

# College Accounting

Seventh Edition

Chapters 14-25

## *Includes*

### *Study Guides*

- Study Plans
- Self-Check Reviews
- Demonstration Problems/Solutions

### *Working Papers*

- Exercises
- A or B Problems
- Challenge Problems
- Critical-Thinking Problems
- Mini-Practice Sets

Price Haddock Brock

**Study Guide and  
Working Papers for**  
**COLLEGE**  
**ACCOUNTING**  
**SEVENTH EDITION**

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# Accounting Principles and Reporting Standards

## TUDY GUIDE

### Objectives

1. Describe the process used to develop generally accepted accounting principles.
2. Identify, assess, and apply the assumptions that underlie current accounting principles and procedures and the modifying conventions that may alter their application.
3. Define the accounting terms new to this chapter.

## CHAPTER ACTIVITIES

**Review Questions** Answer each assigned review question in Chapter 14.

**Managerial Focus** Answer each assigned managerial focus question in Chapter 14.

**Exercises** Complete each assigned exercise in Chapter 14. Use the forms provided in this SGWP. The objectives covered by an exercise are given after the exercise number. If you need help with an exercise, review the portion of the chapter related to the objective(s) covered.

**Problems A/B** Complete each assigned problem in Chapter 14. Use the forms provided in this SGWP. The objectives covered by a problem are given after the problem number. If you need help with a problem, review the portion of the chapter related to the objective(s) covered.

**Challenge Problem** Complete the challenge problem as assigned. Use the forms provided in this SGWP.

**Critical Thinking Problem** Complete the critical thinking problem as assigned. Use the forms provided in this SGWP.

## Self-Check of Reading Comprehension

**True-False** For each of the following statements, circle T in the answer column if the statement is true or F if the statement is false.

- |   |   |   |
|---|---|---|
| 1. The Securities and Exchange Commission has a great deal of power to dictate accounting methods used by companies whose stocks are traded on the stock exchanges. | T | F |
| 2. The SEC often relies on pronouncements of the Financial Accounting Standards Board.  | T | F |
| 3. Statement users should be able to assume that the figures are objective and are based on verifiable evidence.  | T | F |
| 4. The Financial Accounting Standards Board is an agency of the federal government.   | T | F |
| 5. Assets are carried on the books at original cost until completely used up.   | T | F |
| 6. The traits of objectivity and verifiability eliminate subjective decisions.  | T | F |
| 7. An excessive charge to an expense account in one accounting period results in an overstatement of profit in the succeeding period or periods.                    | T | F |
| 8. The exact results of operations can be clearly determined at the end of any accounting period.   | T | F |
| 9. For convenience, accountants assume that the value of money is stable or that changes in its value are insignificant.  | T | F |
| 10. There is only one generally accepted method of accounting for a given transaction.  | T | F |



11. Statement footnotes may disclose information that is vital to a potential investor.	T	F
12. Accountants do not explain the generally accepted accounting principles and methods that have been employed in preparing their statements.	T	F
13. Revenue should not be recognized until it is realized.	T	F
14. Because of the separate entity assumption, the personal activities of an owner of a sole proprietorship will be combined with his or her business activities in the accounting records.	T	F
15. Revenue may be recognized at the time that a commodity is produced.	T	F
16. On a cash basis, expenses are usually recognized when they are paid.	T	F
17. The matching principle requires that all known costs be charged to the current period of operations.	T	F
18. The statements of the Financial Accounting Standards Board are binding on the members of the American Institute of Certified Public Accountants.	T	F
19. All accounting principles are established by law.	T	F
20. Under the realization principle, no revenue is recognized until cash is received.	T	F

**Completion** In the answer column, supply the missing word or words needed to complete each of the following statements.

1. A business enterprise is a separate ____, even from its owners and creditors.	_____
2. The fundamental accounting equation expresses the ____ concept.	_____
3. Cost is an objective, verifiable measure of economic value when determined in a(n) ____ transaction.	_____
4. The assumption that permits carrying forward the undepreciated costs of assets to be charged against future operations is called the ____ assumption.	_____
5. Accounting records are kept in terms of ____.	_____
6. Lack of ____ would result in financial reports that are not comparable with earlier statements and are therefore misleading.	_____
7. Under the modifying convention of ____, assets are sometimes understated.	_____
8. If the books are kept on the ____ basis, income is recognized in the period in which it is realized.	_____
9. ____ refers to the significance of an item relative to the particular situation of which it is realized.	_____
10. The business enterprise is normally thought of by the accountant as a ____ concern.	_____
11. Careful matching of revenue with ____ is essential if financial statements are to provide accurate and useful information.	_____
12. Under the ____ basis of accounting, revenue is recognized when a sale is made.	_____
13. By far the greatest number of businesses follow the general rule that revenue is recognized at the ____.	_____
14. The ____ has authority to define accounting terms and to prescribe accounting procedures used by all publicly held firms.	_____
15. Matching revenues and expenses of specific fiscal periods is called the ____ basis of accounting.	_____

**Exercise**      **Answer each of the following in the space provided. Make your answers complete but as brief as possible.**

- 1.** Why does developing a complete set of generally accepted accounting principles take so long?

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- 2.** Does the separate entity assumption conform to the legal obligations of a sole proprietor? Explain.

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- 3.** Why must the accountant assume continuity in the operation of a business?

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- 4.** How does the realization requirement ensure objective and verifiable evidence of an accounting transaction?

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5. Under what accounting method does the timing of income recognition govern the recognition of the related expense? What principle is involved?

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### DEMONSTRATION PROBLEM

Assume that you are an independent CPA performing audits of financial statements. In your work you encounter the independent situations described in items 1– 6. Review each situation and decide which accounting principle or concept applies to the situation. If the treatment described conforms with generally accepted accounting principles, explain why. If the treatment does not conform, explain which principle or concept has been violated and how the situation should have been reported.

1. The owner of Harper's Ford, a metropolitan automobile dealership, depreciates metal wastebaskets over a period of five years.
2. The liabilities of Jones Construction Company are substantially in excess of the company's assets. To present a more impressive financial picture, Ted Jones, the owner of the company, included in the company's balance sheet such personal assets as a savings account, automobile, and real estate investments.
3. Thomas Brother Company prepares financial statements four times a year. For convenience, these statements are prepared when business is slow and the accounting staff is not busy with other matters. Last year, financial statements were prepared for the three-month period ended March 31, the five-month period ended May 31, the nine-month period ended September 30, and the twelve-month period ended December 31.
4. Maxwell Computer Equipment Company has constructed special-purpose equipment designed for use in building other equipment that will be sold to the public. Because of its special use, this equipment has virtually no resale value to any other company. Therefore, Maxwell charged the entire cost to build the equipment, \$45,000, to expense in the current period.
5. Pay-Less Department Store spends a substantial sum on advertising for various sales promotions during the year. The owner is sure that the advertising will generate revenue in future periods but has no idea of how much revenue will be earned. In the current year, \$250,000 was paid for advertising that was expended in the current period.
6. Casio Motel recognizes room rental revenue on the date a reservation is made. For the summer season, many guests make reservations as far as a year in advance of their intended visit.



## Solution

1. **Materiality.** Although, theoretically, it is correct to depreciate assets over their estimated useful lives, the materiality convention allows a departure from this accounting principle if the amount is immaterial. Although there are no set rules for judging materiality, Harper's Ford could justify charging the cost of the metal wastebaskets to expense in the period of purchase.
2. **Separate entity assumption.** The current procedure used by Jones Construction Company is a violation of the separate entity assumption. The personal assets of the owner should not be shown on the balance sheet of the business. Under the separate entity assumption, accounting records are kept for a particular business. Financial statements that report the assets of both the owner and the entity as one are misleading and are not objective.
3. **Periodicity of income assumption.** The current procedure used by Thomas Brother Company is a violation of the periodicity of income assumption. Financial statements should be prepared on a consistent basis for consistent time intervals. If Thomas Brother Company prepares financial statements four times per year, the statement should be prepared on a quarterly basis so that the results are comparable from one period to another. The preparation of financial statements should not be based relative to times when the business is slow or the accounting staff is not busy with other matters.
4. **Matching principle.** The current procedure used by Maxwell Computer Equipment Company violates the matching principle. Although the equipment may be of a special nature, the matching principle requires the cost of the equipment to be depreciated over its estimated useful life so that this expense can be associated with (matched against) the revenue generated by the equipment.
5. **No generally accepted accounting principles are violated in this situation.** Although the advertising may benefit future accounting periods, there is no way to match the advertising expense against future revenue. Using the principle of conservatism, when in doubt it is best to choose the solution that will least likely overstate assets and income.
6. **Revenue realization.** The current procedure used by Casio is a violation of the revenue realization principle. Under this principle, revenue should be recognized when a sale is made or a service is provided. Revenue should not be recognized on the basis of hotel reservations that may be canceled at any time by a potential guest.

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**EXERCISE 14-1**

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**EXERCISE 14-2**

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**EXERCISE 14-3**

**Name** \_\_\_\_\_

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2.
3.

**EXERCISE 14-4**

1.
2.
3.

### EXERCISE 14-5

**Name** \_\_\_\_\_

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### EXERCISE 14-6

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