What is the Cost Principle?

Worksheet

The cost principle states that assets must be recorded and kept on the books at their original acquisition cost, rather than being adjusted upward for inflation or market appreciation, though they can still be depreciated or written down for impairment.

Questions

1. The cost principle requires assets to be recorded at:
A) Current market value
B) Original purchase price
C) Estimated future value
D) Replacement cost

2. Under the cost principle, if a building's market value rises, the company should:
A) Increase the recorded value
B) Keep recording it at historical cost (less depreciation)
C) Remove it from the books
D) Record the gain as revenue

3. Equipment costs $40,000, salvage value $0, useful life 4 years. What is the straight-line book value after 1 year?
A) $40,000
B) $30,000
C) $10,000
D) $0

4. Which asset is typically NOT depreciated under the cost principle?
A) Equipment
B) Buildings
C) Land
D) Vehicles

5. A company buys a building for $500,000. Five years later it's worth $650,000 on the open market. At what value should the building be recorded on the books (ignoring depreciation)?

6. Equipment costs $60,000, has a $5,000 salvage value, and a 5-year useful life. What is its book value after 2 years using straight-line depreciation?

7. A company purchased land for $200,000 in 2015. In 2026 similar land sells for $350,000. What amount stays on the balance sheet for this land?

8. Define: What is the cost principle?

9. Define: Can an asset's book value ever change under the cost principle?

10. Define: Is land depreciated under the cost principle?

Answer Key

1. B) Original purchase price - Assets are recorded and kept at their historical acquisition cost.

2. B) Keep recording it at historical cost (less depreciation) - Unrealized market gains are not recognized under the cost principle.

3. B) $30,000 - Annual depreciation = 40,000/4 = $10,000; book value = 40,000 10,000 = $30,000.

4. C) Land - Land has an indefinite useful life, so it is not depreciated.

5. The cost principle requires recording the original purchase price Market value changes are not reflected in the recorded amount The building remains recorded at $500,000 (less any accumulated depreciation)

6. Annual depreciation = (60,000 5,000) / 5 = $11,000 Accumulated depreciation after 2 years = 11,000 2 = $22,000 Book value = 60,000 22,000 = $38,000

7. Land is not depreciated The cost principle keeps it recorded at historical cost The balance sheet still shows $200,000, regardless of the $350,000 market value

8. Assets are recorded at their original purchase price, not current market value.

9. Yes - through depreciation, amortization, or impairment write-downs, but never written up for market gains.

10. No - land is not depreciated and stays at historical cost indefinitely.