



Chapter 01 - Uses of Accounting Information and the Financial Statements

TRUE/FALSE

1. The intentional preparation of misleading financial statements is referred to as fraudulent financial reporting.

ANS: T PTS: 1 OBJ: LO1 NAT: AACSB correlation: ethics
 LOC: Learning type: Recall KEY: ethical reporting

2. Fraudulent financial reporting can result from the misapplication of accounting principles.

ANS: T PTS: 1 OBJ: LO1 NAT: AACSB correlation: ethics
 LOC: Learning type: Recall KEY: ethical reporting

3. Criminal penalties cannot be imposed on those who prepare fraudulent financial statements.

ANS: F PTS: 1 OBJ: LO1 NAT: AACSB correlation: ethics
 LOC: Learning type: Recall KEY: ethical reporting

4. The Sarbanes-Oxley Act orders the FASB to hold chief executives and CFOs responsible for the accuracy of their company's financial statements.

ANS: F PTS: 1 OBJ: LO1 NAT: AACSB correlation: ethics
 LOC: Learning type: Recall KEY: ethical reporting

5. Responsibility for ethical financial reporting rests solely with the accountant.

ANS: F PTS: 1 OBJ: LO1 NAT: AACSB correlation: ethics
 LOC: Learning type: Recall KEY: ethical reporting

6. Earned income is a measure of profitability.

ANS: T PTS: 1 OBJ: LO1
 NAT: AACSB correlation: analytic LOC: Learning type: Recall
 KEY: profitability

7. Obtaining funds from a bank is an example of an investing activity.

ANS: F PTS: 1 OBJ: LO1
 NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
 KEY: business activities

8. Paying taxes to the government is an example of an operating activity.

ANS: T PTS: 1 OBJ: LO1
 NAT: AACSB correlation: communication
 LOC: Learning type: Comprehension KEY: business activities

9. Management accounting focuses on external decision making.

ANS: F PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: management functions

10. The processing stage of accounting is accomplished by the recording of data.

ANS: F PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: recording entries

11. The terms *bookkeeping* and *accounting* are synonymous.

ANS: F PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: accounting information and the Internet

12. A company's management information system is a subsystem of its accounting information system.

ANS: F PTS: 1 OBJ: LO1
NAT: AACSB correlation: technology LOC: Learning type: Recall
KEY: accounting information and the Internet| management information systems

13. The modern definition of *accounting* focuses on the role of accounting in making economic decisions rather than on how to do accounting.

ANS: T PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: accounting information and the Internet

14. Two major goals of business are to achieve profitability and to achieve liquidity.

ANS: T PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: business goals

15. Liquidity means having enough funds on hand to pay debts when they fall due.

ANS: T PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: business goals| liquidity and current liabilities

16. Financial accounting information is used primarily by management.

ANS: F PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: accounting information and the Internet| role of financial accounting

17. Accounting ratios are useful as management performance measures.

ANS: T PTS: 1 OBJ: LO1

NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: performance measures

18. The purchase of equipment is an example of a financing activity.

ANS: F PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication
LOC: Learning type: Comprehension KEY: business activities

19. Buying and selling goods and services are examples of operating activities.

ANS: T PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication
LOC: Learning type: Comprehension KEY: business activities

20. A major function of management is to provide the accountant with relevant and useful information.

ANS: F PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: management functions

21. The Federal Reserve Board is an example of an economic planner.

ANS: T PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication
LOC: Learning type: Comprehension KEY: financial information users

22. The primary external users of accounting information are investors and creditors.

ANS: T PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users

23. The Securities and Exchange Commission is an accounting information user with a direct financial interest.

ANS: F PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users

24. Taxing authorities are considered accounting information users with an indirect financial interest.

ANS: T PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users

25. Creditors are those who lend money to others or deliver goods and services before being paid.

ANS: T PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users

26. Regulatory agencies are considered information users with an indirect financial interest.
- ANS: T PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users
27. Accountants consider money the common unit of measure for all business transactions.
- ANS: T PTS: 1 OBJ: LO3
NAT: AACSB correlation: communication
LOC: Learning type: Comprehension KEY: measurement issues| money measure
28. Payment to a creditor is an example of a nonexchange business transaction.
- ANS: F PTS: 1 OBJ: LO3
NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
KEY: business transactions
29. For accounting purposes, a business and its owners are considered separate entities.
- ANS: T PTS: 1 OBJ: LO3
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: concept of separate entity
30. Knowledge of the exchange rate is necessary to apply the money measure concept in case of international transactions.
- ANS: T PTS: 1 OBJ: LO3
NAT: AACSB correlation: diversity LOC: Learning type: Comprehension
KEY: measurement issues| money measure
31. For reporting purposes, the personal assets and debts of a business owner should be combined with the assets and debts of the business.
- ANS: F PTS: 1 OBJ: LO3
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: sole proprietorships
32. Exchange rates for currency change daily according to the supply and demand for each currency.
- ANS: T PTS: 1 OBJ: LO3
NAT: AACSB correlation: diversity LOC: Learning type: Comprehension
KEY: measurement issues| money measure
33. Partnerships in the United States generate more revenue than sole proprietorships and corporations put together.
- ANS: F PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: partnerships

34. A corporation is an economic unit that is legally separate from its owners.

ANS: T PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

35. Corporations represent the largest number of businesses in the United States.

ANS: F PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

36. The liability of corporate stockholders is limited to the amount of their investment.

ANS: T PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

37. The board of directors appoints the audit committee, which in turn performs an independent audit of the company's records.

ANS: F PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

38. The articles of incorporation may be found in the corporate charter.

ANS: T PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication
LOC: Learning type: Comprehension KEY: corporations

39. Authorized shares of stock refer to the number of shares currently held by the stockholders.

ANS: F PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

40. Corporate governance is the oversight of a company's management performance and ethics by its board of directors.

ANS: T PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

41. The board of directors carries out the day-to-day operations of a corporation.

ANS: F PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

42. The number of authorized shares of stock may be less than the number of outstanding shares.

ANS: F PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

43. The management of a corporation is responsible for electing the board of directors.

ANS: F PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

44. In general, any partner can obligate the partnership to another party.

ANS: T PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: partnerships

45. A partnership is dissolved when any partner leaves the business or dies.

ANS: T PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: partnerships

46. Financial position may be assessed by referring to a balance sheet.

ANS: T PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: effects of transactions on accounting equation

47. *Creditors' equities* is another term for *liabilities*.

ANS: T PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: liabilities

48. One way of stating the accounting equation is: Assets + Liabilities = Stockholders' Equity.

ANS: F PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: effects of transactions on accounting equation

49. The economic resources to which the owners have claim are represented by stockholders' equity.

ANS: T PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

50. Equipment is an asset that is considered nonmonetary in nature.

ANS: T PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall

KEY: assets

51. *Net income* is another term for *revenues*.

ANS: F PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

52. *Cash* is another term for *retained earnings*.

ANS: F PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

53. Contributed capital appears in the stockholders' equity section of a corporate balance sheet.

ANS: T PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

54. Revenues have the effect of increasing contributed capital.

ANS: F PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

55. Dividends are an example of an expense.

ANS: F PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
KEY: owner's equity

56. The retained earnings figure is typically divided into par value and additional paid-in capital.

ANS: F PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

57. If a corporation has suffered only net losses since its inception, the Retained Earnings account will have a negative balance.

ANS: T PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

58. Net assets equal assets plus liabilities.

ANS: F PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

59. Stockholders' equity equals contributed capital plus retained earnings.

ANS: T PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

60. Par value is the minimum amount that can be reported as retained earnings.

ANS: F PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: owner's equity

61. The statement of retained earnings discloses the dividends declared during the period.

ANS: T PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: financial statements| statement of stockholders' equity

62. The heading for a balance sheet might include the line "As of December 31, 20xx."

ANS: T PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: balance sheet

63. The income statement is also known as the statement of financial position.

ANS: F PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: income statement

64. The statement of cash flows discloses significant events related to the operating, investing, and financing activities of a business.

ANS: T PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: statement of cash flows

65. The statement of retained earnings relates the income statement to the balance sheet by showing how the Retained Earnings account changed during the accounting period.

ANS: T PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
KEY: financial statements

66. The purchase of land for cash would be disclosed on the statement of cash flows.

ANS: T PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
KEY: business activities| statement of cash flows

67. The accounting fees earned by an accounting firm would appear on its balance sheet.

ANS: F PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: balance sheet

68. A proper heading for the income statement could include "For the Year Ended December 31, 20xx."

ANS: T PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: income statement

69. The title "wages payable" would appear on the income statement.

ANS: F PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: income statement| liabilities

70. An increase in revenue will result in an increase in stockholders' equity.

ANS: T PTS: 1 OBJ: LO5
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: effects of transactions on accounting equation

71. The declaration of a dividend will reduce net income.

ANS: F PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: effects of transactions on accounting equation

72. The title "supplies" will appear as an expense on the income statement.

ANS: F PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: income statement| owner's equity

73. Generally accepted accounting principles encompass the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time.

ANS: T PTS: 1 OBJ: LO7 NAT: AACSB correlation: ethics
LOC: Learning type: Recall KEY: financial statements

74. The International Accounting Standards Board is the primary and most important determinant of generally accepted accounting principles.

ANS: F PTS: 1 OBJ: LO7 NAT: AACSB correlation: ethics
LOC: Learning type: Recall KEY: professional organizations

75. Companies whose securities are sold to the general public must adhere to standards established by the Securities and Exchange Commission.

ANS: T PTS: 1 OBJ: LO7 NAT: AACSB correlation: ethics

LOC: Learning type: Recall

KEY: professional organizations

76. The Internal Revenue Service is responsible for issuing accounting standards for state and local governments.

ANS: F PTS: 1

OBJ: LO7

NAT: AACSB correlation: ethics

LOC: Learning type: Recall

KEY: professional organizations

77. Independence is the avoidance of all relationships that impair or appear to impair the objectivity of the accountant.

ANS: T PTS: 1

OBJ: LO7

NAT: AACSB correlation: ethics

LOC: Learning type: Recall

KEY: professional ethics

78. Both public accountants and management accountants are required to adhere to a code of professional conduct.

ANS: T PTS: 1

OBJ: LO7

NAT: AACSB correlation: ethics

LOC: Learning type: Recall

KEY: professional ethics

79. Objectivity means carrying out one's professional responsibilities with competence and diligence.

ANS: F PTS: 1

OBJ: LO7

NAT: AACSB correlation: ethics

LOC: Learning type: Recall

KEY: professional ethics

80. Due care means carrying out one's professional responsibilities honestly and impartially.

ANS: F PTS: 1

OBJ: LO7

NAT: AACSB correlation: ethics

LOC: Learning type: Recall

KEY: professional ethics

81. The Public Company Accounting Oversight Board (PCOAB) was created to determine the standards that auditors must follow.

ANS: T PTS: 1

OBJ: LO7

NAT: AACSB correlation: ethics

LOC: Learning type: Recall

KEY: professional organizations

MULTIPLE CHOICE

1. The intentional preparation of misleading financial statements, known as fraudulent financial reporting, can result from all of the following *except*
- the misapplication of accounting principles.
 - the manipulation of inventory records.
 - fictitious sales or orders.
 - recording a revenue that has been earned but not yet received.

ANS: D PTS: 1

OBJ: LO1

NAT: AACSB correlation: ethics

LOC: Learning type: Recall

KEY: ethical reporting

2. All of the following statements are true about the Sarbanes-Oxley Act *except*
- it applies to publicly traded companies.
 - it shields chief executives from criminal penalties.

- c. it orders the SEC to draw up certain rules.
- d. its primary goal is to regulate financial reporting and the accounting profession.

ANS: B PTS: 1 OBJ: LO1 NAT: AACSB correlation: ethics
LOC: Learning type: Recall KEY: ethical reporting

3. The purchase of land is an example of a(n)
- a. investing activity.
 - b. operating activity.
 - c. capital activity.
 - d. financing activity.

ANS: A PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication
LOC: Learning type: Comprehension KEY: business activities

4. The correct order of the three stages of accounting is
- a. communication, processing, and measurement.
 - b. measurement, communication, and processing.
 - c. processing, measurement, and communication.
 - d. measurement, processing, and communication.

ANS: D PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: accounting information and the Internet

5. Which of the following is an example of an operating activity?
- a. Obtaining capital from stockholders
 - b. Selling goods and services to customers
 - c. Purchasing equipment
 - d. Selling land

ANS: B PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication
LOC: Learning type: Comprehension KEY: business activities

6. Which of the following is an example of an investing activity?
- a. Purchasing a building
 - b. Obtaining a bank loan
 - c. Paying taxes to the government
 - d. Producing goods and services

ANS: A PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication
LOC: Learning type: Comprehension KEY: business activities

7. Which of the following is an example of a financing activity?
- a. Employing workers
 - b. Selling equipment
 - c. Paying off a loan
 - d. Purchasing land

ANS: C PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication

LOC: Learning type: Comprehension KEY: business activities

8. The communication stage of accounting is accomplished by
- storing data.
 - reporting to decision makers.
 - processing data.
 - recording data.

ANS: B PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: accounting information and the Internet

9. Which of the following is the most appropriate and modern definition of *accounting*?
- Electronic collection, organization, and communication of vast amounts of information
 - The interconnected network of subsystems necessary to operate a business
 - A means of recording transactions and keeping records
 - The measurement, processing, and communication of financial information about an identifiable economic entity

ANS: D PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: accounting information and the Internet

10. The measurement stage of accounting is accomplished by
- recording data.
 - reporting to decision makers.
 - processing data.
 - storing data.

ANS: A PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: accounting information and the Internet

11. The processing stage of accounting is accomplished by
- reporting to decision makers.
 - recording transactions.
 - controlling and evaluating data.
 - bookkeeping, computers, and information systems.

ANS: D PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: accounting information and the Internet

12. A company's ability to attract and hold investment capital ultimately depends on its
- budgeting.
 - planning.
 - liquidity.
 - profitability.

ANS: D PTS: 1 OBJ: LO1
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: business goals

13. The group of users of accounting information charged with achieving the goals of the business is its
- auditors.
 - creditors.
 - management.
 - investors.

ANS: C PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users

14. A primary user of accounting information with a direct financial interest in the business is a
- regulatory agency.
 - creditor.
 - taxing authority.
 - labor union.

ANS: B PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users

15. Which of the following groups uses accounting information primarily to help protect the public?
- Management
 - Regulatory agencies
 - Taxing authorities
 - Economic planners

ANS: B PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users

16. One user of accounting information with an indirect financial interest in a business is
- a creditor.
 - a financial adviser.
 - management.
 - an investor.

ANS: B PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users

17. Companies listed on the stock exchanges must file financial statements with the
- Financial Accounting Standards Board.
 - American Institute of Certified Public Accountants.
 - Securities and Exchange Commission.
 - Internal Revenue Service.

ANS: C PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: professional organizations

18. Which of the following is an agency of the U.S. government?
- IASB
 - SEC

- c. FASB
- d. AICPA

ANS: B PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: professional organizations

19. Those who lend money or deliver goods and services before being paid are called
- a. investors.
 - b. debtors.
 - c. underwriters.
 - d. creditors.

ANS: D PTS: 1 OBJ: LO2
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: financial information users

20. Which of the following transactions does *not* involve an exchange of value?
- a. Payment of a debt
 - b. Purchase of a building on credit
 - c. Borrowing money
 - d. Loss from theft

ANS: D PTS: 1 OBJ: LO3
NAT: AACSB correlation: analytic LOC: Learning type: Recall
KEY: business transactions

21. An accounting measurement is concerned with all *except* which of the following?
- a. Money measure
 - b. Financial position
 - c. Separate entity
 - d. Business transaction

ANS: B PTS: 1 OBJ: LO3
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: measurement issues

22. The separate entity concept requires that
- a. the personal assets and liabilities of an owner not be shown on the business's financial statements.
 - b. transactions that involve an exchange of value be kept separate from those that do not.
 - c. tax records be kept separate from financial reporting records.
 - d. a separate set of books be established for each segment of a business.

ANS: A PTS: 1 OBJ: LO3
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: concept of separate entity

23. The topic of foreign exchange rates relates most closely to the concept of
- a. separate entity.
 - b. money measure.
 - c. nonexchange transactions.
 - d. business transactions.

ANS: B PTS: 1 OBJ: LO3
NAT: AACSB correlation: diversity LOC: Learning type: Comprehension
KEY: money measure

24. All of the following are considered nonexchange transactions *except*
- the day-by-day accumulation of interest.
 - the wear and tear on machinery.
 - the sale of goods and services.
 - losses from fire, flood, and theft.

ANS: C PTS: 1 OBJ: LO3
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: business transactions

25. Which of the following transactions involves an exchange of value?
- Accumulation of interest
 - Sale of services
 - Flood loss
 - Wear and tear on equipment

ANS: B PTS: 1 OBJ: LO3
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: business transactions

26. Which of the following is legally a separate entity from its owner(s)?
- Sole proprietorship only
 - Sole proprietorship and partnership only
 - Corporation only
 - Partnership only

ANS: C PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: sole proprietorships

27. Most business enterprises in the United States are
- government units.
 - partnerships.
 - sole proprietorships.
 - corporations.

ANS: C PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: sole proprietorships

28. Which of the following is considered by *accountants* to be a separate entity from its owner(s)?
- Partnership only
 - Sole proprietorship only
 - Corporation only
 - Sole proprietorship, partnership, and corporation

ANS: D PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: concept of separate entity

29. Dividends of a corporation are declared by its
- board of directors.
 - officers.
 - stockholders.
 - creditors.

ANS: A PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

30. The corporate officers are responsible for
- arranging for major loans with banks.
 - determining corporate policy.
 - carrying out corporate policy.
 - appointing the board of directors.

ANS: C PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

31. The board of directors of a corporation is responsible for all of the following *except*
- arranging for major bank loans.
 - authorizing contracts.
 - carrying out the daily operations of the business.
 - declaring dividends.

ANS: C PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

32. The audit committee is responsible for all of the following *except*
- engaging the company's independent auditors.
 - assuring that reliable accounting records are kept.
 - auditing the company's financial statements.
 - ascertaining that the company safeguards its resources.

ANS: C PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

33. Transfer of ownership will not affect the continuity of a
- corporation..
 - sole proprietorship.
 - partnership
 - corporation or partnership.

ANS: A PTS: 1 OBJ: LO4
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: corporations

34. Which of the following is not a satisfactory statement of the accounting equation?
- $\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$

- b. Assets – Stockholders' Equity = Liabilities
- c. Assets = Liabilities – Stockholders' Equity
- d. Assets – Liabilities = Stockholders' Equity

ANS: C PTS: 1 OBJ: LO5
 NAT: AACSB correlation: analytic LOC: Learning type: Recall
 KEY: effects of transactions on accounting equation

35. The best definition of *assets* is the
- a. cash owned by the company.
 - b. resources belonging to a company having future benefit to the company.
 - c. collection of resources belonging to the company and the claims on these resources.
 - d. owners' investment in the business.

ANS: B PTS: 1 OBJ: LO5
 NAT: AACSB correlation: analytic LOC: Learning type: Recall
 KEY: assets

36. Which of the following items has no effect on stockholders' equity?
- a. Land purchased
 - b. Revenue
 - c. Expense
 - d. Dividend declared and paid

ANS: A PTS: 1 OBJ: LO5
 NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
 KEY: owner's equity

37. Which of the following accounts is *not* considered an asset?
- a. Accounts Receivable
 - b. Inventory
 - c. Retained Earnings
 - d. Trademark

ANS: C PTS: 1 OBJ: LO5
 NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
 KEY: assets

38. An example of a monetary asset is
- a. Accounts Receivable.
 - b. Copyright.
 - c. Retained Earnings.
 - d. Land.

ANS: A PTS: 1 OBJ: LO5
 NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
 KEY: assets

39. Stockholders' equity of a corporation would *not* show
- a. retained earnings.
 - b. additional paid-in capital on stock issued.
 - c. the par value of stock issued.
 - d. revenues and expenses.

ANS: D PTS: 1 OBJ: LO5
 NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
 KEY: owner's equity

40. All of the following will affect retained earnings *except*
- expenses incurred.
 - dividends declared and paid.
 - revenues earned.
 - investments by owners.

ANS: D PTS: 1 OBJ: LO5
 NAT: AACSB correlation: analytic LOC: Learning type: Recall
 KEY: owner's equity

41. A liability would *not* include an obligation to
- transfer assets.
 - hire an employee.
 - pay cash.
 - provide services.

ANS: B PTS: 1 OBJ: LO5
 NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
 KEY: liabilities

42. Which of the following assets could be described as nonphysical?
- Buildings
 - Cash
 - Patents
 - Equipment

ANS: C PTS: 1 OBJ: LO5
 NAT: AACSB correlation: analytic LOC: Learning type: Recall
 KEY: assets

43. Which of the following financial statements is concerned with the enterprise at a point in time?
- Statement of retained earnings
 - Income statement
 - Statement of cash flows
 - Balance sheet

ANS: D PTS: 1 OBJ: LO6
 NAT: AACSB correlation: analytic LOC: Learning type: Recall
 KEY: balance sheet

44. Flores Realty Corporation had the following balance sheet accounts and balances:

Accounts Payable	\$6,000	Common Stock	?
Accounts Receivable	1,000	Equipment	\$7,000
Building	?	Land	7,000
Cash	3,000	Retained Earnings	2,000

If the balance of the Common Stock account were \$29,500, what would be the balance of the Building account?

- a. \$14,500
- b. \$35,500
- c. \$31,500
- d. \$19,500

ANS: D PTS: 1 OBJ: LO6
 NAT: AACSB correlation: analytic LOC: Learning type: Analysis
 KEY: balance sheet

45. Flores Realty Corporation had the following balance sheet accounts and balances:

Accounts Payable	\$6,000	Common Stock	?
Accounts Receivable	1,000	Equipment	\$7,000
Building	?	Land	7,000
Cash	3,000	Retained Earnings	2,000

If the balance of the Building account were \$26,500, what would be the total of liabilities and stockholders' equity?

- a. \$26,500
- b. \$44,500
- c. \$41,500
- d. \$36,500

ANS: B PTS: 1 OBJ: LO6
 NAT: AACSB correlation: analytic LOC: Learning type: Analysis
 KEY: balance sheet

46. Flores Realty Corporation had the following balance sheet accounts and balances:

Accounts Payable	\$6,000	Common Stock	?
Accounts Receivable	1,000	Equipment	\$7,000
Building	?	Land	7,000
Cash	3,000	Retained Earnings	2,000

If the balance of the Building account were \$15,000 and if the equipment were sold for \$7,000, what would be the total of stockholders' equity?

- a. \$27,000
- b. \$16,000
- c. \$15,000
- d. \$33,000

ANS: A PTS: 1 OBJ: LO6
 NAT: AACSB correlation: analytic LOC: Learning type: Analysis
 KEY: balance sheet

47. Flores Realty Corporation had the following balance sheet accounts and balances:

Accounts Payable	\$6,000	Common Stock	?
Accounts Receivable	1,000	Equipment	\$7,000
Building	?	Land	7,000
Cash	3,000	Retained Earnings	2,000

If the balance of the Building account were \$14,000 and \$3,000 of Accounts Payable were paid in cash, what would be the balance of the Common Stock account?

- a. \$24,000
- b. \$21,000
- c. \$32,000
- d. \$34,000

ANS: A PTS: 1 OBJ: LO6
 NAT: AACSB correlation: analytic LOC: Learning type: Analysis
 KEY: balance sheet

48. Flores Realty Corporation had the following balance sheet accounts and balances:

Accounts Payable	\$6,000	Common Stock	?
Accounts Receivable	1,000	Equipment	\$7,000
Building	?	Land	7,000
Cash	3,000	Retained Earnings	2,000

If the balance of the Building account were \$8,000 and \$3,000 of Accounts Payable were paid in cash, what would be the total liabilities and stockholders' equity?

- a. \$14,000
- b. \$23,000
- c. \$18,000
- d. \$19,000

ANS: B PTS: 1 OBJ: LO6
 NAT: AACSB correlation: analytic LOC: Learning type: Analysis
 KEY: balance sheet

49. Following is the balance sheet for Abbot Box Company, Inc.:

Abbot Box Company, Inc. Balance Sheet December 31, 20xx			
Assets		Liabilities	
Cash	\$ 8,000	Accounts payable	\$16,000
Accounts receivable	1,000		
Land	14,000		
Building	44,000	Stockholders' Equity	
Equipment	<u>13,000</u>	Common stock	\$40,000
		Retained earnings	<u>24,000</u>
		Total stockholders' equity	<u>64,000</u>
Total assets	<u>\$80,000</u>	Total liabilities and stockholders' equity	<u>\$80,000</u>

If the balance in the Cash account were used to pay part of Accounts Payable, then total liabilities and stockholders' equity would

- a. decrease by \$8,000.
- b. increase by \$8,000.
- c. increase by \$16,000.
- d. decrease by \$16,000.

ANS: A PTS: 1 OBJ: LO6
 NAT: AACSB correlation: analytic LOC: Learning type: Analysis
 KEY: balance sheet

50. Use this information to answer the following question.

Here is the balance sheet for Abbot Box Company, Inc.:

Abbot Box Company, Inc. Balance Sheet December 31, 20xx			
Assets		Liabilities	
Cash	\$ 8,000	Accounts payable	\$16,000
Accounts receivable	1,000		
Land	14,000	Stockholders' Equity	
Building	44,000	Common stock	\$40,000
Equipment	<u>13,000</u>	Retained earnings	<u>24,000</u>
		Total stockholders' equity	<u>64,000</u>
Total assets	<u>\$80,000</u>	Total liabilities and stockholders' equity	<u>\$80,000</u>

If the equipment were sold for \$13,000, then the Retained Earnings account would

- increase by \$37,000.
- increase by \$13,000.
- decrease by \$13,000.
- stay the same.

ANS: D PTS: 1 OBJ: LO6
 NAT: AACSB correlation: analytic LOC: Learning type: Analysis
 KEY: balance sheet

51. Use this information to answer the following question.

Here is the balance sheet for Abbot Box Company, Inc.:

Abbot Box Company, Inc. Balance Sheet December 31, 20xx			
Assets		Liabilities	
Cash	\$ 8,000	Accounts payable	\$16,000
Accounts receivable	1,000		
Land	14,000	Stockholders' Equity	
Building	44,000	Common stock	\$40,000
Equipment	<u>13,000</u>	Retained earnings	<u>24,000</u>
		Total stockholders' equity	<u>64,000</u>
Total assets	<u>\$80,000</u>	Total liabilities and stockholders' equity	<u>\$80,000</u>

If the balance in the Cash account were used to buy more equipment, then the total assets would

- a. remain unchanged.
- b. increase by \$8,000.
- c. decrease by \$8,000.
- d. increase by \$21,000.

ANS: A

PTS: 1

OBJ: LO6

NAT: AACSB correlation: analytic

LOC: Learning type: Analysis

KEY: balance sheet

52. The net income figure appears in all the following financial statements *except* the

- a. statement of cash flows.
- b. income statement.
- c. statement of retained earnings.
- d. balance sheet.

ANS: D

PTS: 1

OBJ: LO6

NAT: AACSB correlation: analytic

LOC: Learning type: Recall

KEY: net income

53. The statement of cash flows would disclose the payment of a dividend

- a. in the financing activities section.
- b. in the investing activities section.
- c. in the operating activities section.
- d. nowhere on the statement.

ANS: A

PTS: 1

OBJ: LO6

NAT: AACSB correlation: analytic

LOC: Learning type: Recall

KEY: business activities| statement of cash flows

54. The statement of cash flows would disclose the purchase of a building for cash

- a. nowhere on the statement.
- b. in the operating activities section.
- c. in the investing activities section.
- d. in the financing activities section.

ANS: C

PTS: 1

OBJ: LO6

NAT: AACSB correlation: analytic

LOC: Learning type: Recall

KEY: statement of cash flows

55. Which of the following represents the proper order of financial statement preparation?

- a. Statement of cash flows, balance sheet, income statement, statement of retained earnings
- b. Statement of retained earnings, income statement, statement of cash flows, balance sheet
- c. Balance sheet, statement of cash flows, statement of retained earnings, income statement
- d. Income statement, statement of retained earnings, balance sheet, statement of cash flows

ANS: D

PTS: 1

OBJ: LO6

NAT: AACSB correlation: analytic

LOC: Learning type: Comprehension

KEY: financial statements

56. All of the following items would appear on the balance sheet *except*

- a. Dividends

- b. Common Stock
- c. Accounts Receivable
- d. Retained Earnings

ANS: A PTS: 1 OBJ: LO6
NAT: AACSB correlation: analytic LOC: Learning type: Comprehension
KEY: balance sheet

57. Which of the following is a regulatory agency?

- a. IASB
- b. SEC
- c. FASB
- d. GASB

ANS: B PTS: 1 OBJ: LO7 NAT: AACSB correlation: ethics
LOC: Learning type: Recall KEY: professional organizations

58. The authoritative body currently responsible for establishing accounting practice is the

- a. Internal Revenue Service.
- b. Financial Accounting Standards Board.
- c. American Institute of Certified Public Accountants.
- d. Federal Reserve Board.

ANS: B PTS: 1 OBJ: LO7 NAT: AACSB correlation: ethics
LOC: Learning type: Recall KEY: professional organizations

59. Generally accepted accounting principles

- a. are changing continually.
- b. are sound in theory but rarely used in practice.
- c. have eliminated all the weaknesses in accounting practice.
- d. are accounting rules formulated by the Internal Revenue Service.

ANS: A PTS: 1 OBJ: LO7 NAT: AACSB correlation: ethics
LOC: Learning type: Recall KEY: financial statements

60. Standards for state and local governments are established by the

- a. IRS.
- b. IASB.
- c. GASB.
- d. AICPA.

ANS: C PTS: 1 OBJ: LO7 NAT: AACSB correlation: ethics
LOC: Learning type: Recall KEY: professional organizations

61. The purpose of an audit is to

- a. determine whether or not a company is a good investment.
- b. comply with income tax regulations.
- c. determine whether or not a company is a good credit risk.
- d. ascertain that the financial statements follow GAAP.

ANS: D PTS: 1 OBJ: LO7
NAT: AACSB correlation: communication LOC: Learning type: Recall
KEY: independent CPA report

62. An auditor maintains no direct financial interest in the company he or she is auditing. The principle being followed is
- independence.
 - integrity.
 - objectivity.
 - due care.

ANS: A PTS: 1
LOC: Learning type: Recall

OBJ: LO7 NAT: AACSB correlation: ethics
KEY: business ethics

63. Carrying out professional responsibilities with competence and diligence is called
- integrity.
 - independence.
 - objectivity.
 - due care.

ANS: D PTS: 1
LOC: Learning type: Recall

OBJ: LO7 NAT: AACSB correlation: ethics
KEY: business ethics

64. Which of the following is *not* one of the broad principles underlying the accountant's code of professional ethics?
- Objectivity
 - Integrity
 - Loyalty
 - Independence

ANS: C PTS: 1
LOC: Learning type: Recall

OBJ: LO7 NAT: AACSB correlation: ethics
KEY: business ethics

65. The development of international accounting standards is the primary function of the
- IRS.
 - AICPA.
 - IASB.
 - PCOAB.

ANS: C PTS: 1
LOC: Learning type: Recall

OBJ: LO7 NAT: AACSB correlation: ethics
KEY: ethical reporting| professional organizations

66. The Public Company Accounting Oversight Board was created by the
- Sarbanes-Oxley Act.
 - GASB.
 - IRS.
 - IASB.

ANS: A PTS: 1
LOC: Learning type: Recall

OBJ: LO7 NAT: AACSB correlation: ethics
KEY: professional organizations

SHORT ANSWER

1. Distinguish between profitability and liquidity.

ANS:

Profitability is the ability to earn enough income to attract and hold investment capital, whereas liquidity means having enough funds on hand to pay debts when they fall due.

PTS: 1 OBJ: LO1 NAT: AACSB correlation: communication
LOC: Learning type: Recall KEY: business goals

2. Explain why each of the following persons or groups would be interested in seeing the financial statements of a company. Also state whether each has a direct or indirect financial interest.
 - a. Potential investor
 - b. Internal Revenue Service
 - c. A labor union
 - d. Securities and Exchange Commission
 - e. Potential creditor
 - f. Management
 - g. Economic planners

ANS:

- a. To help determine if the prospects for a profitable investment is good relative to other investment opportunities (direct interest)
- b. To help determine the tax that should be levied against the company (indirect interest)
- c. To give the labor union negotiators a basis for negotiating for higher wages and benefits (indirect interest)
- d. To help determine if the investing public is being given accurate and complete information (indirect interest)
- e. To help determine if the creditor should extend credit to the company (direct interest)
- f. To help the company achieve goals such as profitability and liquidity (neither direct nor indirect)
- g. To set economic policies and judge economic programs (indirect interest)

PTS: 1 OBJ: LO2 NAT: AACSB correlation: communication
LOC: Learning type: Comprehension KEY: financial information users

3. List five possible users of these statements and state what each would be interested in learning from its review.

ANS:

Possible users and their reasons for interest could be:

Existing creditors who would be concerned about being repaid on time.

Possible creditors who are considering extending credit or making loans to the corporation and being repaid in a timely fashion.

Current stockholders who want to follow and manage their investment.

Individuals or corporations considering an investment in the company.

College students who would use the statements to learn about financial statement analysis.

Managers of the company who would use the statements to evaluate their areas of operations and make decisions to improve them.

Government bodies such as the SEC, which would review the financial statements to ensure conformity to laws that protect the general public.

Labor unions involved with the company, which would review the statements to evaluate present profitability as part of preparing for contract negotiations. NAT: AACSB correlation: communication

PTS: 1 OBJ: LO2 LOC: Learning type: Recall
KEY: financial information users

4. How do the balance sheets of corporations illustrate the accounting concept of separate entity?

ANS:

Balance sheets (statements of financial position) of corporations illustrate the accounting concept of separate entity in the shareholders' equity section. Individual names of stockholders are not shown. Instead, their ownership is evidenced by shares of stock. The assets and liabilities shown on the consolidated balance sheets are those of the corporation itself, not of the individual stockholders.

PTS: 1 OBJ: LO3 NAT: AACSB correlation: communication
LOC: Learning type: Recall KEY: concept of separate entity

5. In which form of business does CVS operate? List two places where this is revealed in the financial statements.

ANS:

CVS operates as a corporate form of business. This is evidenced in several places in the financial statements:

The title of each statement shows the name of the company as CVS Corporation.

The shareholders' equity section of the consolidated balance sheets contains accounts for stock and retained earnings transactions.

The consolidated statements of earnings contain a line for income taxes. Corporations are subject to income taxes.

The consolidated statements of cash flows and consolidated statements of stockholders' equity both show stock transactions.

PTS: 1 OBJ: LO4 NAT: AACSB correlation: analytic
LOC: Learning type: Recall KEY: corporations

6. Why would it be less risky for a wealthy individual to incorporate his or her business rather than to operate it as a sole proprietorship or partnership?

ANS:

With a sole proprietorship or partnership, the owner or owners have unlimited liability. That is, they may be required to use personal assets to satisfy business debts. The liability of a corporate shareholder, however, is limited to his or her investment in the business.

PTS: 1 OBJ: LO4 NAT: AACSB correlation: analytic
LOC: Learning type: Comprehension KEY: corporations

7. Indicate by letter whether each statement below applies to a sole proprietorship (S), partnership (P), or corporation (C). You may use more than one business organization for an answer.

- _____ a. Separate economic unit
_____ b. Life limited by death of owner(s)
_____ c. Separate legal entity
_____ d. Unlimited liability of owner(s)

- _____ e. Separation of ownership and control
 _____ f. Transfer of ownership does not affect the continuity of business.
 _____ g. Ownership evidenced by stock certificates

ANS:

- a. S, P, C
 b. S, P
 c. C
 d. S, P
 e. C
 f. C
 g. C

PTS: 1

OBJ: LO4

NAT: AACSB correlation: analytic

LOC: Learning type: Recall

KEY: corporations| partnerships| sole proprietorships

8. Barrett Company's stockholders' equity equals one-fourth of the company's total assets. The company's liabilities are \$360,000. What is the amount of the company's stockholders' equity?

ANS:

Assets = Liabilities + Stockholders' Equity

$A = 3/4 A + 1/4 A$

$A = \$360,000 \div 0.75 = \$480,000$

Stockholders' Equity = $\$480,000 - \$360,000 = \$120,000$

PTS: 1

OBJ: LO5

NAT: AACSB correlation: analytic

LOC: Learning type: Analysis

KEY: balance sheet

9. Kalis Corporation's stockholders' equity equals one-third of the company's total assets. The company's liabilities are \$120,000. What is the amount of the company's stockholders' equity?

ANS:

Assets = Liabilities + Stockholders' Equity

$A = 2/3 A + 1/3 A$

$A = \$120,000 \times 3/2 = \$180,000$

Stockholders' Equity = $\$180,000 - \$120,000 = \$60,000$

PTS: 1

OBJ: LO5

NAT: AACSB correlation: analytic

LOC: Learning type: Analysis

KEY: balance sheet

10. Dougan Corporation's stockholders' equity equals one-half of the company's total assets. The company's liabilities are \$173,000. What is the amount of the company's stockholders' equity?

ANS:

Assets = Liabilities + Stockholders' Equity

$A = 1/2 A + 1/2 A$

$A = \$173,000 \times 2 = \$346,000$

Stockholders' Equity = $\$346,000 - \$173,000 = \$173,000$

PTS: 1

OBJ: LO5

NAT: AACSB correlation: analytic

LOC: Learning type: Analysis

KEY: balance sheet

11. Following are the total assets and liabilities at the beginning and end of the year for Maren Corporation:

	Assets	Liabilities
Beginning of the year	\$70,000	\$45,000
End of the year	130,000	40,000

Determine the net income or loss for the year in each of the following situations:

- The stockholders made no investments in the business and no dividends were paid during the year.
- The stockholders made an investment of \$20,000 and a dividend of \$12,000 was paid during the year.

ANS:

- \$65,000 $[(\$130,000 - \$40,000) - (\$70,000 - \$45,000)]$
- \$57,000 $[(\$130,000 - \$40,000) - (\$70,000 - \$45,000) - \$20,000 + \$12,000]$

PTS: 1 OBJ: LO5 NAT: AACSB correlation: analytic
LOC: Learning type: Application KEY: net income

12. At the beginning of the year, Peters Corporation's assets were \$150,000 and its stockholders' equity was \$100,000. During the year, assets decreased \$30,000 and liabilities increased \$15,000. What was the stockholders' equity at the end of the year?

ANS:

\$55,000 $[(\$150,000 - \$30,000) - (\$50,000 + \$15,000)]$

PTS: 1 OBJ: LO5 NAT: AACSB correlation: analytic
LOC: Learning type: Analysis KEY: owner's equity| statement of stockholders' equity

13. At the beginning of the year, Fourman Corporation's assets were \$270,000 and its stockholders' equity was \$243,000. During the year, assets decreased \$35,000 and liabilities increased \$10,000. What was the stockholders' equity at the end of the year?

ANS:

\$198,000 $[(\$270,000 - \$35,000) - (\$27,000 + \$10,000)]$

PTS: 1 OBJ: LO5 NAT: AACSB correlation: analytic
LOC: Learning type: Application KEY: owner's equity| statement of stockholders' equity

14. Which three types of transactions affect retained earnings, and how do they affect it?

ANS:

Revenues increase retained earnings, whereas expenses and dividends decrease retained earnings.

PTS: 1 OBJ: LO5 NAT: AACSB correlation: analytic
LOC: Learning type: Comprehension KEY: analyze transactions

15. Upshaw Corporation had a balance in Retained Earnings on December 31, 2009, of \$260,000. During 2010, the company reported a net income of \$112,000 after taxes. During 2010, the company declared and paid cash dividends totaling \$16,000. Prepare the company's statement of retained earnings for the year ended December 31, 2010.

ANS:

Upshaw Corporation Statement of Retained Earnings For the Year Ended December 31, 2010	
Retained earnings, December 31, 2009	\$260,000
Net income for the year	<u>112,000</u>
Subtotal	\$372,000
Less dividends	<u>16,000</u>
Retained earnings, December 31, 2010	<u>\$356,000</u>

PTS: 1

OBJ: LO6

NAT: AACSB correlation: analytic

LOC: Learning type: Application

KEY: statement of stockholders' equity

16. Lin Wo Corporation had a balance in Retained Earnings on December 31, 2009, of \$360,000. During 2010, the company reported a net income of \$24,000 after taxes. During 2010, the company declared and paid cash dividends totaling \$18,000. Prepare the company's statement of retained earnings for the year ended December 31, 2010.

ANS:

Lin Wo Corporation Statement of Retained Earnings For the Year Ended December 31, 2010	
Retained earnings, December 31, 2009	\$360,000
Net income for the year	<u>24,000</u>
Subtotal	\$384,000
Less dividends	<u>18,000</u>
Retained earnings, December 31, 2010	<u>\$366,000</u>

PTS: 1

OBJ: LO6

NAT: AACSB correlation: analytic

LOC: Learning type: Application

KEY: statement of stockholders' equity

17. Indicate by letter whether each item below would appear on the income statement (IS), balance sheet (BS), or statement of retained earnings (E).

- _____ a. Common Stock
- _____ b. Dividends
- _____ c. Wages Expense
- _____ d. Commissions Earned
- _____ e. Buildings
- _____ f. Accounts Payable
- _____ g. Utilities Expense
- _____ h. Beginning Retained Earnings
- _____ i. Accounts Receivable

_____ j. Notes Payable

ANS:

- | | |
|-------|-------|
| a. BS | f. BS |
| b. E | g. IS |
| c. IS | h. E |
| d. IS | i. BS |
| e. BS | j. BS |

PTS: 1	OBJ: LO6	NAT: AACSB correlation: analytic
LOC: Learning type: Recall	KEY: financial statements	

18. How does the statement of retained earnings relate to the income statement and the balance sheet?

ANS:

The statement of retained earnings provides a link between the income statement and the balance sheet. Specifically, it takes the net income figure from the income statement and uses it (along with dividends) to arrive at the retained earnings figure to be presented on the balance sheet.

PTS: 1	OBJ: LO6	NAT: AACSB correlation: analytic
LOC: Learning type: Recall	KEY: financial statements	

19. Match each organization with its definition by indicating the corresponding letter in the spaces below.

- a. AICPA
- b. FASB
- c. GASB
- d. IASB
- e. IRS
- f. IMA
- g. SEC

- _____ 1. Responsible for interpreting and enforcing tax laws
- _____ 2. Establishes standards for state and local governments
- _____ 3. Developer of international accounting standards
- _____ 4. Consists mainly of industrial accountants
- _____ 5. Protector of the investing public
- _____ 6. Current authoritative body for developing GAAP
- _____ 7. The accounting profession's main organization of certified public accountants

ANS:

- | | |
|------|------|
| 1. e | 5. g |
| 2. c | 6. b |
| 3. d | 7. a |
| 4. f | |

PTS: 1	OBJ: LO7	NAT: AACSB correlation: ethics
LOC: Learning type: Recall	KEY: professional organizations	

20. What is the responsibility of the auditing firm? Who is responsible for the content of the financial statements?

ANS:

The responsibility of the auditors is to express an opinion on the financial statements of the corporation being audited. Company's management is responsible for the content of the published financial statements..

PTS: 1

OBJ: LO7

NAT: AACSB correlation: ethics

LOC: Learning type: Recall

KEY: ethical reporting| independent CPA report

21. What is independence, and why is it important for a CPA to maintain it when conducting an audit?

ANS:

Independence means having no financial or other compromising ties with the company under audit. To give the public confidence in their work, CPAs must maintain their independence whenever they conduct an audit.

PTS: 1

OBJ: LO7

NAT: AACSB correlation: ethics

LOC: Learning type: Comprehension

KEY: business ethics

22. Use the following accounts and information to prepare, in good form, an income statement, statement of retained earnings, and balance sheet for Cray Enterprises for the year ended December 31, 2010.

Accounts Payable	\$4,800	Land	\$39,000
Accounts Receivable	600	Notes Payable	6,000
Buildings	52,000	Rent Expense	3,600
Cash	26,200	Retained Earnings, December 31, 2009	84,400
Commissions Earned	19,000	Salaries Expense	8,400
Common Stock	20,000	Supplies	400
Dividends	3,000		
Insurance Expense	1,000		

ANS:

Cray Enterprises Income Statement For the Year Ended December 31, 2010			
Revenues			
Commissions earned			\$19,000
Expenses			
Insurance expense	\$1,000		
Rent expense	3,600		
Salaries expense	<u>8,400</u>		<u>13,000</u>
Net income			<u>\$ 6,000</u>

Cray Enterprises

**Statement of Retained Earnings
For the Year Ended December 31, 2010**

Retained earnings, December 31, 2009	\$84,400
Net income for the year	<u>6,000</u>
Subtotal	\$90,400
Less dividends	<u>3,000</u>
Retained earnings, December 31, 2010	<u>\$87,400</u>

**Cray Enterprises
Balance Sheet
December 31, 2010**

Assets		Liabilities	
Cash	\$ 26,200	Accounts payable	\$ 4,800
Accounts receivable	600	Notes payable	<u>6,000</u>
Supplies	400	Total liabilities	\$ 10,800
Land	39,000		
Buildings	<u>52,000</u>	Stockholders' Equity	
		Common stock	\$20,000
		Retained earnings	<u>87,400</u>
		Total stockholders' equity	<u>107,400</u>
Total assets	<u>\$118,200</u>	Total liabilities and stockholders' equity	<u>\$118,200</u>

PTS: 1 OBJ: LO6 NAT: AACSB correlation: analytic
 LOC: Learning type: Application KEY: financial statements

23. Use the following accounts and information to prepare, in good form, an income statement, statement of retained earnings, and balance sheet for Hometown Industries for the month ended July 31, 2010.

Accounts Payable	\$3,100	Land	\$35,000
Accounts Receivable	1,400	Notes Payable	3,300
Buildings	22,000	Rent Expense	2,400
Cash	15,600	Retained Earnings, June 30, 2010	57,900
Commissions Earned	12,700	Salaries Expense	10,000
Common Stock	20,000	Supplies	400
Dividends	8,000		
Insurance Expense	2,200		

ANS:

Hometown Industries Income Statement For the Month Ended July 31, 2010		
Revenues		
Commissions earned		\$12,700
Expenses		
Insurance expense	\$ 2,200	
Rent expense	2,400	
Salaries expense	<u>10,000</u>	<u>14,600</u>
Net loss		<u>(\$ 1,900)</u>

Hometown Industries Statement of Retained Earnings For the Month Ended July 31, 2010	
Retained earnings, June 30, 2010	\$57,900
Net loss for the month	<u>(1,900)</u>
Subtotal	\$56,000
Less dividends	<u>8,000</u>
Retained earnings, July 31, 2010	<u>\$48,000</u>

Hometown Industries Balance Sheet July 31, 2010			
Assets		Liabilities	
Cash	\$15,600	Accounts payable	\$ 3,100
Accounts Receivable	1,400	Notes payable	<u>3,300</u>
Supplies	400	Total liabilities	\$ 6,400
Land	35,000		
Buildings	<u>22,000</u>	Stockholders' Equity	
		Common stock	\$20,000
		Retained earnings	<u>48,000</u>
		Total stockholders' equity	<u>68,000</u>
Total assets	<u>\$74,400</u>	Total liabilities and Stockholders' equity	<u>\$74,400</u>

PTS: 1 OBJ: LO6 NAT: AACSB correlation: analytic
 LOC: Learning type: Application KEY: financial statements

24. Use the following information to calculate at, or for the year ended, December 31, 2010 (a) net income, (b) retained earnings, (c) total liabilities and stockholders' equity, and (d) accounts receivable.

Supplies	\$ 1,000	Cash	\$32,000
Wages Expense	14,000	Dividends	16,000
Accounts Payable	22,000	Notes Payable	4,000

Retained Earnings, December 31, 2009	8,000	Patents	7,000
		Retained Earnings, December 31, 2010	?
Accounts Receivable	?		
Rent Expense	6,000	Common Stock	20,000
Commissions Earned	30,000		

ANS:

- a. $\$30,000 - \$6,000 - \$14,000 = \$10,000$
- b. $\$8,000 + \$10,000 - \$16,000 = \$2,000$
- c. $\$22,000 + \$4,000 + \$20,000 + \$2,000 = \$48,000$
- d. $\$48,000 - \$1,000 - \$32,000 - \$7,000 = \$8,000$

PTS: 1 OBJ: LO6 NAT: AACSB correlation: analytic
 LOC: Learning type: Analysis KEY: financial statements

25. Use the following information to calculate at, or for the year ended, December 31, 2010, (a) net income, (b) retained earnings, (c) total assets, and (d) cash.

Salaries Expense	\$4,000	Commissions Earned	\$20,000
Accounts Payable	7,000	Retained Earnings, December 31, 2010	?
Dividends	6,000	Utilities Expense	2,000
Accounts Receivable	8,000	Retained Earnings, December 31, 2009	16,000
Inventories	22,000	Common Stock	10,000
Cash	?		
Salaries Payable	1,000		

ANS:

- a. $\$20,000 - \$4,000 - \$2,000 = \$14,000$
- b. $\$16,000 + \$14,000 - \$6,000 = \$24,000$
- c. Total liabilities and Owner's Equity = Total assets = $\$7,000 + \$1,000 + \$24,000 + \$10,000 = \$42,000$
- d. $\$42,000 - \$8,000 - \$22,000 = \$12,000$

PTS: 1 OBJ: LO6 NAT: AACSB correlation: analytic
 LOC: Learning type: Analysis KEY: financial statements

26. Mara Bolton, an attorney, bills her clients at a rate of \$100 per hour. At the beginning of July, clients owed her \$8,000, of which she collected \$5,600 during the month. In July, Mara billed clients for 160 hours of work. By the end of July, 60 of these hours were unpaid.

Mara has one employee, Lloyd Medvid, who is paid \$20 per hour. During July, Lloyd worked 170 hours, of which 16 hours will be paid in August. The rest were paid in July along with wages for 8 hours worked the last day of June.

Show calculations determining for the month of July:

- a. Amount of revenue earned

- b. Wages expense incurred
- c. Cash received from clients
- d. Cash paid to Lloyd Medvid

ANS:

- a. Revenue earned from clients is \$16,000.
 $160 \text{ hours} \times \$100 = \$16,000$
- b. Wages expense incurred for Lloyd Medvid is \$3,400.
 $170 \text{ hours} \times \$20 = \$3,400$
- c. Cash received from clients is \$15,600.

Received from clients previously billed	\$ 5,600
Received from clients billed in July	
$(160 \text{ hours} - 60 \text{ hours}) \times \100	<u>10,000</u>
Cash received from clients during July	<u>\$15,600</u>
- d. Cash paid to Lloyd Medvid is \$3,240.

Paid for June work $(8 \text{ hours} \times \$20)$	\$ 160
Paid for July work	
$(170 \text{ hours} - 16 \text{ hours}) \times \20	<u>3,080</u>
Cash paid to Lloyd Medvid	<u>\$ 3,240</u>

PTS: 1 OBJ: LO6 NAT: AACSB correlation: analytic
 LOC: Learning type: Analysis KEY: analyze transactions

27. Selected amounts from the condensed financial statements of Timson Corporation for 2009 and 2010 are presented below with several amounts missing. The 2008 year-end balance of retained earnings is \$82,883.

Income Statement	2010	2009
Revenues	\$490,304	\$ a
Costs and expenses	h	(501,295)
Income taxes	<u>(853)</u>	<u>(3,603)</u>
Net income	<u>\$ i</u>	<u>\$</u>

Statement of Retained Earnings

Beginning-of-year balance	\$ j	\$ c
Net income	3,747	d
Dividends	<u>k</u>	<u>(3,845)</u>
End-of-year balance	<u>\$ l</u>	<u>\$ e</u>

Balance Sheet

Total assets	<u>\$ m</u>	<u>\$246,481</u>
Total liabilities	\$110,192	\$102,239
Common stock	57,968	56,800
Retained earnings	<u>n</u>	<u>\$ f</u>
Total liabilities and stockholders' equity	<u>\$255,473</u>	<u>\$ g</u>

- a. Determine the missing amounts indicated by the letters. (Hint: You should not try to find them in alphabetical order.)

b. Given the data presented, did the company's profitability improve from 2009 to 2010? Would you characterize the company as a “growth” company? Why or why not?

ANS:

a.

Income Statement	2010	2009
Revenues	\$490,304	\$513,302(a)
Costs and expenses	(485,704)(h)	(501,295)
Income taxes	<u>(853)</u>	<u>(3,603)</u>
Net income	<u>\$ 3,747(i)</u>	<u>\$ 8,404(b)</u>

Statement of Retained Earnings

Beginning-of-year balance	\$ 87,442(j)	\$ 82,883(c)
Net income	3,747	8,404(d)
Dividends	<u>(3,876)(k)</u>	<u>(3,845)</u>
End-of-year balance	<u>\$ 87,313(l)</u>	<u>\$ 87,442(e)</u>

Balance Sheet

Total assets	<u>\$255,473(m)</u>	<u>\$246,481</u>
Total liabilities	\$110,192	\$102,239
Common stock	57,968	56,800
Retained earnings	<u>87,313(n)</u>	<u>87,442(f)</u>
Total liabilities and stockholders' equity	<u>\$255,473</u>	<u>\$246,481(g)</u>

b. Timson's profitability did not improve from 2009 to 2010, as indicated by a decrease in net income from \$8,404 to \$3,747. Also, based on the data given, the company cannot be characterized as a growth company. Total assets increased by only a small amount (\$246,481 to \$255,473), and dividends paid to stockholders (\$3,876) exceeded net income (\$3,747) in 2010. NAT: AACSB correlation: analytic

PTS: 1

OBJ: LO6

LOC: Learning type: Critical Thinking

KEY: financial statements

28. Use the following accounts and balances to prepare a balance sheet for Havrilla Company at December 31, 2010.

Accounts Payable	\$10,000
Common Stock	12,000
Cash	4,800
Retained Earnings	2,400
Equipment	13,200
Accounts Receivable	6,400

ANS:



Havrilla Company Balance Sheet December 31, 2010			
Assets		Liabilities	
Cash	\$ 4,800	Accounts payable	\$10,000
Accounts receivable	6,400		
Equipment	<u>13,200</u>	Stockholders' Equity	
		Common stock	\$12,000
		Retained earnings	<u>2,400</u>
		Total stockholders' equity	<u>14,400</u>
Total assets	<u>\$24,400</u>	Total liabilities and stockholders' equity	<u>\$24,400</u>

PTS: 1

OBJ: LO6

NAT: AACSB correlation: analytic

LOC: Learning type: Analysis

KEY: balance sheet