

Horngren's Financial and Managerial Accounting, 6e (Miller-Nobles)
Chapter 1 Accounting and the Business Environment

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

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) B 28) C 29) D 30) A

1.2 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) A corporation's board of directors is elected by the chairperson of the company.

Answer: FALSE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

24) A corporation's chief executive officer appoints the members of the board of directors.

Answer: FALSE

Explanation: The stockholders elect the members of the board of directors.

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

25) The creation of a corporation begins when its incorporators obtain a charter from the state.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

26) Mutual agency of the owners is not present in a corporation as it is in a partnership.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

27) Regarding a business organized as a partnership, which of the following is an *incorrect* statement?

A) Partners pay tax on their share of the partnership earnings.

B) Partners are personally liable for the debts of the business.

C) A partnership's life is not dependent on a specific individual's ownership.

D) Mutual agency is present in a partnership.

Answer: C

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

28) Which of the following is a major reason why corporate ownership is popular in the United States?

- A) Stockholders have limited liability for the debts of the corporation.
- B) Most corporations are small- or medium-sized.
- C) The life of a corporation is limited by the death of the owner.
- D) A corporation is usually managed by the owners.

Answer: A

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

29) Which of the following is a characteristic of a corporation?

- A) Corporations are separate taxable entities.
- B) Lenders of a corporation do not have the right to claim the corporation's assets to satisfy their obligations.
- C) Corporations are subjected to less governmental regulation than other forms of businesses.
- D) Each stockholder has the authority to commit the corporation to a binding contract through his/her actions.

Answer: A

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

30) Which of the following actions determines when a corporation comes into existence?

- A) The charter is obtained from the federal government.
- B) The incorporators pay fees, sign the charter, and file required documents with the state.
- C) The first share of stock is issued.
- D) The corporate bylaws are written.

Answer: C

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

31) Regarding the separation of corporate ownership and management, which of the following is a true statement?

- A) The corporate officers elect the board of directors.
- B) The corporation runs better with day-to-day input from stockholders.
- C) Stockholders are required to manage the business.
- D) Stockholders own the business, but a board of directors appoints corporate officers to manage the business.

Answer: D

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

32) Corporations pay their own income tax on corporate income. Stockholders pay personal income tax on the dividends received from corporations. This is an example of _____.

- A) double taxation
- B) continuous life
- C) mutual agency
- D) a limited liability company

Answer: A

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

33) Which of the following statements is true of the corporate form of business?

- A) The board of directors sets policy for the corporation and appoints the officers.
- B) Changes in the ownership of stock have a negative effect on the continuity of the corporation.
- C) Any stockholder may commit the corporation to a contract.
- D) It is easy for stockholders to lodge an effective protest against management.

Answer: A

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

34) 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

35) 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

36) 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

37) 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

38) 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

39) 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

40) Which of the following statements is true of a corporation?

- A) Corporations pay the same variety of taxes as partnerships.
- B) Although a corporation is a separate legal entity, it cannot be sued.
- C) Any stockholder of a corporation can commit the corporation to a binding contract.
- D) The owners of a corporation are called stockholders.

Answer: D

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

41) The ultimate control of the corporation rests with the _____.

- A) board of directors
- B) stockholders
- C) chairperson of Board of Directors
- D) chief operating officer

Answer: B

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: The Economic Entity Assumption

42) 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

43) Briefly discuss each of the following corporate characteristics.

- A. No mutual agency
- B. Separate legal entity
- C. Separation of ownership and management

Answer:

A. No mutual agency - The stockholders of a corporation cannot commit the corporation to a contract unless that stockholder is acting in a different role, such as an officer in the business.

B. Separate legal entity - A corporation is a business entity formed under state law and thus it exists apart from its owners (stockholders).

C. Separation of ownership and management - The board of directors - elected by the stockholders - appoints corporate officers to manage the business. The stockholders are owners of the corporation and do not manage the corporation. The corporate officers manage the business.

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Economic Entity Assumption

44) Briefly discuss each of the following corporate characteristics.

- A. Government regulation
- B. Limited liability of stockholders
- C. Continuous life and transferability of ownership

Answer:

A. Government regulation - Corporations are subjected to more governmental regulation than other forms of business.

B. Limited liability of stockholders - The most that stockholders can lose is the amount they originally paid for the stock. Stockholders are not personally liable for the corporation's debts.

C. Continuous life and transferability of ownership - Stockholders may transfer stock as they wish. This transfer does not affect the continuity of the corporation. A corporation's life is not dependent on a specific individual's ownership.

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Economic Entity Assumption

45) Briefly discuss each of the following corporate characteristics.

- A. Corporate taxation
- B. Separate legal entity
- C. No mutual agency

Answer:

A. Corporate taxation - Corporations are separate taxable entities. Corporate earnings are subject to double taxation. First, corporations pay their own income tax on corporate income. Then, the stockholders pay personal income tax on the dividends that they receive from corporations.

B. Separate legal entity - A corporation is a business entity formed under state law and thus it exists apart from its owners (stockholders).

C. No mutual agency - Stockholders cannot commit the corporation to a contract unless the stockholder is also an officer of the company.

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Economic Entity Assumption

46) List and briefly discuss four features that distinguish a corporation from other types of business organizations.

Answer: Students can list any four of the following:

Separate legal entity - A corporation is a business entity formed under state law and thus it exists apart from its owners (stockholders).

Continuous life and transferability of ownership - Stockholders may transfer stock as they wish. This transfer does not affect the continuity of the corporation. A corporation's life is not dependent on a specific individual's ownership.

No mutual agency - The stockholders of a corporation cannot commit the corporation to a contract unless that stockholder is acting in a different role, such as an officer in the business.

Limited liability of stockholders - The most that stockholders can lose is the amount they originally paid for the stock. Stockholders are not personally liable for the corporation's debts.

Separation of ownership and management - The board of directors - elected by the stockholders - appoints corporate officers to manage the business. The owners do not manage the corporation.

Corporate taxation - Corporations are separate taxable entities. Corporations pay more taxes than partnerships or sole proprietorships. Corporate earnings are subject to double taxation. First, corporations pay their own income tax on corporate income. Then, the stockholders pay personal income tax on the dividends that they receive from corporations.

Government regulation - Corporations are subjected to more governmental regulation than other forms of business.

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Economic Entity Assumption

47) Mason Company purchased land for \$30,000. The president of Mason Company believes that the land is actually worth \$35,000. The land can be recorded at \$35,000.

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

48) 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

49) 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

50) Lisa Smith decided to start her CPA practice as a professional corporation, Smith CPA, PC. The corporation purchased an office building for \$35,000. The real estate agent said the building was worth \$50,000 in the current market. The corporation 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

51) Beverly Dalton incorporated her CPA practice in 2013. At that time, the corporation purchased land for \$29,000. The December 31, 2019 market value of the land is \$85,000. On the December 31, 2019 balance sheet, this asset should be reported at _____ under U.S. GAAP and at _____ under international reporting standards.

- A) \$29,000; \$29,000
- B) \$85,000; \$85,000
- C) \$29,000; \$85,000
- D) \$85,000; \$29,000

Answer: C

Diff: 1

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Cost Principle

52) Thirty years ago, Citywide Grocery Corporation 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

53) Ten years ago a corporation purchased a building for \$160,000. At that time, the corporation felt that the building was worth \$185,000. The current market value of the building is \$430,000. The building has been assessed at \$405,000 for property tax purposes. At which amount should the corporation record the building in its accounting records?

- A) \$160,000
- B) \$185,000
- C) \$405,000
- D) \$430,000

Answer: A

Diff: 2

LO: 1-2

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: The Cost Principle

54) 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

55) 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

56) 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

57) 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

58) 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

59) 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

60) Lawton Corporation 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

61) 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

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

63) 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

64) 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

65) 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

66) 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

67) 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

68) 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

69) 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

70) 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

71) 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

72) 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

73) 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

74) 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

75) 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

76) 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

77) 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

1.3 Learning Objective 1-3

1) The left side of the accounting equation measures the amount that the business owes to creditors and to the stockholders.

Answer: FALSE

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 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) Assets + Liabilities = Equity

B) Assets = Liabilities + Equity

C) Assets + Revenues = Equity

D) Assets + Revenues = Liabilities + 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 \$170,000 and the total liabilities are \$30,000. The total assets are _____.

- A) \$340,000
- B) \$60,000
- C) \$140,000
- D) \$200,000

Answer: D

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

$$\text{Assets} = 170,000 + 30,000 = 200,000$$

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 \$220,000 and \$20,000, respectively. Liabilities total _____.

- A) \$20,000
- B) \$200,000
- C) \$220,000
- D) \$240,000

Answer: B

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

$$\text{Liabilities} = 220,000 - 20,000 = 200,000$$

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 \$120,000 and the total liabilities are \$10,000. The equity is _____.

- A) \$120,000
- B) \$130,000
- C) \$10,000
- D) \$110,000

Answer: D

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

$$\text{Equity} = 120,000 - 10,000 = 110,000$$

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: What is the Accounting Equation? (H1)

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 to
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 stockholders' claims 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 corporation.

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) dividends

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) stockholders' 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 distributions to owners.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

25) Dividends are the expenses of a business.

Answer: FALSE

Explanation: Dividends are a distribution of a corporation's earnings to stockholders.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

26) Dividends are a distribution of a corporation's earnings to stockholders.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

27) The three types of events that affect retained earnings are dividends, revenues, and expenses.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

28) The distribution of dividends represents an increase in retained earnings.

Answer: FALSE

Explanation: Distribution of dividends represents decreases in retained earnings.

Diff: 1

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

29) Common stock represents the basic ownership of every corporation.

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) equity
- 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 owners' claims to the assets of the business are 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 \$90,000 and total liabilities of \$65,000. The revenues and the expenses for the year amounted to \$100,000 and \$70,000, respectively. During the year, the company did not issue any common stock, but it distributed dividends of \$40,000. What is the amount of stockholders' equity at the end of the year?

- A) \$70,000
- B) \$100,000
- C) \$15,000
- D) \$40,000

Answer: C

Explanation: C) $\text{Equity (ending balance)} = \text{Equity (beginning balance)} - \text{Dividends} + \text{Revenues} - \text{Expenses}$

$\text{Equity} = (\$90,000 - \$65,000) - \$40,000 + \$100,000 - \$70,000 = \$15,000$

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 \$120,000 and total liabilities of \$55,000. The revenues and the expenses for the year amounted to \$100,000 and \$80,000, respectively. During the year, the company did not issue any common stock, but it distributed dividends of \$50,000. Calculate Dynamic's net income for the year.

- A) \$20,000
- B) \$100,000
- C) \$80,000
- D) \$120,000

Answer: A

Explanation: A) Net income = Revenues - Expenses

Net income = \$100,000 - \$80,000 = \$20,000

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

34) Metropolitan Casting Services started the year with total assets of \$130,000 and total liabilities of \$45,000. The revenues and the expenses for the year amounted to \$130,000 and \$50,000, respectively. During the year, the company did not issue any common stock, but it distributed dividends of \$60,000. Calculate the amount of increase or decrease in stockholders' equity for the year.

- A) a \$20,000 increase
- B) a \$105,000 increase
- C) a \$85,000 decrease
- D) a \$60,000 increase

Answer: A

Explanation: A) Equity (at the beginning of the year) = \$130,000 - \$45,000 = \$85,000

Equity (at the end of the year) = Equity (beginning balance) - Dividends + Revenues - Expenses

Equity (at the end of the year) = \$85,000 - \$60,000 + \$130,000 - \$50,000 = \$105,000

Change in stockholders' equity for the year = \$105,000 - \$85,000 = \$20,000 increase

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

35) The net income of Hollywood Talent Services is \$26,000. The beginning and ending stockholders' equity balances were \$35,000 and \$56,000, respectively. The company issued no common stock. Calculate the amount of dividends.

- A) \$15,000
- B) \$5,000
- C) \$9,000
- D) \$8,000

Answer: B

Explanation:

B) Stockholders' Equity Beginning Balance	\$35,000
Add: Net Income	26,000
Less: Stockholders' Equity Ending Balance	<u>56,000</u>
Dividends	\$5,000

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

36) _____ is the equity earned by profitable operations that is not distributed to stockholders.

- A) Assets
- B) Dividend
- C) Retained earnings
- D) Common stock

Answer: C

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

37) Which of the following is true of retained earnings?

- A) Retained earnings decrease with payment of dividends.
- B) Retained earnings increase with purchase of assets.
- C) Retained earnings decrease with collection of revenue.
- D) Retained earnings increase with payment on account.

Answer: A

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Equity

38) Equity of a corporation is broken out into two components. Which of the following are the two components of the equity of a corporation?

- A) current assets and fixed assets
- B) common stock and liabilities
- C) revenues and expenses
- D) contributed capital and retained earnings

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:

(1) State whether the event increases (INC) or decreases (DEC) retained earnings. If the event does not affect retained earnings, state NE for no effect.

(2) State which equity account is affected.

Event	1. Retained earnings: INC, DEC, NE 2. Which equity account is affected?
Distribution of a corporation's earnings to stockholders	
Creditor loaned money to the business	
Costs of selling goods or services	

Answer:

Event	1. Retained earnings: INC, DEC, NE 2. Which equity account is affected?
Distribution of a corporation's earnings to stockholders	1. DEC 2. Dividends
Creditor loaned money to the business	1. NE 2. None

Costs of selling goods or services	1. DEC 2. COGS, Expense
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Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

40) For each of the following events:

(1) State whether the event increases (INC) or decreases (DEC) retained earnings. If the event does not affect retained earnings, state NE for no effect.

(2) State which equity account is affected.

Event	1. Retained earnings: INC, DEC , NE 2. Which equity account is affected?
Owner contributions to a corporation	
Amounts earned from delivering goods or services to customers	
Cash paid to acquire land for use in the business	

Answer:

Event	1. Retained earnings: INC, DEC , NE 2. Which equity account is affected?
Owner contributions to a corporation	1. NE 2. Common Stock
Amounts earned from delivering goods or services to customers	1. INC 2. Sales Revenue, Service Revenue
Cash paid to acquire land for use in the business	1. NE 2. None

Diff: 2

LO: 1-3

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Equity

1.4 Learning Objective 1-4

1) A transaction is any event that affects the financial position of the business and can be easily estimated.

Answer: FALSE

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 cost \$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 to the business by opening a bank account in the name of the business, United Marketing. The corporation issued common stock to John. 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 is 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 is 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) Dividends affect the business's net income or net loss and are recorded as an expense.

Answer: FALSE

Explanation: Dividends 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 Corporation in exchange for stock. 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 corporation 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) Mars Electronic Company receives cash from a stockholder, John Tilden, and issues common stock to him. The two accounts involved in this transaction are _____.

A) Accounts Payable and Cash

B) Cash and Common Stock

C) Common Stock and Accounts Payable

D) Common Stock 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 Corporation 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) Adventures Unlimited Company distributes cash dividends. 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 incurred \$800 as a repair expense and paid for it in cash. This transaction will _____.

- A) decrease the stockholders' 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) Retained Earnings

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 Corporation incurred \$1,500 as advertising expense and promised to pay the advertising agency within 30 days. Which of the following will decrease as a result of this transaction?

- A) Assets
- B) Stockholders' equity
- 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) Retained Earnings
- 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, Inc. had the following transactions during June:

Performed services for \$2,000 on account; received cash on account, \$8,000; paid \$700 for repair expense; paid \$1,800 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 - \$700 - \$1,800 = \$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, Inc. paid \$13,000 on accounts payable. How does this transaction affect the accounting equation of Saturn?

- A) Assets decrease by \$13,000 and equity increases by \$13,000.
- B) Assets decrease by \$13,000 and liabilities decrease by \$13,000.
- C) Assets increase by \$13,000 and equity decreases by \$13,000.
- D) Assets increase by \$13,000 and liabilities increase by \$13,000.

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 Corporation 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 Corporation 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 Corporation originally purchased land for \$20,000. It later sold the land for \$20,000 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 \$20,000.
- B) Assets and equity increase by \$40,000.
- C) Assets increase by \$20,000; equity increases by \$20,000.
- 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 Corporation purchased land for \$100,000 by making a cash payment of \$38,000 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 \$100,000 and liabilities decrease by \$38,000.
- B) Assets increase by \$100,000 and liabilities decrease by \$62,000.
- C) Assets and equity increase by \$62,000.
- D) Assets and liabilities increase by \$62,000.

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 Corporation collected \$16,000 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 \$16,000; liabilities decrease by \$16,000.
- B) Assets increase by \$16,000; assets decrease by \$16,000.
- C) Assets increase by \$16,000; liabilities increase by \$16,000.
- D) Assets increase by \$16,000; equity increases by \$16,000.

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 Corporation just recorded a transaction in its books. If this transaction increased the total liabilities by \$10,000, then _____.

- A) assets must increase, or equity must decrease by \$10,000
- B) either assets or equity must decrease by \$10,000
- C) both assets and equity must each decrease by \$5,000
- D) assets must decrease by \$10,000

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 corporation 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 Corporation provides plumbing services. Transactions during the first year of operations are provided below.

- a) Received \$11,000 cash and issued common stock to Mitchell Johnson.
- b) Paid \$1,200 for equipment to be used for plumbing repairs.
- c) Borrowed \$15,000 from a local bank and deposited the money in the checking account.
- d) Paid \$400 in rent for the year.
- e) Paid \$400 for plumbing supplies to be used on various jobs next year.
- f) Completed a plumbing repair for a law firm and received \$3,500.

Calculate the amount of total assets at the end of the first year. Assume the plumbing supplies of \$400 are left at the end of the year.

- A) \$1,600
- B) \$1,200
- C) \$26,000
- D) \$29,100

Answer: D

Explanation: D)

Cash (\$11,000 + \$15,000 + \$3,500 - \$1,200 - \$400 - \$400)	\$27,500
Equipment	1,200
Supplies	<u>400</u>
Total assets	<u>\$29,100</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 Corporation provides plumbing services. Transactions during the first year of operations are provided below.

- a) Received \$12,000 cash and issued common stock to Sharon McCoy.
- b) Paid \$1,900 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 \$400 rent for the year.
- e) Purchased \$500 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) \$10,000
- B) \$12,000
- C) \$20,100
- D) \$3,200

Answer: A

Explanation: A) Borrowings from bank = \$10,000

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 Corporation provides plumbing services. Transactions during the first year of operations are given below.

- a) Received \$4,000 cash and issued common stock to Jason Robinson.
- b) Paid \$2,000 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 \$800 rent for the year.
- e) Purchased \$800 of office supplies on account.
- f) Completed a plumbing repair project for a local lawyer and received \$3,500 cash.

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

- A) \$6,700
- B) \$3,500
- C) \$4,000
- D) \$26,000

Answer: A

Explanation: A) $\text{Equity (ending)} = \text{Common Stock} - \text{Dividends} + \text{Revenues} - \text{Expenses}$

Stockholders' Equity = \$4,000 + \$3,500 - \$800 = \$6,700

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 Corporation 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 \$600 of repair expense and paid cash; paid \$200 for rent that it owed from the previous month.

What is the net income in August?

- A) \$600
- B) \$4,000
- C) \$5,400
- D) \$1,400

Answer: D

Explanation: D) Net income = Revenue - Expenses = \$2,000 - \$600 = \$1,400.

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 Corporation for b) to d) below. Use proper account titles. Transaction a) is answered as a guide.

a) Received cash from Mary Johnson; issued common stock to her.

Answer: Increase asset (Cash); Increase equity (Common Stock)

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 Corporation for b) to d) below. Use proper account titles. Transaction a) is answered as a guide.

a) Received cash from Maxwell Jones; issued common stock to him.

Answer: Increase asset (Cash); Increase equity (Common Stock)

b) Received cash from a customer on accounts receivable.

c) Paid cash dividends to the stockholder.

d) Paid cash on accounts payable.

Answer:

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

c) Decrease asset (Cash); Decrease equity (Dividend)

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 Corporation for b) to d) below. Use proper account titles. Transaction a) is answered as a guide.

a) Received cash from Trent Garland issued common stock to him.

Answer: Increase asset (Cash); Increase equity (Common Stock)

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. Enter the correct amounts in the columns of the spreadsheet.

a) James Osgood contributes \$75,000 to the business. The business issues common stock to James.

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 office rent expense, \$800 and utilities expense, \$400.

f) Cash dividends of \$1,000 are paid to stockholders.

	Cash	Accounts Receivable	Office Supplies	Assets Delivery Van	=	Liabilities + Accounts Payable	+	Common Stock		Equity Service Revenue	Rent Expense	Utilities Expense
a												
b												
c												
d												
e												
f												

Answer:

	Cash	Accounts Receivable	Office Supplies	Assets Delivery Van	=	Liabilities + Accounts Payable	+	Common Stock	Dividends	Equity Service Revenue	Rent Expense	Utilities Expense		
a	75000							75000						
b			750			750								
c	(25000)			25000										
d	5000									5000				
e	(1200)										(800)	(400)		
f	(1000)								(1000)					
	52800	0	750	25000	0	0	750	0	0	75000	(1000)	5000	(800)	(400)

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

1.5 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 retained earnings → balance sheet → statement of cash flows
- B) Statement of retained earnings → balance sheet → income statement → statement of cash flows
- C) Balance sheet → statement of retained earnings → income statement → statement of cash flows
- D) Balance sheet → income statement → statement of retained earnings → 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) Prepare an income statement and a statement of retained earnings for the month of May. Also, prepare a balance sheet as of May 31, 2019, for McGuire Corporation. The financial transactions of McGuire Corporation for the month of May, their first month of operations, are as follows:

- On May 1, 2019, McGuire Corporation issued common stock in exchange for \$20,000 cash from a stockholder, Deborah Merchant.
- On May 3, the corporation 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 corporation purchased \$15,000 of equipment for cash.
- On May 8, McGuire Corporation rendered service to a client and received \$3,000 in cash.
- On May 12, the corporation incurred a repair expense of \$1,800 and promised to pay the repair contractor the following month.
- On May 18, the corporation 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, McGuire Corporation distributed cash dividends of \$1,500.

Answer:

McGuire Corporation
Income Statement
Month Ended May 31, 2019

Revenues:

Service Revenue	\$11,000
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Expenses:

Repair Expense	<u>\$1,800</u>
Total Expenses	<u>1,800</u>

Net Income	<u>\$9,200</u>
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McGuire Corporation
Statement of Retained Earnings
Month Ended May 31, 2019

Retained Earnings, May 1, 2019	\$0
Net Income for the month	<u>9,200</u>
	9,200
Dividends	<u>(1,500)</u>
Retained Earnings, May 31, 2019	<u>\$7,700</u>

McGuire Corporation
Balance Sheet
May 31, 2019

Assets		Liabilities	
Cash	\$11,500	Accounts Payable	\$1,800
Accounts Receivable	8,000	Notes Payable	<u>5,000</u>
Equipment	15,000	Total Liabilities	6,800
		Stockholders' Equity	
		Common Stock	20,000
		Retained Earnings	<u>7,700</u>
		Total Stockholders' Equity	<u>27,700</u>
Total Assets	<u>\$34,500</u>	Total Liabilities and Stockholders' Equity	<u>\$34,500</u>

Note:

Calculation of cash balance, May 31, 2019:

Common stock issued	\$20,000
Borrowing from creditor	5,000
Service fees received	<u>3,000</u>
Receipts	28,000
Less payments:	
Purchase of equipment	(15,000)
Dividends	<u>(1,500)</u>
Cash balance, May 31, 2019	<u>\$11,500</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) Prepare an income statement and a statement of retained earnings for the month of June. Also, prepare a balance sheet at June 30. The transactions of Modern Designer Corporation for the first month of their operations are as follows:

- On June 1, 2019, Modern Designer Corporation received \$25,000 cash from its stockholders and gave common stock to the stockholders.
- The company rendered services to three clients on account with total revenues earned of \$9,000.
- It then 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 dividends were paid during the month.

Answer: Modern Designer Corporation
 Income Statement
 Month Ended June 30, 2019

Revenues:		
Service Revenue		\$9,000
Expenses:		
Advertising Expense	\$1,200	
Legal Expense	<u>1,300</u>	
Total Expenses		<u>2,500</u>
Net Income		<u>\$6,500</u>

Modern Designer Corporation
 Statement of Retained Earnings
 Month Ended June 30, 2019

Retained Earnings, June 1, 2019	\$0
Net income for the month	<u>6,500</u>
	6,500
Dividends	<u>0</u>
Retained Earnings, June 30, 2019	<u>\$6,500</u>

Modern Designer Corporation
Balance Sheet
June 30, 2019

Assets		Liabilities	
Cash	\$24,200	Accounts Payable	\$ 700
Account Receivable	7,000		
Office Supplies	1,000		
		Stockholders' Equity	
		Common Stock	25,000
		Retained Earnings	<u>6,500</u>
		Total Stockholders' Equity	<u>31,500</u>
Total Assets	<u>\$32,200</u>	Total Liabilities and Stockholders' Equity	<u>\$32,200</u>

Note:

Calculation of cash balance, June 30, 2019

Common stock issued	\$25,000
Service fees received	<u>2,000</u>
Receipts	27,000
Less payments:	
Legal expense	(1,300)
Office supplies	(1,000)
Advertising expenses	<u>(500)</u>
Cash balance, June 30, 2019	<u>\$24,200</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 retained earnings	Retained Earnings, Beginning + Net income for the period or - Net Loss for the period - Dividends for the period = Retained Earnings, Ending
3. Balance sheet	Assets = Liabilities + Stockholders' 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 retained earnings	How much of the earnings were kept and reinvested in the company
3. Balance Sheet	Economic resources the company has (assets); debts the company owes (liabilities); elements of stockholders' equity
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 retained earnings

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 Corporation provides plumbing services. Selected transactions of Regent Plumbing Corporation are described as follows:

- a) Received \$8,000 cash and issued common stock to Sharon Regent.
- b) Paid \$5,000 cash for equipment to be used for plumbing repairs.
- c) Borrowed \$11,000 from a local bank and deposited the money in the checking account.
- d) Paid \$900 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) \$700
- B) \$2,800
- C) \$3,000
- D) \$2,100

Answer: D

Explanation: D) Net income = Revenues - Expenses

Net income = \$3,000 - \$900 = \$2,100

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	\$6,000
Accounts Payable	5,000
Salaries Expense	7,000
Repairs Expense	900
Truck	11,000
Equipment	12,000
Notes Payable	26,100
Cash	20,000
Supplies Expense	200
Service Revenue	32,000
Gasoline Expense	7,200
Salaries Payable	1,200

Calculate the net income.

A) \$16,700

B) \$31,100

C) \$17,900

D) \$49,000

Answer: A

Explanation: A) Service Revenue\$32,000

Salaries Expense (7,000)

Repairs Expense (900)

Supplies Expense (200)

Gasoline Expense (7,200)

Net income \$16,700

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 company. 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	Retained Earnings, Jan. 1, 2018	8,300
Common Stock	9,000	Salaries Expense	36,000
Dividends	13,500	Service Revenue	84,000
Equipment	15,000	Utilities Expense	6,200
Insurance Expense	4,000		

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 \$4,000

Total Expenses 62,300

Net Income \$21,700

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 retained earnings, the effect of dividends on the ending balance of retained earnings can be determined.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Retained Earnings

16) The net income (or net loss) must be calculated after the statement of retained earnings 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 retained earnings.

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Retained Earnings

17) Which of the following transactions will affect the balance of Retained Earnings?

A) issued common stock for cash

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 Retained Earnings

18) In a statement of retained earnings, decreases in retained earnings result from _____.

A) issuance of stock

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 Retained Earnings

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

A) the income statement; the statement of retained earnings

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 Retained Earnings

20) Which of the following appears on both the income statement and statement of retained earnings?

- A) Ending stockholders' equity
- B) Total revenues
- C) Net income
- D) Dividends

Answer: C

Diff: 1

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Retained Earnings

21) Which of the following financial statements shows the dividends distributed to stockholders?

- A) Income statement
- B) Statement of retained earnings
- 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 Retained Earnings

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 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	Retained Earnings, Jan. 1, 2018	8,300
Common Stock	9,000	Salaries Expense	36,000
Dividends	13,500	Service Revenue	84,000
Equipment	15,000	Utilities Expense	6,200
Insurance Expense	4,000		

Prepare the statement of retained earnings for the year. Use a proper heading.

Answer:

Merian Company
Statement of Retained Earnings
Year Ended December 31, 2018

Retained Earnings, January 1, 2018	\$ 8,300
Net Income for the year	<u>21,700</u>
	30,000
Dividends	<u>(13,500)</u>
Retained Earnings, December 31, 2018	<u>\$16,500</u>

Diff: 3

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Statement of Retained Earnings

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 stockholders' 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 stockholders' 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 retained earnings.

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 retained earnings 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 retained earnings.

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) Dividends

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 retained earnings
- 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 stockholders' equity?

- A) Statement of retained earnings
- 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 retained earnings and the balance sheet?

- A) Ending retained earnings
- 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 stockholders' equity as of a specific date?

- A) Balance sheet
- B) Statement of retained earnings
- 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	\$6,000
Accounts Payable	4,000
Salaries Expense	5,000
Repairs Expense	500
Truck	11,000
Equipment	11,000
Notes Payable	8,500
Cash	7,300
Supplies Expense	1,500
Service Revenue	29,000
Gasoline Expense	2,900
Salaries Payable	200

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

- A) \$17,000
- B) \$35,300
- C) \$22,000
- D) \$29,300

Answer: B

Explanation: B) Accounts Receivable\$6,000

Truck	11,000
Equipment	11,000
Cash	<u>7,300</u>
Total assets	<u>\$35,300</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. The company issued no common stock and paid no dividends during the year.

	Total Assets	Total Liabilities
Beginning of year	\$405,000	\$295,000
End of year	455,000	305,000

What was the amount of net income for the year?

- A) \$50,000
- B) \$10,000
- C) \$40,000
- D) \$60,000

Answer: C

Explanation: C) Calculations:

	Assets	Liabilities
End of year total	\$455,000	\$305,000
Less: beginning of year total	<u>(405,000)</u>	<u>(295,000)</u>
Increase or (decrease)	<u>\$50,000</u>	<u>\$10,000</u>

Net increase or (decrease) = \$50,000 - \$10,000 = \$40,000

Diff: 3

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Balance Sheet

35) The balance of stockholders' equity at the beginning of the year and the end of the year was \$50,000 and \$60,000, respectively. The company issued no common stock during the year. Dividends were \$24,000. What was the net income or loss for the year?

- A) Net income of \$84,000
- B) Net loss of \$84,000
- C) Net loss of \$34,000
- D) Net income of \$34,000

Answer: D

Explanation: D) Stockholders' equity at the end of the year	\$60,000
Add: Dividends	<u>24,000</u>
	\$84,000
Less: Stockholders' equity at the beginning of the year	<u>(50,000)</u>
Net income	<u>\$34,000</u>

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 Corporation was \$71,000 for this year. The beginning balance of stockholders' equity was \$33,000 and the ending balance was \$72,000. The company issued no common stock during the year. What was the amount of dividends distributed during the year?

- A) \$72,000
- B) \$32,000
- C) \$143,000
- D) \$33,000

Answer: B

Explanation: B) Stockholders' equity, beginning balance\$33,000

Add:

Stock issued during the year	0
Net income	71,000
Less: Stockholders' equity, ending balance	<u>(72,000)</u>
Dividends	<u>\$32,000</u>

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	\$5,000
Accounts Payable	5,000
Salaries Expense	4,000
Repairs Expense	600
Truck	9,000
Equipment	10,000
Notes Payable	8,500
Cash	11,500
Supplies Expense	1,400
Service Revenue	31,000
Gasoline Expense	3,200
Salaries Payable	200

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

A) \$13,700

B) \$22,900

C) \$19,700

D) \$13,500

Answer: A

Explanation: A) Accounts Payable\$5,000

Notes Payable 8,500

Salaries Payable 200

Total liabilities \$13,700

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 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	Retained Earnings, Jan. 1, 2018	8,300
Common Stock	9,000	Salaries Expense	36,000
Dividends	13,500	Service Revenue	84,000
Equipment	15,000	Utilities Expense	6,200
Insurance Expense	4,000		

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	<u>\$12,200</u>
Accounts Receivable	14,500	Total Liabilities	<u>12,200</u>
Equipment	15,000		
		Stockholders' Equity	
		Common Stock	9,000
		Retained Earnings	<u>16,500</u>
		Total Stockholders' Equity	<u>25,500</u>
Total Assets	<u>\$37,700</u>	Total Liabilities and Stockholders' 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 stockholders.

Answer: FALSE

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

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 dividends

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 retained earnings

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 retained earnings
- C) Statement of cash flows
- D) Cash 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 received from issuance of shares of common stock

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 received from issuance of shares of common stock

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 received from issuance of shares of common stock

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) Stockholders' equity (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 investment activities	Purchase and sale of land and equipment for cash
3. Cash flows from financing activities	Cash contributions by stockholders and cash dividends paid to the stockholders

Diff: 2

LO: 1-5

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Concept

H2: Statement of Cash Flows

1.6 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 stockholders' 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 retained earnings informs users about how much of the earnings were kept and reinvested in 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)

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 how much of the earnings were kept and reinvested in the company.

Answer: FALSE

Explanation: The statement of retained earnings informs users about how much of the earnings were kept and reinvested in 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)

8) The statement of retained earnings informs users about how much of the earnings were kept and reinvested in 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)

9) The balance sheet helps analyze the business 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 retained earnings

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 retained earnings
- 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 retained earnings
- 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 retained earnings
- 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) $\text{Average total assets} = (\text{Beginning total assets} + \text{Ending total assets}) \times 2$
- B) $\text{Average total assets} = (\text{Beginning total assets} - \text{Ending total assets}) \times 2$
- C) $\text{Average total assets} = (\text{Beginning total assets} - \text{Ending total assets}) / 2$
- D) $\text{Average total assets} = (\text{Beginning total assets} + \text{Ending total assets}) / 2$

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 Corporation had a net income of \$2,500 for the year ending December 2018. Its beginning and ending total assets were \$32,500 and \$19,500, respectively. Calculate Metro's return on assets (ROA). (Round your percentage answer to two decimal places.)

A) 7.69%

B) 12.82%

C) 9.62%

D) 4.81%

Answer: C

Explanation: C) $\text{Return on assets (ROA)} = \$2,500 / [(\$32,500 + \$19,500) / 2] = 9.62\%$

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 Stockholders' 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

Return on Assets = \$125,000 / [(\$196,300 + \$225,700) / 2]
= \$125,000 / \$211,000
= 59.24%

Diff: 2

LO: 1-6

AACSB: Application of knowledge

AICPA Functional: Measurement

PE Question Type: Application

H2: Return on Assets (ROA)

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 Stockholders' Equity	\$90,000	Total Stockholders' Equity	\$137,000
Total Revenues	\$82,000	Total Revenues	\$70,000
Net Income	\$12,000	Net Income	\$18,000

The total assets and total stockholders' equity balances are at December 31, 2018. Total revenues and net income are for the year ended December 31, 2018. No dividends were paid. 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.

- Which business owes more to creditors?
- Which business has more stockholders' equity at the end of the year?
- Which business had more expenses?
- 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:

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

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

Uptown owes more to creditors.

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

- 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.

- 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

H2: Return on Assets (ROA)