

Chapter_1

1 ■ ■ The objective of most businesses is to maximize profits.

- True
 False

2 ■ ■ A limited liability company combines attributes of a partnership and a corporation.

- True
 False

3 ■ ■ A partnership is owned by two or more individuals.

- True
 False

4 ■ ■ Manufacturing businesses change basic inputs into products that are sold to individual customers.

- True
 False

5 ■ ■ Merchandising businesses produce products rather than provide services to customers.

- True
 False

6 ■ ■ A corporation is a business that is legally separate and distinct from its owners.

- True
 False

7 ■ ■ The popularity of the sole proprietorship is due to the ease and low cost of organizing.

- True
 False

8 ■ ■ A primary disadvantage of corporations is that the financial resources available to them are limited.

- True
 False

9

- ■ The ownership of a proprietorship is divided into shares of stock owned by its stockholders.
- True
- False

- 10 ■ ■ All merchandising businesses are organized as corporations.
- True
- False

- 11 ■ ■ Stockholders of a corporation are its internal stakeholders.
- True
- False

- 12 ■ ■ John Deere is a leading manufacturer of agricultural machinery in the world producing products that serve unique market needs. Therefore, John Deere is an example of a company that uses a *premium-price* emphasis to attract customers.
- True
- False

- 13 ■ ■ A business stakeholder has an interest in the economic performance of a business.
- True
- False

- 14 ■ ■ Companies using a *low-cost* emphasis provide products and services that compete on features other than price.
- True
- False

- 15 ■ ■ The basic type of stock issued to owners is called common stock.
- True
- False

- 16 ■ ■ Assets are acquired through investing activities when resources are purchased.
- True
- False

- 17 ■ ■ Creditors have preference to assets behind stockholders if a business fails.
- True
- False

18 ■ ■ A liability is a legal obligation to repay the amount borrowed according to the terms of the borrowing agreement.

True
 False

19 ■ ■ Accounting is thought to be the "language of business" because business information is communicated to stakeholders.

True
 False

20 ■ ■ The branch of accounting related to the management's financial decisions is known as financial accounting.

True
 False

21 ■ ■ The stockholders' equity of a company should equal the sum of its total assets and total liabilities.

True
 False

22 ■ ■ The balance sheet represents the accounting equation.

True
 False

23 ■ ■ —
■ ■ — What is the primary objective of most businesses?

To maximize profits
 To pay dividends to stockholders
 To provide a benefit to society
 To manufacture a quality product

24 ■ ■ —
■ ■ — Which of the following would *not* be an example of a merchandising business?

The Walt Disney Company
 JCPenney
 Amazon.com
 Wal-Mart

25 ■ ■ —
■ ■ — Which of the items below is *not* a business organization form?

Venture entrepreneurship
 Proprietorship
 Partnership
 Corporation

26 ■ ■ —

Which of the following types of business is popular for its ease and low cost of organizing?

- Not-for-profit
- Corporation
- Partnership
- Proprietorship

27 Which of the following is true about limited liability company?

- It is taxed as a separate legal entity.
- It combines attributes of a partnership and a corporation.
- Its financial resources are limited to the individual owner's resources.
- Its formation process is complex.

28 Under a _____, a business designs products that possess unique attributes or characteristics for which customers are willing to pay more.

- premium-price emphasis
- outreach emphasis
- low-cost emphasis
- customer emphasis

29 Which of the following is *not* a characteristic of a corporation?

- Corporations are organized as a separate legal taxable entity.
- Ownership is divided into shares of stock.
- Corporations experience an ease in obtaining large amounts of resources by issuing stock.
- A corporation can elect to be taxed as a partnership.

30 A corporation is _____.

- an entity that is organized according to state or federal statutes and in which ownership is divided into shares of stock
- an entity that is owned by an individual
- an entity which has unlimited liability to creditors for the debts of the company
- an entity which has limited access to capital

31 A *low-cost* emphasis strives to provide:

- no-frills, standardized products and services.
- products and services that provide unique market needs.
- products and services that provide prestige and image for customers.
- products and services that compete on features other than price.

32 Which of the following businesses use a *premium-price* emphasis?

- Value City Furniture selling furniture at affordable prices
- Tommy Hilfiger selling products that have a unique image
- Wal-Mart reselling standardized products
- Southwest Airlines providing standardized services

33 Motel 6, a company that helps customers find budget motels across the nation, is an example of a business using which of the following?

- Low-cost emphasis

- Outreach emphasis
- Customer emphasis
- Premium-price emphasis

34 Which of the following are business stakeholders?

- Stockholders
- Suppliers
- Customers
- All of these

35 _____ is an example of internal stakeholders.

- Managers
- Creditors
- Stockholders
- Suppliers

36 Which of the following is *not* an example of a capital market stakeholder?

- Banks
- Owners
- Suppliers
- Stockholders

37 Capital market stakeholders have an interest in the company because:

- they provide incentives for the company to market their products.
- they are part of the Marketing Department that is responsible for promoting the products or services to increase the business profits.
- they help market their products to customers or find vendors to supply needed inputs.
- they provide major financing for the business.

38 Who has the first preference to assets in case a business fails?

- Stockholders
- Long-term creditors
- Customers
- Employees

39 Governments have an interest in the economic performance of business because of:

- tax collections.
- community involvement from the business.
- business incentives.
- all of these.

40 Managers are evaluated primarily on the business's:

- tax collections.
- growth.
- economic performance.
- all of these.

41 When a business borrows money, it incurs a(n):

- tax.

- liability.
- receivable.
- additional equity.

42 ■ —
■ — ■ — When a product is sold, the cost of the product sold is often called:

- cost of goods sold.
- selling cost.
- period cost.
- retained cost.

43 ■ —
■ — ■ — A note payable requires payment of the amount borrowed plus:

- interest.
- tax.
- overhead.
- dividend.

44 ■ —
■ — ■ — Shares of ownership are evidenced by issuing:

- shares payable.
- commercial paper.
- shares of stock.
- notes payable.

45 ■ —
■ — ■ — The resources a business owns are called:

- assets.
- liabilities.
- earnings.
- stockholders' equity.

46 ■ —
■ — ■ — The purchase of factory equipment would be an example of which type of business activity?

- Financing
- Investing
- Operating
- All of these

47 ■ —
■ — ■ — Which of the following is an intangible asset?

- Patent
- Cash
- Land
- Equipment

48 ■ —
■ — ■ — Rights to payments from customers are:

- liabilities.
- prepaid expenses.
- accounts receivable.
- accounts payable.

49 ■ —
■ — ■ — Which of the following is considered an asset until consumed?

- Accounts payable
- Prepaid expense
- Accounts receivable

Stockholders' equity

50 _____ is the increase in assets from selling products and services.

- Revenue
- Liabilities
- Products
- Stockholders' Equity

51 Cash collected from sales during the normal course of business would be an example of which type of business activity?

- Operating
- Investing
- Financing
- None of these

52 Costs incurred in operating a business are also known as:

- revenues.
- expenses.
- liabilities.
- dividends.

53 Debts owed by a business are referred to as:

- accounts receivable.
- equities.
- stockholders' equity.
- liabilities.

54 Cash investments made by the stockholders of the business are reported on the statement of cash flows in the:

- financing activities section.
- investing activities section.
- operating activities section.
- supplemental statement.

55 Financing activities _____ .

- involve obtaining funds to operate a business
- involve obtaining assets such as buildings and equipment
- help to earn revenues and profits
- help to make wise investments in other companies

56 Reporting the financial condition of a business at a point in time and the changes in the financial condition of a business over a period of time are the two major objectives of:

- tax accounting.
- union contracts.
- managerial accounting.
- financial accounting.

57 The role of accounting in business is best defined as:

- an information system that provides reports to stakeholders about the economic activities and condition of a business.

- a method of forecasting the future profitability of a company.
- the policies, procedures, and strategies used in a business.
- transaction analysis.

58 A list of assets, liabilities, and owners' equity as of a specific date is a(n):

- income statement.
- balance sheet.
- statement of cash flows.
- retained earnings statement.

59 Given the following list of accounts, calculate Total Assets:

Accounts Receivable	\$ 10,000
Capital Stock	20,000
Cash	25,300
Equipment	16,800
Fees Earned	44,400
Miscellaneous Expense	17,800
Rent Expense	3,250
Retained Earnings	7,850
Salaries Expense	15,400
Wages Expense	15,000

- \$52,100
- \$55,300
- \$54,600
- \$40,050

60 Which of the following is an appropriate representation of the accounting equation?

- Assets + Liabilities = Stockholders' equity
- Assets = Liabilities + Stockholders' equity
- Assets = Liabilities
- Assets = Liabilities + Retained earnings


61 Use the following information to determine Total Stockholders' Equity:

Total Assets	\$ 45,000
Total Liabilities	18,000


Total Stockholders' Equity x

Total Retained Earnings 5,000


- \$58,000
- \$27,000
- \$32,000
- \$40,000

62  A summary of the cash receipts and cash payments for a specific period of time is a(n):


- income statement.
- balance sheet.
- statement of cash flows.
- retained earnings statement.

63  The portion of a corporation's net income retained in the business is called:


- interest earnings.
- dividends.
- tax expense.
- retained earnings.

64  The debt created by a business when it makes a purchase on account is referred to as an:


- account payable.
- account receivable.
- asset.
- expense payable.

65  If there was no beginning retained earnings, net income of \$30,300, and ending retained earnings of \$8,000, how much were dividends?

- \$38,300
- \$22,300
- \$6,000
- \$8,000

66  During 2015, Trinder Corporation had an increase in total assets of \$80,000 and an increase in total liabilities of \$60,000. Assuming that capital stock increased by \$8,000 and no dividends were paid, calculate Trinder's net income or net loss for 2015.

- Net income of \$12,000
- Net income of \$72,000
- Net income of \$28,000
- Net loss of \$20,000

67  The financial statement that presents a summary of the revenues and expenses of a business for a specific period of time, such as a month or an year, is called a(n):

- prior period statement.
- statement of retained earnings.
- income statement.
- balance sheet.

68  Which of the following is the correct order for preparing financial statements?

- Income statement, Statement of cash flows, Retained earnings statement, Balance sheet
- Retained earnings statement, Income statement, Statement of cash flows, Balance sheet
- Statement of cash flows, Retained earnings statement, Balance sheet, Income statement
- Income statement, Retained earnings statement, Balance sheet, Statement of cash flows

69 A summary of the cash receipts and cash payments for a specific period of time is a(n):

- income statement.
- balance sheet.
- statement of cash flows.
- retained earnings statement.

70 Tadeo, Inc. had the following account balances at September 30, 2015. What is Tadeo's net income for the month of September?

Accounts Payable	\$ 5,800
Capital Stock	12,000
Cash	15,500
Equipment	14,300
Fees Earned	53,000
Miscellaneous Expense	16,800
Rent Expense	4,000
Retained Earnings	7,000
Wages Expense	17,850

- \$10,800
- \$14,350
- \$14,450
- \$27,500


71 Univeo, Inc. had revenues of \$245,000, expenses of \$180,000, and dividends of \$45,000 during 2015. Which of the following statements is correct?

- Net income for 2015 totaled \$65,000.
- Net income for 2015 totaled \$20,000.
- Total retained earnings increased by \$65,000 during 2015.
- Total retained earnings decreased by \$20,000 during 2015.


72 A summary of changes in the earnings retained by the corporation for a specific period of time is known as a(n):

- income statement.

- balance sheet.
- statement of cash flows.
- retained earnings statement.


73  Including all relevant data a reader needs to understand the financial condition and performance of a business refers to which concept?

- Adequate disclosure concept
- Going concern concept
- Objectivity concept
- Business entity concept


74  Heedy Company had the following account balances in 2015 and 2016, respectively. Assuming dividends of \$20,000 were paid in 2016, how much was net income?

	<u>2016</u>	<u>2015</u>
Capital Stock	\$ 42,000	\$ 40,000
Retained Earnings	x 210,000	
Total Stockholders' Equity	\$ 314,000	\$ 250,000


- \$62,000
- \$82,000
- \$272,000
- \$252,000

75  The "rules" of accounting are called:


- income tax regulations.
- SEC regulations.
- Internet rules.
- Generally Accepted Accounting Principles.

76  Which of the following is true about the cost principle?


- It limits the economic data recorded in an accounting system to data related to the activities of that company.
- It initially records assets in the accounting records at their purchase price.
- It assumes that a company will continue in business indefinitely.
- It reports the revenues earned by a company for a period with the expenses incurred in generating the revenues.

77  Recording revenue when a sale is made most directly relates to which concept?


- Going concern concept
- Periodicity concept
- Matching concept
- Adequate disclosure concept

78  Expressing financial data as if a business will continue operating for an indefinite period time refers to which concept?


- Business entity concept
- Going concern concept
- Objectivity concept
- Adequate disclosure concept

79  Due to various fraudulent business practices and accounting coverups in the early 2000s, Congress enacted the Sarbanes-Oxley Act of 2002. The act was responsible for establishing a new oversight board for public accountants called the:


- Generally Accepted Accounting Practices for Public Accountants Board.
- Public Company Accounting Oversight Board.
- Congressional Accounting Oversight Board.
- Financial Accounting Standards Board.

80  Which of the following is true of rate of return on assets?


- It is a measure of a company's profitability.
- It is used to evaluate a company's ability to pay off its short-term debts.
- It is used to determine the financial leverage of a company.
- It is a measure of the optimum capital structure.

81  The return on assets is calculated by _____.


- dividing interest expense by average total asset and average current assets
- dividing net income before taxes and interest expense by average total asset
- dividing average total asset and interest expense by net income taxes
- dividing net income before taxes and interest expense by average current assets

82  Return on assets of 4.25% implies:

- \$4.25 return on every \$100 of total assets.
- \$4.25 return on every \$100 of debt.
- \$4.25 return on every \$100 of current assets.
- \$4.25 return on every \$100 invested to purchase new assets.


83  Profitability ratios such as _____ can be used to analyze and assess a company's financial performance.

- fixed assets turnover
- current ratios
- dividend pay out ratios
- return on assets

84  Name the three different types of businesses that operate for profit and their respective characteristics.


Answer:

- (1) **Manufacturing:** These businesses change basic inputs into products to sell to individual customers.
- (2) **Merchandising:** These businesses sell products to individual customers, but do not make the products. The products are purchased from other businesses and resold to customers.
- (3) **Service:** These businesses do not make or sell products. They provide services for fees.

85  Name and describe the three forms of businesses and their advantages and disadvantages (if any).

Answer:

- (1) **Proprietorship:** owned by one individual
 Advantages: ease and low cost of organizing
 Disadvantages: the financial resources available to this type of business are limited to the owners' resources and to borrowing
- (2) **Corporation:** organized under state or federal statutes as a separate legal entity
 Ownership is divided into shares of stock
 Advantages: ability to obtain large amounts of resources by issuing stock
 Disadvantages: dividend distributions from corporations are taxed twice
- (3) **Partnership:** owned by two or more individuals
 Advantages: provides for pooling of talent
 Disadvantages: may outgrow its ability to finance operations

86  For each of the following companies, identify whether it is a service, merchandising, or manufacturing business.

A.	Dillards
B.	Time Warner Cable
C.	Kohl's
D.	Ford Motor Co.
E.	Applebee's
F.	Sylvania
G.	Best Buy
H.	GAP
I.	H & R Block

Answer:

A.	Merchandising
B.	Service
C.	Merchandising
D.	Manufacturing
E.	Service
F.	Manufacturing

G.	Merchandising
H.	Merchandising
I.	Service

87



How do businesses make money? What strategies can they use to gain a competitive advantage?

Answer:

Businesses have the objective of making money by generating more revenues than costs. Businesses can seek competitive advantage by using a *premium-price* strategy or by using a *low-cost* strategy. A *premium-price* strategy tries to meet a unique market need based on quality, reliability, image, or design, allowing it to charge a higher price. A *low-cost* strategy focuses on efficiency in product design and production to offer a lower price due to lower costs.

88



Describe business stakeholders. State the classification of business stakeholders.

Answer:

Business stakeholders are persons or entities that have an interest in the economic performance of a company.

- (1) Capital market stakeholder
- (2) Product or service market stakeholder
- (3) Government stakeholder
- (4) Internal stakeholder

89



Indicate whether each of the following activities would be reported on the statement of cash flows as an operating activity, an investing activity, a financing activity, or does not appear on the statement of cash flows.

- (a) Cash paid for building
- (b) Cash paid to suppliers
- (c) Cash paid for dividends
- (d) Cash received from customers
- (e) Cash received from the sale of capital stock.
- (f) Cash received from the sale of a building
- (g) Borrowed cash from a bank

Answer:

- (a) Investing activity
- (b) Operating activity
- (c) Financing activity
- (d) Operating activity
- (e) Financing activity
- (f) Investing activity
- (g) Financing activity

90



Define accounting and its role in business.

Answer:

Accounting provides information for managers that can be used in operations of a business. Accounting provides information to external stakeholders to use in assessing the economic performance and condition of the business.

91

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Answer:

Degen Temporary Services Income Statement For the Year Ended December 31, 2015		
Revenues:		
Service Revenue		\$1,750
Expenses:		
Salaries Expense	\$525	
Insurance Expense	75	
Supplies Expense	<u>50</u>	
Total Expenses		<u>650</u>
Net income		\$1,100

93



Three different companies--A, B, and C--have the same balance sheet at the beginning and the end of a year. These are summarized below:

	Total Assets	Total Liabilities
Beginning of the year	\$ 500,000	\$250,000
End of the year	\$1,200,000	\$350,000

Given the data above and the additional information for each company below, determine the net income (loss) for each company.

- Company A No additional investment was made by stockholders, and no dividends were paid.
- Company B Stockholders invested an additional \$200,000, and no dividends were paid.
- Company C Stockholders invested \$450,000, and dividends of \$50,000 were paid.

Answer:

- Company A Net income \$600,000
- Company B Net income \$400,000
- Company C Net income \$200,000

94



Fill in the missing amounts of the following balance sheet:

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**Prova Company
Balance Sheet
December 31, 2015**

Assets		
Cash		\$ 3,300
Accounts Receivable		2,400
Supplies		(a)
Inventory		5,700
Equipment		7,400
Land		9,250
Total Assets		\$32,550
Liabilities		
Accounts Payable	\$ 850	
Notes Payable	(b)	
Total Liabilities		\$(c)
Stockholders' Equity		
Common Stock	\$18,500	
Retained Earnings	4,200	
Total Stockholders' Equity		\$22,700
Total Liabilities and Stockholders' Equity		\$(d)

Answer:

- a) \$4,500
- b) \$9,000
- c) \$9,850
- d) \$32,550



Classify the following as an asset, liability, revenue, or expense.

- (1) Unearned revenue

- (2) Office equipment
- (3) Wages payable
- (4) Salary expense
- (5) Dividends payable
- (6) Art fees earned
- (7) Prepaid rent
- (8) Accounts receivable
- (9) Income tax expense
- (10) Office supplies

Answer:

- (1) Liability
- (2) Asset
- (3) Liability
- (4) Expense
- (5) Liability
- (6) Revenue
- (7) Asset
- (8) Asset
- (9) Expense
- (10) Asset

96



Match the following items with the appropriate financial statement:

- a. Income statement
- b. Balance sheet
- c. Retained earnings statement
- d. Statement of cash flows

- (1) Cash
- (2) Salary expense
- (3) Unearned revenue
- (4) Depreciation expense
- (5) Capital stock
- (6) Cash flows from operating activities
- (7) Accounts receivable
- (8) Beginning balance of retained earnings
- (9) Notes payable
- (10) Accounts payable
- (11) Changes in current assets and current liabilities
- (12) Total expenses

Answer:

- (1) Balance sheet
- (2) Income statement
- (3) Balance sheet
- (4) Income statement
- (5) Balance sheet
- (6) Statement of cash flows
- (7) Balance sheet
- (8) Retained earnings statement
- (9) Balance sheet
- (10) Balance sheet
- (11) Statement of cash flows
- (12) Income statement

97





Review Coke-Cola's financial statements and answer the following questions:

- (1) How are Coke's numbers reported (in what denomination)?
- (2) What is Coke's net operating revenue for 2008?
- (3) What is Coke's cost of goods sold for 2008?
- (4) What is Coke's net income 2008?
- (5) What is Coke's percent of interest expense to net operating revenue on its 2008 income statement?
- (6) What is Coke's percent of increase in net operating revenue from 2007 to 2008?

Answer:

- (1) In millions of dollars
- (2) \$31,944,000,000
- (3) \$11,374,000,000
- (4) \$5,807,000,000
- (5) $438/31,944 = 1.37\%$
- (6) $(31,944 - 28,857)/28,857 = 10.7\%$





Review Coke-Cola's financial statements and answer the following questions:

- (1) What is Coke's percent of current assets to total assets on its December 31, 2008 balance sheet?
- (2) What is Coke's percentage of current liabilities to total stockholders' equity on its December 31, 2008 balance sheet?
- (3) What is the percentage increase in cash and cash equivalents from 2007 to 2008?
- (4) What percentage did total assets decrease from 2007 to 2008?

Answer:

- (1) $12,176/40,519 = 30.05\%$
- (2) $12,988/20,472 = 63.44\%$
- (3) $(4,701 - 4,093)/4,093 = 14.85\%$
- (4) $(40,519 - 43,269)/43,269 = (6.36\%)$

99



On May 31, 2015, Deana's Services Company had account balances as follows:

Accounts payable	\$ 9,900
Accounts receivable	26,950
Cash	11,390

Fees earned	70,800
Insurance expense	1,475
Land	74,400
Miscellaneous expense	1,510
Prepaid insurance	2,000
Rent expense	8,000
Salary expense	35,300
Dividends	15,100
Supplies	950
Supplies expense	825
Utilities expense	3,800
Capital stock	81,000
Retained earnings (beginning balance on May 1, 2015)	20,000

Present, in good form, (a) an income statement for May, (b) a statement of retained earnings for May, and (c) a balance sheet as of May 31.

Answer:

(a)

Deana's Services Company
Income Statement

For the Month Ended May 31, 2015

Fees earned	\$70,800
Operating expenses:	
Salary expense	\$35,300
Rent expense	8,000
Utilities expense	3,800
Supplies expense	825
Insurance expense	1,475
Miscellaneous expense	<u>1,510</u>
Total operating expenses	<u>50,910</u>
Net income	\$19,890

(b)

Deana's Services Company Statement of Retained Earnings For the Month Ended May 31, 2015	
Retained earnings, May 1, 2015	\$20,000
Net income for the month	<u>19,890</u>
Subtotal	39,890
Less dividends	<u>15,100</u>
Retained earnings, May 31, 2015	\$24,790

(c)

Deana's Services Company
Balance Sheet
May 31, 2015

<u>Assets</u>		<u>Liabilities</u>	
Cash	\$ 11,390	Accounts payable	\$ 9,900
Accounts receivable	26,950		
Prepaid insurance	2,000	<u>Stockholders' Equity</u>	
Supplies	950	Capital stock 81,000	
Land	<u>74,400</u>	Retained earnings <u>24,790</u>	
		Total stockholders'	<u>105,790</u>
		equity	
		Total liabilities and	
Total assets	\$115,690	stockholders' equity	\$115,690

100



Match each statement with the appropriate accounting concept. (Some items may not be used. Others may be used more than once.)

- Accounting period concept
- Adequate disclosure concept
- Business entity concept
- Cost concept
- Going concern concept
- Matching concept
- Objectivity concept
- Unit of measure concept

- Owners' transactions are separate from business transactions.
- Financial statements are prepared at the end of each year.
- Land purchased for \$50,000, 10 years ago, is reported on the Balance Sheet at \$50,000.
- December rent expense paid in January is reported with the December revenues.
- All transactions are recorded and reported in dollars.
- Providing a summary of significant accounting policies
- Assumes that IBM will continue as a corporation forever
- The length of time left on debt obligations is shown.

Answer:

- c
- a
- d
- f
- h
- b
- e
- b

■ — From the following information for BlueInks Corporation, compute the rate on return of assets.
■ —
■ —

Net income after tax	\$30,548
Taxes	\$6,785
Interest expense	\$3,545
Total assets at beginning of year	\$150,500
Total assets at end of year	\$175,684

- 20.90%
- 25.06%
- 22.89%
- 18.73%