liabilities. When are the liabilities for these types of expenses recorded and why?**

Estimated liabilities for premiums, warranties, and service contracts are recorded in the same period as the revenue associated with the various transactions in order to accomplish matching of costs and revenues.

**What is the equation to calculate the *present value of $1*?**

$$PV = FV / (1 + r)^n$$

Where:

$PV$ = present value
$FV$ = future value
$r$ = interest rate
$n$ = number of years

**What is the difference between an *ordinary annuity* and an *annuity due*?**

*Timing of Payments*

- *Ordinary annuity*–Payments are at end of each period
- *Annuity due*–Payments are at beginning of each period

**How are notes payable recorded in the financial statements?**

Notes payables must be recorded at present value at the date of issuance.

If a note is non-interest bearing or the interest rate is unreasonable (usually below market), the value of the note must be determined by imputing the market rate of the note and by using the effective interest method.

**What is the effective interest rate method?**

The effective interest method is a method under which each payment on a note (or other loan) would be divided between an interest component and a principal component as though the note had a constant effective stated rate (or adequate rate) of interest.

**How are premiums or discounts resulting from recording notes payable and receivable at present value presented in the financial statements?**

The premium or discount that arises from the use of present values on cash and noncash transactions is inseparable from the related asset or liability. Therefore, such premium or discount valuation accounts are added to (or deducted from) their related asset or liability on the balance sheet.

**Why do creditors use *debt covenants* in lending agreements, and how could this impact the issuer?**

*Debt covenants* are stipulated in lending agreements to protect the creditors' interests by limiting or prohibiting certain actions of the debtors that may be harmful to the creditors' interests (i.e., issuing more debt).

*Debt covenants* are disadvantageous to the issuer (the debtor), as they may restrict certain management activities (i.e., selling assets).

**When is a bond issued at a discount? A premium?**

A bond is issued at a discount when the coupon/stated interest rate is less than the market/effective rate of interest.

A bond is issued at a premium when the bond interest rate is greater than the market rate of interest.

**How is the bond selling price computed?**

The price is the sum of the present value of the future principal payment plus the present value of the periodic interest payments discounted using the market/effective rate on the date the bonds are issued.

**What is the preferred method of accounting for bond issuance costs under U.S. GAAP?**

Deducted from the carrying amount of the liability and amortized using the effective interest method.

**Name two methods of amortizing bond premium (discount).**

*Straight-Line Method*
Premium (Discount) / Number of periods outstanding

*Interest (Effective Rate) Method (U.S. GAAP)*
Premium (Discount) amortized = (Carrying value × Effective rate) − (Face value × Stated rate)
Interest expense = (Face value × Stated rate) + Discount amortized − Premium amortized = Carrying value × Effective rate

*Note:* The straight-line method is permitted under U.S. GAAP if not materially different from the effective interest method.

**What are the major disclosures for *long-term debt*?**

1. Maturity dates
2. Interest rates
3. Call and conversion privileges
4. Assets pledged as security
5. Borrower-imposed restrictions

**Name four types of *restructurings* involving debt.**

1. Transfer of assets
2. Transfer of equity interest
3. Modification of terms
4. A combination of the above three

**How is the gain (loss) measured in a *troubled debt restructuring* involving a transfer of assets?**

Restate the assets transferred to fair value and recognize a gain or loss in ordinary income.

Recognize a gain for the difference between the fair value of the assets transferred and the carrying amount of the debt forgiven.

**How is the gain (loss) measured in a *troubled debt restructuring* involving the modification of terms?**

It is the difference between the carrying amount of the obligation prior to restructuring and undiscounted total future cash flows required after restructuring, if undiscounted future cash flows are less than the carrying amount.

**When is a loan considered *impaired*?**

When it is probable that all amounts due under the original contract will not be received when due.

**How is the loss incurred as a result of a modification of terms of an *impaired loan* reported by the creditor?**

The amount of the loss is the present value of the loan's expected future cash flows discounted at the loan's effective interest rate minus the carrying value of the loan before the modification of terms.

DR Bad debt expense

CR Allowance for credit losses

**When is a liability considered *extinguished?***

If either one of the following conditions is met:

- If the debtor pays the creditor and is relieved of its obligations for the liability.
- If the debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.

**Define *in-substance defeasance.***

An arrangement in which a company places purchased securities into an irrevocable trust and pledges them for the future principal and interest payments on its long-term debt.

The company remains the primary obligor; therefore, the liability is not considered extinguished.

**How is the gain or loss on *early extinguishment of debt* treated?**

Gain or loss on the income statement, shown as a separate line item, if material, in *income from continuing operations*.
The gain or loss is the difference between net carrying value (including unamortized bond issuance costs and premium or discount) and the reacquisition price of the debt.

**Identify and define a lease and the parties to a lease.**

*Lease*
A contract that identifies an asset, accounts for the lessor's right of substitution of that asset, and conveys to the lessee the right to control the use and obtain economic benefits from the asset over the lease term.

*Parties to a Lease*
A lessor conveys the right to use the asset (real or personal property) to the lessee, who agrees to pay consideration for this right over the lease term.

**Describe the two options that the lessee has for accounting for a contract that has lease and nonlease components.**

*Option 1*
Lease components are treated as separate units of account from nonlease components within the same contract.

*Option 2*
A lease component of a contract may be combined with a related nonlease component within the same contract to be treated as a single unit of account.

| | |
|---|---|
| **Name the different types of lease classifications applicable to lessees.** | Lessees will treat a lease as either an operating or finance lease. |
| **Name the criteria for determining whether a lease is a finance lease for the lessee.** | If any of one of the five **OWNES** criteria are met, the lease will be classified as a finance lease by the lessee.<br>• **Ownership** of the underlying asset transfer from the lessor to the lessee by the end of the lease term.<br>• The lessee has the **written option** to purchase the underlying asset; the option is one that the lessee is "reasonably certain" to exercise.<br>• The **net present value** of the lease payments and any guaranteed residual value equals or exceeds substantially the underlying asset's fair value.<br>• The term of the lease represents the major part of the **economic life** remaining for the underlying asset.<br>• The asset is **specialized** such that it will not have an expected, alternative use to the lessor when the lease term ends. |
| **Describe the classification of a lease for a lessee if none of the OWNES criteria are met.** | If none of the five **OWNES** criteria are met, or if the lease is short-term, the lessee will treat the lease as an operating lease. |
| **How long is the period covered by a lease and how are options to extend or terminate a lease handled?** | A lease begins on the commencement date (when the asset is available for use) and extends until the end of the noncancelable period.<br><br>The lease term will account for an:<br>• Option to extend if the lessee is reasonably certain to exercise the option.<br>• Option to terminate if the lessee is reasonably certain not to exercise.<br>• Option to either extend (or not to terminate) if the decision is controlled by the lessor. |
| **What components will be *included* and *excluded* from lease payments?** | Lessee lease payments will include:<br>• **R**equired contractual fixed payments<br>• **E**xercise option (if reasonably assured)<br>• **P**urchase price at the end of lease<br>• **O**nly indexed or rate variable payments<br>• **R**esidual guarantees likely to be owed<br>• **T**ermination penalties (if reasonably assured)<br>Lessee lease may or may not include (at lessee's option):<br>• **N**onlease components<br>Lessee lease payments specifically exclude:<br>• **G**uarantees of lessor debt by lessee<br>• **O**ther variable lease payments |
| **What rates should the lessee use to calculate the present value of the minimum lease payments?** | The lessee should use the rate implicit in the lease. If the rate is not known, the lessee should use its incremental borrowing rate. |

**Which initial direct costs are *included/excluded* in the valuation of the right-of-use (ROU) asset?**

*Include* any initial direct costs that are incurred as a result of the execution of the leases.

*Exclude* any costs incurred prior to signing the lease (document preparation, credit checks, etc.).

**How does a lessee account for an *operating lease*?**

With an *operating lease*, the lessee will record a right-of-use (ROU) asset and a lease liability on the balance sheet. The ROU asset will be amortized as the lease liability is paid down over the life of the lease. On the income statement, lease expense will be recognized each lease over the lease term.

**List the initial and subsequent journal entries recorded by a lessee when the lease qualifies as an operating lease.**

<u>Initial Entry:</u>

DR ROU asset

CR Lease liability

<u>Subsequent Entries:</u>

DR Lease expense

CR Cash/lease liability

DR Lease liability

CR Accumulated amortization–ROU asset

**How does a lessee account for a *finance* lease?**

With a *finance lease*, the lessee will record both an ROU asset and a lease liability on its balance sheet. Each lease payment will consist of interest and principal pay down. Interest expense will be shown on the income statement and the reduction of the liability will be reflected on the balance sheet.

**List the initial and subsequent journal entries recorded by a lessee when the lease qualifies as a finance lease.**

<u>Initial Entry:</u>

DR ROU asset

CR Lease liability

<u>Subsequent Entries:</u>

DR Interest expense

DR Lease liability

CR Cash/lease payable

DR Amortization expense

CR Accumulated amortization–ROU asset

| | |
|---|---|
| **Over what period will the lessee depreciate the leased asset under a finance lease?** | Asset's use life: (O or W) if ownership transfers to the lessee or if the lessee is reasonably certain to exercise an option to purchase the asset.<br><br>Shorter of lease term or asset's useful life: (N, E, or S) if any of the other criteria are met. |
| **Describe the accounting policy election that lessees can make regarding the balance sheet treatment of leases.** | For leases with terms of 12 months or less, a lessee can make an accounting policy election and choose to not recognize ROU assets or lease liabilities. The election must be made by class of underlying asset, and leases falling into this category cannot include purchase options for the asset that the lessee would be reasonably certain to exercise. |
| **For finance and operating leases, which cash flows are treated as operating cash flows?** | For finance leases, the interest payments and any variable and short-term lease payments not included in the lease liability are treated as cash flows from operations (principal payments are cash flows from financing).<br><br>For operating leases, lease payments, variable lease payments, and short-term lease payments are all treated as cash flows from operations. |
| **Describe the financial instrument fair value option under U.S. GAAP.** | On specified election dates, an entity may choose to measure eligible financial instruments at fair value with unrealized gains and losses reported in earnings. The fair value option is irrevocable. |
| **On the balance sheet, debt securities classified as *trading* or *available-for-sale* are valued how?** | At fair value. |
| **On the balance sheet, debt securities classified as *held-to-maturity* are valued how (assuming no expected credit loss)?** | At amortized cost. |
| **List three conditions when losses on debt securities classified as *available-for-sale* are recognized in income.** | • Sale of the security.<br>• Transfer of the security to trading classification.<br>• When there is an expected credit loss on the available-for-sale security. The credit loss reported in net income cannot exceed the amount by which fair value is below amortized cost. |
| **When does credit loss have to be booked for debt investments?** | A credit loss must be reported on an available-for-sale or held-to-maturity debt security when it is probable that the amounts due (principal and interest) will not be collected. |

**How is a credit loss recognized for an available-for-sale or held-to-maturity debt security?**

When there is an expected credit loss, the investment should be reported at the present value of the principal and interest that is expected to be collected. The credit loss is the difference between amortized cost and the present value.
For an available-for-sale security, the credit loss cannot exceed the amount by which fair value is below amortized cost, because the investor has the option to sell an available-for-sale investment if the loss on the sale will be less than the expected credit loss.

**How is the realized gain or loss calculated for trading and available-for-sale debt securities when they are sold?**

**Trading Securities**
Realized gain/loss = Selling price versus the adjusted cost (Original cost +/– Unrealized gains or losses previously recognized in net income)

**Available-for-Sale Securities**
Realized gain/loss = Selling price versus the original cost, adjusted for any credit losses recorded on the income statement from previous periods (note that any unrealized gains or losses in AOCI must be reversed)

**How are equity securities typically valued?**

Equity securities are typically carried at fair value through net income (FVTNI), with unrealized gains and losses included in earnings.

**Describe the "practicality exception" for equity securities.**

For equity investments that do not have a readily determinable fair value, this exception allows an entity to measure equity investments at cost, less impairment, plus/minus observable price changes of identical or similar investments from the same owner.

**How is the realized gain or loss calculated for equity securities when they are sold?**

Realized gain/loss = Selling price versus the adjusted cost (Original cost +/– Unrealized gains or losses previously recognized in net income)

**How is the year-end *investment in investee* reported on the balance sheet calculated under the equity method?**

Beginning investment in investee
\+ Investor's share of investee earnings
– Investor's share of investee dividends
<u>– Amortization of FV differences</u>
Ending investment in investee

**How is an investor's equity method investment reported on the income statement?**

Investor's share of investee earnings
<u>– Amortization of FV differences</u>
Equity in earnings/investee income

**When a parent company owns less than 100% of the stock of a subsidiary company, what amount of the subsidiary's *assets*, *liabilities*, and *equity* are included on the consolidated balance sheet?**

The consolidated balance sheet includes 100% of the parent's subsidiary's assets and liabilities, but does not include the subsidiary's equity. Noncontrolling interest is presented as part of equity, separately from the equity of the parent company.

**State the criteria to consolidate subsidiaries.**

- Consolidate when the parent is able to control the subsidiary. Usually this is indicated by greater than 50 percent ownership of the voting stock of the subsidiary.
- Do not consolidate when control is not with owners (as in bankruptcy of subsidiary).

**Name several simple workpaper elimination entries that are necessary to eliminate intercompany payables and receivables when producing consolidated financial statements.**

Eliminate:
- Accounts payable/accounts receivable
- Bonds payable/bonds receivable
- Accrued bond interest payable/accrued bond interest receivable

**State the workpaper elimination entry for intercompany *inventory* transactions.**

Dr Retained earnings (intercompany profit in beginning inventory)
Dr Intercompany sales
Cr Intercompany cost of goods sold
Cr Cost of goods sold (intercompany profit in goods sold)
Cr Ending inventory (intercompany profit in ending inventory)

**State the workpaper elimination entry for intercompany *bond* transactions.**

Dr Bonds payable
Dr Premium (or credit discount)
Cr Investment in affiliates bonds
Cr Gain on extinguishment of bonds (or debit loss on extinguishment of bonds)

**State the workpaper elimination entry for intercompany *land* transactions.**

Dr Intercompany gain on sale of land
Cr Land

**State the workpaper elimination entries for intercompany *depreciable assets* transactions.**

*Elimination Entry 1*–Eliminate intercompany gain and adjust asset and accumulated depreciation to original amounts:
Dr Intercompany gain on sale of machinery
Cr Machinery
Cr Accumulated depreciation

*Elimination Entry 2*–Eliminate excess depreciation:
Dr Accumulated depreciation
Cr Depreciation expense

**What three considerations must be taken into account when preparing consolidated statements of cash flow that are not present when preparing statements of cash flow for a nonconsolidated entity?**

1. When reconciling net income to net cash provided by operating activities, total consolidated net income (including net income attributable to both the parent and the noncontrolling interest) should be used.
2. The financing section should report dividends paid by the subsidiary to noncontrolling shareholders. Dividends paid by the subsidiary to the parent company should not be reported.
3. The investing section may report the acquisition of additional subsidiary shares by the parent if the acquisition was an open-market purchase.

**In acquisition accounting, state the consolidating workpaper elimination entry.**

**CARINBIG**

DR **C**ommon stock–subsidiary
DR **A**PIC–subsidiary
DR **R**etained earnings–subsidiary
CR **I**nvestment in subsidiary
CR **N**oncontrolling interest
DR **B**alance sheet adjustments to fair value
DR **I**dentifiable intangible assets to fair value
DR **G**oodwill

**In creating a new partnership interest with an investment of additional capital, what three methods can be used?**

- Exact method
- Bonus method
- Goodwill method

**Describe the *exact method* of creating a new partnership interest with an investment of additional capital.**

The purchase price equals the book value of the capital account purchased.

- No adjustment to the existing partners' capital accounts
- No goodwill or bonus

**Describe the *bonus method* of creating a new partnership interest with an investment of additional capital.**

*Bonus Method*

New partner's capital account = (A + B + C) × C's percentage ownership.

Excess of new partner's contribution over capital interest received is a bonus to the old partners.

Excess of capital interest received over new partner's contribution is a bonus to the new partner.

**Describe the *goodwill method* of creating a new partnership interest with an investment of additional capital.**

- Goodwill is recognized based on the total value of the partnership implied by the new partner's contribution.
- Goodwill is shared by the existing partners using the agreed profit/loss ratio.

$100(partner C contrib) X 30%(Partnership share)=Each

Difference is Goodwill split.

**Describe the *bonus method* of withdrawal of a partner.**

- The difference between the balance of the withdrawing partner's capital account and the amount that person is paid is the amount of the bonus.
- The bonus is allocated among the remaining partners' capital accounts in accordance with their remaining profit and loss ratios.

**Describe the *goodwill method* of withdrawal of a partner.**

The partners may elect to record the implied goodwill in the partnership based on the payment to the withdrawing partner. The amount of the implied goodwill is allocated to all of the partners in accordance with their profit and loss ratios.

After allocating goodwill, the balance in the withdrawing partner's capital account should equal the final distribution to the withdrawing partner.

**In liquidating a partnership, what is the order of preference?**

- Creditors
- Loans and advances to partners
- Capital accounts of partners

Remember that all losses must be provided for before disposal; that is, maximum potential losses before distribution of cash.

**What are the three sections of the *statement of cash flows*? What cash flows are included in each section?**

- Operating activities–cash flows from income statement transactions and current assets/liabilities
- Investing activities–cash flows from non-current assets
- Financing activities–cash flows from debt and equity

**Name the common adjustments made to cash flows from operating activities using the *indirect* method.**

CLAD

**C**urrent assets and liabilities
**L**osses and gains
**A**mortization and depreciation
**D**eferred items

**Define *permanent differences* and list examples.**

Permanent differences are transactions that affect either taxable income or financial income, but not both, and only in the period in which they occur. They do not affect future financial or taxable income.

- Premium on key-officer life insurance policy when entity is owner and beneficiary
- Proceeds from key-officer life insurance
- Tax-exempt interest on state and municipal bonds
- Nondeductible portion of meals and entertainment
- Fines and expenses in violation of law
- Dividends-received deduction

**Define *temporary differences* and list examples.**

Temporary differences are differences between taxable income and financial income that result in taxable or deductible amounts in future years and necessitate the recognition of deferred tax assets or liabilities.

- Depreciation (financial vs. MACRS)
- Gross profit on long-term construction contracts (percentage completion vs. completed contract)
- Estimated warranty costs
- Gross profit on installment sales (accrual vs. cash)
- Bad debt expense using the allowance method vs. actual bad debt expense

**Define *deferred tax liability.***

Anticipated future tax **liabilities** derived from situations in which future taxable income will be **greater** than future financial income due to temporary differences.

A deferred tax liability is measured by applying the applicable enacted tax rate and provisions of the enacted tax law to temporary differences in the periods in which they are expected to reverse.

**Define *deferred tax asset.***

Anticipated future taxable income will be **less** than future financial income due to temporary differences.

A deferred tax asset is recognized for all deductible temporary differences, operating losses, and tax credit carryforwards by applying the applicable enacted tax rate and provisions of the enacted tax law to temporary differences in the period in which they are expected to reverse. Deferred tax assets are also subject to recording a valuation allowance to reduce the asset to its net realizable value if it is more likely than not that its full value will not be recognized.

**What is the *valuation allowance*?**

If it is more likely than not (>50 percent) that some portion or all of the deferred tax asset will not be realized, a valuation allowance needs to be created to recognize the reduction in the carrying amount of the deferred tax asset (DTA).

**Identify the tax rate used to measure deferred tax assets and liabilities under U.S. GAAP.**

The enacted tax rate expected to apply to taxable items (temporary differences) in the periods the taxable item is expected to be paid (liability) or realized (asset).

Do **not** allow the examiners to trick you into using the *anticipated, proposed,* or *unsigned* tax rate.

**How are deferred tax assets and liabilities classified on the balance sheet under U.S. GAAP?**

Deferred tax assets and deferred tax liabilities are reported as non-current on the balance sheet. Deferred tax assets and deferred tax liabilities may be netted if the entity has a legally enforceable right to offset current tax assets against current tax liabilities and the deferred tax assets and deferred tax liabilities relate to income taxes levied by the same tax authorities. Deferred tax assets and liabilities are not netted if they are attributable to different tax-paying components of the entity or to different tax jurisdictions.

Question

**Name the *primary authoritative source for GAAP* for not-for-profit organizations.**

Answer

Financial Accounting Standards Board

Question

**What financial statements are prepared for nongovernmental not-for-profit entities?**

Answer

- Statement of financial position
- Statement of activities
- Statement of cash flows

Question

**Identify the three required elements in the *statement of activities* for not-for-profit organizations.**

Answer

- Change in total net assets
- Change in net assets without donor restrictions
- Change in net assets with donor restrictions

Question

**Name the functional classification of expenses commonly used in not-for-profit organizations.**

Answer

- Program expenses
- Support expenses
    - Fundraising expenses
    - Management and general
    - Membership development

Question

**Name the classifications of the *statement of cash flows* for not-for-profit organizations.**

Answer

- Cash flows from operating activities
- Cash flows from investing activities
- Cash flows from financing activities

Question

**Conditions that preclude the recognition of revenue for a contribution to a not-for-profit organization are indicated by both of the following.**

Answer

1. Measurable barriers
2. Right of the donor to demand return of transferred assets or retract
   pledge/promise to give

Question

**Identify the *basis of accounting* for not-for-profit organizations.**

Answer

Full accrual basis of accounting

Question

**Identify four barriers that may indicate a conditional contribution to a not-for-profit organization.**

Answer

1. Specific levels of service are required.
2. Specific outputs or outcomes are required.
3. Matching provisions are attached to the gift.
4. Outside events must occur or be resolved (e.g., contingencies).

Question

**What are the recognition criteria for cash contributions?**

Answer

**Cash contributions:**
Recognized as revenues or gains in the period in which they are received, measured at fair value at the date of gift.

| Question | Answer |
| --- | --- |
| **What are the recognition criteria for conditional promises?** | **Conditional promises (pledges):** No recognition of receivable or revenue occurs until a future event occurs (condition met). |
| **What are the recognition criteria for unconditional promises?** | **Unconditional promises (pledges):** Pledge receivable and related contribution revenue are recognized at fair value when received. |
| **What are the recognition criteria for multiyear pledges?** | **Multiyear pledges:** Pledge receivable and associated contribution revenue are recognized at net present value at the date the pledge is made, with future collections considered restricted (by time). |

| Question | Answer |
| --- | --- |
| **What is a reclassification of net assets?** | Simultaneous increase in one class of net assets and decrease in another. A reclassification of net assets usually results from donor-imposed restrictions being satisfied or otherwise lapsing. |
| **When are donated services displayed as revenue and expense (or capital improvement) on the financial statements of not-for-profit organizations?**<br>**SOME** | Donated services are recognized as revenue of the financial statements of not-for-profit organizations **SOME** of the time. Recognized donated services must meet the following criteria:<br><br>The service creates or enhances nonfinancial assets, or:<br><br>**S**pecialized skill was required to deliver the service and it was delivered by an individual possessing those skills;<br>**O**therwise needed service (would have been purchased by the organizations anyway);<br>**M**easured **E**asily (the accurate valuation of the service is easy). |
| **What are the criteria that must be met in order to *not record* the donation of works of art or historical treasures?** | Donated materials are recorded as revenue at fair value on date of receipt, if the fair value can be objectively determined.<br><br>Contributions of works of art, historical treasures, etc., need not be recognized as revenue if they are protected by the organization, held by the organization for display and, if sold, the proceeds of the sale are designated for the acquisitions of other works. |
| **For a university, identify *common revenues without donor restrictions*.** | • Student tuition and fees<br>• Government aid, grants, and contracts<br>• Gifts and private grants<br>• Endowment income<br>• Sales and services of educational departments<br>• Revenues of auxiliary enterprises |
| **If student tuition and fees are displayed at gross amount, what happens to scholarships and tuition waivers?** | Scholarships and tuition waivers may be displayed as expenditures or as a contra-revenue line item. |
| **For health care entities, identify the revenue accounts.** | • Patient service revenue.<br>• Other operating revenue, including tuition from schools, educational programs, donated supplies and equipment, and specific purpose grants.<br>• Nonoperating revenue, gains and/or losses, including unrestricted interest and dividend income from investment activities, unrestricted grants, donated services, etc. |
| **How are *pledges* (promises to contribute in the future without donor restrictions) accounted for?** | Unconditional promises to contribute in the future (pledges) are reported as restricted support (time restriction), at the present value of the estimated future cash flows using a discount rate commensurate with the risks involved. |

**Describe the treatment of *charity care* in a health care organization.**

Charity care is not recognized as either revenue or expense on the financial statements of a health care organization.

Charity care represents services for which the health care organization does not anticipate any cash flows.

**Describe how *patient service revenue* is recorded.**

Patient service revenue is recorded on the gross basis using established rates. Note that charity care does not qualify for recognition as revenue.

Provisions for contractual adjustments and discounts are then deducted to arrive at net service revenue for external reporting.

**In considering transferring assets from a recipient organization to a beneficiary organization, when are the assets received recognized as *liabilities* by the recipient organization?**

When assets are transferred without variance power, so that the recipient organization does not have the unilateral authority to redirect assets to another beneficiary, those transfers are recognized as liabilities.

**What does the term *variance power* mean in the context of not-for-profit accounting and reporting?**

The unilateral authority to redirect assets to another beneficiary.

**In considering transferring assets from a recipient organization to a beneficiary organization, when are the assets received recognized as *revenue* by the recipient organization?**

When assets are transferred with variance power, which gives the recipient organization the unilateral authority to redirect assets to another beneficiary, the transfer is recognized as revenue.

**How are *marketable securities* reported?**

All debt securities and those equity securities that have readily determinable fair values are measured at fair value.

**Where are gains and losses on investments reported?**

Gains and losses on investments are reported in the statement of activities as increases or decreases in net assets without donor restrictions, unless the use of the investment is restricted by explicit donor stipulations or by law.

**Is depreciation expense recorded in the financial statements of a not-for-profit organization?**

Depreciation expense and accumulated depreciation are recorded in not-for-profit organizations in a manner consistent with recognition used in commercial enterprises.

**What is an endowment fund?**

An established fund of assets to provide income for the maintenance of a not-for-profit entity. The use of the fund may be with *or* without donor-imposed restrictions.

Endowment funds are, however, *generally* established by donor-restricted gifts to provide a source of income either:

- in perpetuity; or
- for a specified period.

**What is a board-designated endowment fund?**

It is an endowment fund created by a not-for-profit entity's governing board by designating a portion of its net assets *without donor restrictions* to be invested to *provide income* for a long but not necessarily specified period. Board-designated endowments are also referred to as funds functioning as an endowment or quasi-endowment funds.

**What is an underwater endowment fund?**

A donor-restricted endowment fund for which the fair value of the fund at the reporting date is less than either the original gift amount or the amount required to be maintained either by the donor or by law that extends donor restrictions.

**What are the conditions that define a not-for-profit organization's *economic interest* in another entity?**

A not-for-profit entity is deemed to have an economic interest in another entity if either of the following criteria are met:

1. The entity holds or utilizes significant resources that must be used for the purpose of the not-for-profit either indirectly or directly by producing income or providing services; or
2. The not-for-profit is responsible for the liabilities of the other entity.

**Name the primary authoritative body for GAAP for governmental entities.**

Governmental Accounting Standards Board (GASB)

**What are the three accounting themes addressed by governmental accounting?**

- Fund structure
- Fund accounting
- External reporting

**Identify the major categories of funds used by state and local governmental units.**

- Governmental
- Proprietary
- Fiduciary

**What are the fund accounting principles applicable to *governmental funds*?**

- Current financial resources measurement focus
- Modified accrual basis of accounting

**Name each *governmental fund* type.**

**G** **G**eneral Fund

**R** Special **R**evenue Funds

**S** Debt **S**ervice Funds

**P** Capital **P**rojects Funds

**P** **P**ermanent Funds

**What are the fund accounting principles applicable to *proprietary funds*?**

Measurement focus: Economic resources
Basis of accounting: Full accrual

**Name each *proprietary fund* type.**

**S** Internal **S**ervice Funds

**E** **E**nterprise Funds

**What are the fund accounting principles applicable to *fiduciary funds*?**

Measurement focus: Economic resources
Basis of accounting: Full accrual

**Name each *fiduciary fund* type.**

**C**ustodial funds
**I**nvestment trust funds
**P**rivate purpose trust funds
**P**ension and **O**ther **E**mployee benefit trust funds

**Distinguish between alternative measurement focuses.**

Current Financial Resources (GRSPP)

- No fixed assets are recorded; capital outlays displayed as expenditures
- No depreciation
- No non-current liabilities are recorded; debt proceeds displayed as resource inflows
- Principal payments displayed as an expenditure
- Premiums and discounts on debt are not amortized; they are included as an increase or decrease of debt proceeds

Economic Resources (SE-CIPPOE)

- Fixed assets are recorded
- Non-current liabilities are recorded

**Define *modified accrual* and list the funds that use it as a basis of accounting.**

Modified accrual:

Revenues should be recognized when measurable and available; expenditures are generally (with the exception of interest expenditures) recognized when fund liability is incurred.

Funds using modified accrual basis:

**G** **G**eneral Fund

**R** Special **R**evenue Funds

**S** Debt **S**ervice Funds

**P** Capital **P**roject Funds

**P** **P**ermanent Funds

**What do the terms *measurable* and *available* mean in the context of the modified accrual basis of revenue accounting?**

- Measurable means quantifiable in monetary terms.
- Available means collectible within (generally) 60 days of year-end.

**What is the basic structure of the statement of revenues, expenditures, and changes in fund balance for the governmental funds?**

Revenues
(Expenditures)
Other financing sources and uses
Net change in fund balance