VOLUME I CHAPTERS 1-13 STUDY GUIDE WITH SOLUTIONS

FOR USE WITH

ACCOUNTING PRINCIPLES

THIRTEENTH EDITION

KERMIT D. LARSON PAUL B. W. MILLER

VOLUME I CHAPTERS 1-13 STUDY GUIDE

for use with

FUNDAMENTAL ACCOUNTING PRINCIPLES

Thirteenth Edition

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To the Student

This booklet is designed to help you review the material covered in Chapters 1–13 and Part V of Fundamental Accounting Principles, 13th edition. You should understand that the booklet is not intended to substitute for your review of Fundamental Accounting Principles. Instead, the objectives of this booklet are as follows:

- 1. To remind you of important information that is explained in the text. For example, the topical outline of each chapter reminds you of important topics in the chapter. In reading the outline, you should ask yourself whether or not you understand sufficiently the listed topics. If not, you should return to the appropriate chapter in Fundamental Accounting Principles and read carefully the portions that explain the topics about which you are unclear.
- 2. To provide you with a quick means of testing your knowledge of the chapter. If you are unable to correctly answer the problems that follow the chapter outline, you should again return to the appropriate chapter in *Fundamental Accounting Principles* and review the sections about which you are unclear.

Your best approach to the use of this booklet is as follows:

First, read the learning objectives and the related summary paragraphs. Then, ask whether your understanding of the chapter seems adequate for you to accomplish the objectives.

Second, review the topical outline, taking time to think through (describing to yourself) the explanations that would be required to expand the outline. Return to *Fundamental Accounting Principles* to cover areas of weakness.

Third, answer the requirements of the problems that follow the topical outline. Then, check your answers against the solutions that are provided after the problems.

Fourth, return to *Fundamental Accounting Principles* for further study of the portions of the chapter about which you made errors.

Table of Contents

Chapter	1	Accounting: An Introduction to Its Concepts	1
Chapter	2	Recording Transactions	21
Chapter	3	Adjusting the Accounts and Preparing the Statements (includes Appendix A: Recording Prepaid and Unearned Items in Income Statement Accounts)	37
Chapter	4	The Work Sheet and Closing the Accounts of Proprietorships, Partnerships, and Corporations (includes Appendix B: Reversing Entries)	57
Chapter	5	Accounting for a Merchandising Concern (includes Appendix C: The Adjusting Entry Approach to Accounting for Merchandise Inventories)	77
Chapter	6	Accounting Systems	95
Chapter	7	Internal Control and Accounting for Cash (includes Appendix D: Recording Vouchers, Manual System)	115
Chapter	8	Short-Term Investments and Receivables	141
Chapter	9	Inventories and Cost of Goods Sold	161
Chapter	10	Plant and Equipment	177
Chapter	11	Plant and Equipment, Natural Resources, and Intangible Assets	191
Chapter	12	Current and Long-Term Liabilities (includes Appendix E: Financial Reporting of Income Tax Liabilities and Expense; and Appendix F: Payroll Reports, Records, and Procedures)	205
Chapter	13	Partnership Accounting	231
Part V		Accounting Principles, the FASB's Conceptual Framework, and Alternative Valuation Methods	243

Accounting: An Introduction to Its Concepts

Learning Objective 1:

Describe the function of accounting and the nature and purpose of the information it provides.

Summary

The function of accounting is to provide useful information to people who make rational investment, credit, and similar decisions. In effect, accountants serve decision makers by providing them with financial information to help them reach better decisions. The decision makers include the owners and creditors of a business. Other users include business managers and those who sell to or buy from businesses. Financial reports are used to describe the activities and financial status of many different organizations in addition to businesses.

Learning Objective 2:

List the main fields of accounting and the activities carried on in each field.

Summary

Accountants work as private accountants, public accountants, and government accountants. All three groups have members who work in the fields of financial accounting, managerial accounting, and tax accounting. Financial accounting involves preparing and auditing financial statements that are distributed to people who are not involved in day-to-day management. Managerial accounting provides information to those who are involved in day-to-day management. Activities related to this field include general accounting, cost accounting, budgeting, internal auditing, and management advisory services. Tax accounting is concerned with determining the proper amount of income taxes to be paid, preparing tax returns, and tax planning.

Learning Objective 3:

Describe the information contained in the financial statements of a business and be able to prepare simple financial statements.

Summary

The income statement shows a business's revenues, expenses, and net income or loss. The balance sheet lists a business's assets, liabilities, and owner's equity. The statement of changes in owner's equity shows the increase in owner's equity from investments by the owner, the decrease from withdrawals, and the increase from net income or the decrease from a net loss. The statement of cash flows shows the events that caused cash to change; it classifies the cash flows as coming from operating, investing, and financing activities.

Learning Objective 4:

Briefly explain the accounting principles introduced in the chapter and describe the process by which generally accepted accounting principles are established.

Summary

Accounting principles are intended to help accountants produce relevant and reliable information. Broad accounting principles include the business entity principle, the objectivity principle, the cost principle, the going-concern principle, and the revenue recognition principle. Specific accounting principles for financial accounting are established in the United States primarily by the Financial Accounting Standards Board (FASB), which operates under the oversight of the Securities and Exchange Commission (SEC). Auditing standards are established by the Auditing Standards Board (ASB) which is a committee of the American Institute of CPAs (AICPA). The International Accounting Standards Committee (IASC) identifies preferred practices and encourages their adoption throughout the world. However, the IASC does not have the authority to impose its standards.

Learning Objective 5:

Briefly explain the differences between a single proprietorship, a partnership, and a corporation, comparing the differing responsibilities of their owners for the debts of the business.

Summary

A single (or sole) proprietorship is an unincorporated business owned by one individual. A partnership differs from a single proprietorship in that it has more than one owner. Proprietors and partners are personally responsible for the debts of their businesses. A corporation is a separate legal entity. As such, its owners (called *stockholders*) are not personally responsible for its debts.

Learning Objective 6:

Recognize and be able to indicate the effects of transactions on the elements of the accounting equation.

Summary

The accounting equation states that Assets = Liabilities + Owner's Equity. Business transactions always affect at least two elements in the accounting equation. The accounting equation is always in balance when business transactions are properly recorded.

Learning Objective 7:

Define or explain the words and phrases listed in the chapter glossary.

Summary

See Problem III.

Topical Outline

- I. Accounting as a profession
 - A. Accounting is a service-oriented activity. Its function is to provide useful information to people who make rational investment, credit, and similar decisions in order to help them reach better decisions.
 - B. All states license CPAs (Certified Public Accountants).
 - C. Some private accountants hold CMA (Certificate in Management Accounting) or CIA (Certified Internal Auditor) certificates.
- II. Accountants practice in three fields of accounting: financial accounting, managerial accounting, and tax accounting. The types of services provided in these fields depend on whether the work is being done by a private accountant, public accountant, or government accountant. The services performed by each type of accountant in each field of accounting include:

A. Financial accounting

- 1. Private accountants prepare financial statements.
- Public accountants audit financial statements. This involves examining an entity's accounting records and statements to determine whether the statements fairly reflect the company's financial position and operating results in accordance with generally accepted accounting principles; an audit is designed to add credibility to the information in the financial statements.
- 3. Government accountants:
 - a. Prepare financial statements.
 - b. Review financial reports.
 - c. Write regulations.
 - d. Assist companies.
 - e. Investigate violations.

B. Managerial accounting

- 1. Private accountants:
 - a. Perform general accounting activities. This includes recording transactions, processing the recorded data, and preparing financial reports for management, investors, creditors, and others.
 - b. Perform cost accounting activities. These activities are designed to help managers identify, measure, and control operating costs.
 - c. Perform budgeting activities. This involves developing formal plans for future business and government activities, which then serve as a basis for evaluating actual accomplishments.
 - d. Perform internal audits. This includes evaluating the record keeping processes, assessing whether managers throughout the organization are following established operating procedures, and evaluating the efficiency of the operating procedures.

- 2. Public accountants provide management advisory services. Advice provided to managers includes designing and installing an accounting system, advice on selecting a new computer system, or help with budgeting or selecting employee benefit plans.
- 3. Government accountants provide the same services as listed under B.1.

C. Tax accounting

- 1. Private accountants:
 - a. Prepare tax returns.
 - b. Provide tax planning services. This involves planning future transactions to minimize the amount of tax that will have to be paid.
- 2. Public accountants provide the same services as listed under C.1.
- 3. Government accountants:
 - a. Review tax returns.
 - b. Assist taxpayers.
 - c. Write regulations.
 - d. Investigate violations.

III. Important accounting statements include:

- A. The income statement, which indicates whether a business earned a net income (a profit) by showing the:
 - 1. Revenues earned—an inflow of assets received in exchange for goods or services provided to customers as part of the major or central operations of the business.
 - 2. Expenses incurred—outflows or the using up of assets as a result of the major or central operations of a business.
 - 3. Net income (excess of revenues over expenses) or net loss (excess of expenses over revenues).
- B. The balance sheet—shows the financial position of a business on a specific date by listing the:
 - Assets—the properties or economic resources owned by the business. Assets are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
 - Liabilities—debts owed by a business or organization. Liabilities are probable future sacrifices
 of economic benefits arising from present obligations of a particular entity to transfer assets or
 provide services to other entities in the future as a result of past transactions or events.
 - Equity—the difference between a company's assets and its liabilities. Equity is the residual
 interest in the assets of an entity that remains after deducting its liabilities; also called net
 assets.
- C. Statement of changes in owner's equity—presents information about what happened to equity during a time period; it shows the beginning amount of equity, the events that increased it (new investments and net income) and the events that decreased it (net loss, if any, and withdrawals).

- D. Statement of cash flows—describes where the business's cash came from and where it went during the period; the cash flows are classified as being associated with operating activities, investing activities, and financing activities.
- IV. Generally accepted accounting principles (GAAP)—rules adopted by the accounting profession as guides in measuring, recording, and reporting the financial affairs and activities of a business; GAAP include both broad and specific principles.
 - A. Sources of accounting principles
 - 1. American Institute of Certified Public Accountants (AICPA).
 - 2. Committee on Accounting Procedure (CAP)—established by the AICPA in 1936.
 - 3. Accounting Principles Board (APB)—replaced the CAP in 1959.
 - 4. Financial Accounting Standards Board (FASB)-replaced the APB in 1973.
 - 5. Securities and Exchange Commission (SEC)—created by Congress in 1934; has "oversight" authority over FASB.
 - B. Important accounting principles and concepts
 - 1. Relevance concept—information is relevant if it is capable of making a difference in a decision.
 - 2. Reliability concept—information is useful only if it is believable.
 - 3. Business entity principle—every business is to be accounted for separately and distinctly from its owner or owners.
 - 4. Objectivity principle—the amounts used in recording transactions are to be based on verifiable evidence such as business transactions between independent parties.
 - Cost principle—the financial statements are to present information based on costs incurred in a transaction; assets, services, and liabilities are to be recorded initially at the cash or cashequivalent amount given in exchange.
 - 6. Going-concern principle—financial statements are to be prepared under the assumption that the business will continue operating instead of being put up for sale or closed, unless there is evidence that shows that it will not continue.
 - 7. Revenue recognition principle—revenue should be reported when it is earned and not before; the inflow of assets associated with revenue does not have to be in the form of cash; and the amount of revenue should be measured as the cash received plus the cash equivalent value of any noncash assets received from customers in exchange for goods or services.
- V. Business organizations include three general types:
 - A. Single proprietorship—a business owned by one individual, not organized as a corporation. There are no legal requirements to be met in starting a single proprietorship business. They are the most numerous of all business concerns.
 - B. Partnership—a business that is owned by two or more people and that is not organized as a corporation. A partner is personally responsible for all the debts of the partnership.

- C. Corporation—a business established as a separate legal entity under the laws of a state or the federal government. The owners of a corporation are called stockholders because their ownership of the corporation's equity is divided into units that are called shares of stock.
- VI. Recording transactions
 - A. Accounting equation (or balance sheet equation)

Assets = Liabilities + Owner's Equity

B. Double-entry system—the effects of each transaction on the accounting equation are such that the equation always remains in balance.

Problem I

The following statements are either true or false. Place a (T) in the parentheses before each true statement and an (F) before each false statement.

- () A type of accounting designed to help managers identify, measure, and control operating costs is called auditing.
- 2. () In the financial statements of a business operating as a sole proprietorship, it is acceptable to combine the owner's personal transactions with business transactions.
- 3. () Land appraised at \$40,000 and worth that much to its purchaser should be recorded at its worth (\$40,000), even though it was purchased through hard bargaining for \$35,000.
- 4. () If a business is to be liquidated and its assets sold, the losses incurred in converting assets into cash must exceed the equity of the owner or owners before the creditors will incur any losses.
- 5. () Net income + Owner's investments Owner's withdrawals = The increase in owner's equity during the year.

Problem II

You are given several words, phrases or numbers to choose from in completing each of the following statements or in answering the following questions. In each case select the one that best completes the statement or answers the question and place its letter in the answer space provided.

_ 1. Financial statement information about Company B is as follows:

December 31, 1992:	
Assets	\$42,000
Liabilities	17,000
December 31, 1993:	
Assets	47,000
Liabilities	14,800
During 1993:	
Net income	18,000
Owner's investments	?
Owner's withdrawals	10,800

The amount of owner investments during 1993 is:

- a. \$ 7,200
- b. \$14,400
- c. \$25,000
- d. \$ -0-
- e. some other amount.

- 2. The term "management advisory services" describes:
 - a. the phase of public accounting dealing with the examination of an entity's accounting records and statements.
 - b. the phase of public accounting dealing with the design and installation of a client's accounting system.
 - c. the phase of accounting dealing with the development of formal plans for future business and government activities, which then serve as a basis for evaluating actual accomplishments.
 - d. the phase of public accounting dealing with the preparation of tax returns and planning future transactions to minimize the amount of tax that will have to be paid.
 - e. the phase of accounting dealing primarily with recording transactions and preparing financial statements.

3. The cost principle:

- a. states that revenue should be reported when it is earned and not before; the inflow of assets associated with revenue does not have to be in the form of cash; and the amount of revenue should be measured as the cash received plus the cash equivalent value of any noncash assets received from customers in exchange for goods or services.
- b. requires the information in financial statements to be supported by evidence other than someone's imagination or opinion.
- c. states that all expenses incurred in earning a revenue be deducted from the revenue in determining net income.
- d. requires the financial statements to present information based on costs incurred in a transaction; it requires assets, services, and liabilities to be recorded initially at the cash or cash-equivalent amount given in exchange.
- e. is another name for the recognition principle.

_ 4. The APB was a(n):

- a. professional association of Certified Public Accountants.
- b. committee of the American Institute of Certified Public Accountants that, prior to the FASB, was responsible for formulating generally accepted accounting principles.
- c. agency of the federal government that was established to regulate securities markets.
- d. professional association of people who teach accounting.
- e. certification of an individual's professional level of competence in the field of internal auditing.
- 5. If on January 16, 1993, Mary Kay Company rendered services for a customer in exchange for \$175 cash, what would be the effects on the accounting equation?
 - a. Assets, \$175 increase; Liabilities, no effect; Owner's Equity, \$175 increase.
 - b. Assets, no effect; Liabilities, \$175 decrease; Owner's Equity, \$175 increase.
 - c. Assets, \$175 increase; Liabilities, \$175 increase; Owner's Equity, no effect.
 - d. Assets, \$175 increase; Liabilities, \$175 decrease; Owner's Equity, \$350 increase.
 - e. There is no effect on the accounting equation because Mary Kay Company is a single proprietorship.

Problem III

Many of the important ideas and concepts discussed in Chapter 1 are reflected in the following list of key terms. Test your understanding of these terms by matching the appropriate definitions with the terms. Record the number identifying the most appropriate definition in the blank space next to each term.

AAA	Generally accepted accounting principles
Accounting equation	
Accounting	Generally accepted auditing standards
Accounts payable	Going-concern principle
Accounts receivable	Government accountants
AICPA	IASC
AIMR	IMA
APB	Income statement
ASB	Internal auditing
Assets	IRS
Audit	Liabilities
Balance sheet equation	Management advisory services
Balance sheet	NASBA
Bookkeeping	Net assets
Budgeting	Net income
Business entity principle	Net loss
Business transaction	Objectivity principle
CAP	Partnership
CIA	Private accountants
CMA	Public accountants
Continuing-concern principle	Realization principle
Controller	Revenues
Corporation	Revenue recognition principle
Cost accounting	SEC
Cost principle	Shareholders
CPA	SIA
Creditors	Single proprietorship
Debtors	Sole proprietorship
Equity	Statement of cash flows

Expenses	Statement of changes in owner's
FASB	equity
FEI	Statement of financial position
GAAP	Statements of Financial Accounting Standards
GAAS	Stock
General accounting	Stockholders
	Tax accounting

- 1. A financial statement that provides information that helps users understand the financial status of the business; it lists the types and amounts of assets, liabilities, and equity as of a specific date.
- 2. The accounting guideline that requires the information in financial statements to be supported by evidence other than someone's imagination or opinion; objectivity adds to the reliability of accounting information.
- 3. American Institute of Certified Public Accountants; the leading national professional organization of certified public accountants in the United States.
- 4. A service-oriented activity that provides useful information to people who make rational investment, credit, and similar decisions in order to help them reach better decisions.
- 5. The field of accounting that includes preparing tax returns and planning future transactions to minimize the amount of tax that will have to be paid; involves private, public, and government accountants.
- 6. Inflows of assets received in exchange for goods or services provided to customers as part of the major or central operations of the business; may occur as decreases in liabilities as well as inflows of assets.
- 7. The financial statement that shows whether the business earned a profit; it also lists the types and amounts of the revenues and expenses.
- 8. Another name for the accounting equation.
- 9. A business established as a separate legal entity (incorporated) under the laws of a state or the federal government.
- 10. The accounting principle that requires the financial statements to present information based on costs incurred in a transaction; it requires assets, services, and liabilities to be recorded initially at the cash or cash-equivalent amount given in exchange.
- 11. The difference between a company's assets and its liabilities; more precisely, it is the residual interest in the assets of an entity that remains after deducting its liabilities.
- 12. Financial Accounting Standards Board; the seven-member private board that currently has the authority to issue pronouncements of generally accepted accounting principles.
- 13. A business that is owned by two or more people and that is not organized as a corporation.
- 14. Another name for the balance sheet.
- 15. Another name for the revenue recognition principle.

- 16. An activity that adds credibility to reports produced and used within an organization; internal auditors not only evaluate the record keeping processes but also assess whether managers throughout the organization are following established operating procedures; internal auditors also evaluate the efficiency of the operating procedures.
- 17. The excess of revenues over expenses.
- 18. The process of developing formal plans for future business and government activities, which then serve as a basis for evaluating actual accomplishments.
- 19. A type of accounting designed to help managers identify, measure, and control operating costs.
- 20. The rule that requires accountants to prepare financial statements under the assumption that the business will continue operating instead of being put up for sale or closed, unless there is evidence that shows that it will not continue.
- 21. The excess of expenses over revenues.
- 22. Individuals or organizations that owe an amount to a business.
- 23. Outflows or the using up of assets as a result of the major or central operations of a business; also, liabilities may be incurred as an alternative to outflows of assets.
- 24. The owners of a corporation.
- 25. Another name for a single proprietorship.
- 26. The chief accounting officer of a business.
- 27. Amounts owed to a business by its customers for goods or services sold to them on credit.
- 28. The rule that states: (1) revenue should be reported when it is earned and not before, (2) the inflow of assets associated with revenue does not have to be in the form of cash, and (3) the amount of revenue should be measured as the cash received plus the cash equivalent value of any noncash assets received from customers in exchange for goods or services.
- 29. A completed exchange between two parties of economic consideration, such as goods, services, money, or rights to collect money.
- 30. Equity of a corporation divided into units or shares.
- 31. Rules adopted by the accounting profession as guides in measuring, recording, and reporting the financial affairs and activities of a business; GAAP include both broad and specific principles.
- 32. An examination of an entity's accounting records and statements designed to determine whether the statements fairly reflect the company's financial position and operating results in accordance with generally accepted accounting principles; an audit is designed to add credibility to the information in the financial statements.
- 33. A financial statement that presents information about what happened to equity during a time period; it shows the beginning amount of equity, the events that increased it (new investments and net income) and the events that decreased it (net loss, if any, and withdrawals).
- 34. The activity in which public accountants provide advice to managers; the services may include designing and installing an accounting system, advice on selecting a new computer system, or help with budgeting or selecting employee benefit plans.
- 35. Securities and Exchange Commission; a federal agency created by Congress in 1934 to regulate securities markets, including the flow of information from companies to the public; the SEC granted authority to the FASB for creating generally accepted accounting principles.

- 36. Individuals or organizations entitled to receive payments from a company.
- 37. Debts owed by a business or organization; probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.
- 38. The part of accounting that records transactions and other events, either manually or with computers.
- 39. The American Accounting Association; the professional association of people who teach accounting.
- 40. Another name for the going-concern principle.
- 41. Liabilities resulting from the purchase of goods or services on credit.
- 42. The properties or economic resources owned by the business; more precisely, they are probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.
- 43. The principle that requires every business to be accounted for separately and distinctly from its owner or owners; based on the goal of providing relevant information about the business.
- 44. An expression in dollar amounts of the relationship between the assets and the liabilities and equity of an enterprise; stated as Assets = Liabilities + Owner's Equity.
- 45. Financial Executives Institute; a professional association of private accountants.
- 46. A business owned by one individual, not organized as a corporation.
- 47. Accounting Principles Board; a former authoritative committee of the AICPA that was responsible for identifying generally accepted accounting principles prior to the FASB.
- 48. Certified Public Accountant; an accountant who has passed a rigorous examination of accounting and related knowledge and has met education and experience requirements.
- 49. Another name for stockholders.
- 50. The field of accounting that deals primarily with recording transactions, processing the recorded data, and preparing financial reports for management, investors, creditors, and others.
- 51. The abbreviation for generally accepted accounting principles.
- 52. Institute of Management Accountants; a professional association of private accountants, formerly called the National Association of Accountants.
- 53. A financial statement that describes where the business's cash came from and where it went during the period; the cash flows are classified as being associated with operations, investing activities, and financing activities.
- 54. The publications of the FASB that establish generally accepted accounting standards.
- 55. Certified Internal Auditor; a certification of an individual's professional level of competence in the field of internal auditing; granted by the Institute of Internal Auditors.
- 56. Internal Revenue Service; the federal agency that has the duty of collecting federal income taxes and otherwise enforcing the income tax laws.
- 57. Another name for equity.
- 58. National Association of State Boards of Accountancy.
- 59. Certificate in Management Accounting; a certification of an individual's professional level of competence in management accounting, granted by the Institute of Management Accountants.
- 60. The Auditing Standards Board; the authority for identifying generally accepted auditing standards.