

chapter 5 intermediate accounting solutions

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Introduction

Intermediate accounting is a cornerstone of any finance or accounting curriculum, bridging the gap between introductory coursework and professional practice. Among the many chapters that students tackle, **Chapter 5** often stands out as a pivotal point where foundational concepts—such as the measurement and presentation of assets, liabilities, and equity—are refined and expanded. Mastering this chapter is essential for those aiming to excel in exams, pursue accounting certifications, or build a career in financial reporting.

In this guide, we'll dive deep into the core themes of Chapter 5, uncover common pitfalls, and present **practical solutions** that will help you navigate complex problems with confidence. Whether you're a student preparing for the CPA exam, a professional refreshing your knowledge, or an educator seeking fresh teaching materials, this article offers a comprehensive, step by step walkthrough that blends theory with real world application.

By the end of this read, you'll have a clear roadmap for tackling the most challenging aspects of Chapter 5, a set of proven study techniques, and a collection of resources that will keep you ahead of the curve.

Overview of Chapter 5: Assets, Liabilities, and Equity

Chapter 5 of most intermediate accounting texts focuses on the accounting for assets, liabilities, and equity—three pillars that form the backbone of the balance sheet. The chapter typically covers:

- Classifications and measurement of current and non current assets.
- Detailed exploration of inventory valuation methods (FIFO, LIFO, weighted average).
- Recognition and measurement of property, plant, and equipment (PP&E) including depreciation methods.
- Accounting for intangible assets and goodwill.
- Liabilities—both short term and long term—and their impact on the balance sheet.
- Equity transactions, including common stock, retained earnings, and dividends.
- The interplay between the balance sheet and the income statement.

Understanding these concepts is crucial because they directly influence financial ratios, tax calculations, and compliance with Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS). A solid grasp of Chapter 5 ensures that you can interpret financial statements accurately and prepare high quality reports.

Key Topics Covered in Chapter 5

1. Current vs. Non Current Assets

Current assets—cash, receivables, inventory, and short term investments—are expected to be converted into cash or used within one year. Non current assets—such as PP&E, intangible assets, and long term investments—are held for longer periods. Recognizing the difference is essential for accurate classification and subsequent calculations of liquidity ratios like the current ratio and quick ratio.

2. Inventory Valuation Methods

Inventory can be valued using:

- FIFO (First In, First Out)—assumes the oldest costs are recognized first.
- LIFO (Last In, First Out)—recognizes the newest costs first.
- Weighted Average Cost—calculates an average cost per unit.

Choosing the appropriate method affects cost of goods sold (COGS), gross profit, and ultimately taxable income. Many students struggle with converting between methods, especially when dealing with large datasets.

3. Property, Plant, and Equipment (PP&E)

PP&E is recorded at cost, then depreciated over its useful life. Chapter 5 delves into:

- Capitalization criteria.
- Depreciation methods: straight line, declining balance, units of production.
- Impairment testing and write downs.
- Revaluation of assets under IFRS.

Accurate depreciation calculation is vital for both financial reporting and tax purposes.

4. Intangible Assets and Goodwill

Intangibles—patents, trademarks, customer lists—are often amortized over their useful life, while goodwill is tested for impairment. Chapter 5 explains the criteria for recognition, measurement, and amortization schedules.

5. Liability Recognition and Measurement

Liabilities are obligations that require future outflows of resources. They are classified as current or long term based on maturity. Key concepts include:

- Accrued expenses and deferred revenues.
- Contingent liabilities and their disclosure.
- Leases and the distinction between operating and finance leases.
- Bond issuance, amortization of premium/discount, and interest expense calculation.

6. Equity Transactions

Equity changes arise from stock issuances, dividends, and retained earnings. Chapter 5 covers:

- Common and preferred stock issuance.
- Stock splits and reverse splits.
- Dividends declared, declared and paid, and their impact on retained earnings.
- Retained earnings adjustments for prior period corrections.

7. The Balance Sheet and Its Relationship to the Income Statement

Understanding how each line item on the balance sheet ties back to the income statement is essential for comprehensive financial analysis. For instance, the depreciation expense on the income statement directly reduces the carrying amount of PP&E on the balance sheet.

Common Challenges Students Face

While Chapter 5 is fundamental, many students encounter specific hurdles:

1. Converting between inventory methods—students often misapply FIFO or LIFO during transitions, leading to incorrect COGS calculations.
2. Calculating depreciation correctly—especially when multiple methods are used across different asset classes.
3. Understanding impairment thresholds—determining when an asset must be written down.

4. Reconciling cash flows—linking balance sheet changes to the statement of cash flows.
5. Applying lease accounting standards—particularly the transition from ASC 842/IFRS 16.

Addressing these challenges early on can drastically improve exam performance and professional competence.

Practical Solutions for Mastering Chapter 5

1. Create a Master Inventory Conversion Cheat Sheet

Develop a one page reference that outlines formulas for converting FIFO to LIFO, LIFO to weighted average, and vice versa. Include sample calculations to reinforce learning.

2. Use a Depreciation Tracker Spreadsheet

Set up a dynamic spreadsheet that automatically updates depreciation expense and accumulated depreciation based on input parameters such as cost, useful life, salvage value, and chosen method. This tool not only aids in practice problems but also serves as a handy reference for real world asset management.

3. Build an Impairment Decision Flowchart

Design a flowchart that guides you through the impairment testing process: assess recoverable amount, compare with carrying amount, and decide whether a write down is necessary. Visualizing the steps reduces cognitive load during exams.

4. Align Balance Sheet Changes with Cash Flow Items

Practice mapping each balance sheet movement to its corresponding cash flow effect. For instance, an increase in accounts payable is a cash inflow, while a decrease is a cash outflow. This exercise enhances understanding of the interdependence of financial statements.

5. Simulate Lease Accounting Scenarios

Work through multiple lease scenarios—short term, low value, operating, finance—to grasp the nuances of ASC 842 and IFRS 16. Pay special attention to the recognition of right of use assets and lease liabilities.

6. Leverage Peer Reviewed Study Groups

Form study circles where each member tackles a specific subtopic and presents their solutions. Peer teaching reinforces concepts and uncovers alternative problem solving approaches.

Sample Problems and Step by Step Solutions

Below are three representative problems that illustrate common Chapter 5 challenges, along with detailed solutions.

Problem 1: Inventory Method Conversion

Company X had the following inventory transactions in 2024:

- Beginning inventory: 1,000 units @ \$10 each.
- Purchases: 2,000 units @ \$12 each on March 1; 1,500 units @ \$13 each on September 1.
- Sales: 3,000 units on December 31.

Calculate COGS under FIFO, LIFO, and weighted average methods.

Solution 1

FIFO:

1. Cost of goods sold = 1,000 units @ \$10 + 2,000 units @ \$12 + 1,000 units @ \$13 = \$10,000 + \$24,000 +

$\$13,000 = \$47,000$.

LIFO:

1. $\text{COGS} = 1,500 \text{ units @ } \$13 + 1,500 \text{ units @ } \$12 + 1,000 \text{ units @ } \$10 = \$19,500 + \$18,000 + \$10,000 = \$47,500$.

Weighted Average:

1. Total cost = $\$10,000 + \$24,000 + \$19,500 = \$53,500$.
2. Total units = $1,000 + 2,000 + 1,500 = 4,500$.
3. Average cost per unit = $\$53,500 \div 4,500 = \11.89 (rounded).
4. $\text{COGS} = 3,000 \text{ units} \times \$11.89 = \$35,670$.

Problem 2: Depreciation Calculation

ABC Corp purchases equipment for \$120,000 with a useful life of 8 years and no salvage value. Calculate annual depreciation under:

- Straight line method.
- Double declining balance method (no salvage value).

Solution 2

Straight line:

1. Annual depreciation = $\$120,000 \div 8 = \$15,000$.

Double declining balance:

1. Depreciation rate = $2 \div 8 = 25\%$.
2. Year 1: $\$120,000 \times 25\% = \$30,000$.
3. Year 2: $(\$120,000 - \$30,000) \times 25\% = \$22,500$.
4. Continue until the book value is close to zero.

Problem 3: Lease Accounting

XYZ Inc. enters into a 5 year operating lease for office equipment with annual lease payments of \$20,000, payable at the beginning of each year. The lease rate (discount rate) is 5%. Determine:

- Right of use asset and lease liability at inception.
- Annual amortization expense and interest expense.

Solution 3

First, calculate the present value (PV) of lease payments:

1. $\text{PV} = \$20,000 \times [1 - (1 + 0.05)^{-5}] \div 0.05 = \$20,000 \times 4.32948 = \$86,589$.

Thus:

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