

Horngren's Accounting, 12e (Miller-Nobles et al.)
Chapter 1 Accounting and the Business Environment

Learning Objective 1-1

1) Accounting is the information system that measures business activities, processes the information into reports, and communicates the results to decision makers.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Why is Accounting Important? (H1)

2) Critical thinking and judgment skills are not necessary for accountants because technology has made the activities routine.

Answer: FALSE

Explanation: Technology plays an important supporting role in performing routine accounting functions. This allows accountants to have more time to focus on reviewing and evaluating economic activities using critical thinking and judgment.

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Why is Accounting Important? (H1)

3) Accounting starts with economic activities that accountants review and evaluate using critical thinking and judgment to create useful information that helps individuals make good decisions.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Why is Accounting Important? (H1)

4) Accounting is referred to as the language of business because it is the method of communicating business information to decision makers.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Why is Accounting Important? (H1)

5) Managerial accounting focuses on providing information for external decision makers.

Answer: FALSE

Explanation: Managerial accounting focuses on providing information for internal decision makers.

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

6) Investors primarily use managerial accounting information for decision-making purposes.

Answer: FALSE

Explanation: External users (investors) use financial accounting information.

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

7) A creditor is a person who owes money to the business.

Answer: FALSE

Explanation: A creditor is a person to whom a business owes money.

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

8) Income tax is calculated using accounting information.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

9) Financial accounting focuses on information for decision makers outside of the business, such as creditors and taxing authorities.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

10) Business owners use accounting information to set goals, evaluate progress toward those goals, and make adjustments when needed.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

11) Outside investors ordinarily use financial accounting information to decide whether or not to invest in a business.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

12) A creditor is any person who has an ownership interest in a business.

Answer: FALSE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

13) Managerial accounting focuses on information needed by lenders, customers, and the federal government.

Answer: FALSE

Explanation: Financial accounting focuses on providing information for external decision makers. Lenders, customers, and the federal government are external users.

Diff: 1

LO: 1-1

AACSB: Interpersonal relations and teamwork

AICPA Functional: Reporting

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

14) Any person or business to whom a business owes money is called the business's creditor.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

15) Decision makers are looking for an international accounting language because the most significant change in the business world in the last decade has been the huge increase in international commerce.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Reporting

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

16) Managerial accounting provides information to _____.

A) internal decision makers

B) outside investors and lenders

C) creditors

D) taxing authorities

Answer: A

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

17) The field of accounting that focuses on providing information for external decision makers is _____.

- A) managerial accounting
- B) financial accounting
- C) cost accounting
- D) nonmonetary accounting

Answer: B

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

18) The field of accounting that focuses on providing information for internal decision makers is _____.

- A) managerial accounting
- B) financial accounting
- C) nonmonetary accounting
- D) governmental accounting

Answer: A

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Decision Makers: The Users of Accounting Information

19) Which of the following users would rely on managerial accounting information for decision-making purposes?

- A) potential investors
- B) creditors
- C) customers
- D) company managers

Answer: D

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Decision Makers: The Users of Accounting Information

20) Which of the following is a decision made by an internal user?

- A) Should we lend money to the business?
- B) How much money should the business budget for production?
- C) Should I invest in the business?
- D) All of the above are correct.

Answer: B

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Decision Makers: The Users of Accounting Information

21) For each user of accounting information, identify if the user would use financial accounting (FA) or managerial accounting (MA).

Accounting Information User	FA or MA
Business manager	
Creditor	
Stockholder	
Human resources director	
Internal Revenue Service	

Answer:

Accounting Information User	FA or MA
Business manager	MA
Creditor	FA
Stockholder	FA
Human resources director	MA
Internal Revenue Service	FA

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Decision Makers: The Users of Accounting Information

22) For each of the following decisions, identify if it applies to a financial accounting (FA) or a managerial accounting (MA) decision maker. Your answer should be either FA or MA. Include only one choice for each accounting decision.

Accounting Decision	Decision Maker (FA or MA)
Should the business expand to a new location?	
Is the business profitable?	
How do actual costs compare to budgeted costs?	
Should I invest in the business?	

Answer:

Accounting Decision	Decision Maker (FA or MA)
Should the business expand to a new location?	MA
Is the business profitable?	FA
How do actual costs compare to budgeted costs?	MA
Should I invest in the business?	FA

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Decision Makers: The Users of Accounting Information

23) Financial analysts perform reviews of companies to ensure compliance to rules and regulations.

Answer: FALSE

Explanation: Auditors perform reviews of companies to ensure compliance to rules and regulations.

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Accounting Matters

24) Certified Management Accountants (CMAs) specialize only in financial management knowledge and typically work for a single company.

Answer: FALSE

Explanation: Certified Management Accountants (CMAs) specialize in accounting and financial management knowledge and typically work for a single company.

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Accounting Matters

25) Certified Public Accountants are licensed professional accountants who serve the general public.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Accounting Matters

26) _____ are professional accountants who serve the general public, not one particular company.

A) Certified public accountants

B) Financial managers

C) Internal auditors

D) Controllers

Answer: A

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Accounting Matters

Match the accounting position to the job description.

- A) Specializes in accounting and financial management knowledge
- B) Serves the general public
- C) Performs reviews of companies to ensure compliance to rules and regulations
- D) Compiles financial statements, interacts with auditors, oversees regulatory reporting

27) Controller

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Accounting Matters

28) Certified Management Accountant

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Accounting Matters

29) Certified Public Accountant

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Accounting Matters

30) Auditor

Diff: 1

LO: 1-1

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Accounting Matters

Answers: 27) D 28) A 29) B 30) C

Learning Objective 1-2

1) The Financial Accounting Standards Board is a U.S. governmental agency that oversees the creation and governance of accounting standards.

Answer: FALSE

Explanation: The Financial Standards Board is a privately funded organization.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Governing Organizations

2) The SEC is a governmental agency that oversees world-wide financial markets and organizations that set accounting standards.

Answer: FALSE

Explanation: The SEC is a U.S. governmental agency that oversees the U.S. financial markets.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Governing Organizations

3) Which of the following organizations is responsible for the creation and governance of accounting standards in the United States?

A) Financial Accounting Standards Board

B) Institute of Management Accountants

C) American Institute of Certified Public Accountants

D) Securities and Exchange Commission

Answer: A

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Governing Organizations

4) The Financial Accounting Standards Board (FASB) works with the following groups. Which of these groups was congressionally created?

- A) Institute of Management Accountants
- B) Public Company Accounting Oversight Board
- C) International Accounting Standards Board
- D) American Institute of CPAs

Answer: B

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Governing Organizations

5) List three private groups that work with the Financial Accounting Standards Board (FASB).

Answer: Private groups that work with FASB are the American Institute of CPAs (AICPA), Institute of Management Accountants (IMA), and International Accounting Standards Board (IASB).

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Governing Organizations

6) The guidelines for accounting information are called Generally Accepted Accounting Principles (GAAP).

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Generally Accepted Accounting Principles

7) To be useful, accounting must be relevant and have faithful representation.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Generally Accepted Accounting Principles

8) The primary objective of financial reporting is to ensure that all investment decisions are risk free.

Answer: FALSE

Explanation: The primary objective of financial reporting is to provide information useful for making investment and lending decisions.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Generally Accepted Accounting Principles

9) The primary objective of financial reporting is to provide information useful for making investment and lending decisions.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Generally Accepted Accounting Principles

10) GAAP refers to guidelines for accounting information in the United States. The acronym GAAP in this statement refers to _____.

A) Globally Accepted Accounting Policies

B) Government Approved Accounting Principles

C) Generally Accredited Accounting Policies

D) Generally Accepted Accounting Principles

Answer: D

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Generally Accepted Accounting Principles

11) Regarding generally accepted accounting principles (GAAP), which of the following statements is incorrect?

- A) GAAP rests on a conceptual framework that identifies the objectives, characteristics, elements, and implementation of financial statements.
- B) The primary objective of financial reporting is to provide information useful for making investment and lending decisions.
- C) Relevant information is complete, neutral, and free from error.
- D) GAAP is currently formulated by the Financial Accounting Standards Board.

Answer: C

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Generally Accepted Accounting Principles

12) Which of the follow statements regarding the primary objective of financial reporting is correct?

- A) The primary objective of financial reporting is to provide information useful for the acquisition of long-term assets.
- B) Information that is faithfully represented is complete, neutral, and free from error.
- C) Relevant information ensures that users of the information will make the correct decisions.
- D) To be useful, information must follow the Generally Accepted Accounting Principles which are created and governed by the Securities and Exchange Commission.

Answer: B

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Generally Accepted Accounting Principles

13) What are Generally Accepted Accounting Principles (GAAP)? Which entity is currently responsible for determining GAAP?

Answer: Generally Accepted Accounting Principles (GAAP) are the guidelines for accounting information. GAAP is the main U.S. accounting rule book. The Financial Accounting Standards Board (FASB) is currently responsible for determining GAAP.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Generally Accepted Accounting Principles

14) What is the primary objective of financial reporting?

Answer: The primary objective of financial reporting is to provide information useful for making investment and lending decisions.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Generally Accepted Accounting Principles

15) As per the economic entity assumption, an organization and its owners should be seen as the same entity.

Answer: FALSE

Explanation: An economic entity is an organization that stands apart as a separate economic entity.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

16) An economic entity is an organization that stands apart as a separate economic entity.

Answer: TRUE

Explanation: An economic entity is an organization that stands apart as a separate economic entity.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

17) An entity refers to one business which includes its owners.

Answer: FALSE

Explanation: An entity refers to one business, separate from its owners.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

18) In a sole proprietorship, the owner is personally liable for the debts of the business.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

19) The most that the owner of a sole proprietorship can lose, as a result of business debts or lawsuits, is the amount he/she has invested in the business.

Answer: FALSE

Explanation: The owner of a sole proprietorship is personally liable for the debts of a business.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

20) Members of a limited-liability company (LLC) are not personally liable for the debts of the business.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

21) A business can be organized as a sole proprietorship, partnership, corporation, or limited-liability company (LLC).

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

22) In a limited-liability company (LLC), the members are personally liable for the debts of the business.

Answer: FALSE

Explanation: In a limited-liability company (LLC), the members are not personally liable for the debts of the business.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

23) Which of the following statements is TRUE of a sole proprietorship?

A) A sole proprietorship joins two or more individuals as co-owners.

B) The sole proprietor is personally liable for the liabilities of the business.

C) A sole proprietorship is taxed separately from the owner.

D) A sole proprietorship has to pay business income taxes.

Answer: B

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

24) Which of the following is a characteristic of a limited-liability company (LLC)?

A) An LLC's life is terminated at any member's choice or death.

B) Each member of an LLC is liable only for his or her own actions.

C) An LLC must have more than five members.

D) The earnings of an LLC are subject to double taxation.

Answer: B

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

25) Jason Ford has been the sole owner of a bicycle sales and repair shop for several years. Which of the following business types would limit Jason's personal liability exposure to the entity's debts?

- A) partnership
- B) limited-liability company
- C) sole proprietorship
- D) Any of the above.

Answer: B

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Economic Entity Assumption

26) Marcus has decided to open an auto-detailing business. He will pick up an automobile from the client, take it to his parents' garage, detail it, and return it to the client. If he does all of the work himself and takes no legal steps to form a special organization, which type of business organization, in effect, has he chosen?

- A) A limited-liability company
- B) A partnership
- C) A corporation
- D) A sole proprietorship

Answer: D

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

27) In a limited-liability company, the _____.

- A) members are personally liable to pay the company's debts
- B) business terminates at the death of a member
- C) members are liable for each other's actions
- D) members pay income tax on their share of earnings

Answer: D

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

- 28) The earnings of a sole proprietorship are _____.
- A) combined with the personal income of the proprietor
 - B) not combined with the proprietor's personal income
 - C) subject to double taxation
 - D) handled similarly to that of a corporation

Answer: A

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

- 29) For each of the following characteristics of a business organization, state whether it applies to a sole proprietorship (SP), partnership (P) or a corporation (C). There may be more than one correct answer for a characteristic.

Business organization characteristic	Entity(ies) to which the characteristic applies - SP, P, C
Separate legal entity	
Owner(s) are personally liable for the business's debts	
Separate taxable entity	
One owner	

Answer:

Business organization characteristic	Entity(ies) to which the characteristic applies - SP, P, C
Separate legal entity	C
Owner(s) are personally liable for the business's debts	SP, P
Separate taxable entity	C
One owner	SP, C

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Economic Entity Assumption

30) Mason Company purchased land for \$80,000. The president of Mason Company believes that the land is actually worth \$85,000. The land can be recorded at \$85,000.

Answer: FALSE

Explanation: The cost principle states that acquired assets are recorded at their actual cost.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Cost Principle

31) Since cost is a reliable measure, the cost principle holds that the accounting records should continue reporting an asset at its historical cost over its useful life.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Cost Principle

32) According to the _____, acquired assets should be recorded at the amount actually paid rather than at the estimated market value.

A) going concern assumption

B) economic entity concept

C) cost principle

D) monetary unit assumption

Answer: C

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Cost Principle

33) Lisa Smith decided to start her CPA practice as a sole proprietorship. The business purchased an office building for \$35,000. The real estate agent said the building was worth \$50,000 in the current market. The business recorded the building as a \$50,000 asset because Lisa believes that is the real value of the building. Which of the following concepts or principles of accounting is being violated?

- A) cost principle
- B) economic entity assumption
- C) monetary unit assumption
- D) going concern assumption

Answer: A

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Cost Principle

34) Beverly Dalton started her business as a sole proprietorship. At that time, the business purchased land for \$51,000. The December 31, 2019 market value of the land is \$92,000. On the December 31, 2019 balance sheet, this asset should be reported at _____ under U.S. GAAP and at _____ under international reporting standards.

- A) \$51,000; \$51,000
- B) \$92,000; \$92,000
- C) \$51,000; \$92,000
- D) \$92,000; \$51,000

Answer: C

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Cost Principle

35) Thirty years ago, Citywide Grocery Company purchased a building for its grocery store for \$30,000. Based on inflation estimates, the amount of the building has been adjusted in the accounting records. The building is now reported at \$75,000 in Citywide's financial statements. Which of the following concepts or principles of accounting is being violated?

- A) going concern assumption
- B) revenue realization concept
- C) economic entity assumption
- D) cost principle

Answer: D

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Cost Principle

36) Ten years ago, a company purchased a building for \$190,000. At that time, the company felt that the building was worth \$215,000. The current market value of the building is \$450,000. The building has been assessed at \$425,000 for property tax purposes. At which amount should the company record the building in its accounting records?

- A) \$190,000
- B) \$215,000
- C) \$425,000
- D) \$450,000

Answer: A

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Cost Principle

37) A business purchases a building for \$250,000. The current market value is \$375,000. The tax assessment value is \$325,000. At what value should the building be recorded, and which accounting principle supports your answer?

Answer: The building should be recorded at the actual cost of \$250,000. This is supported by the cost principle.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Cost Principle

38) Under the going concern principle, accountants must provide proof that the business will remain in operations long enough to use existing resources for their intended purpose.

Answer: FALSE

Explanation: Accountants base going concern on assumptions. Actual proof is not needed to make this determination.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Going Concern Assumption

39) Under the going concern principle, accountants assume that the business will remain in operations long enough to use existing resources for their intended purpose.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Going Concern Assumption

40) As per the _____, the entity will remain in operation for the foreseeable future.

A) economic entity concept

B) monetary unit assumption

C) going concern assumption

D) cost principle

Answer: C

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Going Concern Assumption

41) Accountants assume that the dollar's purchasing power is stable.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Monetary Unit Assumption

42) In the United States, transactions are recorded in dollars because the dollar's purchasing power does not change over time.

Answer: FALSE

Explanation: In the United States, transactions are recorded in dollars because the dollar is the medium of exchange.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Monetary Unit Assumption

43) Lawton Company records business transactions in dollars and disregards changes in the value of a dollar over time. Which of the following accounting assumptions does this represent?

A) economic entity assumption

B) going concern assumption

C) accounting period assumption

D) monetary unit assumption

Answer: D

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Monetary Unit Assumption

44) Regarding the monetary unit assumption, which of the following statements is correct?

A) This assumption requires that the items on the financial statements be measured at their current market value.

B) Accountants assume that the dollar's purchasing power is stable.

C) The value of a dollar does not change over time.

D) During periods of inflation, a dollar will purchase more.

Answer: B

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Monetary Unit Assumption

45) Stuart Allen Company manufactures computer hardware. The president of the company bought a new car as a gift for his daughter and paid for it using cash from the business. Since the company paid for the car, it was recorded in its books as an asset. Which of the following concepts or principles of accounting did the company violate?

- A) monetary unit assumption
- B) economic entity assumption
- C) cost principle
- D) going concern assumption

Answer: B

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Economic Entity Assumption

46) Under U.S. GAAP, the monetary unit assumption states that transactions are recorded in dollars. What is the basis for this assumption?

Answer: Under U.S. GAAP, transactions are recorded in dollars because accountants assume that the dollar's purchasing power is stable.

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Monetary Unit Assumption

47) Provide the definition of each of the following accounting assumptions.

Assumption	Definition
Monetary Unit	
Economic Entity	

Answer:

Assumption or Principle	Definition
Monetary Unit	The assumption that requires the items on the financial statements to be measured in terms of a monetary unit. The dollar's purchasing power is assumed to be stable.
Economic Entity	An organization that stands apart as a separate economic unit. The business is separate from the owners.

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Economic Entity Assumption

48) Provide the definition of each of the following accounting assumptions or principles.

Assumption or Principle	Definition
Going Concern Assumption	
Cost Principle	

Answer:

Assumption or Principle	Definition
Going Concern Assumption	This assumption assumes that the entity will remain in operation for the foreseeable future.
Cost Principle	This principle states that the acquired assets and services should be recorded at their actual cost.

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Cost Principle, Going Concern Assumption

49) International Financial Reporting Standards (IFRS) is the main U.S. accounting rule book and is currently created and governed by the Financial Accounting Standards Board.

Answer: FALSE

Explanation: Generally Accepted Accounting Principles represent the accounting guidelines, currently formulated by the Financial Accounting Standards Board. GAAP is the main U.S. accounting rule book.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: International Financial Reporting Standards

50) The Securities and Exchange Commission allows U.S. businesses to choose whether they follow U.S. GAAP or International Financial Reporting Standards.

Answer: FALSE

Explanation: The Securities and Exchange Commission requires that U.S. businesses follow U.S. GAAP.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: International Financial Reporting Standards

51) International Financial Reporting Standards are comparatively more specific and more rule-based than U.S. GAAP.

Answer: FALSE

Explanation: International Financial Reporting Standards are comparatively less specific and based more on principle than U.S. GAAP.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: International Financial Reporting Standards

52) International Financial Reporting Standards (IFRS) allows periodic revaluation of certain assets and liabilities to restate them to market value.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: International Financial Reporting Standards

53) International Financial Reporting Standards _____ U.S. Generally Accepted Accounting Principles.

A) are the same as

B) are generally less specific than

C) are based less on principle than

D) leave less room for professional judgment than

Answer: B

Diff: 1

LO: 1-2

AACSB: Analytical thinking

AICPA Functional: Reporting

PE Question Type: Critical thinking

H2: International Financial Reporting Standards

54) Which of the following statements, regarding International Financial Reporting Standards (IFRS), is correct?

A) International Financial Reporting Standards are issued by the Financial Accounting Standards Board.

B) The Securities and Exchange Commission is the private organization that oversees the creation and governance of International Financial Reporting Standards.

C) International Financial Reporting Standards represent a set of global accounting standards that are generally more specific and based less on principle than U.S. Generally Accepted Accounting Principles.

D) Companies who are incorporated in or do significant business in another country might be required to publish financial statements using International Financial Reporting Standards.

Answer: D

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Reporting

PE Question Type: Concept

H2: International Financial Reporting Standards

55) The Public Company Accounting Oversight Board is a watchdog agency that monitors the work of independent accountants who audit public companies.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Ethics in Accounting and Business

56) An audit is an examination of a company's financial statements and records.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Ethics in Accounting and Business

57) The Sarbanes-Oxley Act (SOX) requires companies to review internal control and take responsibility for the accuracy and completeness of their financial reports.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Ethics in Accounting and Business

58) The Sarbanes-Oxley Act (SOX) _____.

- A) requires independent accountants to take responsibility for the accuracy and completeness of the financial reports
- B) created the SEC
- C) ensures that financial scandals will no longer occur
- D) requires companies to take responsibility for the accuracy and completeness of their financial reports

Answer: D

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Ethics in Accounting and Business

59) Which of the following organizations requires publicly owned companies to be audited by independent accountants (CPAs)?

- A) Securities and Exchange Commission (SEC)
- B) Public Company Accounting Oversight Board (PCAOB)
- C) Financial Accounting Standards Board (FASB)
- D) American Institute of Certified Public Accountants (AICPA)

Answer: A

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Ethics in Accounting and Business

60) The Public Company Accounting Oversight Board (PCAOB) was created _____.

- A) by the Sarbanes-Oxley Act (SOX)
- B) to perform audits of public companies
- C) to make restitution to investors who were defrauded by the issuance of fraudulent financial reports
- D) to require auditors to take responsibility for the accuracy and completeness of financial reports from firms they audit

Answer: A

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Ethics in Accounting and Business

Learning Objective 1-3

1) The left side of the accounting equation measures the total amount of assets of a business.

Answer: TRUE

Explanation: Assets appear on the left side of the accounting equation .

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: What is the Accounting Equation? (H1)

2) The total amount of assets a business possesses may or may not be equal to the total of liabilities and owner's equity of the business.

Answer: FALSE

Explanation: The accounting equation is an equation, thus the left side of the equation always equals the right side of the equation.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: What is the Accounting Equation? (H1)

3) The left side of the accounting equation always equals the right side of the accounting equation.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: What is the Accounting Equation? (H1)

4) Which of the following is the correct accounting equation?

A) $\text{Assets} + \text{Liabilities} = \text{Equity}$

B) $\text{Assets} = \text{Liabilities} + \text{Equity}$

C) $\text{Assets} + \text{Revenues} = \text{Equity}$

D) $\text{Assets} + \text{Revenues} = \text{Liabilities} + \text{Expenses}$

Answer: B

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: What is the Accounting Equation? (H1)

5) The equity of Alliance Company is \$100,000 and the total liabilities are \$10,000. The total assets are _____.

- A) \$200,000
- B) \$20,000
- C) \$90,000
- D) \$110,000

Answer: D

Explanation: D) $\text{Assets} = \text{Liabilities} + \text{Equity}$

$$\text{Assets} = 100,000 + 10,000 = 110,000$$

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: What is the Accounting Equation? (H1)

6) Spring Company has assets and equity that amount to \$260,000 and \$70,000, respectively. Liabilities total _____.

- A) \$70,000
- B) \$190,000
- C) \$260,000
- D) \$330,000

Answer: B

Explanation: B) $\text{Liabilities} = \text{Assets} - \text{Equity}$

$$\text{Liabilities} = 260,000 - 70,000 = 190,000$$

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: What is the Accounting Equation? (H1)

7) The assets of Star Company are \$110,000 and the total liabilities are \$10,000. The equity is _____.

- A) \$110,000
- B) \$120,000
- C) \$10,000
- D) \$100,000

Answer: D

Explanation: D) $\text{Equity} = \text{Assets} - \text{Liabilities}$

$$\text{Equity} = 110,000 - 10,000 = 100,000$$

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: What is the Accounting Equation? (H1)

8) Regarding the accounting equation, which of the following is a correct statement?

- A) The accounting equation is made up of three parts.
- B) The accounting equation is the basic tool of accounting.
- C) Assets - Liabilities = Equity.
- D) All of the statements are correct.

Answer: D

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: What is the Accounting Equation? (H1)

9) Using the following information, provide the complete accounting equation.

Use this information to	Provide the accounting equation
Assets \$150,000; Equity \$60,000	
Liabilities \$200,000; Equity \$45,000	
Assets \$75,000; Liabilities \$40,000	

Answer:

Use this information to	Provide the accounting equation
Assets \$150,000; Equity \$60,000	Assets = Liabilities + Equity \$150,000 = \$90,000 + \$60,000
Liabilities \$200,000; Equity \$45,000	Assets = Liabilities + Equity \$245,000 = \$200,000 + \$45,000
Assets \$75,000; Liabilities \$40,000	Assets = Liabilities + Equity \$75,000 = \$40,000 + \$35,000

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: What is the Accounting Equation? (H1)

10) Using the following information, provide the complete accounting equation.

Use this information to	Provide the accounting equation
Equity \$200,000; Assets \$360,000	
Liabilities \$180,000; Assets \$320,000	
Equity \$725,000 Liabilities \$350,000	

Answer:

Use this information to	Provide the accounting equation
Equity \$200,000; Assets \$360,000	Assets = Liabilities + Equity \$360,000 = \$160,000 + \$200,000
Liabilities \$180,000; Assets \$320,000	Assets = Liabilities + Equity \$320,000 = \$180,000 + \$140,000
Equity \$725,000 Liabilities \$350,000	Assets = Liabilities + Equity \$1,075,000 = \$350,000 + \$725,000

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: What is the Accounting Equation? (H1)

11) What is the accounting equation? Briefly explain each of the three parts.

Answer: Assets = Liabilities + Equity.

Assets are economic resources that are expected to benefit the business in the future. They are things of value that a business owns or controls. Liabilities are debts that are owed to creditors. They are one source of claims against assets. Equity is the other source of claims against assets. Equity is the owner's claim against assets and is the amount of assets that is left over after the company has paid its liabilities. It represents the net worth of the business.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: What is the Accounting Equation? (H1)

12) Assets are something of value that the business owns or has control of.

Answer: TRUE

Explanation: Assets are economic resources that are expected to benefit the business in the future.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Assets

13) Assets are economic resources that have no future benefits for the business.

Answer: FALSE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Assets

14) The economic resources of a business such as furniture, building, and land are its _____.

A) liabilities

B) revenues

C) assets

D) owner's equity

Answer: C

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Assets

15) Which of the following is TRUE of assets?

A) Assets include Cash, Merchandise Inventory, and Accounts Payable.

B) Assets are something of value the business owns or controls.

C) Assets do not need to provide future benefit to the business.

D) Assets can be recorded at the market value if acquired at a bargain.

Answer: B

Diff: 2

LO: 1-3

AACSB: Analytical thinking

AICPA Functional: Measurement

PE Question Type: Critical thinking

H2: Assets

16) Define assets. Provide three examples of assets.

Answer: Assets are economic resources that are expected to benefit the business in the future. Assets are something the business owns or has control of. Examples include cash, merchandise inventory, furniture, and land.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Assets

17) Liabilities represent creditors' claims on the business's assets.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Liabilities

18) Many liabilities have the word *receivable* in their titles.

Answer: FALSE

Explanation: Many liabilities have the word *payable* in their titles.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Liabilities

19) A creditor who has loaned money to a business has a claim to some of the assets of the business until the debt is paid.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Liabilities

20) A debt that a business owes is called _____.

- A) an asset
- B) a liability
- C) owner's equity
- D) revenue

Answer: B

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Liabilities

21) Regarding liabilities, which of the following statements is incorrect?

- A) Liabilities represent one of the two claims to assets.
- B) A creditor who has loaned money to a business has a claim to some of the business's assets until the business pays the debt.
- C) Liabilities are economic resources that are expected to benefit the business in the future.
- D) Many, but not all, liabilities have the word *payable* in their titles.

Answer: C

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Liabilities

22) Define liabilities. Provide three examples of liabilities.

Answer: Liabilities are debts that are owed to creditors. Liabilities are something the business owes and represent the creditors' claims on the business's assets. Examples include Accounts Payable, Notes Payable, and Salaries Payable.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Liabilities

23) Equity increases when revenues are earned.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

24) Equity decreases with expenses and revenues.

Answer: FALSE

Explanation: Equity decreases with expenses and withdrawals by the owner.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

25) An owner's withdrawal represents an expense of the business.

Answer: FALSE

Explanation: An owner's withdrawal is a distribution of cash to the owner.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

26) An owner's withdrawal represents a distribution of earnings to the owner.

Answer: FALSE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

27) An owner's capital balance changes with an owner's withdrawals, revenues, and expenses.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

28) An owner's withdrawal increases owner's equity.

Answer: FALSE

Explanation: An owner's withdrawal decreases owner's equity.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

29) The owner's capital account increases with each capital contribution made by the owner.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

30) Maxwell Plumbing Services earned \$500 by completing a job for Smith Company. The \$500 earned by Maxwell Plumbing Services is its _____.

A) revenue

B) expense

C) gain

D) debt

Answer: A

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

31) The owner's claim to the assets of the business is called _____.

A) return on assets

B) expenses

C) equity

D) debt

Answer: C

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

32) Precision Camera Services started the year with total assets of \$120,000 and total liabilities of \$40,000. The company is a sole proprietorship. The revenues and the expenses for the year amounted to \$140,000 and \$50,000, respectively. During the year, there were no new capital contributions and the owner withdrew \$45,000. What is the amount of owner's equity at the end of the year?

- A) \$50,000
- B) \$140,000
- C) \$125,000
- D) \$45,000

Answer: C

Explanation: C) Owner, Capital, Ending Balance = Owner, Capital (beginning balance) - Owner, Withdrawals + Revenues - Expenses

Owner, Capital, Ending balance = $(\$120,000 - \$40,000) - \$45,000 + \$140,000 - \$50,000 = \$125,000$

Diff: 3

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

33) Dynamic Production Services started the year with total assets of \$130,000 and total liabilities of \$50,000. The company is a sole proprietorship. The revenues and the expenses for the year amounted to \$100,000 and \$60,000, respectively. During the year, there were no new capital contributions and the owner withdrew \$45,000. Calculate Dynamic's net income for the year.

- A) \$40,000
- B) \$100,000
- C) \$60,000
- D) \$130,000

Answer: A

Explanation: A) Net income = Revenues - Expenses

Net income = $\$100,000 - \$60,000 = \$40,000$

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

36) Which of the following is TRUE of the owner's capital account?

- A) The owner's capital account decreases with the owner's withdrawals.
- B) The owner's capital account increases with the purchase of a plant asset.
- C) The owner's capital account decreases with the collection of revenue.
- D) The owner's capital account increases with the payment on account.

Answer: A

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

37) The owner's capital account increases with _____.

- A) the owner's contributions of cash and other assets
- B) the owner's withdrawals of cash
- C) net loss of the business
- D) the purchase of plant assets

Answer: A

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

38) The owner's capital account decreases with _____.

- A) net income
- B) the purchase of long-term assets
- C) the owner's contributions
- D) the owner's withdrawals

Answer: D

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

39) For each of the following events:

State whether the event increases (INC) or decreases (DEC) owner's capital. If the event does not affect owner's capital, state NE for no effect.

Event	INC, DEC, NE Owner's Capital
Withdrawal of cash by owner of sole proprietorship for personal use	
Creditor loaned money to the business	
Costs of selling goods or services	

Answer:

Event	INC, DEC, NE Owner's Capital
Withdrawal of cash by owner of sole proprietorship for personal use	DEC
Creditor loaned money to the business	NE
Costs of selling goods or services	DEC

Diff: 2

LO: 1-3

AACSB: Analytical thinking

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

40) For each of the following events:
 State whether the event increases (INC) or decreases (DEC) owner's capital. If the event does not affect owner's capital, state NE for no effect.

Event	INC, DEC, NE Owner's Capital
Owner contributions of cash to a sole proprietorship	
Amounts earned from delivering goods or services to customers	
Cash paid to acquire land for use in the business	

Answer:

Event	INC, DEC, NE Owner's Capital
Owner contributions of cash to a sole proprietorship	INC
Amounts earned from delivering goods or services to customers	INC
Cash paid to acquire land for use in the business	NE

Diff: 2

LO: 1-3

AACSB: Analytical thinking

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

Learning Objective 1-4

1) A transaction is any event that affects the financial position of the business and can be measured with faithful representation.

Answer: TRUE

Explanation: A transaction is any event that affects the financial position of the business and can be measured with faithful representation.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Analyze a Transaction? (H1)

2) Accountants record _____.

- A) economic recessions
- B) estimated future transactions
- C) only those events that have dollar amounts than can be measured reliably
- D) the \$20,000 increase in value of a building that actually costs \$50,000 but could be sold for \$70,000

Answer: C

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Analyze a Transaction? (H1)

3) Which of the following events is NOT recorded by accountants?

- A) purchase of a building for \$200,000 cash
- B) effects of an economic boom
- C) sale of merchandise on account
- D) signing a \$400,000 note to purchase land

Answer: B

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: How Do You Analyze a Transaction? (H1)

4) John contributed \$6,000 cash to a sole proprietorship by opening a bank account in the name of the business, United Marketing. John received capital in the business in exchange. This transaction results in an increase in the assets of the business.

Answer: TRUE

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

5) For the accounting equation to balance, a transaction must affect both sides of the equation.

Answer: FALSE

Explanation: As long as an increase and decrease of the same amount are recorded on one side of the accounting equation, the accounting equation remains in balance.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

6) As long as an increase and decrease of the same amount are recorded on one side of the accounting equation, the accounting equation remains in balance.

Answer: TRUE

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

7) A payable is always a liability.

Answer: TRUE

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

8) Office Supplies is an expense because the supplies will be used up in the future.

Answer: FALSE

Explanation: Office Supplies is an asset because the supplies will be used up in the future.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

9) An owner's withdrawals affect the business's net income or net loss and are recorded as an expense.

Answer: FALSE

Explanation: An owner's withdrawals do not represent an expense because they are not related to the earning of revenue.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

10) Janice Wilford contributed \$50,000 cash to JW Company in exchange for capital. JW Company is a sole proprietorship. As a result of this transaction, assets and revenues will increase.

Answer: FALSE

Explanation: Assets and equity will increase.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

11) A sole proprietorship purchased office supplies on account. As a result of this transaction, expenses and liabilities will increase.

Answer: FALSE

Explanation: Assets and liabilities increase.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

12) A law firm provides legal services for clients who do not pay immediately. There is no effect on the accounting equation until the clients pay for the services.

Answer: FALSE

Explanation: Assets and revenues are increased.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

13) A law firm provides legal services for clients who do not pay immediately. As a result of this transaction, assets and revenues increase.

Answer: TRUE

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

14) An accounting firm collected cash on account. As a result of this transaction, assets and revenues increase.

Answer: FALSE

Explanation: The asset Cash increases and the asset Accounts Receivable decreases.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

15) An accounting firm collected cash on account. As a result of this transaction, total assets, liabilities, and equity are all unchanged.

Answer: TRUE

Explanation: The asset Cash increases and the asset Accounts Receivable decreases. Liabilities and equity are not affected.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

16) John Tilden contributes cash to his business in exchange for capital. John is the sole proprietor. The two accounts involved in this transaction are _____.

A) Accounts Payable and Cash

B) Cash and Tilden, Capital

C) Tilden, Capital and Accounts Payable

D) Tilden, Capital and Accounts Receivable

Answer: B

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

17) Green Lawns Company earned \$500 for landscaping services rendered. The customer promised to pay at a later time. Which of the following accounts increased as a result of this transaction?

- A) Accounts Payable
- B) Supplies
- C) Cash
- D) Accounts Receivable

Answer: D

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

18) Fred Jones, the sole owner of a business, withdraws cash for his personal use. How does this transaction affect the accounting equation?

- A) The assets, liabilities, and equity remain the same.
- B) The assets decrease and equity decreases.
- C) The assets increase and liabilities decrease.
- D) The assets decrease and equity increases.

Answer: B

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

19) Jackson Electric Services Company incurred \$800 as a repair expense and paid for it in cash. The company is a sole proprietorship. This transaction will _____.

- A) decrease the owner's equity
- B) increase the assets of the business
- C) increase the liabilities of the business
- D) decrease the liabilities of the business

Answer: A

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

20) Nick's Landscaping Services incurred \$500 as a repair expense and promised to pay the repair company within 30 days. Which of the following accounts will increase as a result of this transaction?

- A) Accounts Receivable
- B) Cash
- C) Accounts Payable
- D) Nick, Capital

Answer: C

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

21) Jason Repair Company incurred \$1,500 as an advertising expense and promised to pay the advertising agency within 30 days. The company is a sole proprietorship. Which of the following will decrease as a result of this transaction?

- A) Assets
- B) Jason, Capital
- C) Liabilities
- D) Revenues

Answer: B

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

22) Jones Supply Services paid \$350 cash, the amount owed from the previous month, to a materials supplier. Which of the following accounts decrease?

- A) Accounts Receivable
- B) Accounts Payable
- C) Jones, Capital
- D) Office Supplies

Answer: B

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

23) Montgomery Equipment Rental Company received \$1,000 cash from a customer; the amount was owed to the business from the previous month. What is the effect of this transaction on the accounting equation?

- A) Accounts Receivable increases and Service Revenue increases
- B) Cash increases and Accounts Receivable decreases
- C) Cash increases and Service Revenue increases
- D) Cash increases and Accounts Payable decreases

Answer: B

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

24) Westwood Supply Services received \$1,000 cash from a customer; the amount was owed to the business from the previous month. Which of the following accounts will decrease as a result of this transaction?

- A) Cash
- B) Revenue
- C) Accounts Payable
- D) Accounts Receivable

Answer: D

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

25) Diamond Company had the following transactions during June:

Performed services for \$3,000 on account; received cash on account, \$8,000; paid \$900 for repair expense; paid \$1,600 to a supplier that it owed from the previous month. What is the combined effect on Cash of these June transactions?

- A) \$5,500 increase
- B) \$5,500 decrease
- C) \$8,000 increase
- D) \$2,500 decrease

Answer: A

Explanation: A) Cash = \$8,000 - \$900 - \$1,600 = \$5,500 increase

Diff: 3

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

26) Saturn Company paid \$10,000 on accounts payable. How does this transaction affect the accounting equation of Saturn?

- A) assets decrease by \$10,000 and equity increases by \$10,000
- B) assets decrease by \$10,000 and liabilities decrease by \$10,000
- C) assets increase by \$10,000 and equity decreases by \$10,000
- D) assets increase by \$10,000 and liabilities increase by \$10,000

Answer: B

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

27) Brooks Landscaping Company performs lawn mowing services for its customers in May. Payments for May's services are expected to be received in June. How does the transaction for performing services in May affect the accounting equation of Brooks Landscaping?

- A) liabilities increase and equity decreases
- B) assets and equity increase
- C) assets and equity decrease
- D) liabilities and equity increase

Answer: B

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

28) Gena's Cleaning Services performs services for its customers during March. Payments for the March services are received in June. How does the transaction for the collection of cash from customers affect the accounting equation of Gena's Cleaning Services?

- A) liabilities increase and assets increase
- B) total assets remain the same
- C) assets increase and revenues increase
- D) assets increase and equity decreases

Answer: B

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

29) Mitchell Company receives a bill from one of its suppliers for advertising services received and will pay the supplier next month. How does the receipt of the bill from the supplier affect the accounting equation of Mitchell?

- A) assets and equity decrease
- B) liabilities increase and equity decreases
- C) assets and liabilities increase
- D) liabilities and equity increase

Answer: B

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

30) Newton Company settles a liability by making a payment in cash. How does paying this liability affect the accounting equation of the business?

- A) assets and liabilities decrease
- B) liabilities decrease and equity increases
- C) assets and liabilities increase
- D) assets increase and equity decreases

Answer: A

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

31) Lamar Company originally purchased land for \$33,000. It later sold the land for \$33,000 in cash. Which of the following is TRUE of the effect of the sale of land on the accounting equation?

- A) assets increase and liabilities decrease by \$33,000
- B) assets and equity increase by \$66,000
- C) assets increase by \$33,000; equity increases by \$33,000
- D) the amount of total assets remains the same

Answer: D

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

32) Rosewood Company purchased land for \$140,000 by making a cash payment of \$36,000 and promising to pay the remaining amount in a later accounting period. What is the net effect of this transaction on Rosewood's accounting equation?

- A) assets increase by \$140,000 and liabilities decrease by \$36,000
- B) assets increase by \$140,000 and liabilities decrease by \$104,000
- C) assets and equity increase by \$104,000
- D) assets and liabilities increase by \$104,000

Answer: D

Diff: 3

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

33) Mulberry Company collected \$7,000 from one of its customers, the amount owed from the previous month. How does this affect the accounting equation for Mulberry?

- A) assets increase by \$7,000; liabilities decrease by \$7,000
- B) assets increase by \$7,000; assets decrease by \$7,000
- C) assets increase by \$7,000; liabilities increase by \$7,000
- D) assets increase by \$7,000; equity increases by \$7,000

Answer: B

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

34) Country Homes Company just recorded a transaction in its books. If this transaction increased the total liabilities by \$16,000, then _____.

- A) assets must increase, or equity must decrease by \$16,000
- B) either assets or equity must decrease by \$16,000
- C) both assets and equity must each decrease by \$8,000
- D) assets must decrease by \$16,000

Answer: A

Diff: 3

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

35) Which of the following can be an effect of a transaction that increased an asset of a sole proprietorship for the accounting equation to balance?

- A) there is an equal decrease in another asset
- B) there is an equal decrease in equity
- C) there is an equal decrease in a liability account
- D) both liabilities and equity decrease

Answer: A

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

36) Johnson Waterworks Company provides plumbing services. The company is a sole proprietorship. Transactions during the first year of operations are provided below.

- a) The owner, Mitchell Johnson, contributed \$14,000 cash in exchange for capital.
- b) Paid \$1,100 for equipment to be used for plumbing repairs.
- c) Borrowed \$13,000 from a local bank and deposited the money in the checking account.
- d) Paid \$300 in rent for the year.
- e) Paid \$200 for plumbing supplies to be used on various jobs next year.
- f) Completed a plumbing repair for a law firm and received \$3,300.

Calculate the amount of total assets at the end of the first year. Assume the plumbing supplies of \$200 are left at the end of the year.

- A) \$1,300
- B) \$1,100
- C) \$27,000
- D) \$30,000

Answer: D

Explanation: D) Cash (\$14,000 + \$13,000 + \$3,300 - \$1,100 - \$300 - \$200)	\$28,700
Equipment	1,100
Supplies	<u>200</u>
Total assets	<u>\$30,000</u>

Diff: 3

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

37) McCoy Company provides plumbing services. The company is a sole proprietorship. Transactions during the first year of operations are provided below.

- a) The owner, Sharon McCoy, contributed \$10,000 cash in exchange for capital.
- b) Paid \$1,100 cash for equipment to be used for plumbing repairs.
- c) Borrowed \$12,000 from a local bank and deposited the money in the checking account.
- d) Paid \$300 rent for the year.
- e) Purchased \$200 of office supplies by cash.
- f) Completed a plumbing repair project for a local lawyer and received \$3,200 cash.

Calculate the amount of total liabilities at the end of the first year.

- A) \$12,000
- B) \$10,000
- C) \$20,900
- D) \$3,200

Answer: A

Explanation: A) Borrowings from bank = \$12,000

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

38) Gulf Waterworks Company provides plumbing services. The company is a sole proprietorship. Transactions during the first year of operations are given below.

- a) The owner, Jason Robinson, contributed \$6,000 cash in exchange for capital.
- b) Paid \$5,000 cash for equipment to be used for plumbing repairs.
- c) Borrowed \$26,000 from a local bank and deposited the money in the checking account.
- d) Paid \$600 rent for the year.
- e) Purchased \$1,800 of office supplies on account.
- f) Completed a plumbing repair project for a local lawyer and received \$3,200 cash.

Calculate the amount of total owner's equity at the end of the first year after recording the transactions. Assume office supplies of \$1,800 are left at the end of the year.

- A) \$8,600
- B) \$3,200
- C) \$6,000
- D) \$26,000

Answer: A

Explanation: A) Robinson, Capital, Ending = Capital contributions - Withdrawals + Revenues - Expenses

$$= \$6,000 \text{ (contribution)} + \$3,200 \text{ (revenue)} - \$600 \text{ (rent expense)} = \$8,600$$

Diff: 3

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

39) Springer Company, a sole proprietorship, had the following transactions in August:

Earned \$2,000 of revenues on account; collected \$4,000 from a customer for services provided last month; incurred \$800 of repair expense and paid cash; paid \$500 for rent that it owed from the previous month.

What is the net income in August?

- A) \$800
- B) \$4,000
- C) \$5,200
- D) \$1,200

Answer: D

Explanation: D) Net income = Revenue - Expenses = \$2,000 - \$800 = \$1,200.

Diff: 3

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

40) _____ represent the right to receive cash in the future from customers for goods sold or for services performed.

- A) Accounts Receivable
- B) Accounts Payable
- C) Equity
- D) Expenses

Answer: A

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

41) _____ represents a short-term liability created by purchasing "on account."

- A) Accounts Receivable
- B) Notes Payable
- C) Accounts Payable
- D) Expenses

Answer: C

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

42) Indicate the effects on the accounting equation of the following business transactions of ABC Service

Company for b) to d) below. The company is a sole proprietorship. Use proper account titles.

Transaction a) is answered as a guide.

a) Mary Johnson, the sole proprietor, contributed cash in exchange for capital.

Answer: Increase asset (Cash); Increase equity (Johnson, Capital)

b) Purchased equipment; signed a note payable.

c) Performed services for a customer on account.

d) At the end of the first month, paid office rent.

Answer:

b) Increase asset (Equipment); Increase liability (Note Payable)

c) Increase asset (Accounts Receivable); Increase equity (Service Revenue)

d) Decrease equity (Rent Expense); Decrease asset (Cash)

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

43) Indicate the effects on the accounting equation of the following business transactions of Pilgrim Service Company for b) to d) below. The company is a sole proprietorship. Use proper account titles. Transaction a) is answered as a guide.

a) Maxwell Jones, the sole proprietor, contributed cash to the business in exchange for capital.

Answer: Increase asset (Cash); Increase equity (Jones, Capital)

b) Received cash from a customer on accounts receivable.

c) Maxwell Jones withdrew cash from the business for personal use.

d) Paid cash on accounts payable.

Answer:

b) Increase asset (Cash); Decrease asset (Accounts Receivable)

c) Decrease asset (Cash); Decrease equity (Jones, Withdrawals)

d) Decrease asset (Cash); Decrease liability (Accounts Payable)

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

44) Indicate the effects on the accounting equation of the following business transactions of Garland Service

Company for b) to d) below. The company is a sole proprietorship. Use proper account titles. Transaction a) is answered as a guide.

a) Trent Garland contributed cash to the business in exchange for capital.

Answer: Increase asset (Cash); Increase equity (Garland, Capital)

b) Collected cash on accounts receivable (created 20 days earlier).

c) Purchased office supplies on account.

d) Paid cash for the current month's electric bill.

Answer:

b) Increase asset (Cash); Decrease asset (Accounts Receivable)

c) Increase asset (Office Supplies); Increase liability (Accounts Payable)

d) Decrease asset (Cash); Decrease equity (Utility Expense)

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

45) Analyze each of the following transactions in terms of their effects on the accounting equation of Osgood Delivery Service. The company is a sole proprietorship. Enter the correct amounts in the columns of the spreadsheet.

- a) James Osgood contributes \$75,000 cash to the business in exchange for capital.
- b) The business purchases \$750 of office supplies on account.
- c) The business pays cash to purchase a delivery van for \$25,000.
- d) Services are performed for clients and \$5,000 cash is received.
- e) Cash is paid for rent expense, \$800 and utilities expense, \$400.
- f) James Osgood withdraws \$1,000 from the business for personal use.

	Cash	Accts. Receivable	Office Supplies	Delivery Van	Accts. Payable	Osgood, Capital	Osgood, Withdrawals	Service Revenue	Rent Expense	Utilities Expense
a										
b										
c										
d										
e										
f										

Answer:

	Cash	Accts. Receivable	Office Supplies	Delivery Van	Accts. Payable	Osgood, Capital	Osgood, Withdrawals	Service Revenue	Rent Expense	Utilities Expense
a	+75,000					+75,000				
b			+750		+750					
c	(25,000)			+25,000						
d	+5,000							+5,000		
e	(1,200)								(800)	(400)
f	(1,000)						(1,000)			
	<u>52,800</u>		<u>750</u>	<u>25,000</u>	<u>750</u>	<u>75,000</u>	<u>(1,000)</u>	<u>5,000</u>	<u>(800)</u>	<u>(400)</u>

Diff: 2

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Transaction Analysis for Smart Touch Learning

46) List the steps, in the correct order, that are used when analyzing transactions.

Answer: Step 1: Identify the accounts and the account type.

Step 2: Decide if each account increases or decreases.

Step 3: Determine if the accounting equation is in balance.

Diff: 1

LO: 1-4

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Transaction Analysis for Smart Touch Learning

Learning Objective 1-5

1) Financial statements are business documents used to communicate information needed to make business decisions.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Prepare Financial Statements? (H1)

2) Which of the following statements best defines financial statements?

A) Financial statements are the information systems that record monetary and nonmonetary business transactions.

B) Financial statements are the verbal statements made to business news organizations by chief financial officers.

C) Financial statements are business documents that report on a business in monetary terms, providing information to help users make informed business decisions.

D) Financial statements are plans and forecasts for future time periods based on information from past financial periods.

Answer: C

Diff: 2

LO: 1-5

AACSB: Analytical thinking

AICPA Functional: Reporting

PE Question Type: Critical thinking

H2: How Do You Prepare Financial Statements? (H1)

3) Which of the following is the correct order of preparation of financial statements?

A) Income statement → statement of owner's equity → balance sheet → statement of cash flows

B) Statement of owner's equity → balance sheet → income statement → statement of cash flows

C) Balance sheet → statement of owner's equity → income statement → statement of cash flows

D) Balance sheet → income statement → statement of owner's equity → statement of cash flows

Answer: A

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Prepare Financial Statements? (H1)

4) McGuire Company is a sole proprietorship. The financial transactions of McGuire Company for the month of May, their first month of operations, are as follows:

- On May 1, 2019, Deborah McGuire, the owner, contributed \$20,000 cash in exchange for capital.
- On May 3, the company borrowed \$5,000 from a creditor and executed a note payable with the principal and interest to be due in one year.
- On May 7, the company purchased \$15,000 of equipment for cash.
- On May 8, McGuire Company rendered service to a client and received \$3,000 in cash.
- On May 12, the company incurred a repair expense of \$1,800 and promised to pay the repair contractor the following month.
- On May 18, the company rendered service to a new client in the amount of \$8,000 on account, as the client promised to pay the following month.
- At the end of May, Deborah McGuire withdrew \$1,500 cash for personal use.

Required:

1. Prepare a transaction analysis of the transactions. Determine the effects of the transactions on the accounting equation.
2. Prepare an income statement and a statement of owner's equity for the month ending May 31, 2019 for McGuire Company.
3. Prepare a balance sheet at May 31, 2019.

Answer:

1.

	Cash	Accts. Receivable	Equip-ment	Accts. Payable	Notes Payable	McGuire, Capital	McGuire, With-drawals	Service Revenue	Repair Expense
5/1	+20,000					+20,000			
5/3	+5,000				+5,000				
5/7	(15,000)		+15,000						
5/8	+3,000						+3,000		
5/12				+1,800					(1,800)
5/18		+8,000					+8,000		
5/31	(1,500)						(1,500)		
	<u>11,500</u>	<u>8,000</u>	<u>15,000</u>	<u>1,800</u>	<u>5,000</u>	<u>20,000</u>	<u>(1,500)</u>	<u>11,000</u>	<u>(1,800)</u>

2.

McGuire Company		
Income Statement		
Month Ended May 31, 2019		
Revenues:		
Service Revenue		\$11,000
Expenses:		
Repair Expense	\$1,800	
Total Expenses		<u>1,800</u>
Net Income		<u>\$9,200</u>

McGuire Company	
Statement of Owner's Equity	
Month Ended May 31, 2019	
McGuire, Capital, May 1, 2019	\$0
Owner contribution	20,000
Net Income for the month	<u>9,200</u>
	29,200
<u>Owner withdrawals</u>	<u>(1,500)</u>
McGuire, Capital, May 31, 2019	<u>\$27,700</u>

3.

McGuire Company	
Balance Sheet	
May 31, 2019	
Assets	
Cash	\$11,500
Accounts Receivable	8,000
Equipment	<u>15,000</u>
Total Assets	<u>\$34,500</u>
Liabilities	
Accounts Payable	\$1,800
Notes Payable	<u>5,000</u>
Total Liabilities	\$6,800
Owner's Equity	
McGuire, Capital	<u>\$27,700</u>
Total Owner's Equity	<u>\$27,700</u>
Total Liabilities and Owner's Equity	<u>\$34,500</u>

Diff: 3

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: How Do You Prepare Financial Statements? (H1)

5) Modern Designer Company is a sole proprietorship. The transactions for the first month of operations are as follows:

- On June 1, 2019, the owner, Cindee Litfin, contributed \$25,000 cash to the business in exchange for capital.
- On June 2, the company rendered services to three clients on account with total revenues earned of \$9,000.
- On June 5, the company incurred an advertising expense on four different web sites and promised to pay a total of \$1,200 at a later date.
- On June 13, Modern Designer purchased \$1,000 worth of office supplies for cash. (The supplies are not used by June 30.)
- On June 22, it received \$2,000 on account from a client and deposited it into the business account.
- On June 23, it incurred \$1,300 for a legal expense and paid cash.
- On June 30, Modern Designer made a payment of \$500 to one of the web sites that it owed for advertising provided earlier in the month.
- No withdrawals were made during the month.

Required:

1. Prepare a transaction analysis of the transactions. Determine the effects of the transactions on the accounting equation.
2. Prepare an income statement and a statement of owner's equity for the month ended June 30, 2019.
3. Prepare a balance sheet at June 30, 2019.

Answer:

1.

	Cash	Accts. Receivable	Office Supplies	Accts. Payable	Litfin, Capital	Litfin, Withdrawals	Service Revenue	Advertising Expense	Legal Expense
6/1	+25,000				+25,000				
6/2		+9,000					+9,000		
6/5				+1,200				(1,200)	
6/13	(1,000)		+1,000						
6/22	+2,000	(2,000)							
6/23	(1,300)								(1,300)
6/30	(500)			(500)					
	<u>24,200</u>	<u>7,000</u>	<u>1,000</u>	<u>700</u>	<u>25,000</u>		<u>9,000</u>	<u>(1,200)</u>	<u>(1,300)</u>

2.

Modern Designer Company		
Income Statement		
Month Ended June 30, 2019		
Revenues:		
Service Revenue		\$9,000
Expenses:		
Legal Expense	\$1,300	
Advertising Expense	<u>1,200</u>	
Total Expenses		<u>2,500</u>
Net Income		<u>\$6,500</u>

Modern Designer Company	
Statement of Owner's Equity	
Month Ended June 30, 2019	
Litfin, Capital, June 1, 2019	\$0
Owner contribution	25,000
Net Income for the month	<u>6,500</u>
	31,500
<u>Owner withdrawals</u>	<u>(0)</u>
Litfin, Capital, June 30, 2019	<u>\$31,500</u>

3.

Modern Designer Company	
Balance Sheet	
June 30, 2019	
Assets	
Cash	\$24,200
Accounts Receivable	7,000
Office Supplies	<u>1,000</u>
Total Assets	<u>\$32,200</u>
Liabilities	
Accounts Payable	<u>\$700</u>
Total Liabilities	\$700
Owner's Equity	
Litfin, Capital	<u>\$31,500</u>
Total Owner's Equity	<u>31,500</u>
Total Liabilities and Owner's Equity	<u>\$32,200</u>

Diff: 3

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: How Do You Prepare Financial Statements? (H1)

6) List the four financial statements and briefly explain how each is prepared.

Financial statement	How it is prepared
1.	
2.	
3.	
4.	

Answer:

Financial statement	How it is prepared
1. Income statement	Revenues -Expenses = Net Income or Net Loss
2. Statement of owner's equity	Owner, Capital, Beginning +Owner contributions +Net income for the period or - Net Loss for the period -Owner withdrawals for the period =Owner, Capital, Ending
3. Balance sheet	Assets = Liabilities + Owner's Equity
4. Statement of cash flows	Cash flows from operating activities Cash flows from investing activities Cash flows from financing activities

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Prepare Financial Statements? (H1)

7) List the four financial statements and describe the information provided by each.

Financial statement	Information provided
1.	
2.	
3.	
4.	

Answer:

Financial statement	Information provided
1. Income statement	Profitability for a particular period of time
2. Statement of owner's equity	Show changes in the owner's capital account for a period of time
3. Balance Sheet	Economic resources the company has (assets); debts the company owes (liabilities); owner's capital
4. Statement of cash flows	Cash receipts and cash payments for a period of time

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Prepare Financial Statements? (H1)

8) The income statement is also called the statement of financial position.

Answer: FALSE

Explanation: The income statement is also called the statement of earnings.

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Income Statement

9) The income statement is also called the statement of earnings.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Income Statement

10) Which of the following statements is TRUE of an income statement?

A) There is net income when total expenses are greater than total revenues.

B) There is a net loss when total expenses are less than total revenue.

C) There is a net loss when total expenses are greater than total liabilities.

D) There is net income when total revenues are greater than total expenses.

Answer: D

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Income Statement

11) Which of the following financial statements reports expenses in decreasing order of their amounts, by stating the largest expense first?

A) Statement of cash flows

B) Income statement

C) Statement of owner's equity

D) Balance sheet

Answer: B

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Income Statement

12) Regent Plumbing Company provides plumbing services. The company is a sole proprietorship. Selected transactions of Regent Plumbing Company are described as follows:

- a) Sharon Regent, the owner, contributed \$6,000 cash in exchange for capital.
- b) Paid \$4,000 cash for equipment to be used for plumbing repairs.
- c) Borrowed \$10,000 from a local bank and deposited the money in the checking account.
- d) Paid \$700 rent for the year.
- e) Paid \$200 cash for plumbing supplies to be used next year.
- f) Completed a plumbing repair project for a local lawyer and received \$3,000 cash.

Calculate the net income. Assume plumbing supplies of \$200 are left at the end of the accounting period.

- A) \$500
- B) \$2,800
- C) \$3,000
- D) \$2,300

Answer: D

Explanation: D) Net income = Revenues - Expenses

Net income = \$3,000 - \$700 = \$2,300

Diff: 3

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Income Statement

13) Following is a list of account balances of Lincoln Lawn Services as of December 31, after the first year of operations.

Accounts Receivable	\$7,000
Accounts Payable	6,000
Salaries Expense	6,000
Repairs Expense	900
Truck	8,000
Equipment	11,000
Notes Payable	26,000
Cash	8,000
Supplies Expense	11,000
Service Revenue	26,000
Gasoline Expense	7,500
Salaries Payable	1,200

Calculate the net income.

- A) \$600
- B) \$32,500
- C) \$1,000
- D) \$33,500

Answer: A

Explanation: A) Service Revenue	\$26,000
Salaries Expense	(6,000)
Repairs Expense	(900)
Supplies Expense	(11,000)
Gasoline Expense	<u>(7,500)</u>
Net income	<u>\$600</u>

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Income Statement

14) Michael Company has just completed operations for the year ended December 31, 2018. This is the second year of operations for the sole proprietorship. The following data have been assembled for the business.

Accounts Payable	\$ 12,200	Office Expense	\$ 6,500
Accounts Receivable	14,500	Rent Expense	9,600
Cash	8,200	Michael, Capital, Jan. 1, 2018	17,300
Michael, Withdrawals	13,500	Salaries Expense	36,000
Equipment	15,000	Service Revenue	84,000
Insurance Expense	4,000	Utilities Expense	6,200

Prepare the income statement. Use a proper heading.

Answer: Michael Company
Income Statement
Year Ended December 31, 2018

Revenues:	
Service Revenue	\$84,000
Expenses:	
Salaries Expense	\$36,000
Rent Expense	9,600
Office Expense	6,500
Utilities Expense	6,200
Insurance Expense	<u>4,000</u>
Total Expenses	<u>62,300</u>
Net Income	<u>\$21,700</u>

Diff: 3

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Income Statement

15) By looking at a statement of owner's equity, the effect of the owner's withdrawals on the ending balance of capital can be determined.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Owner's Equity

16) The net income (or net loss) must be calculated after the statement of owner's equity is prepared.

Answer: FALSE

Explanation: The net income (or net loss) must first be calculated on the income statement and then carried to the statement of owner's equity.

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Owner's Equity

17) Which of the following transactions will affect the balance of Owner, Capital?

A) paid accounts payable

B) paid rent expense for the month

C) purchased land for cash

D) collection on account

Answer: B

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Statement of Owner's Equity

18) In a statement of owner's equity, decreases in Owner, Capital result from _____.

A) gains on sale of land

B) net losses

C) net income

D) revenues earned

Answer: B

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Owner's Equity

19) The amount of net income is transferred from _____ to _____.

- A) the income statement; the statement of owner's equity
- B) the balance sheet; the statement of cash flows
- C) the balance sheet; the income statement
- D) the income statement; the statement of expenditures

Answer: A

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Owner's Equity

20) Which of the following appears on both the income statement and statement of owner's equity?

- A) Owner, Capital, ending balance
- B) Total revenues
- C) Net income
- D) Owner, Withdrawals

Answer: C

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Owner's Equity

21) Which of the following financial statements shows the owner's withdrawals?

- A) Income statement
- B) Statement of owner's equity
- C) Budgeted balance sheet
- D) Balance sheet

Answer: B

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Owner's Equity

22) Merian Company has just completed operations for the year ended December 31, 2018. This is the second year of operations for the company. The company is a sole proprietorship. The following data have been assembled for the business at December 31, 2018.

Accounts Payable	\$ 12,200	Office Expense	\$ 6,500
Accounts Receivable	14,500	Rent Expense	9,600
Cash	8,200	Merian, Capital, Jan. 1, 2018	17,300
Merian, Withdrawals	13,500	Salaries Expense	36,000
Equipment	15,000	Service Revenue	84,000
Insurance Expense	4,000	Utilities Expense	6,200

Prepare the statement of owner's equity for the year. There were no new capital contributions during the year. Use a proper heading.

Answer: Merian Company
Statement of Owner's Equity
Year Ended December 31, 2018

Merian, Capital, January 1, 2018	\$17,300
Net Income for the year	<u>21,700</u>
	39,000
Owner Withdrawals	<u>(13,500)</u>
Merian, Capital, December 31, 2018	<u>\$25,500</u>

Service Revenue \$84,000 - Insurance Expense \$4,000 - Office Expense \$6,500 - Rent Expense \$9,600 - Salaries Expense \$36,000 - Utilities Expense \$6,200 = Net Income \$21,700

Diff: 3

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Statement of Owner's Equity

23) The balance sheet of a business summarizes an entity's revenues and expenses.

Answer: FALSE

Explanation: The balance sheet reports on the assets, liabilities, and owner's equity of the business as of a specific date.

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Balance Sheet

24) The balance sheet reports on the assets, liabilities, and owner's equity of the business as of a specific date.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Balance Sheet

25) The heading of a balance sheet will show the date as a specific date, not a period of time.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Balance Sheet

26) The heading of a balance sheet will show the same information for the date line as the heading for a statement of owner's equity.

Answer: FALSE

Explanation: The heading of a balance sheet will show the date as a specific date, not a period of time. The heading of a statement of owner's equity will show a period of time.

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Balance Sheet

27) The balance sheet is prepared after the statement of owner's equity.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Balance Sheet

28) Which of the following is included on the balance sheet?

- A) Revenues
- B) Expenses
- C) Assets
- D) Owner, Withdrawals

Answer: C

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Balance Sheet

29) Which financial statement includes a specific date in its heading?

- A) Statement of owner's equity
- B) Statement of cash flows
- C) Income statement
- D) Balance sheet

Answer: D

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Balance Sheet

30) Which of the following financial statements reports that total assets are equal to total liabilities plus total owner's equity?

- A) Statement of owner's equity
- B) Statement of cash flows
- C) Income statement
- D) Balance sheet

Answer: D

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Balance Sheet

31) Which of the following appears on both the statement of owner's equity and the balance sheet?

- A) Owner, Capital, ending balance
- B) Total assets
- C) Total revenues
- D) Net income

Answer: A

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Balance Sheet

32) Which of the following financial statements lists the entity's assets, liabilities, and owner's equity as of a specific date?

- A) Balance sheet
- B) Statement of owner's equity
- C) Income statement
- D) Statement of cash flows

Answer: A

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Balance Sheet

33) Following is an extract of account balances of Aztec Moving Services as of December 31, after the first year of operation.

Accounts Receivable	\$4,000
Accounts Payable	4,000
Salaries Expense	7,000
Repairs Expense	700
Truck	10,000
Equipment	9,000
Notes Payable	8,200
Cash	7,100
Supplies Expense	1,200
Service Revenue	35,000
Gasoline Expense	3,600
Salaries Payable	300

What is the amount of total assets at the end of the year?

- A) \$14,000
- B) \$30,100
- C) \$19,000
- D) \$26,100

Answer: B

Explanation: B) Accounts Receivable	\$4,000
Truck	10,000
Equipment	9,000
Cash	<u>7,100</u>
Total assets	<u>\$30,100</u>

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Balance Sheet

34) The total assets and the total liabilities of Atlas Financial Services are shown below. There were no capital contributions and no withdrawals during the year.

	Total Assets	Total Liabilities
Beginning of year	\$400,000	\$295,000
End of year	440,000	320,000

What was the amount of net income for the year?

- A) \$40,000
- B) \$25,000
- C) \$15,000
- D) \$65,000

Answer: C

Explanation: C) Calculations:

	Assets	Liabilities
End of year total	\$440,000	\$320,000
Less: beginning of year total	<u>(400,000)</u>	<u>(295,000)</u>
Increase or (decrease)	<u>\$40,000</u>	<u>\$25,000</u>

Net increase or (decrease) = \$40,000 - \$25,000 = \$15,000

Diff: 3

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Balance Sheet

35) The balance of Morgan, Capital at the beginning of the year and the end of the year was \$50,000 and \$63,000, respectively. There were no new capital contributions during the year. Owner withdrawals were \$25,000. What was the net income or loss for the year?

- A) Net income of \$88,000
- B) Net loss of \$88,000
- C) Net loss of \$38,000
- D) Net income of \$38,000

Answer: D

Explanation: D)

Morgan, Capital, Beginning of year	\$50,000
Add: Net Income	?
Less: Owner Withdrawals	<u>(25,000)</u>
Morgan, Capital, End of year	<u>\$63,000</u>

? = \$38,000

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Balance Sheet

36) The net income of Thomas Company was \$73,000 for this year. The beginning balance of Thomas, Capital was \$32,000 and the ending balance was \$71,000. There were no new capital contributions during the year. What was the amount of withdrawals during the year?

- A) \$71,000
- B) \$34,000
- C) \$144,000
- D) \$32,000

Answer: B

Explanation: B) Thomas, Capital, beginning balance \$32,000

Add: Net income 73,000

Less: Thomas, Capital, ending balance (71,000)

Owner withdrawals \$34,000

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Balance Sheet

37) Following is a list of account balances of Nabers Delivery Services as of December 31, after the first year of operations.

Accounts Receivable	\$4,000
Accounts Payable	7,000
Salaries Expense	7,000
Repairs Expense	700
Truck	12,000
Equipment	11,000
Notes Payable	8,200
Cash	7,300
Supplies Expense	1,300
Service Revenue	34,000
Gasoline Expense	3,000
Salaries Payable	300

What is the amount of total liabilities at the end of the year?

- A) \$15,500
- B) \$27,500
- C) \$24,500
- D) \$15,200

Answer: A

Explanation:

A) Accounts Payable	\$7,000
Notes Payable	8,200
Salaries Payable	<u>300</u>
Total liabilities	<u>\$15,500</u>

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Balance Sheet

38) Wylie Company has just completed operations for the year ended December 31, 2018. This is the second year of operations for the company. The company is a sole proprietorship. The following data have been assembled for the business. There were no new capital contributions during the year.

Accounts Payable	\$ 12,200	Office Expense	\$ 6,500
Accounts Receivable	14,500	Rent Expense	9,600
Cash	8,200	Wylie, Capital, Jan. 1, 2018	17,300
Wylie, Withdrawals	13,500	Salaries Expense	36,000
Equipment	15,000	Service Revenue	84,000
Insurance Expense	4,000	Utilities Expense	6,200

Prepare the balance sheet at December 31, 2018. Use a proper heading.

Answer: Wylie Company
Balance Sheet
December 31, 2018

Assets		Liabilities	
Cash	\$8,200	Accounts Payable	\$12,200
Accounts Receivable	14,500	Total Liabilities	12,200
Equipment	15,000		
		Owner's Equity	
		Wylie, Capital	\$25,500
		Total Owner's Equity	25,500
Total Assets	<u>\$37,700</u>	Total Liabilities and Owner's Equity	<u>\$37,700</u>

Diff: 3

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Balance Sheet

39) If a transaction does not involve cash, such as the purchase of supplies on account, it will not be reported on the statement of cash flows.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

40) A statement of cash flows always represents a period of time.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

41) On the statement of cash flows, investing activities include cash contributions by the owner.

Answer: FALSE

Explanation: On the statement of cash flows, financing activities include cash contributions by the owner.

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

42) On the statement of cash flows, investing activities include purchases of land and equipment with the issuance of a note payable.

Answer: FALSE

Explanation: The statement of cash flows only reports transactions that involve cash.

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

43) Financial statements are prepared after an entity's transactions are analyzed and recorded. Which of the following reports is one of the required financial statements?

A) Statement of cash flows

B) Statement of return on assets

C) Statement of expenditures

D) Expense statement

Answer: A

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

44) Which of the following financial statements reports cash receipts and cash payments during a period of time?

- A) Statement of cash flows
- B) Balance sheet
- C) Cash receipts budget
- D) Statement of owner's equity

Answer: A

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

45) Which of the following financial statements reports an increase or decrease in net cash during a specific period of time?

- A) Income statement
- B) Statement of owner's equity
- C) Statement of cash flows
- D) Operating expense budget

Answer: C

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

46) Which of the following will be categorized as an operating activity on the statement of cash flows?

- A) Cash received by selling old equipment
- B) Cash paid for purchase of new machinery
- C) Cash paid to employees
- D) Cash paid for patent

Answer: C

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

47) Which of the following will be categorized as a financing activity on the statement of cash flows?

- A) Cash received by selling old equipment
- B) Cash paid for purchase of new machinery
- C) Cash paid for rent
- D) Cash contribution by owner

Answer: D

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

48) Which of the following will be categorized as an investing activity on the statement of cash flows?

- A) Purchase of land with a mortgage
- B) Cash paid for purchase of new machinery
- C) Cash paid for purchase of office supplies
- D) Cash contribution by owner

Answer: B

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

49) Which of the following is shown on the balance sheet as well as the statement of cash flows?

- A) Owner, Capital (ending balance)
- B) Net income
- C) Total assets (ending balance)
- D) Cash (ending balance)

Answer: D

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

50) List the three sections of the statement of cash flows and state what is included in each section.

Statement of cash flows sections	What is included in each section
1.	
2.	
3.	

Answer:

Statement of cash flows sections	What is included in each section
1. Cash flows from operating activities	Cash receipts for services and cash payments for expenses
2. Cash flows from investing activities	Purchase and sale of land and equipment for cash
3. Cash flows from financing activities	Owner contributions and owner withdrawals; long-term borrowings

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

Learning Objective 1-6

1) The income statement shows whether or not a business can generate enough cash to pay its liabilities.

Answer: FALSE

Explanation: The income statement provides information about profitability for a particular period for the company.

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

2) The income statement provides information about profitability for a particular period for the company.

Answer: TRUE

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

3) The balance sheet shows whether or not a business is profitable.

Answer: FALSE

Explanation: The balance sheet provides information about assets, liabilities, and owner's equity.

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

4) The balance sheet allows decision makers to determine their opinion about the financial position of the company.

Answer: TRUE

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

5) The statement of owner's equity informs users about changes in the owner's capital account over a period of time.

Answer: TRUE

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

6) Economic resources and debts of the company are shown on the balance sheet.

Answer: TRUE

Diff: 2

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

7) The statement of cash flows informs users about the changes in the owner's capital account over a period of time.

Answer: FALSE

Explanation: The statement of owner's equity informs users about the changes in the owner's capital account over a period of time.

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

8) The statement of owner's equity informs users about changes in the owner's capital account over a period of time.

Answer: TRUE

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

9) The balance sheet helps analyze the business's performance in terms of profitability.

Answer: FALSE

Explanation: The balance sheet allows decision makers to determine their opinion about the financial position of the company.

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

10) Which of the following financial statements is used to report the economic resources, debt, and overall financial position of a company?

A) income statement

B) balance sheet

C) statement of cash flows

D) statement of owner's equity

Answer: B

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

11) Which of the following financial statements is used to report cash receipts for services provided?

- A) income statement
- B) balance sheet
- C) statement of owner's equity
- D) statement of cash flows

Answer: D

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

12) Which of the following financial statements would be most useful if an analyst wants to know the likelihood of repayment of business debts?

- A) income statement
- B) balance sheet
- C) statement of owner's equity
- D) statement of cash flows

Answer: B

Diff: 2

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

13) Which of the following financial statements would be most useful if an analyst wants to know the profitability of a company?

- A) income statement
- B) balance sheet
- C) statement of owner's equity
- D) statement of cash flows

Answer: A

Diff: 2

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: How Do You Use Financial Statements to Evaluate Business Performance? (H1)

14) The return on assets is calculated by _____.

- A) subtracting net income from average total assets
- B) adding net income and average total assets
- C) dividing net income by average total assets
- D) multiplying net income and average total assets

Answer: C

Diff: 2

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Return on Assets (ROA)

15) Which of the following formulae is used to calculate average total assets for the return on assets ratio?

- A) Average total assets = (Beginning total assets + Ending total assets) \times 2
- B) Average total assets = (Beginning total assets - Ending total assets) \times 2
- C) Average total assets = (Beginning total assets - Ending total assets) / 2
- D) Average total assets = (Beginning total assets + Ending total assets) / 2

Answer: D

Diff: 2

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Return on Assets (ROA)

16) Assume Metro Company had a net income of \$2,100 for the year ending December 2018. Its beginning and ending total assets were \$33,500 and \$19,500, respectively. Calculate Metro's return on assets (ROA). (Round your percentage answer to two decimal places.)

- A) 6.27%
- B) 10.77%
- C) 7.92%
- D) 3.96%

Answer: C

Explanation: C) Return on assets (ROA) = $\$2,100 / [(\$33,500 + \$19,500) / 2] = 7.92\%$

Diff: 2

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Return on Assets (ROA)

17) McAlister Repair Service had net income for the year of \$125,000. In addition, the balance sheet reports the following balances:

	Jan. 1, 2018	Dec. 31, 2018
Accounts Receivable	\$ 5,600	\$ 14,200
Accounts Payable	12,000	9,500
Building	125,000	125,000
Cash	37,500	35,000
Office Furniture	25,000	50,000
Office Supplies	3,200	1,500
Notes Payable	60,000	75,000
Total Owner's Equity	124,300	141,200

Calculate the return on assets (ROA) for McAlister Repair Service for the year ending December 31, 2018.

Answer:

Total Assets	1/1/2018	12/31/2018
Accounts Receivable	\$ 5,600	\$ 14,200
Building	125,000	125,000
Cash	37,500	35,000
Office Furniture	25,000	50,000
Office Supplies	3,200	1,500
Total Assets	<u>\$ 196,300</u>	<u>\$ 225,700</u>

Return on Assets = Net Income / Average total assets

Average total assets = (Beginning total assets + Ending total assets) / 2

$$\begin{aligned}
 \text{Return on Assets} &= \$125,000 / [(\$196,300 + \$225,700) / 2] \\
 &= \$125,000 / \$211,000 \\
 &= 59.24\%
 \end{aligned}$$

Diff: 2

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

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18) Adams Service Company had a net income of \$14,500 for the year ending December 31, 2018. The total assets on January 1, 2018 were \$28,000. The total assets on December 31, 2018 were \$16,000.

Calculate Adam's return on assets (ROA). Show your computations and label your work. Round your answer to two decimal places.

Answer: Return on Assets = Net Income / Average total assets

Average total assets = (Beginning total assets + Ending total assets) / 2

$$\begin{aligned}\text{Return on Assets} &= \$14,500 / [(\$28,000 + \$16,000) / 2] \\ &= \$14,500 / \$22,000 \\ &= 65.91\%\end{aligned}$$

Diff: 2

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Return on Assets (ROA)

19) What is the calculation for return on assets (ROA)? What does ROA measure?

Answer: Return on Assets = Net income / Average total assets. Average total assets equal beginning total assets plus ending total assets divided by two.

ROA measures how profitably a company uses its assets.

Diff: 1

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Return on Assets (ROA)

20) Selected information for Uptown Spa Services and Downtown Spa Services follows:

Uptown Spa Services		Downtown Spa Services	
Total Assets	\$125,000	Total Assets	\$162,000
Total Owner's Equity	\$90,000	Total Owner's Equity	\$137,000
Total Revenues	\$82,000	Total Revenues	\$70,000
Net Income	\$12,000	Net Income	\$18,000

The total assets and total owner's equity balances are at December 31, 2018. Total revenues and net income are for the year ended December 31, 2018. There were no new capital contributions during the year. No owner withdrawals were taken. Average net assets are \$128,000 for Uptown and \$178,000 for Downtown.

Provide answers for the following questions. Show your work and explain your answer.

1. Which business owes more to creditors?
2. Which business has more owner's equity at the end of the year?
3. Which business had more expenses?
4. What is the ROA for each business? (Show this as a percentage and round to one decimal place) Based on ROA, which company is more profitable?

Answer:

1. Uptown has liabilities of \$35,000 (Assets \$125,000 - Total Owner's Equity \$90,000 = Liabilities \$35,000)

Downtown has liabilities of \$25,000 (Assets \$162,000 - Total Owner's Equity \$137,000 = Liabilities \$25,000)

Uptown owes more to creditors.

2. The end of year owner's equity for Uptown is \$90,000 and for Downtown is \$137,000, thus Downtown has more owner's equity at the end of the year.

3. The expenses for Uptown are \$70,000 (Total Revenues \$82,000 - Net Income \$12,000 = Total Expenses \$70,000).

The expenses for Downtown are \$52,000 (Total Revenues \$70,000 - Net Income \$18,000 = Total Expenses \$52,000).

Uptown has more expenses.

4. ROA: Uptown (Net Income \$12,000/Average Total Assets \$128,000 = ROA 9.4%)

Downtown (Net Income \$18,000/Average Total Assets \$178,000 = ROA 10.1%)

Based on ROA, Downtown is more profitable because its ROA is higher.

Diff: 3

LO: 1-3, 1-6

AACSB: Analytical thinking

AICPA Functional: Measurement

PE Question Type: Critical thinking

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