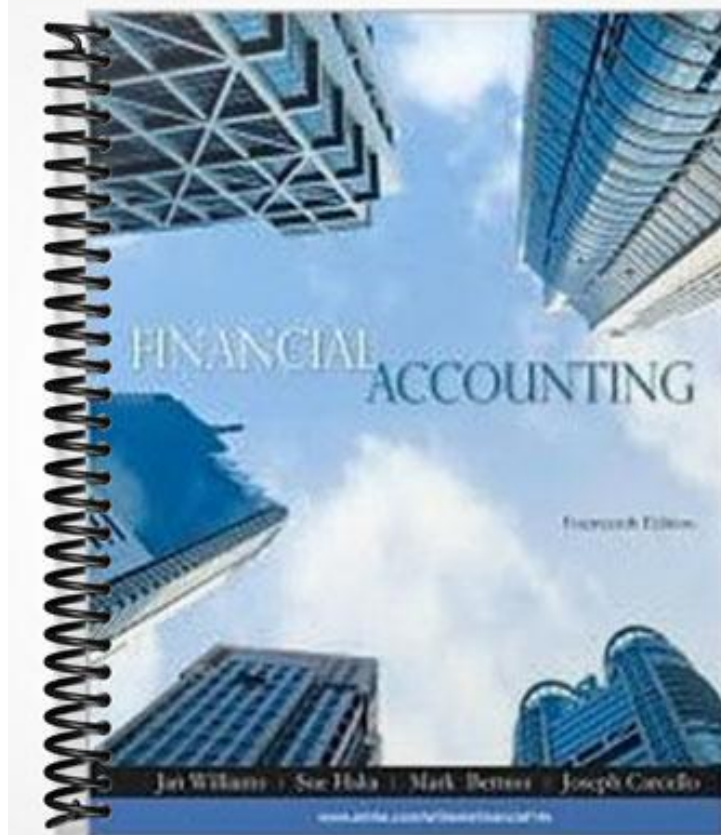


TEST BANK



Chapter 02 Basic Financial Statements

True / False Questions

1. A business entity is regarded as separate from the personal activities of its owners whether it is a sole proprietorship, a partnership, or a corporation.

True False

2. Assets need not always have physical characteristics such as buildings, machinery or inventory.

True False

3. The going concern principle assumes that the business will continue indefinitely.

True False

4. Notes payable and accounts payable are written promises to pay an amount owed by a certain date. Notes payable generally have interest but accounts payable generally do not.

True False

5. A net profit results from having more revenues than liabilities.

True False

6. The sale of additional shares of capital stock will cause treasury stock to increase.

True False

7. Articulation between the financial statements means that they relate closely to each other.

True False

8. Limited liability means that owners of a business are only liable for the debts of the business up to the amounts they can afford.

True False

9. In a business organized as a corporation, it is not necessary to list the equity of each stockholder on the balance sheet.

True False

10. Total assets always equal total liabilities plus total owners' equity.

True False

11. A cash flow statement reports revenue and expense activities for a specific time period such as one month or one year.

True False

12. Any business event that might affect the future profitability of a business should be reported in its balance sheet.

True False

13. Total assets plus total liabilities equals total owners' equity.

True False

14. The practice of showing assets on the balance sheet at their cost rather than at their current market value is explained in part by the fact that cost is supported by objective evidence that can be verified by independent experts.

True False

15. The realization principle states that the activities of an entity should be kept separate from those of its owner.

True False

16. The entity principle states that the affairs of the owners are not part of the financial operations of a business entity and should be separated.

True False

17. The accounting equation may be stated as "assets minus liabilities equals owners' equity."

True False

18. A transaction that causes an increase in an asset may also cause a decrease in another asset, an increase in a liability, or an increase in owners' equity.

True False

19. The collection of an account receivable will cause total assets to decrease.

True False

20. The payment of a liability causes an increase in owners' equity.

True False

21. When a business borrows money from a bank, the immediate effect is an increase in total assets and a decrease in liabilities or owners' equity.

True False

22. The purchase of an asset such as office equipment, for cash will cause owners' equity to decrease.

True False

23. The owner of a sole proprietorship is personally liable for the debts of the business, whereas the stockholders of a corporation are not personally liable for the debts of the business.

True False

24. If a company purchases equipment for cash, its total assets will increase.

True False

25. If a company purchases equipment by issuing a note payable, its total assets will not change.

True False

26. It is not unusual for an entity to report a significant increase in cash from operating activities, but a decrease in the total amount of cash.

True False

27. The cash flow statement provides a link between two balance sheets by showing how net income (or loss) has changed owners' equity from one balance sheet date to the next.

True False

28. According to Sarbanes-Oxley, internal controls must be audited by the same accounting firm that audits the financial statements.

True False

29. The Public Company Accounting Oversight Board was created by the American Institute of CPAs to oversee the public accounting profession.

True False

30. The major outgrowth from business failures and allegations of fraudulent financial reporting during the 1990's was the passage of the Securities and Exchange Act.
True False

Multiple Choice Questions

31. Which of the following best describes liquidity?

- A. The ability to increase the value of retained earnings
- B. The ability to pay the debts of the company as they become due.
- C. Being able to buy everything the company requires for cash.
- D. Purchasing everything the company requires on credit.

32. Profitability may be defined as:

- A. The ability to pay the debts of the company as they fall due.
- B. The ability to increase retained earnings.
- C. Distributing dividends
- D. Having excess cash

33. The principle of adequate disclosure means that a company should disclose:

- A. Only the important monetary information.
- B. All confidential information regarding the company.
- C. Any financial facts that a reasonable informed person would consider necessary for the proper interpretation of the financial statements.
- D. Only subsequent events.

34. Blue Wholesale Shirt Co. sold shirts to Pink Retail Shoppe. The owner of Pink Retail said she would pay Blue at a later date which Blue Wholesale Shirt Co. agreed to. Blue Wholesale Shirt Co. is considered to be a:

- A. borrower
- B. liability
- C. creditor
- D. debtor

35. Owners' equity in a business increases as a result of which of the following?

- A. Payments of cash to the owners.
- B. Losses from unprofitable operation of the business.
- C. Earnings from profitable operation of the business.
- D. Borrowing from a commercial bank.

36. Owners' equity in a business decreases as a result of which of the following?

- A. Investments of cash by the owners.
- B. Profits from operating the business.
- C. Losses from unprofitable operation of the business
- D. Repaying a loan to a commercial bank

37. Which one of the following is not considered one of the three primary financial statements?

- A. Balance sheet.
- B. Income statement.
- C. Statement of cash flows.
- D. Statement of budgeting activities.

38. Which of the following is the primary objective of financial statements?

- A. Providing managers with detailed information tailored to the managers' specific information needs.
- B. Providing people outside the business organization with information about the company's financial position and operating results.
- C. Reporting to the Internal Revenue Service the company's taxable income.
- D. Indicating to investors in a particular company the current market values of their investments.

39. Which of the following is descriptive of the proper form of a balance sheet?

- A. The heading sets forth the period of time covered.
- B. Cash is always the first asset listed, followed by permanent assets (such as land and buildings), and finally by assets such as receivables and supplies.
- C. Liabilities are listed before owners' equity.
- D. A subtotal for total assets plus total liabilities is shown.

40. A balance sheet is designed to show:

- A. How much a business is worth.
- B. The profitability of the business during the current year.
- C. The assets, liabilities, and owners' equity of a business as of a particular date.
- D. The cost of replacing the assets and of paying off the liabilities at December 31.

41. The way in which financial statements relate is known as:

- A. Solvency.
- B. Objectivity.
- C. Articulation.
- D. Entity.

42. If total assets equal \$270,000 and total liabilities equal \$202,500, the total owners' equity must equal:

- A. \$472,500.
- B. \$67,500.
- C. Can not be determined from the information given.
- D. Some other amount.

43. Which of the following best defines an asset?

- A. Something with physical form that is valued at cost in the accounting records.
- B. An economic resource owned by a business and expected to benefit future operations.
- C. An economic resource representing cash or the right to receive cash in the near future.
- D. Something owned by a business that has a ready market value.

44. To appear in a balance sheet of a business entity, an asset need not:

- A. Be an economic resource.
- B. Have a ready market value.
- C. Be expected to benefit future operations.
- D. Be owned by the business.

45. If total assets equal \$345,000 and total owners' equity equal \$120,000, then total liabilities must equal:

- A. \$465,000.
- B. \$225,000.
- C. Can not be determined from the information given.
- D. Some other amount.

46. A balance sheet:

- A. Provides owners, investors, and other interested parties with all the financial information they need to evaluate the financial strength, profitability, and future prospects of a given business entity.
- B. Shows the current market value of the owners' equity in the business at the balance sheet date.
- C. Assists creditors in evaluating the debt-paying ability of a business by showing the assets and liabilities of the business combined with those of its owner (or owners).
- D. Shows the assets, liabilities, and owners' equity of a business entity, valued in conformity with generally accepted accounting principles.

47. Which of the following is correct if a company purchases equipment for \$70,000 cash?

- A. Total assets will increase by \$70,000.
- B. Total assets will decrease by \$70,000.
- C. Total assets will remain the same.
- D. The company's total owners' equity will decrease.

48. From an accounting viewpoint, when is a business considered an entity separate from its owner(s)?

- A. Only when organized as a sole proprietorship.
- B. Only when organized as a partnership.
- C. Only when organized as a corporation.
- D. In each of the above situations, the business is an accounting entity separate from the activities of the owner(s).

49. If a company purchases equipment for \$65,000 by issuing a note payable:

- A. Total assets will increase by \$65,000.
- B. Total assets will decrease by \$65,000.
- C. Total assets will remain the same.
- D. The company's total owners' equity will decrease.

50. The valuation of assets in the balance sheet is based primarily upon:

- A. What it would cost to replace the assets.
- B. Cost, because cost is usually factual and verifiable.
- C. Current fair market value as established by independent appraisers.
- D. Cost, because in the event of liquidation, the assets would be sold at an amount equal to their original cost.

51. Which of the following is not a generally accepted accounting principle relating to the valuation of assets?

- A. The cost principle - in general, assets are valued at cost, rather than at estimated market values.
- B. The objectivity principle - accountants prefer to use objective, rather than subjective, information as the basis for accounting information.
- C. The safety principle - assets are valued at no more than the value for which they are insured.
- D. The going-concern assumption - one reason for valuing assets such as buildings and equipment at cost rather than at their current market values is the assumption that the business will use these assets rather than sell them.

52. Each year the accountant for Southern Real Estate Company adjusts the recorded value of each asset to its market value. Using these market value figures on the balance sheet violates:

- A. The accounting equation.
- B. The stable-dollar assumption.
- C. The business entity concept.
- D. The cost principle.

53. The owner of Westhampton Fish Eatery purchased a new car for his daughter who is away at college at a cost of \$43,000 and reported this amount as Delivery Vehicle in the restaurant's balance sheet. The reporting of this item in this manner violated the:

- A. Cost principle.
- B. Business entity concept
- C. Objectivity principle.
- D. Going-concern assumption.

54. Which of the following is correct when a company uses cash to pay for an expense?

- A. Total assets will decrease.
- B. Retained earnings will decrease.
- C. Owners' equity will decrease.
- D. All three of the above statements are correct.

55. If cash flows from operating activities is a negative amount:

- A. The company must have a net loss for the year.
- B. The company must have a net profit for the year.
- C. The company must have paid off more debts than it earned during the year.
- D. The company may have net income or a net loss for the year.

56. Eton Corporation purchased land in 1990 for \$190,000. In 2008, it purchased a nearly identical parcel of land for \$430,000. In its 2008 balance sheet, Eton valued these two parcels of land at a combined value of \$860,000. Reporting the land in this manner violated the:

- A. Cost principle.
- B. Principle of the business entity.
- C. Objectivity principle.
- D. Going-concern assumption

57. Bob Bertolucci, owner of Bob's Bazaar, also owns a personal residence that cost \$575,000, but has a market value of \$725,000. During preparation of the financial statements for Bob's Bazaar, the accounting principle most relevant to the presentation of Bob's home is:

- A. The concept of the business entity.
- B. The cost principle.
- C. The going-concern assumption.
- D. The objectivity principle.

58. Which of the following will not cause a change in the owners' equity of a business?

- A. Payment of an interest free business debt.
- B. Withdrawal of cash by the owner.
- C. Sale of land at a profit.
- D. Losses from unprofitable operations.

59. Which business organization is recognized as a separate legal entity under the law?

- A. Corporation.
- B. Sole proprietorship.
- C. Partnership.
- D. All three.

60. The amount of owners' equity in a business is not affected by:

- A. The percentage of total assets held in cash.
- B. Investments made in the business by the owner.
- C. The profitability of the business.
- D. The amount of dividends paid to stockholders.

61. Decreases in owners' equity are caused by:

- A. Purchases of assets and payment of liabilities.
- B. Purchases of assets and incurrence of liabilities.
- C. Payment of liabilities and unprofitable operations.
- D. Distributions of assets to the owner and unprofitable operations.

62. Which of the following transactions would cause a change in owners' equity?

- A. Repayment of the principal on a bank loan.
- B. Purchase of a delivery truck on credit.
- C. Sale of land on credit for a price above cost.
- D. Borrowing money from a bank.

63. An expense is best defined as:

- A. Any payment of cash for the benefit of the company.
- B. Past, present or future payments of cash required to generate revenues.
- C. Past payments of cash required to generate revenues.
- D. Future payments of cash required to generate revenues.

64. If a transaction causes an asset account to decrease, which of the following related effects may occur?

- A. An increase of equal amount in an owners' equity account.
- B. An increase in a liability account.
- C. An increase of equal amount in another asset account.
- D. An increase in the combined total of liabilities and owners' equity.

65. The payment of a business debt not including interest:

- A. Decreases total assets.
- B. Increases total liabilities.
- C. Increases the owners' equity in the business.
- D. Decreases the owners' equity in the business.

66. The accounting principle that assumes that a company will operate in the foreseeable future is:

- A. Going concern.
- B. Objectivity.
- C. Liquidity.
- D. Disclosure.

67. Deerpark Corporation recently borrowed \$70,000 cash from its bank. Which of the following was unaffected by this transaction?

- A. Assets.
- B. Liabilities.
- C. Owners' equity.
- D. Cash.

68. Which of the following transactions would cause an increase in both assets and owners' equity?

- A. Investment of cash in the business by the owner.
- B. Sale of land for a price less than its cost.
- C. Borrowing money from a bank.
- D. Sale of land for cash at a price equal to its cost.

69. A transaction caused an increase in both assets and owners' equity. This transaction could have been:

- A. A sale of service to a customer producing revenue.
- B. Sale of land for a price less than its cost.
- C. Borrowing money from a bank.
- D. Sale of land for cash at a price equal to its cost.

70. Retained earnings is:

- A. The positive cash flows of a company.
- B. Net worth of a company.
- C. The owners' equity that has accumulated as a result of profitable operations.
- D. Equal to the total assets of a company.

71. A revenue transaction results in all of the following except:

- A. An increase in assets.
- B. An increase in owners' equity.
- C. A positive cash flow in either the past, present, or future.
- D. An increase in liabilities.

72. If a company has a profit:

- A. Assets will be equal to liabilities plus owners' equity.
- B. Assets will be less than liabilities plus owners' equity.
- C. Assets will be greater than liabilities plus owners' equity.
- D. Owner's equity will be greater than its assets.

73. Which of the following activities is not a category into which cash flows are classified?

- A. Marketing activities.
- B. Operating activities.
- C. Financing activities.
- D. Investing activities.

74. The change in owners' equity from one balance sheet to the next is partially explained by the:

- A. Statement of cash flows.
- B. Statement of financial position.
- C. Income statement.
- D. Tax return.

75. Capital stock represents:

- A. The amount invested in the business by stockholders when shares of stock were initially issued by a corporation.
- B. The owners' equity for a business organized as a corporation.
- C. The owners' equity accumulated through profitable operations that have not been paid out as dividends.
- D. The price paid by the current owners to acquire shares of stock in the corporation, regardless of whether they bought the shares directly from the corporation or from another stockholder.

76. The balance sheet item that represents the portion of owners' equity resulting from profitable operation of the business is:

- A. Accounts receivable.
- B. Cash.
- C. Capital stock.
- D. Retained earnings.

77. Retained earnings appears on:

- A. The income statement.
- B. The balance sheet.
- C. The statement of cash flows.
- D. All three statements.

78. Which of the following statements regarding liquidity and profitability is not true?

- A. If a business is unable to pay its debts as they come due, it is operating unprofitably.
- B. A business may be liquid, yet operate unprofitably for several years.
- C. A business may operate profitably, yet be unable to meet its obligations.
- D. In order to survive in the long run, a business must both remain liquid and operate profitably.

79. The concept of adequate disclosure means that:

- A. The accounting department of a business must inform management of the accounting principles used in preparing the financial statements.
- B. The company must inform users of any significant facts necessary for proper interpretation of the financial statements, including events occurring after the financial statement date.
- C. The independent auditors must disclose in the financial statements any and all errors detected in the company's accounting records.
- D. The financial statements should include a comprehensive list of each transaction that occurred during the year.

80. If cash increases during a year, it must mean that:

- A. There was positive net income on the income statement.
- B. Retained earnings increased.
- C. The net worth of a company increased.
- D. None of the three statements above must necessarily be true.

81. A strong statement of cash flows indicates that significant cash is being generated by:

- A. Operating activities.
- B. Financing activities.
- C. Investing activities.
- D. Effective tax planning.

At December 31, 2009, the accounting records of Braun Corporation contain the following items:

Accounts Payable	\$16,000		Accounts Receivable	\$40,000
Land	\$240,000		Cash	?
Capital Stock	?		Equipment	\$120,000
Building	\$180,000		Notes Payable	\$190,000
Retained Earnings	\$160,000			

82. Refer to the above data. If Capital Stock is \$260,000, what is the December 31, 2009 cash balance?

- A. \$86,000.
- B. \$94,000.
- C. \$46,000.
- D. \$686,000.

83. Refer to the above data. If Capital Stock is \$320,000, total assets of Braun Corporation at December 31, 2009, amount to:

- A. \$686,000.
- B. \$926,000.
- C. \$726,000.
- D. \$106,000.

84. Refer to the above data. If Cash at December 31, 2009, is \$86,000, Capital Stock is:

- A. \$260,000.
- B. \$300,000.
- C. \$620,000.
- D. \$168,000.

85. Refer to the above data. If Cash at December 31, 2009, is \$26,000, total owners' equity is:

- A. \$160,000.
- B. \$366,000.
- C. \$606,000.
- D. \$400,000.

86. Refer to the above data. If Cash at December 31, 2009, is \$66,000, total assets amount to:
- A. \$606,000.
 - B. \$806,000.
 - C. \$662,000.
 - D. \$646,000.

At December 31, 2010, the accounting records of Hercules Manufacturing, Inc. contain the following items:

Accounts Payable	\$12,000	Accounts Receivable	\$30,000
Land.....	\$90,000	Cash	\$7,000
Building	\$250,000	Equipment	?
Notes Payable	\$135,000	Capital Stock	188,000
Retained Earnings	?		

87. Refer to the above data. If total assets of Hercules Manufacturing, Inc. are \$556,000, Equipment is carried in Hercules Manufacturing accounting records at:
- A. \$377,000.
 - B. \$179,000.
 - C. \$150,000.
 - D. \$ 90,000.

88. Refer to the above data. If total assets of Hercules Manufacturing, Inc. are \$556,000, Retained Earnings at December 31, 2010, must be:
- A. \$811,000.
 - B. \$180,000.
 - C. \$221,000.
 - D. \$335,000.

89. Refer to the above data. If Retained Earnings at December 31, 2010, is \$140,000, total assets amount to:
- A. \$ 98,000.
 - B. \$377,000.
 - C. \$475,000.
 - D. \$188,000.

90. Refer to the above data. If Retained Earnings at December 31, 2010, is \$100,000, Equipment is carried in Hercules Manufacturing, Inc. accounting records at:

- A. \$ 42,000.
- B. \$ 58,000.
- C. \$ 43,500.
- D. \$345,000.

91. Refer to the above data. Assume the Equipment shown above was acquired by the business five years ago and has a book value of \$156,000, but has a current appraised value of \$200,000. Hercules Manufacturing's Retained Earnings at December 31, 2010, amounts to:

- A. \$533,000.
- B. \$345,000.
- C. \$198,000.
- D. \$356,000.

At December 31, 2011 the accounting records of Gordon, Inc. contain the following items:

Accounts Payable	\$2,500	Accounts Receivable	\$18,750
Land.....	\$30,000	Cash	?
Building	\$31,250	Equipment	\$40,000
Notes Payable	?	Capital Stock	\$12,500
Retained Earnings	\$125,000		

92. Refer to the above data. If the Notes Payable is \$10,000, the December 31, 2011 cash balance is:

- A. \$ 60,000.
- B. \$160,000.
- C. \$ 30,000.
- D. \$ 20,000.

93. Refer to the above data. If the Note Payable balance is \$25,000, then the total assets of Gordon, Inc. at December 31, 2011 amount to:

- A. \$27,500.
- B. \$152,500.
- C. \$120,000.
- D. \$165,000.

94. Refer to the above data. If the Cash balance at December 31, 2011 is \$67,500, the Note Payable balance is:

- A. \$118,750.
- B. \$ 47,500.
- C. \$137,500.
- D. \$140,000.

95. Refer to the above data. If the Cash balance at December 31, 2011 is \$62,500 then total liabilities amount to:

- A. \$ 42,500.
- B. \$140,000.
- C. \$ 45,000.
- D. \$182,500.

96. Which of the following is correct if at the end of Crystal Imports' first year of operations, assets are \$800,000 and owners' equity is \$720,000?

- A. The owner must have invested \$720,000 to start the business.
- B. The business must be operating profitably.
- C. Liabilities are \$80,000.
- D. Liabilities are \$1,520,000.

97. During the current year, the assets of Wheatley's increased by \$362,000, and the liabilities increased by \$260,000. The owners' equity in the business must have:

- A. Decreased by \$102,000.
- B. Decreased by \$622,000.
- C. Increased by \$102,000.
- D. Increased by \$622,000.

98. The total liabilities of Hogan's Company on the balance sheet are \$270,000; this amount is equal to three-fourths of the total assets. What is the amount of owners' equity?

- A. \$202,500.
- B. \$ 90,000.
- C. \$360,000.
- D. \$630,000.

99. Thirty percent of the total assets of Shanahan Corporation have been financed through borrowing. The total liabilities of the company are \$600,000. What is the amount of owners' equity?

- A. \$ 180,000.
- B. \$2,000,000.
- C. \$1,400,000.
- D. \$2,600,000.

100. A transaction caused a \$60,000 increase in both assets and total liabilities. This transaction could have been which of the following?

- A. Purchase for office equipment for \$60,000 cash.
- B. Purchase of office equipment for \$120,000, paying \$60,000 cash and issuing a note payable for the balance.
- C. Repayment of a \$60,000 bank loan.
- D. Investment of \$60,000 cash in the business by the owner.

101. If \$9,600 cash and a \$31,000 note payable are given in exchange for some office machines to be used in a business:

- A. Total assets are increased.
- B. Total liabilities are decreased.
- C. Total assets are decreased.
- D. The owners' equity is increased.

102. During the current year, liabilities of Corbett's Store increased by \$220,000, and owners' equity increased by \$160,000 then

- A. Assets at the end of the year total \$380,000.
- B. Assets at the end of the year total \$60,000.
- C. Assets increased during the year by \$380,000.
- D. Assets decreased during the year by \$60,000.

103. During the current year, liabilities of Hayden Travel decreased by \$50,000, and owners' equity increased by \$75,000 then.

- A. Assets at the end of the year total \$125,000.
- B. Assets at the end of the year total \$25,000.
- C. Assets increased during the year by \$25,000.
- D. Assets decreased during the year by \$125,000.

104. At the end of the current year, the owners' equity in Barclay Bakery is \$246,000. During the year the assets of the business had increased by \$120,000, and the liabilities had increased by \$72,000. Owners' equity at the beginning of the year must have been:

- A. \$198,000.
- B. \$174,000.
- C. \$284,000.
- D. \$438,000.

105. At the end of the current year, the owners' equity in Durante Co. is \$360,000. During the year the assets of the business had increased by \$68,000, and the liabilities had increased by \$118,000. Owners' equity at the beginning of the year must have been:

- A. \$410,000.
- B. \$310,000.
- C. \$546,000.
- D. \$174,000.

106. During the current year, the assets of Quality Stairs increased by \$175,000 and the liabilities decreased by \$15,000. If the owners' equity in the business is \$475,000 at the end of the year, the owners' equity at the beginning of the year must have been:

- A. \$335,000.
- B. \$285,000.
- C. \$665,000.
- D. \$615,000.

107. During the month of May, 2009, the Henderson Company had the following transactions:

- * Revenues of \$60,000 were earned and received in cash.
- * Bank loans of \$9,000 were paid off.
- * Equipment of \$20,000 was purchased.
- * Expenses of \$36,800 were paid.
- * Stockholders purchased additional shares for \$22,000 cash.

A statement of cash flows for May, 2009, would report net cash flows from operating activities of:

- A. \$60,000
- B. \$16,200
- C. \$23,200
- D. \$20,000

Astoria Co. had the following transactions during the month of August, 2010:

- * Cash received from bank loans was \$20,000.
- * Dividends of \$9,500 were paid to stockholders in cash.
- * Revenues earned and received in cash amounted to \$33,500
- * Expenses incurred and paid were \$26,000

108. Refer to the above data. What amount of net income will be reported on an income statement for the month of August, 2010?

- A. \$20,000.
- B. \$7,500.
- C. \$0.
- D. \$33,500.

109. Refer to the above data. At the beginning of August, 2010, owners' equity in Astoria was \$160,000. Given the transactions of August, 2010, what will owners' equity be at the end of the month?

- A. \$167,500.
- B. \$150,500.
- C. \$193,500.
- D. \$158,000.

110. Refer to the above data. For the month of August, 2010, net cash flows from operating activities for Astoria were:

- A. \$33,500.
- B. \$7,500.
- C. \$20,000.
- D. \$26,000.

111. The major provisions of the Sarbanes-Oxley Act of 2002 include all of the following except:

- A. The creation of a new agency to over see the public accounting profession.
- B. Restrictions on the types of consulting services that accounting firms can provide to audit clients.
- C. Reducing responsibility for audit committees when overseeing the financial reporting process.
- D. Requiring the chief executive office and the chief financial officer to certify the accuracy of their company's financial statements.

112. According to the Sarbanes-Oxley Act, CEOs and CFOs must certify to the accuracy of their company's financial statements

- A. Monthly and Quarterly
- B. Quarterly and Annually
- C. Monthly and Annually
- D. CEOs and CFOs are not required to certify to the company's financial statement; only CPA's do.

Essay Questions

113. Accounting terminology

Listed below are nine technical accounting terms introduced in this chapter:

<i>Assets</i>	<i>Accounting equation</i>	<i>Inflation</i>
<i>Balance Sheet</i>	<i>Liabilities</i>	<i>Going concern assumption</i>
<i>Cost principle</i>	<i>Owners' equity</i>	<i>Liquidity</i>

Each of the following statements may (or may not) describe one of these technical terms. In the space provided below each statement, indicate the accounting term described, or answer "None" if the statement does not correctly describe any of the terms. Do not use a term more than once.

- (A.) Having the financial ability to pay debts as they become due.
- (B.) An assumption that a business will operate in the foreseeable future.
- (C.) Economic resources owned by businesses that are expected to benefit future operations.
- (D.) The debts or obligations of a business organization.
- (E.) $\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$
- (F.) The principle which states that assets are valued in the balance sheet at their historical cost.
- (G.) A residual amount equal to assets minus liabilities.

114. Accounting equation

- (A.) During the current year, the assets of Duffy Stationery increased by \$650,000, and the liabilities decreased by \$340,000. What was the change in owners' equity during the year?
- (B.) The owners' equity of Graham Interiors appears on the balance sheet as \$720,000 and is equal to one-fourth of total assets. Compute the amount of total liabilities.
- (C.) At the end of 2009 the owners' equity in Scott Mfg. amounted to \$845,000. During 2009, the assets of the business increased by \$515,000, and the liabilities increased by \$205,000. The owners' equity at the beginning of 2009 was how much?

115. Effects of transactions on elements of the accounting equation

Some of the transactions carried out by Tudor Wholesale during the first month of the company's existence are listed below. You are to determine the effect of each transaction on the total assets, the total liabilities, and the owners' equity. Prepare your answer in columnar form, identifying each transaction by letter and using the symbols (+) for increase, (-) for decrease, and (NC) for no change. An answer is provided for the first transaction to serve as an example.

Transactions	Total Assets	Total Liabilities	Owners' Equity
A. Issued capital stock in exchange for cash	+	NC	+
B. Bought land and a building at a total price of \$165,000. Made a down payment of \$65,000 cash and signed a note payable for the balance.			
C. Bought adjoining lot for use as parking lot; paid cash in full			
D. Sold a portion of the land on credit at a price equal to its cost.			
E. Obtained a loan from a bank.			
F. Purchased office equipment on credit.			
G. Paid a liability.			
H. Collected part of amount owned to the business from purchaser of land.			
I. Sold another portion of the land for cash at a price in excess of cost.			

116. Effects of transactions on elements of the accounting equation

Some of the transactions carried out by Tsang Company during the first month of the company's existence are listed below. You are to determine the dollar effect of each transaction on the total assets, the total liabilities, and the owners' equity of Tsang Company. Use the symbols (+) for increase, (?) (-) for decrease, and (NC) for no change. An answer is provided for the first transaction to serve as an example.

Transaction	Total Assets	Total Liabilities	Owners' Equity
A. Issued capital stock to Don Tsang in exchange for his investment of \$200,000 in the business	+\$200,000	NC	+200,000
B. Purchased a computer for the business for \$5,500 cash.			
C. Borrowed \$20,000 from the bank.			
D. Purchased office furnishings at a total price of \$4,200, terms \$600 cash and balance payable in two installments.			
E. Paid \$1,800 of the balance due on the office furnishings.			
F. Sold an extra monitor that had cost \$250 for \$300 on credit.			
G. Collected \$150 of amount receivable from purchaser of the monitor.			
H. Bought a small truck to be used in the business for \$29,000; paid cash in full.			

117. Computation of assets, liabilities, and owners' equity after a series of transactions
On April 30, 2009, the balance sheet of China Collectibles showed total assets of \$700,000, total liabilities of \$400,000, and owners' equity of \$300,000. The following transactions occurred in May of 2009:

- (1) Capital stock was issued in exchange for \$165,000 cash.
- (2) The business purchased equipment for \$360,000, paying \$160,000 cash and issuing a note payable for \$200,000.
- (3) The business paid off \$70,000 of its accounts payable.
- (4) The business collected \$54,000 of its accounts receivable.

Compute the following as of May 31, 2009:

- (A.) Total assets \$ _____
- (B.) Total liabilities \$ _____
- (C.) Owners' equity \$ _____

118. Computation of assets, liabilities, and owners' equity after a series of transactions
The December 31, 2009, balance sheet of Charles Realty reported total assets of \$900,000, total liabilities of \$350,000, and owners' equity of \$550,000. The following transactions occurred in January of 2010:

- (1) The business purchased land for \$250,000, paying \$100,000 cash and issuing a note payable for the balance.
- (2) The business collected accounts receivable totaling \$45,000.
- (3) The business sold one-fifth of the land (which had cost \$50,000) land costing \$50,000 for \$60,000 cash.
- (4) The business paid off \$50,000 of the note payable.

Compute the following at January 31, 2010:

- (A.) Total assets\$ _____
- (B.) Total liabilities\$ _____
- (C.) Owners' equity\$ _____

119. Preparation of balance sheet

Prepare the balance sheet as of December 31, 2009, for Gamma Company, from the following list of items which are arranged in random order. You must compute the amount for accounts payable to complete the balance sheet.

Accounts payable.....	\$?	Land	\$260,000
Office equipment.....	\$41,600	Notes payable	\$377,000
Buildings	\$533,000	Accounts receivable.....	\$97,500
Capital stock	\$494,000	Cash	\$19,760

120. Preparation of balance sheet after a series of transactions

The balance sheet was as follows for Custom Ceramics on February 1, 2010:

Custom Ceramics Balance Sheet February 1, 2010				
Assets		Liabilities & Owners' Equity		
Cash	\$7,000	Liabilities:		
Accounts receivable	5,200	Notes payable		\$ 40,000
Land	80,000	Accounts payable		<u>6,000</u>
Buildings	50,000	Total liabilities		\$ 46,000
Office Equipment	30,000	Owners' equity:		
		Capital stock	\$100,000	
		Retained earnings	<u>26,200</u>	<u>\$126,200</u>
		Total liabilities		
Total assets	<u>\$172,200</u>	Owners' equity		<u>\$172,200</u>

During the first week of February, the following transactions occurred:

- * The business used cash to pay off \$5,000 of its accounts payable. (No payment was made on the notes payable.)
- * Additional capital stock was issued to Joan Custom for \$15,000 cash.
- * Equipment was purchased on credit for \$1,800
- * The business collected \$4,000 cash from accounts receivable.

Complete the balance sheet for Custom Ceramics as of February 8, 2010.

Custom Ceramics Balance Sheet February 8, 2010				
Assets		Liabilities & Owners' Equity		
Cash	\$	Liabilities:		
Accounts receivable		Notes payable		\$
Land		Accounts payable		
Buildings		Total liabilities		\$
Office Equipment		Owners' equity:		
		Capital stock		
		Retained earnings		\$
		Total liabilities		
Total assets	<u>\$</u>	Owners' equity		<u>\$</u>

121. Completion of Balance Sheet

Use the following information to complete the balance sheet of Adelphi Construction as of December 31, 2010.

- (1) The company was organized on January 1, 2010, and has operated for the full year 2010.
- (2) Earnings have amounted to \$275,000, and dividends of \$70,000 have been paid to stockholders.
- (3) Cash and accounts receivable together amount to one and one-half times as much as notes payable.

Adelphi Construction			
Balance Sheet			
December 31, 2010			
Assets		Liabilities & Owners' Equity	
Cash	\$	Liabilities:	
Accounts receivable	85,000	Notes payable	\$
Land.....	184,000	Accounts payable.....	
Building.....	250,000	Income taxes payable	\$ 40,000
Equipment.....	96,000	Total liabilities	\$215,000
		Owners' equity:	
	_____	Capital stock	\$
		Retained earnings	\$ _____
		Total liabilities and	
Total assets.....	\$ _____	owners' equity.....	<u>\$620,000</u>

122. Completion of balance sheet

Use the following information to complete the December 31, 2009, balance sheet of Copper Supplies Company.

- (1) Owners' equity as of January 1, 2009, totaled \$175,000, which included capital stock of \$150,000.
- (2) Additional capital stock was issued during 2009 in exchange for \$40,000 cash.
- (3) Net income for 2009 amounted to \$200,000; no dividends were paid during 2009.
- (4) Cash and accounts receivable together amount to 3 times as much as accounts payable.

Copper Supplies Company			
Balance Sheet			
December 31, 2009			
Assets		Liabilities & Owners' Equity	
Cash	\$ 30,000	Liabilities:	
Accounts receivable	?	Accounts payable	\$ 40,000
Land.....	215,000	Notes payable.....	?
Building.....	300,000	Total liabilities.....	\$?
Equipment.....	?	Owners' equity:	
		Capital stock	\$
		Retained earnings	\$?
		Total liabilities and	
Total assets.....	<u>\$835,000</u>	owners' equity.....	<u>\$?</u>

123. Effects of transactions on balance sheet items

Show the effect of each of the seven listed transactions on the balance sheet items of Distinctive Draperies. Indicate the new balances after the transaction of May 2 and each subsequent transaction. The effects of the May 1 transaction are already filled in to provide you with an example.

May	1	Issued capital stock for \$75,000.
	2	Purchased a small office building at a price of \$58,000 for the land and \$65,000 for the building. Paid \$43,000 cash and signed a note payable for the balance.
	8	Borrowed \$15,000 from the bank. Signed a 60-day note payable for this amount.
	16	Purchased copying machines, computers, and other office equipment for \$19,000. Paid \$9,000 cash and signed a note payable for the balance.
	28	Sold an item of office equipment (computer) to a stockholder at its cost of \$2,800. The stockholder paid \$800 cash and promised to pay the balance within 30 days.
	30	Paid \$5,000 on the liability for the office equipment.
	31	Collected \$500 from the stockholder who had bought the computer.

	Assets						=	Liabilities	+	Owners' Equity			
	Cash	+	Accounts Receivable	+	Land	+	Buildings	+	Office Equipment	=	Notes Payable	+	Capital Stock
May 1	+\$75,000												+\$75,000
2													
Balance													
8													
Balance													
16													
Balance													
28													
Balance													
30													
Balance													
31													
Balance													

124. Effects of transactions on balance sheet items

Show the effect of each of the seven listed transactions on the balance sheet items of Renaissance Investment Services, Inc. Indicate the new balances after the transaction of November 2 and each subsequent transaction. The effects of the November 1 transaction are already filled in to provide you with an example.

Nov.	1	Issued capital stock for \$200,000.
	2	Purchased a small office building at a price of \$86,000 for the land and \$74,000 for the building. Made a cash payment of 20% of the total price and signed a note payable for the balance.
	7	Purchased telephones, computers, and other office equipment for \$58,000. Paid \$23,000 cash and signed a note payable for the balance.
	12	Sold one of the computers to a stockholder at its cost of \$3,500. The stockholder paid \$500 cash and agreed to pay the balance within 10 days.
	22	Received \$3,000 due from the stockholder who had purchased the computer.
	30	Paid \$17,500 on the note payable for the office equipment.

	Assets						=	Liabilities	+	Owners' Equity			
	Cash	+	Accounts Receivable	+	Land	+	Buildings	+	Office Equipment	=	Notes Payable	+	Capital Stock
Nov 1	+\$200,000												+\$200,000
2													
Balance													
7													
Balance													
12													
Balance													
22													
Balance													
30													
Balance													

125. An inexperienced accounting intern at Tasso Company prepared the following income statement for the month of July, 2009:

Tasso Company Month of July, 2009		
Revenues:		
Services provided to customers	\$25,000	
Capital stock	12,500	
Loan from bank	<u>37,500</u>	\$75,000
Expenses:		
Payments to long-term creditors	\$20,000	
Expenses required to provide services to customers	18,750	
Purchase of equipment	<u>10,000</u>	<u>48,750</u>
Net income		\$ 26,250

Instructions: Prepare a revised income statement in accordance with generally accepted accounting principles.

126. List the following accounts in the order that they would appear on a balance sheet

- Capital stock
- Equipment
- Accounts Receivable
- Retained Earnings
- Revenue
- Accounts Payable
- Cash
- Rent Expense

127. From the following accounts and amounts prepare a balance sheet for the Swell Company for December 31, 2010. You must compute the amount for retained earnings to complete the balance sheet.

Accounts Payable	\$61,250
Accounts Receivable	\$70,500
Building	\$50,000
Capital Stock	\$50,000
Cash	\$64,000
Equipment	\$30,000
Insurance Expense	\$5,000
Land	\$125,000
Notes Payable	\$175,000
Sales Revenue	\$25,000
Salaries Expense	\$20,000

128. Financial statements

A set of financial statements for a company includes three related accounting reports, or statements. In the space provided, list the names of three primary statements, and give a brief description of the accounting information contained in each.

129. Development of generally accepted accounting principles

(A.) What is meant by the phrase "generally accepted accounting principles?"

(B.) Give the names of three organizations that currently play an active role in the development of accounting principles in the United States.

130. Valuation of assets under generally accepted accounting principles

Under generally accepted accounting principles, the assets owned by a business are reported in the balance sheet at their historical cost. Identify and briefly explain two accounting principles other than the cost principle that support the valuation of assets at cost in the balance sheet.

131. Forms of Business Organization

State and describe the three most common forms of business organizations in the United States.

Chapter 02 Basic Financial Statements **Answer Key**

True / False Questions

1. A business entity is regarded as separate from the personal activities of its owners whether it is a sole proprietorship, a partnership, or a corporation.

TRUE

AACSB: Reflective Thinking
AICPA BB: Legal
AICPA FN: Reporting
Learning Objective: 2
Learning Objective: 8

2. Assets need not always have physical characteristics such as buildings, machinery or inventory.

TRUE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 2

3. The going concern principle assumes that the business will continue indefinitely.

TRUE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 1
Learning Objective: 2

4. Notes payable and accounts payable are written promises to pay an amount owed by a certain date. Notes payable generally have interest but accounts payable generally do not.

TRUE

*AACSB: Reflective Thinking
AICPA BB: Resource Management
AICPA FN: Measurement
Learning Objective: 4*

5. A net profit results from having more revenues than liabilities.

FALSE

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 5*

6. The sale of additional shares of capital stock will cause treasury stock to increase.

FALSE

*AACSB: Reflective Thinking
AICPA BB: Resource Management
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4*

7. Articulation between the financial statements means that they relate closely to each other.

TRUE

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 7*

8. Limited liability means that owners of a business are only liable for the debts of the business up to the amounts they can afford.

FALSE

AACSB: Reflective Thinking
AICPA BB: Legal
AICPA FN: Measurement
Learning Objective: 8

9. In a business organized as a corporation, it is not necessary to list the equity of each stockholder on the balance sheet.

TRUE

AACSB: Reflective Thinking
AICPA BB: Legal
AICPA FN: Reporting
Learning Objective: 8

10. Total assets always equal total liabilities plus total owners' equity.

TRUE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

11. A cash flow statement reports revenue and expense activities for a specific time period such as one month or one year.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 6

12. Any business event that might affect the future profitability of a business should be reported in its balance sheet.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 3
Learning Objective: 4

13. Total assets plus total liabilities equals total owners' equity.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

14. The practice of showing assets on the balance sheet at their cost rather than at their current market value is explained in part by the fact that cost is supported by objective evidence that can be verified by independent experts.

TRUE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 2

15. The realization principle states that the activities of an entity should be kept separate from those of its owner.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 2

16. The entity principle states that the affairs of the owners are not part of the financial operations of a business entity and should be separated.

TRUE

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 2*

17. The accounting equation may be stated as "assets minus liabilities equals owners' equity."

TRUE

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3*

18. A transaction that causes an increase in an asset may also cause a decrease in another asset, an increase in a liability, or an increase in owners' equity.

TRUE

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3*

19. The collection of an account receivable will cause total assets to decrease.

FALSE

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3*

20. The payment of a liability causes an increase in owners' equity.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

21. When a business borrows money from a bank, the immediate effect is an increase in total assets and a decrease in liabilities or owners' equity.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

22. The purchase of an asset such as office equipment, for cash will cause owners' equity to decrease.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

23. The owner of a sole proprietorship is personally liable for the debts of the business, whereas the stockholders of a corporation are not personally liable for the debts of the business.

TRUE

AACSB: Reflective Thinking
AICPA BB: Legal
AICPA FN: Measurement
Learning Objective: 8

24. If a company purchases equipment for cash, its total assets will increase.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

25. If a company purchases equipment by issuing a note payable, its total assets will not change.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

26. It is not unusual for an entity to report a significant increase in cash from operating activities, but a decrease in the total amount of cash.

TRUE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 6

27. The cash flow statement provides a link between two balance sheets by showing how net income (or loss) has changed owners' equity from one balance sheet date to the next.

FALSE

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 6

28. According to Sarbanes-Oxley, internal controls must be audited by the same accounting firm that audits the financial statements.

TRUE

*AACSB: Ethics
AICPA BB: Legal
AICPA FN: Reporting
Learning Objective: 9*

29. The Public Company Accounting Oversight Board was created by the American Institute of CPAs to oversee the public accounting profession.

FALSE

*AACSB: Ethics
AICPA BB: Legal
AICPA FN: Reporting
Learning Objective: 9*

30. The major outgrowth from business failures and allegations of fraudulent financial reporting during the 1990's was the passage of the Securities and Exchange Act.

FALSE

*AACSB: Ethics
AICPA BB: Legal
AICPA FN: Reporting
Learning Objective: 9*

Multiple Choice Questions

31. Which of the following best describes liquidity?

- A. The ability to increase the value of retained earnings
- B.** The ability to pay the debts of the company as they become due.
- C. Being able to buy everything the company requires for cash.
- D. Purchasing everything the company requires on credit.

*AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 4*

32. Profitability may be defined as:

- A. The ability to pay the debts of the company as they fall due.
- B.** The ability to increase retained earnings.
- C. Distributing dividends
- D. Having excess cash

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 5

33. The principle of adequate disclosure means that a company should disclose:

- A. Only the important monetary information.
- B. All confidential information regarding the company.
- C.** Any financial facts that a reasonable informed person would consider necessary for the proper interpretation of the financial statements.
- D. Only subsequent events.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 2

34. Blue Wholesale Shirt Co. sold shirts to Pink Retail Shoppe. The owner of Pink Retail said she would pay Blue at a later date which Blue Wholesale Shirt Co. agreed to. Blue Wholesale Shirt Co. is considered to be a:

- A. borrower
- B. liability
- C.** creditor
- D. debtor

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

35. Owners' equity in a business increases as a result of which of the following?

- A. Payments of cash to the owners.
- B. Losses from unprofitable operation of the business.
- C. Earnings from profitable operation of the business.**
- D. Borrowing from a commercial bank.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

36. Owners' equity in a business decreases as a result of which of the following?

- A. Investments of cash by the owners.
- B. Profits from operating the business.
- C. Losses from unprofitable operation of the business**
- D. Repaying a loan to a commercial bank

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

37. Which one of the following is not considered one of the three primary financial statements?

- A. Balance sheet.
- B. Income statement.
- C. Statement of cash flows.
- D. Statement of budgeting activities.**

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 7

38. Which of the following is the primary objective of financial statements?

- A. Providing managers with detailed information tailored to the managers' specific information needs.
- B.** Providing people outside the business organization with information about the company's financial position and operating results.
- C. Reporting to the Internal Revenue Service the company's taxable income.
- D. Indicating to investors in a particular company the current market values of their investments.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 1
Learning Objective: 4
Learning Objective: 5
Learning Objective: 6

39. Which of the following is descriptive of the proper form of a balance sheet?

- A. The heading sets forth the period of time covered.
- B. Cash is always the first asset listed, followed by permanent assets (such as land and buildings), and finally by assets such as receivables and supplies.
- C.** Liabilities are listed before owners' equity.
- D. A subtotal for total assets plus total liabilities is shown.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 4

40. A balance sheet is designed to show:

- A. How much a business is worth.
- B. The profitability of the business during the current year.
- C.** The assets, liabilities, and owners' equity of a business as of a particular date.
- D. The cost of replacing the assets and of paying off the liabilities at December 31.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 4

41. The way in which financial statements relate is known as:

- A. Solvency.
- B. Objectivity.
- C. Articulation.**
- D. Entity.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 7

42. If total assets equal \$270,000 and total liabilities equal \$202,500, the total owners' equity must equal:

- A. \$472,500.
- B. \$67,500.**
- C. Can not be determined from the information given.
- D. Some other amount.

$$\$270,000 - \$202,500 = \$67,500$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

43. Which of the following best defines an asset?

- A. Something with physical form that is valued at cost in the accounting records.
- B. An economic resource owned by a business and expected to benefit future operations.**
- C. An economic resource representing cash or the right to receive cash in the near future.
- D. Something owned by a business that has a ready market value.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 4

44. To appear in a balance sheet of a business entity, an asset need not:

- A. Be an economic resource.
- B. Have a ready market value.**
- C. Be expected to benefit future operations.
- D. Be owned by the business.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 4

45. If total assets equal \$345,000 and total owners' equity equal \$120,000, then total liabilities must equal:

- A. \$465,000.
- B. \$225,000.**
- C. Can not be determined from the information given.
- D. Some other amount.

$$\$345,000 - \$120,000 = \$225,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

46. A balance sheet:

- A. Provides owners, investors, and other interested parties with all the financial information they need to evaluate the financial strength, profitability, and future prospects of a given business entity.
- B. Shows the current market value of the owners' equity in the business at the balance sheet date.
- C. Assists creditors in evaluating the debt-paying ability of a business by showing the assets and liabilities of the business combined with those of its owner (or owners).
- D. Shows the assets, liabilities, and owners' equity of a business entity, valued in conformity with generally accepted accounting principles.**

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 4

47. Which of the following is correct if a company purchases equipment for \$70,000 cash?

- A. Total assets will increase by \$70,000.
- B. Total assets will decrease by \$70,000.
- C.** Total assets will remain the same.
- D. The company's total owners' equity will decrease.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

48. From an accounting viewpoint, when is a business considered an entity separate from its owner(s)?

- A. Only when organized as a sole proprietorship.
- B. Only when organized as a partnership.
- C. Only when organized as a corporation.
- D.** In each of the above situations, the business is an accounting entity separate from the activities of the owner(s).

AACSB: Reflective Thinking
AICPA BB: Legal
AICPA FN: Decision Making
Learning Objective: 2
Learning Objective: 8

49. If a company purchases equipment for \$65,000 by issuing a note payable:

- A.** Total assets will increase by \$65,000.
- B. Total assets will decrease by \$65,000.
- C. Total assets will remain the same.
- D. The company's total owners' equity will decrease.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

50. The valuation of assets in the balance sheet is based primarily upon:

- A. What it would cost to replace the assets.
- B.** Cost, because cost is usually factual and verifiable.
- C. Current fair market value as established by independent appraisers.
- D. Cost, because in the event of liquidation, the assets would be sold at an amount equal to their original cost.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 3
Learning Objective: 4

51. Which of the following is not a generally accepted accounting principle relating to the valuation of assets?

- A. The cost principle - in general, assets are valued at cost, rather than at estimated market values.
- B. The objectivity principle - accountants prefer to use objective, rather than subjective, information as the basis for accounting information.
- C.** The safety principle - assets are valued at no more than the value for which they are insured.
- D. The going-concern assumption - one reason for valuing assets such as buildings and equipment at cost rather than at their current market values is the assumption that the business will use these assets rather than sell them.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 2

52. Each year the accountant for Southern Real Estate Company adjusts the recorded value of each asset to its market value. Using these market value figures on the balance sheet violates:

- A. The accounting equation.
- B. The stable-dollar assumption.
- C. The business entity concept.
- D.** The cost principle.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 2

53. The owner of Westhampton Fish Eatery purchased a new car for his daughter who is away at college at a cost of \$43,000 and reported this amount as Delivery Vehicle in the restaurant's balance sheet. The reporting of this item in this manner violated the:

- A. Cost principle.
- B. Business entity concept**
- C. Objectivity principle.
- D. Going-concern assumption.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 2

54. Which of the following is correct when a company uses cash to pay for an expense?

- A. Total assets will decrease.
- B. Retained earnings will decrease.
- C. Owners' equity will decrease.
- D. All three of the above statements are correct.**

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

55. If cash flows from operating activities is a negative amount:

- A. The company must have a net loss for the year.
- B. The company must have a net profit for the year.
- C. The company must have paid off more debts than it earned during the year.
- D. The company may have net income or a net loss for the year.**

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 6

56. Eton Corporation purchased land in 1990 for \$190,000. In 2008, it purchased a nearly identical parcel of land for \$430,000. In its 2008 balance sheet, Eton valued these two parcels of land at a combined value of \$860,000. Reporting the land in this manner violated the:

- A. Cost principle.
- B. Principle of the business entity.
- C. Objectivity principle.
- D. Going-concern assumption

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 2

57. Bob Bertolucci, owner of Bob's Bazaar, also owns a personal residence that cost \$575,000, but has a market value of \$725,000. During preparation of the financial statements for Bob's Bazaar, the accounting principle most relevant to the presentation of Bob's home is:

- A. The concept of the business entity.
- B. The cost principle.
- C. The going-concern assumption.
- D. The objectivity principle.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 2

58. Which of the following will not cause a change in the owners' equity of a business?

- A. Payment of an interest free business debt.
- B. Withdrawal of cash by the owner.
- C. Sale of land at a profit.
- D. Losses from unprofitable operations.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

59. Which business organization is recognized as a separate legal entity under the law?

- A.** Corporation.
- B. Sole proprietorship.
- C. Partnership.
- D. All three.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 8

60. The amount of owners' equity in a business is not affected by:

- A.** The percentage of total assets held in cash.
- B. Investments made in the business by the owner.
- C. The profitability of the business.
- D. The amount of dividends paid to stockholders.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

61. Decreases in owners' equity are caused by:

- A. Purchases of assets and payment of liabilities.
- B. Purchases of assets and incurrence of liabilities.
- C. Payment of liabilities and unprofitable operations.
- D.** Distributions of assets to the owner and unprofitable operations.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

62. Which of the following transactions would cause a change in owners' equity?

- A. Repayment of the principal on a bank loan.
- B. Purchase of a delivery truck on credit.
- C.** Sale of land on credit for a price above cost.
- D. Borrowing money from a bank.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

63. An expense is best defined as:

- A. Any payment of cash for the benefit of the company.
- B.** Past, present or future payments of cash required to generate revenues.
- C. Past payments of cash required to generate revenues.
- D. Future payments of cash required to generate revenues.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 5

64. If a transaction causes an asset account to decrease, which of the following related effects may occur?

- A. An increase of equal amount in an owners' equity account.
- B. An increase in a liability account.
- C.** An increase of equal amount in another asset account.
- D. An increase in the combined total of liabilities and owners' equity.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

65. The payment of a business debt not including interest:

- A. Decreases total assets.
- B. Increases total liabilities.
- C. Increases the owners' equity in the business.
- D. Decreases the owners' equity in the business.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

66. The accounting principle that assumes that a company will operate in the foreseeable future is:

- A. Going concern.
- B. Objectivity.
- C. Liquidity.
- D. Disclosure.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 2

67. Deerpark Corporation recently borrowed \$70,000 cash from its bank. Which of the following was unaffected by this transaction?

- A. Assets.
- B. Liabilities.
- C. Owners' equity.
- D. Cash.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

68. Which of the following transactions would cause an increase in both assets and owners' equity?

- A. Investment of cash in the business by the owner.
- B. Sale of land for a price less than its cost.
- C. Borrowing money from a bank.
- D. Sale of land for cash at a price equal to its cost.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

69. A transaction caused an increase in both assets and owners' equity. This transaction could have been:

- A. A sale of service to a customer producing revenue.
- B. Sale of land for a price less than its cost.
- C. Borrowing money from a bank.
- D. Sale of land for cash at a price equal to its cost.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

70. Retained earnings is:

- A. The positive cash flows of a company.
- B. Net worth of a company.
- C. The owners' equity that has accumulated as a result of profitable operations.
- D. Equal to the total assets of a company.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 4

71. A revenue transaction results in all of the following except:

- A. An increase in assets.
- B. An increase in owners' equity.
- C. A positive cash flow in either the past, present, or future.
- D.** An increase in liabilities.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4
Learning Objective: 5

72. If a company has a profit:

- A.** Assets will be equal to liabilities plus owners' equity.
- B. Assets will be less than liabilities plus owners' equity.
- C. Assets will be greater than liabilities plus owners' equity.
- D. Owner's equity will be greater than its assets.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4
Learning Objective: 5

73. Which of the following activities is not a category into which cash flows are classified?

- A.** Marketing activities.
- B. Operating activities.
- C. Financing activities.
- D. Investing activities.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 6

74. The change in owners' equity from one balance sheet to the next is partially explained by the:

- A. Statement of cash flows.
- B. Statement of financial position.
- C. Income statement.**
- D. Tax return.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 4
Learning Objective: 7

75. Capital stock represents:

- A. The amount invested in the business by stockholders when shares of stock were initially issued by a corporation.**
- B. The owners' equity for a business organized as a corporation.
- C. The owners' equity accumulated through profitable operations that have not been paid out as dividends.
- D. The price paid by the current owners to acquire shares of stock in the corporation, regardless of whether they bought the shares directly from the corporation or from another stockholder.

AACSB: Reflective Thinking
AICPA BB: Legal
AICPA FN: Measurement
Learning Objective: 4

76. The balance sheet item that represents the portion of owners' equity resulting from profitable operation of the business is:

- A. Accounts receivable.
- B. Cash.
- C. Capital stock.
- D. Retained earnings.**

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 4

77. Retained earnings appears on:

- A. The income statement.
- B.** The balance sheet.
- C. The statement of cash flows.
- D. All three statements.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 4
Learning Objective: 5
Learning Objective: 6

78. Which of the following statements regarding liquidity and profitability is not true?

- A.** If a business is unable to pay its debts as they come due, it is operating unprofitably.
- B. A business may be liquid, yet operate unprofitably for several years.
- C. A business may operate profitably, yet be unable to meet its obligations.
- D. In order to survive in the long run, a business must both remain liquid and operate profitably.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 4
Learning Objective: 5
Learning Objective: 6

79. The concept of adequate disclosure means that:

- A. The accounting department of a business must inform management of the accounting principles used in preparing the financial statements.
- B.** The company must inform users of any significant facts necessary for proper interpretation of the financial statements, including events occurring after the financial statement date.
- C. The independent auditors must disclose in the financial statements any and all errors detected in the company's accounting records.
- D. The financial statements should include a comprehensive list of each transaction that occurred during the year.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 2
Learning Objective: 4
Learning Objective: 5

80. If cash increases during a year, it must mean that:
- A. There was positive net income on the income statement.
 - B. Retained earnings increased.
 - C. The net worth of a company increased.
 - D.** None of the three statements above must necessarily be true.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 4
Learning Objective: 5

81. A strong statement of cash flows indicates that significant cash is being generated by:
- A.** Operating activities.
 - B. Financing activities.
 - C. Investing activities.
 - D. Effective tax planning.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 6

At December 31, 2009, the accounting records of Braun Corporation contain the following items:

Accounts Payable	\$16,000		Accounts Receivable	\$40,000
Land	\$240,000		Cash	?
Capital Stock	?		Equipment	\$120,000
Building	\$180,000		Notes Payable	\$190,000
Retained Earnings	\$160,000			

82. Refer to the above data. If Capital Stock is \$260,000, what is the December 31, 2009 cash balance?

- A. \$86,000.
- B. \$94,000.
- C. \$46,000.**
- D. \$686,000.

$$\begin{aligned} &A/P(16,000) + N/P(190,000) + \text{Capital Stock}(260,000) + R.E.(160,000) = 626,000 \\ &\text{Cash}(?) + A/R(40,000) + \text{Land}(240,000) + \text{Building}(180,000) + \text{Equipment}(120,000) = \\ &626,000 \\ &\text{Cash} = \$45,000 \end{aligned}$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

83. Refer to the above data. If Capital Stock is \$320,000, total assets of Braun Corporation at December 31, 2009, amount to:

- A. \$686,000.**
- B. \$926,000.
- C. \$726,000.
- D. \$106,000.

$$\begin{aligned} &A/P(16,000) + N/P(190,000) + \text{Capital Stock}(320,000) + R.E.(160,000) = 686,000 \text{ Total} \\ &\text{Assets} = \$686,000 \end{aligned}$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

84. Refer to the above data. If Cash at December 31, 2009, is \$86,000, Capital Stock is:

- A. \$260,000.
- B. \$300,000.**
- C. \$620,000.
- D. \$168,000.

$$\text{Cash}(86,000) + \text{A/R}(40,000) + \text{Land}(240,000) + \text{Building}(180,000) + \text{Equipment}(120,000) = 666,000$$

$$\text{A/P}(16,000) + \text{N/P}(190,000) + \text{Capital Stock}(?) + \text{R.E.}(160,000) = 666,000.$$

$$\text{Capital} = \$300,000$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement, Reporting

Learning Objective: 3

Learning Objective: 4

85. Refer to the above data. If Cash at December 31, 2009, is \$26,000, total owners' equity is:

- A. \$160,000.
- B. \$366,000.
- C. \$606,000.
- D. \$400,000.**

$$\text{Cash}(26,000) + \text{A/R}(40,000) + \text{Land}(240,000) + \text{Building}(180,000) + \text{Equipment}(120,000) = 606,000$$

$$\text{A/P}(16,000) + \text{N/P}(190,000) + \text{Capital Stock}(?) + \text{R.E.}(160,000) = 606,000$$

$$\text{Capital Stock} = (240,000) + \text{R. E.}(160,000) = \$400,000$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement, Reporting

Learning Objective: 3

Learning Objective: 4

86. Refer to the above data. If Cash at December 31, 2009, is \$66,000, total assets amount to:
- A. \$606,000.
 - B. \$806,000.
 - C. \$662,000.
 - D. \$646,000.**

$$\text{Cash}(66,000) + \text{A/R}(40,000) + \text{Land}(240,000) + \text{Building}(180,000) + \text{Equipment}(120,000) = 646,000$$

AACSB: Analytic
 AICPA BB: Critical Thinking
 AICPA FN: Measurement, Reporting
 Learning Objective: 3
 Learning Objective: 4

At December 31, 2010, the accounting records of Hercules Manufacturing, Inc. contain the following items:

Accounts Payable	\$12,000		Accounts Receivable	\$30,000
Land	\$90,000		Cash	\$7,000
Building	\$250,000		Equipment	?
Notes Payable	\$135,000		Capital Stock	188,000
Retained Earnings	?			

87. Refer to the above data. If total assets of Hercules Manufacturing, Inc. are \$556,000, Equipment is carried in Hercules Manufacturing accounting records at:
- A. \$377,000.
 - B. \$179,000.**
 - C. \$150,000.
 - D. \$ 90,000.

$$\text{Cash}(7,000) + \text{A/R}(30,000) + \text{Land}(90,000) + \text{Building}(250,000) + \text{Equipment}(?) = 556,000$$

$$\text{Equipment} = \$179,000$$

AACSB: Analytic
 AICPA BB: Critical Thinking
 AICPA FN: Measurement, Reporting
 Learning Objective: 3
 Learning Objective: 4

88. Refer to the above data. If total assets of Hercules Manufacturing, Inc. are \$556,000, Retained Earnings at December 31, 2010, must be:

- A. \$811,000.
- B. \$180,000.
- C. \$221,000.**
- D. \$335,000.

$$A/P(12,000) + N/P(135,000) + \text{Capital Stock}(188,000) + R.E.(?) = 556,000, R. E. = \$221,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

89. Refer to the above data. If Retained Earnings at December 31, 2010, is \$140,000, total assets amount to:

- A. \$ 98,000.
- B. \$377,000.
- C. \$475,000.**
- D. \$188,000.

$$A/P(12,000) + N/P(135,000) + \text{Capital Stock}(188,000) + R.E.(140,000) = 475,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

90. Refer to the above data. If Retained Earnings at December 31, 2010, is \$100,000, Equipment is carried in Hercules Manufacturing, Inc. accounting records at:

- A. \$ 42,000.
- B.** \$ 58,000.
- C. \$ 43,500.
- D. \$345,000.

$$\begin{aligned} &A/P(12,000) + N/P(135,000) + \text{Capital Stock}(188,000) + R.E.(100,000) = 435,000 \\ &\text{Cash}(7,000) + A/R(30,000) + \text{Land}(90,000) + \text{Building}(250,000) + \text{Equipment}(?) = 435,000 \\ &\text{Equipment} = \$58,000 \end{aligned}$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

91. Refer to the above data. Assume the Equipment shown above was acquired by the business five years ago and has a book value of \$156,000, but has a current appraised value of \$200,000. Hercules Manufacturing's Retained Earnings at December 31, 2010, amounts to:

- A. \$533,000.
- B. \$345,000.
- C.** \$198,000.
- D. \$356,000.

$$\begin{aligned} &\text{Cash}(7,000) + A/R(30,000) + \text{Land}(90,000) + \text{Building}(250,000) + \text{Equipment}(156,000) = \\ &533,000 \\ &A/P(12,000) + N/P(135,000) + \text{Capital Stock}(188,000) + R.E.(?) = 533,000 \\ &R.E. = 198,000 \end{aligned}$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 2
Learning Objective: 3
Learning Objective: 4

At December 31, 2011 the accounting records of Gordon, Inc. contain the following items:

Accounts Payable	\$2,500	Accounts Receivable	\$18,750
Land	\$30,000	Cash	?
Building	\$31,250	Equipment	\$40,000
Notes Payable	?	Capital Stock	\$12,500
Retained Earnings	\$125,000		

92. Refer to the above data. If the Notes Payable is \$10,000, the December 31, 2011 cash balance is:

- A. \$ 60,000.
- B. \$160,000.
- C.** \$ 30,000.
- D. \$ 20,000.

$$\text{Cash(?) + A/R(18,750) + Land(30,000) + Building(31,250) + Equipment(40,000) = 150,000,}$$

$$\text{Cash = 30,000}$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

93. Refer to the above data. If the Note Payable balance is \$25,000, then the total assets of Gordon, Inc. at December 31, 2011 amount to:

- A. \$27,500.
- B. \$152,500.
- C. \$120,000.
- D.** \$165,000.

$$\text{A/P(2,500) + N/P(25,000) + Capital Stock(12,500) + R.E.(125,000) = 165,000}$$

$$\text{Total Assets = 165,000}$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

94. Refer to the above data. If the Cash balance at December 31, 2011 is \$67,500, the Note Payable balance is:

- A. \$118,750.
- B. \$ 47,500.**
- C. \$137,500.
- D. \$140,000.

$$\text{Cash}(67,500) + \text{A/R}(18,750) + \text{Land}(30,000) + \text{Building}(31,250) + \text{Equipment}(40,000) = 187,500$$

$$\text{A/P}(2,500) + \text{N/P}(?) + \text{Capital Stock}(12,500) + \text{R.E.}(125,000) = 187,500$$

$$\text{N/P} = 47,500$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement, Reporting

Learning Objective: 3

Learning Objective: 4

95. Refer to the above data. If the Cash balance at December 31, 2011 is \$62,500 then total liabilities amount to:

- A. \$ 42,500.
- B. \$140,000.
- C. \$ 45,000.**
- D. \$182,500.

$$\text{Cash}(62,500) + \text{A/R}(18,750) + \text{Land}(30,000) + \text{Building}(31,250) + \text{Equipment}(40,000) = 182,500, \text{A/P}(2,500) + \text{N/P}(?) + \text{Capital Stock}(12,500) + \text{R.E.}(125,000) = 182,500$$

$$\text{N/P} = 42,500; \text{Total liabilities} = 2,500 + 42,500 = 45,000$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement, Reporting

Learning Objective: 3

Learning Objective: 4

96. Which of the following is correct if at the end of Crystal Imports' first year of operations, assets are \$800,000 and owners' equity is \$720,000?

- A. The owner must have invested \$720,000 to start the business.
- B. The business must be operating profitably.
- C. Liabilities are \$80,000.**
- D. Liabilities are \$1,520,000.

$$800,000 - 720,000 = 80,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

97. During the current year, the assets of Wheatley's increased by \$362,000, and the liabilities increased by \$260,000. The owners' equity in the business must have:

- A. Decreased by \$102,000.
- B. Decreased by \$622,000.
- C. Increased by \$102,000.**
- D. Increased by \$622,000.

$$\$362,000 - \$260,000 = \$102,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

98. The total liabilities of Hogan's Company on the balance sheet are \$270,000; this amount is equal to three-fourths of the total assets. What is the amount of owners' equity?

- A. \$202,500.
- B. \$ 90,000.**
- C. \$360,000.
- D. \$630,000.

$$\frac{3}{4} A = \$270,000, A = \$360,000$$
$$\text{O.E.} = (360,000 - 270,000) \text{ or } \$90,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

99. Thirty percent of the total assets of Shanahan Corporation have been financed through borrowing. The total liabilities of the company are \$600,000. What is the amount of owners' equity?

- A. \$ 180,000.
- B. \$2,000,000.
- C. \$1,400,000.**
- D. \$2,600,000.

$$30\% A = 600,000, A = 2,000,000$$
$$\text{O.E.} = (2,000,000 - 600,000) \text{ or } 1,400,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

100. A transaction caused a \$60,000 increase in both assets and total liabilities. This transaction could have been which of the following?

- A. Purchase for office equipment for \$60,000 cash.
- B.** Purchase of office equipment for \$120,000, paying \$60,000 cash and issuing a note payable for the balance.
- C. Repayment of a \$60,000 bank loan.
- D. Investment of \$60,000 cash in the business by the owner.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

101. If \$9,600 cash and a \$31,000 note payable are given in exchange for some office machines to be used in a business:

- A.** Total assets are increased.
- B. Total liabilities are decreased.
- C. Total assets are decreased.
- D. The owners' equity is increased.

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

102. During the current year, liabilities of Corbett's Store increased by \$220,000, and owners' equity increased by \$160,000 then

- A. Assets at the end of the year total \$380,000.
- B. Assets at the end of the year total \$60,000.
- C.** Assets increased during the year by \$380,000.
- D. Assets decreased during the year by \$60,000.

$$\$220,000 + \$160,000 = \$380,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

103. During the current year, liabilities of Hayden Travel decreased by \$50,000, and owners' equity increased by \$75,000 then.

- A. Assets at the end of the year total \$125,000.
- B. Assets at the end of the year total \$25,000.
- C.** Assets increased during the year by \$25,000.
- D. Assets decreased during the year by \$125,000.

$$\$75,000 - \$50,000 = \$25,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

104. At the end of the current year, the owners' equity in Barclay Bakery is \$246,000. During the year the assets of the business had increased by \$120,000, and the liabilities had increased by \$72,000. Owners' equity at the beginning of the year must have been:

- A.** \$198,000.
- B. \$174,000.
- C. \$284,000.
- D. \$438,000.

$$\begin{aligned} \$120,000 - \$72,000 &= \$48,000 \\ \$246,000 - \$48,000 &= \$198,000 \end{aligned}$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

105. At the end of the current year, the owners' equity in Durante Co. is \$360,000. During the year the assets of the business had increased by \$68,000, and the liabilities had increased by \$118,000. Owners' equity at the beginning of the year must have been:

- A.** \$410,000.
- B. \$310,000.
- C. \$546,000.
- D. \$174,000.

$$\begin{aligned} \$68,000 - 118,000 &= (\$50,000) \\ \$360,000 - (\$50,000) &= \$410,000 \end{aligned}$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

106. During the current year, the assets of Quality Stairs increased by \$175,000 and the liabilities decreased by \$15,000. If the owners' equity in the business is \$475,000 at the end of the year, the owners' equity at the beginning of the year must have been:

- A. \$335,000.
- B.** \$285,000.
- C. \$665,000.
- D. \$615,000.

$$\begin{aligned} 175,000 + 15,000 &= 190,000 \\ 475,000 - 190,000 &= 285,000 \end{aligned}$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

107. During the month of May, 2009, the Henderson Company had the following transactions:

- * Revenues of \$60,000 were earned and received in cash.
- * Bank loans of \$9,000 were paid off.
- * Equipment of \$20,000 was purchased.
- * Expenses of \$36,800 were paid.
- * Stockholders purchased additional shares for \$22,000 cash.

A statement of cash flows for May, 2009, would report net cash flows from operating activities of:

- A. \$60,000
- B. \$16,200
- C. \$23,200**
- D. \$20,000

$$\$60,000 - 36,800 = \$23,200$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 6

Astoria Co. had the following transactions during the month of August, 2010:

- * Cash received from bank loans was \$20,000.
- * Dividends of \$9,500 were paid to stockholders in cash.
- * Revenues earned and received in cash amounted to \$33,500
- * Expenses incurred and paid were \$26,000

108. Refer to the above data. What amount of net income will be reported on an income statement for the month of August, 2010?

- A. \$20,000.
- B. \$7,500.**
- C. \$0.
- D. \$33,500.

$$33,500 - 26,000 = 7,500$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 5

109. Refer to the above data. At the beginning of August, 2010, owners' equity in Astoria was \$160,000. Given the transactions of August, 2010, what will owners' equity be at the end of the month?

- A. \$167,500.
- B. \$150,500.
- C. \$193,500.
- D.** \$158,000.

$$160,000 + 7,500[\text{Net income}] - 9,500[\text{Dividends}] = 158,000$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 3
Learning Objective: 4

110. Refer to the above data. For the month of August, 2010, net cash flows from operating activities for Astoria were:

- A. \$33,500.
- B.** \$7,500.
- C. \$20,000.
- D. \$26,000.

$$33,500 - 26,000 = 7,500$$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 6

111. The major provisions of the Sarbanes-Oxley Act of 2002 include all of the following except:

- A. The creation of a new agency to over see the public accounting profession.
- B. Restrictions on the types of consulting services that accounting firms can provide to audit clients.
- C.** Reducing responsibility for audit committees when overseeing the financial reporting process.
- D. Requiring the chief executive office and the chief financial officer to certify the accuracy of their company's financial statements.

AACSB: Ethics
AICPA BB: Legal
AICPA FN: Reporting
Learning Objective: 9

112. According to the Sarbanes-Oxley Act, CEOs and CFOs must certify to the accuracy of their company's financial statements

- A. Monthly and Quarterly
- B.** Quarterly and Annually
- C. Monthly and Annually
- D. CEOs and CFOs are not required to certify to the company's financial statement; only CPA's do.

AACSB: Ethics
AICPA BB: Legal
AICPA FN: Reporting
Learning Objective: 9

Essay Questions

113. Accounting terminology

Listed below are nine technical accounting terms introduced in this chapter:

<i>Assets</i>	<i>Accounting equation</i>	<i>Inflation</i>
<i>Balance Sheet</i>	<i>Liabilities</i>	<i>Going concern assumption</i>
<i>Cost principle</i>	<i>Owners' equity</i>	<i>Liquidity</i>

Each of the following statements may (or may not) describe one of these technical terms. In the space provided below each statement, indicate the accounting term described, or answer "None" if the statement does not correctly describe any of the terms. Do not use a term more than once.

- (A.) Having the financial ability to pay debts as they become due.
- (B.) An assumption that a business will operate in the foreseeable future.
- (C.) Economic resources owned by businesses that are expected to benefit future operations.
- (D.) The debts or obligations of a business organization.
- (E.) $\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$
- (F.) The principle which states that assets are valued in the balance sheet at their historical cost.
- (G.) A residual amount equal to assets minus liabilities.

(A.) Liquidity; (B.) Going concern assumption; (C.) Assets; (D.) Liabilities; (E.) Accounting equation; (F.) Cost principle; (G.) Owners' equity

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 1 - 4

114. Accounting equation

(A.) During the current year, the assets of Duffy Stationery increased by \$650,000, and the liabilities decreased by \$340,000. What was the change in owners' equity during the year?

(B.) The owners' equity of Graham Interiors appears on the balance sheet as \$720,000 and is equal to one-fourth of total assets. Compute the amount of total liabilities.

(C.) At the end of 2009 the owners' equity in Scott Mfg. amounted to \$845,000. During 2009, the assets of the business increased by \$515,000, and the liabilities increased by \$205,000. The owners' equity at the beginning of 2009 was how much?

(A.) Change in owners' equity = $\$650,000 + \$340,000 = \$990,000$ increase

(B.) Total assets = four times $\$720,000 = \$2,880,000$

Total liabilities = $\$2,880,000$ assets - $\$720,000$ owners' equity = $\$2,160,000$

(C.) Change in owners' equity = $\$515,000 - \$205,000 = \$310,000$ increase

Beginning owners' equity = $\$845,000$ ending balance - $\$310,000$ increase = $\$535,000$

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3

115. Effects of transactions on elements of the accounting equation

Some of the transactions carried out by Tudor Wholesale during the first month of the company's existence are listed below. You are to determine the effect of each transaction on the total assets, the total liabilities, and the owners' equity. Prepare your answer in columnar form, identifying each transaction by letter and using the symbols (+) for increase, (-) for decrease, and (NC) for no change. An answer is provided for the first transaction to serve as an example.

Transactions	Total Assets	Total Liabilities	Owners' Equity
A. Issued capital stock in exchange for cash	+	NC	+
B. Bought land and a building at a total price of \$165,000. Made a down payment of \$65,000 cash and signed a note payable for the balance.			
C. Bought adjoining lot for use as parking lot; paid cash in full			
D. Sold a portion of the land on credit at a price equal to its cost.			
E. Obtained a loan from a bank.			
F. Purchased office equipment on credit.			
G. Paid a liability.			
H. Collected part of amount owned to the business from purchaser of land.			
I. Sold another portion of the land for cash at a price in excess of cost.			

Transactions	Total Assets	Total Liabilities	Owners' Equity
A. Issued capital stock in exchange for cash	+	NC	+
B. Bought land and a building at a total price of \$165,000. Made a down payment of \$65,000 cash and signed a note payable for the balance.	+	+	NC
C. Bought adjoining lot for use as parking lot; paid cash in full	NC	NC	NC
D. Sold a portion of the land on credit at a price equal to its cost.	NC	NC	NC
E. Obtained a loan from a bank.	+	+	NC
F. Purchased office equipment on credit.	+	+	NC
G. Paid a liability.	-	-	NC
H. Collected part of amount owned to the business from purchaser of land.	NC	NC	NC
I. Sold another portion of the land for cash at a price in excess of cost.	+	NC	+

AACSB: Analytic
 AICPA BB: Critical Thinking
 AICPA FN: Measurement
 Learning Objective: 3

116. Effects of transactions on elements of the accounting equation

Some of the transactions carried out by Tsang Company during the first month of the company's existence are listed below. You are to determine the dollar effect of each transaction on the total assets, the total liabilities, and the owners' equity of Tsang Company. Use the symbols (+) for increase, (?) (-) for decrease, and (NC) for no change. An answer is provided for the first transaction to serve as an example.

Transaction	Total Assets	Total Liabilities	Owners' Equity
A. Issued capital stock to Don Tsang in exchange for his investment of \$200,000 in the business	+\$200,000	NC	+200,000
B. Purchased a computer for the business for \$5,500 cash.			
C. Borrowed \$20,000 from the bank.			
D. Purchased office furnishings at a total price of \$4,200, terms \$600 cash and balance payable in two installments.			
E. Paid \$1,800 of the balance due on the office furnishings.			
F. Sold an extra monitor that had cost \$250 for \$300 on credit.			
G. Collected \$150 of amount receivable from purchaser of the monitor.			
H. Bought a small truck to be used in the business for \$29,000; paid cash in full.			

Transaction	Total Assets	Total Liabilities	Owners' Equity
A. Issued capital stock to Don Tsang in exchange for his investment of \$200,000 in the business	+\$200,000	NC	+200,000
B. Purchased a computer for the business for \$5,500 cash.	NC	NC	NC
C. Borrowed \$20,000 from the bank.	+\$20,000	+\$20,000	NC
D. Purchased office furnishings at a total price of \$4,200, terms \$600 cash and balance payable in two installments.	+\$3,600	+\$3,600	NC
E. Paid \$1,800 of the balance due on the office furnishings.	-\$1,800	-\$1,800	NC
F. Sold an extra monitor that had cost \$250 for \$300 on credit.	+\$50	NC	+\$50
G. Collected \$150 of amount receivable from purchaser of the monitor.	NC	NC	NC
H. Bought a small truck to be used in the business for \$29,000; paid cash in full.	NC	NC	NC

AACSB: Analytic
 AICPA BB: Critical Thinking
 AICPA FN: Measurement
 Learning Objective: 3

117. Computation of assets, liabilities, and owners' equity after a series of transactions
 On April 30, 2009, the balance sheet of China Collectibles showed total assets of \$700,000, total liabilities of \$400,000, and owners' equity of \$300,000. The following transactions occurred in May of 2009:

- (1) Capital stock was issued in exchange for \$165,000 cash.
- (2) The business purchased equipment for \$360,000, paying \$160,000 cash and issuing a note payable for \$200,000.
- (3) The business paid off \$70,000 of its accounts payable.
- (4) The business collected \$54,000 of its accounts receivable.

Compute the following as of May 31, 2009:

- (A.) Total assets \$ _____
- (B.) Total liabilities \$ _____
- (C.) Owners' equity \$ _____

(A.) Total assets: $\$700,000 + \$165,000 + \$360,000 - \$160,000 - \$70,000 + \$54,000 - \$54,000 = \$995,000$

(B.) Total liabilities: $\$400,000 + \$200,000 - \$70,000 = \$530,000$

(C.) Owners' equity: $\$300,000 + \$165,000 = \$465,000$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement, Reporting

Learning Objective: 3

Learning Objective: 4

118. Computation of assets, liabilities, and owners' equity after a series of transactions
The December 31, 2009, balance sheet of Charles Realty reported total assets of \$900,000, total liabilities of \$350,000, and owners' equity of \$550,000. The following transactions occurred in January of 2010:

(1) The business purchased land for \$250,000, paying \$100,000 cash and issuing a note payable for the balance.

(2) The business collected accounts receivable totaling \$45,000.

(3) The business sold one-fifth of the land (which had cost \$50,000) land costing \$50,000 for \$60,000 cash.

(4) The business paid off \$50,000 of the note payable.

Compute the following at January 31, 2010:

(A.) Total assets\$_____

(B.) Total liabilities\$_____

(C.) Owners' equity\$_____

(A.) Total assets: $\$900,000 + \$250,000 - \$100,000 + \$45,000 - \$45,000 - \$50,000 + \$60,000 - \$50,000 = \$1,010,000$

(B.) Total liabilities: $\$350,000 + \$150,000 - \$50,000 = \$450,000$

(C.) Owners' equity: $\$550,000 + \$10,000 = \$560,000$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement, Reporting

Learning Objective: 3

Learning Objective: 4

119. Preparation of balance sheet

Prepare the balance sheet as of December 31, 2009, for Gamma Company, from the following list of items which are arranged in random order. You must compute the amount for accounts payable to complete the balance sheet.

Accounts payable.....	\$?	Land	\$260,000
Office equipment.....	\$41,600	Notes payable	\$377,000
Buildings	\$533,000	Accounts receivable.....	\$97,500
Capital stock	\$494,000	Cash	\$19,760

GAMMA Company
Balance Sheet
December 31, 2009

Assets		Liabilities & owners' Equity	
Cash	\$19,760	Liabilities:	
Accounts receivable	97,500	Notes Payable	\$377,000
Land	260,000	Accounts Payable	<u>80,860</u>
Buildings	533,000	Total Liabilities	\$457,860
Office Equipment	<u>41,600</u>	Owners' equity	
		Capital Stock	<u>494,000</u>
		Total Liabilities	
Total Assets	<u>\$951,860</u>	Owners' equity	<u>\$951,860</u>

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement, Reporting
Learning Objective: 4

120. Preparation of balance sheet after a series of transactions

The balance sheet was as follows for Custom Ceramics on February 1, 2010:

Custom Ceramics Balance Sheet February 1, 2010				
Assets		Liabilities & Owners' Equity		
Cash	\$7,000	Liabilities:		
Accounts receivable	5,200	Notes payable		\$ 40,000
Land	80,000	Accounts payable		<u>6,000</u>
Buildings	50,000	Total liabilities		\$ 46,000
Office Equipment	30,000	Owners' equity:		
		Capital stock	\$100,000	
		Retained earnings	<u>26,200</u>	<u>\$126,200</u>
		Total liabilities		
Total assets	<u>\$172,200</u>	Owners' equity		<u>\$172,200</u>

During the first week of February, the following transactions occurred:

- * The business used cash to pay off \$5,000 of its accounts payable. (No payment was made on the notes payable.)
- * Additional capital stock was issued to Joan Custom for \$15,000 cash.
- * Equipment was purchased on credit for \$1,800
- * The business collected \$4,000 cash from accounts receivable.

Complete the balance sheet for Custom Ceramics as of February 8, 2010.

Custom Ceramics Balance Sheet February 8, 2010				
Assets		Liabilities & Owners' Equity		
Cash	\$	Liabilities:		
Accounts receivable		Notes payable		\$
Land		Accounts payable		
Buildings		Total liabilities		\$
Office Equipment		Owners' equity:		
		Capital stock		
		Retained earnings		\$
		Total liabilities		
Total assets	<u>\$</u>	Owners' equity		<u>\$</u>

Custom Ceramics Balance Sheet February 8, 2010					
Assets		Liabilities & Owners' Equity			
Cash	\$21,000 ^a	Liabilities:			
Accounts receivable	1,200 ^b	Notes payable		\$ 40,000	
Land	80,000	Accounts payable		<u>2,800</u> ^d	
Buildings	50,000	Total liabilities		\$ 42,800	
Office Equipment	31,800 ^c	Owners' equity:			
		Capital stock	\$115,000		
		Retained earnings	<u>26,200</u>	\$141,200 ^c	
		Total liabilities			
Total assets	<u>\$184,000</u>	owners' equity		<u>\$184,000</u>	

Feedback: (A.) $\$7,000 + \$4,000 + \$15,000 - \$5,000 = \$21,000$

(B.) $\$5,200 - \$4,000 \text{ collected} = \$1,200$

(C.) $\$30,000 + \$1,800 = \$31,800$

(D.) $\$6,000 + \$1,800 \text{ (equipment purchase)} - \$5,000 \text{ paid} = \$2,800$

(E.) $\$126,200 + \$15,000 \text{ (additional investment)} = \$141,200$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement, Reporting

Learning Objective: 4

121. Completion of Balance Sheet

Use the following information to complete the balance sheet of Adelphi Construction as of December 31, 2010.

- (1) The company was organized on January 1, 2010, and has operated for the full year 2010.
- (2) Earnings have amounted to \$275,000, and dividends of \$70,000 have been paid to stockholders.
- (3) Cash and accounts receivable together amount to one and one-half times as much as notes payable.

Adelphi Construction			
Balance Sheet			
December 31, 2010			
Assets		Liabilities & Owners' Equity	
Cash	\$	Liabilities:	
Accounts receivable	85,000	Notes payable	\$
Land.....	184,000	Accounts payable.....	
Building.....	250,000	Income taxes payable	\$ 40,000
Equipment.....	96,000	Total liabilities	\$215,000
		Owners' equity:	
	_____	Capital stock	\$
		Retained earnings	\$ _____
		Total liabilities and	
Total assets.....	<u>\$ _____</u>	owners' equity.....	<u>\$620,000</u>

Adelphi Construction					
Balance Sheet					
December 31, 2010					
Assets		Liabilities & Owners' Equity			
Cash	\$ 5,000	^b	Liabilities:		
Accounts receivable	85,000		Notes payable	\$ 60,000 ^c	
Land.....	184,000		Accounts payable.....	115,000 ^d	
Building.....	250,000		Income taxes payable	\$ 40,000	
Equipment.....	96,000		Total liabilities.....	\$ 215,000	
			Owners' equity:		
			Capital stock	\$200,000 ^f	
			Retained earnings	205,000 ^e	\$405,000
			Total liabilities and		
Total assets.....	<u>\$620,000</u>	^a	owners' equity.....	<u>\$620,000</u>	

Feedback: (A.) Total assets must be \$620,000 to agree with the total of liabilities plus owners' equity.

(B.) Cash must be \$5,000 to achieve a total asset figure of \$620,000.

(C.) Cash (\$5,000) plus accounts receivable (\$85,000) equals \$90,000. This total is stated to be 1.5 times the amount of notes payable. Notes payable is computed as \$90,000 divided by 1.5, or \$60,000.

(D.) Accounts payable must be \$115,000 to achieve total liabilities figure of \$215,000.

(E.) Retained earnings at the end of the first accounting period must be earnings (\$275,000) less dividends (\$70,000) or \$205,000.

(F.) Capital stock must be \$200,000 to achieve total liabilities and owners' equity figure of \$620,000.

AACSB: Analytic
 AICPA BB: Critical Thinking
 AICPA FN: Measurement, Reporting
 Learning Objective: 4

122. Completion of balance sheet

Use the following information to complete the December 31, 2009, balance sheet of Copper Supplies Company.

- (1) Owners' equity as of January 1, 2009, totaled \$175,000, which included capital stock of \$150,000.
- (2) Additional capital stock was issued during 2009 in exchange for \$40,000 cash.
- (3) Net income for 2009 amounted to \$200,000; no dividends were paid during 2009.
- (4) Cash and accounts receivable together amount to 3 times as much as accounts payable.

Copper Supplies Company			
Balance Sheet			
December 31, 2009			
Assets		Liabilities & Owners' Equity	
Cash	\$ 30,000	Liabilities:	
Accounts receivable	?	Accounts payable	\$ 40,000
Land.....	215,000	Notes payable.....	?
Building.....	300,000	Total liabilities.....	\$?
Equipment.....	?	Owners' equity:	
		Capital stock	\$
		Retained earnings	\$?
		Total liabilities and	
Total assets.....	<u>\$835,000</u>	owners' equity.....	<u>\$?</u>

Copper Supplies Company			
Balance Sheet			
December 31, 2009			
Assets		Liabilities & Owners' Equity	
Cash	\$ 30,000	Liabilities:	
Accounts receivable	90,000 ^b	Accounts payable	\$ 40,000
Land	215,000	Notes payable	380,000 ^g
Building	300,000	Total liabilities	\$420,000 ^f
Equipment	200,000 ^c	Owners' equity:	
		Capital stock	\$190,000 ^d
		Retained earnings	225,000 ^e
			\$415,000
		Total liabilities and	
Total assets	<u>\$835,000</u>	owners' equity	<u>\$835,000^a</u>

Feedback: (A.) Total of liabilities & owners' equity must be \$835,000 to agree with the amount of total assets.

(B.) Cash and accounts receivable together amount to 3 times accounts payable, or \$120,000. Since cash is \$30,000, accounts receivable are \$120,000 - \$30,000, or \$90,000.

(C.) Equipment must be \$200,000 to achieve total assets of \$835,000.

(D.) Beginning capital stock is \$150,000 + stock issued of \$40,000 = \$190,000.

(E.) Beginning retained earnings (175,000 - 150,000) + net income of 200,000 = 225,000

(F.) Total liabilities must be \$420,000 to achieve the total of liabilities & owners' equity of \$835,000.

(G.) Since total liabilities are \$420,000 and accounts payable are \$40,000, notes payable must be \$380,000.

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement, Reporting

Learning Objective: 4

123. Effects of transactions on balance sheet items

Show the effect of each of the seven listed transactions on the balance sheet items of Distinctive Draperies. Indicate the new balances after the transaction of May 2 and each subsequent transaction. The effects of the May 1 transaction are already filled in to provide you with an example.

May	1	Issued capital stock for \$75,000.
	2	Purchased a small office building at a price of \$58,000 for the land and \$65,000 for the building. Paid \$43,000 cash and signed a note payable for the balance.
	8	Borrowed \$15,000 from the bank. Signed a 60-day note payable for this amount.
	16	Purchased copying machines, computers, and other office equipment for \$19,000. Paid \$9,000 cash and signed a note payable for the balance.
	28	Sold an item of office equipment (computer) to a stockholder at its cost of \$2,800. The stockholder paid \$800 cash and promised to pay the balance within 30 days.
	30	Paid \$5,000 on the liability for the office equipment.
	31	Collected \$500 from the stockholder who had bought the computer.

	Assets						=	Liabilities	+	Owners' Equity			
	Cash	+	Accounts Receivable	+	Land	+	Buildings	+	Office Equipment	=	Notes Payable	+	Capital Stock
May 1	+\$75,000												+\$75,000
2													
Balance													
8													
Balance													
16													
Balance													
28													
Balance													
30													
Balance													
31													
Balance													

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	Assets						=	Liabilities	+	Owners' Equity			
	Cash	+	Accounts Receivable	+	Land	+	Buildings	+	Office Equipment	=	Notes Payable	+	Capital stock
May 1	+\$75,000												+\$75,000
2	-43,000			+\$58,000		+\$65,000					+\$80,000		
Balance	\$32,000			\$58,000		\$65,000					\$80,000		\$75,000
8	+ 15,000										+ 15,000		
Balance	\$47,000			\$58,000		\$65,000					\$95,000		\$75,000
16	- 9,000							+\$19,000			+ 10,000		
Balance	\$38,000			\$58,000		\$65,000		\$19,000			\$105,000		\$75,000
28	+ 800		+\$2,000					- 2,800					
Balance	\$38,800		\$2,000	\$58,000		\$65,000		\$16,200			\$105,000		\$75,000
30	- 5,000										- 5,000		
Balance	\$33,800		\$2,000	\$58,000		\$65,000		\$16,200			\$100,000		\$75,000
31	+ 500		-500										
Balance	\$34,300		\$1,500	\$58,000		\$65,000		\$16,200			\$100,000		\$75,000

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

124. Effects of transactions on balance sheet items

Show the effect of each of the seven listed transactions on the balance sheet items of Renaissance Investment Services, Inc. Indicate the new balances after the transaction of November 2 and each subsequent transaction. The effects of the November 1 transaction are already filled in to provide you with an example.

Nov.	1	Issued capital stock for \$200,000.
	2	Purchased a small office building at a price of \$86,000 for the land and \$74,000 for the building. Made a cash payment of 20% of the total price and signed a note payable for the balance.
	7	Purchased telephones, computers, and other office equipment for \$58,000. Paid \$23,000 cash and signed a note payable for the balance.
	12	Sold one of the computers to a stockholder at its cost of \$3,500. The stockholder paid \$500 cash and agreed to pay the balance within 10 days.
	22	Received \$3,000 due from the stockholder who had purchased the computer.
	30	Paid \$17,500 on the note payable for the office equipment.

	Assets							=	Liabilities	+	Owners' Equity		
	Cash	+	Accounts Receivable	+	Land	+	Buildings	+	Office Equipment	=	Notes Payable	+	Capital Stock
Nov 1	+\$200,000												+\$200,000
2													
Balance													
7													
Balance													
12													
Balance													
22													
Balance													
30													
Balance													

Chapter 02 - Basic Financial Statements

	Assets						=	Liabilities	+	Owners' Equity			
	Cash	+	Accounts Receivable	+	Land	+	Buildings	+	Office Equipment	=	Notes Payable	+	Capital stock
Nov 1	+\$200,000												+\$200,000
2	-32,000			+\$86,000		+\$74,000					+\$128,000		
Balance	\$168,000			\$86,000		\$74,000					\$128,000		\$200,000
7	- 23,000							+ 58,000			+ 35,000		
Balance	\$145,000			\$86,000		\$74,000		\$58,000			\$163,000		\$200,000
12	+ 500		+ \$3,000					- 3,500					
Balance	\$145,500		3,000	\$86,000		\$74,000		\$54,500			\$163,000		\$200,000
22	+ 3,000		- 3,000										
Balance	\$148,500			\$86,000		\$74,000		\$54,500			\$163,000		\$200,000
30	- 17,500										- 17,500		
Balance	<u>\$131,000</u>	=	<u> </u>	=	<u>\$86,000</u>	=	<u>\$74,000</u>	=	<u>\$54,500</u>	=	<u>\$145,500</u>	=	<u>\$200,000</u>

AACSB: Analytic
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 3
Learning Objective: 4

125. An inexperienced accounting intern at Tasso Company prepared the following income statement for the month of July, 2009:

Tasso Company Month of July, 2009		
Revenues:		
Services provided to customers	\$25,000	
Capital stock	12,500	
Loan from bank	<u>37,500</u>	\$75,000
Expenses:		
Payments to long-term creditors	\$20,000	
Expenses required to provide services to customers	18,750	
Purchase of equipment	<u>10,000</u>	<u>48,750</u>
Net income		\$ 26,250

Instructions: Prepare a revised income statement in accordance with generally accepted accounting principles.

Tasso Company Month of July, 2009		
Revenues:		
Services provided to customers	\$ 25,000	
Expenses:		
Expenses required to provide services to customers	<u>18,750</u>	
Net income	<u>\$ 6,250</u>	

AACSB: Analytic
 AICPA BB: Critical Thinking
 AICPA FN: Reporting
 Learning Objective: 5

126. List the following accounts in the order that they would appear on a balance sheet

Capital stock

Equipment

Accounts Receivable

Retained Earnings

Revenue

Accounts Payable

Cash

Rent Expense

Cash

Accounts Receivable

Equipment

Accounts Payable

Capital Stock

Retained Earnings

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Learning Objective: 1

Learning Objective: 4

127. From the following accounts and amounts prepare a balance sheet for the Swell Company for December 31, 2010. You must compute the amount for retained earnings to complete the balance sheet.

Accounts Payable	\$61,250
Accounts Receivable	\$70,500
Building	\$50,000
Capital Stock	\$50,000
Cash	\$64,000
Equipment	\$30,000
Insurance Expense	\$5,000
Land	\$125,000
Notes Payable	\$175,000
Sales Revenue	\$25,000
Salaries Expense	\$20,000

Swell Company			
Balance Sheet			
December 31, 2010			
Assets		Liabilities & Owners' Equity	
		Liabilities	
Cash	\$64,000	Notes Payable	\$175,000
Accounts Receivable	70,500	Accounts Payable	<u>61,250</u>
Equipment	30,000	Total Liabilities	236,250
Land	125,000	Owners' Equity	
Building	<u>50,000</u>	Capital Stock	\$50,000
		Retained Earnings	<u>53,250</u>
		Total Liabilities	
Total Assets	<u>\$339,500</u>	& Owners' Equity	<u>\$339,500</u>

AACSB: Analytic
 AICPA BB: Critical Thinking
 AICPA FN: Reporting
 Learning Objective: 4

128. Financial statements

A set of financial statements for a company includes three related accounting reports, or statements. In the space provided, list the names of three primary statements, and give a brief description of the accounting information contained in each.

- * Balance sheet. A report showing at a specific date the financial position of the company by reporting the assets (resources) that it owns, the liabilities (debts) that it owes, and the amount of the owners' equity in the business.
- * Income statement. A report indicating the profitability (or net income) of the business over a specific time period.
- * Statement of cash flows. A report summarizing the cash receipts and cash payments of the business over the same time period covered by the income statement.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 1 - 6

129. Development of generally accepted accounting principles

- (A.) What is meant by the phrase "generally accepted accounting principles?"
(B.) Give the names of three organizations that currently play an active role in the development of accounting principles in the United States.

(A.) Generally accepted accounting principles are the concepts, standards, or ground rules used in the preparation of financial statements.

(B.) Student may list any three of the following:

- * Financial Accounting Standards Board (FASB)
- * American Institute of Certified Public Accountants (AICPA)
- * Securities and Exchange Commission (SEC)
- * American Accounting Association (AAA)

AACSB: Ethics
AICPA BB: Critical Thinking
AICPA FN: Reporting
Learning Objective: 2

130. Valuation of assets under generally accepted accounting principles

Under generally accepted accounting principles, the assets owned by a business are reported in the balance sheet at their historical cost. Identify and briefly explain two accounting principles other than the cost principle that support the valuation of assets at cost in the balance sheet.

Student may choose any two of the following:

- * **Going-concern assumption.** An assumption by accountants that a business will operate indefinitely unless specific evidence to the contrary exists, such as impending bankruptcy. Since assets of the business were acquired for use and not for resale, estimated current market prices or appraisal values are of less importance than if these items were intended for sale.
- * **Objectivity principle.** Accounting measurements should be based upon dollar amounts that are factual and subject to independent verification. Historical cost of assets is objective; estimated market values or appraisals change over time and are not factual or objective.
- * **Stable-dollar assumption.** An assumption by accountants that the dollar is a stable unit of measure. This assumption permits reporting assets at cost, even though individual assets may have been acquired in different years.

AACSB: Reflective Thinking
AICPA BB: Critical Thinking
AICPA FN: Measurement
Learning Objective: 2
Learning Objective: 4

131. Forms of Business Organization

State and describe the three most common forms of business organizations in the United States.

(1) Sole Proprietorship

- * One person
- * Unlimited liability
- * Owner acts as manager

(2) Partnership

- * Two or more persons
- * Owners are personally responsible for debts

(3) Corporation

- * Stockholders are owners
- * Limited liability
- * Ease of transfer of ownership
- * Separate entity under the law

AACSB: Reflective Thinking

AICPA BB: Legal

AICPA FN: Reporting

Learning Objective: 8

CHAPTER 2 **NAME** _____ # _____

10-MINUTE QUIZ A **SECTION** _____

Indicate the best answer for each question in the space provided.

- _____ **1** The financial statements of a business entity:
- a** Include the balance sheet, income statement, and income tax return.
 - b** Provide information about the profitability and financial position of the company.
 - c** Are the first step in the accounting process.
 - d** Are prepared for a fee by the Financial Accounting Standards Board.
- _____ **2** A balance sheet is designed to show the financial position of an entity:
- a** At a single point in time.
 - b** Over a period of time such as a year or quarter.
 - c** At December 31 of the current year.
 - d** At January 1 of the coming year.
- _____ **3** Accounts payable and notes payable are:
- a** Always less than the amount of cash a business owns.
 - b** Creditors.
 - c** Written promises to pay a certain amount, plus interest, at a definite future date.
 - d** Liabilities.
- _____ **4** The balance sheet of Doty Designs includes the following items:
- | | |
|---------------------|------------------|
| Accounts Receivable | Cash |
| Capital Stock | Accounts Payable |
| Equipment | Supplies |
| Notes Payable | Notes Receivable |
- This list includes:
- a** Four assets and three liabilities.
 - b** Five assets and three liabilities.
 - c** Five assets and two liabilities.
 - d** Six assets and two liabilities.
- _____ **5** An accounting entity may best be described as:
- a** An individual.
 - b** A particular economic unit.
 - c** A publicly owned corporation.
 - d** Any corporation, regardless of size.

CHAPTER 2 NAME _____ # _____

10-MINUTE QUIZ B SECTION _____

Presented below is the balance sheet for Sabino Family Dentistry on January 1 of the current year.

SABINO FAMILY DENTISTRY
Balance Sheet
January 1, 20__

Assets		Liabilities & Stockholders' Equity	
Cash	\$ 33,000	Liabilities:	
Accounts receivable.....	51,150	Accounts payable	\$ 74,250
Land	313,500	Total liabilities	\$ 74,250
Building	371,250	Owners' equity:	
Equipment.....	<u>57,750</u>	Capital stock.....	<u>752,400</u>
Total assets.....	<u>\$826,650</u>	Total liabilities and owners' equity	<u>\$826,250</u>

During the first few days of January, the following transactions occurred:

- Jan 1 The business borrowed \$99,000 from the bank, giving a note payable due in 90 days.
- 3 Additional capital stock was issued in exchange for \$44,550 cash.
- 3 Equipment was purchased for \$62,700 on credit.
- 5 The business collected \$26,400 of its accounts receivable and paid off \$37,950 of its accounts payable.

Indicate your answer to each of the following questions in the space provided.

- _____ **1** On January 6, total assets of the business amount to:
 a \$826,650. **b** \$994,950 **c** \$957,000. **d** \$950,400.

- _____ **2** On January 6, owners' equity amounts to:
 a \$752,400. **b** \$44,550. **c** \$796,950. **d** \$895,950.

- _____ **3** On January 6, the accounts payable balance is:
 a \$136,950. **b** \$36,300. **c** \$24,750. **d** \$99,000.

- _____ **4** On January 6, the accounts receivable balance is:
 a \$24,750. **b** \$38,775. **c** \$77,550. **d** \$63,525.

- _____ **5** On January 6, the cash balance is:
 a \$127,050. **b** \$138,600. **c** \$165,000. **d** \$202,950

CHAPTER 2 **NAME** _____ **#** _____

10-MINUTE QUIZ C **SECTION** _____

Presented below is the balance sheet for Manhattan Family Dentistry on January 1 of the current year.

MANHATTAN FAMILY DENTISTRY
Balance Sheet
January 1, 20__

Assets		Liabilities & Stockholders' Equity	
Cash	\$ 20,000	Liabilities:	
Accounts receivable.....	31,000	Accounts payable	<u>\$ 45,000</u>
Land	190,000	Total liabilities	<u>\$ 45,000</u>
Building	225,000	Owners' equity:	
Equipment.....	<u>35,000</u>	Capital stock.....	<u>456,000</u>
Total assets.....	<u>\$501,000</u>	Total liabilities and owners' equity	<u>\$501,000</u>

During the first few days of January, the following transactions occurred:

- Jan 2 Equipment was purchased for \$38,000 on credit.
- 2 The business collected \$16,000 of its accounts receivable and paid off \$23,000 of its accounts payable.
- 3 The business borrowed \$60,000 from the bank, giving a note payable due in 90 days.
- 3 Additional capital stock was issued in exchange for \$27,000 cash.

Complete the following balance sheet for Manhattan Family Dentistry on January 4 of the current year.

MANHATTAN FAMILY DENTISTRY
Balance Sheet
January 4, 20__

Assets		Liabilities & Owners' Equity	
Cash	\$	Liabilities:	
Accounts receivable.....		Notes payable	\$
Land		Accounts payable	
Building		Total liabilities	\$
Equipment.....		Owners' equity:	
		Capital stock.....	
Total assets.....	<u>\$</u>	Total liabilities and owners' equity	<u>\$</u>

CHAPTER 2 NAME _____ # _____

10-MINUTE QUIZ D SECTION _____

Complete the January 31, 20__, balance sheet of Countrywide Legal Services using the following information.

- (1) Stockholders' equity at January 1, 20__, included capital stock of \$140,000.
- (2) The land and building were purchased by the business for a total price of \$200,000 on January 25, 20__, from a company forced out of business. On January 31, an appraiser valued the property at \$260,000.
- (3) Additional capital stock was issued in exchange for \$50,000 cash.
- (4) Retained earnings at January 31, 20__, amounted to \$49,400.

COUNTRYWIDE LEGAL SERVICES

**Balance Sheet
January 31, 20__**

Assets		Liabilities & Owners' Equity	
Cash	\$ 90,000	Liabilities:	
Accounts receivable		Notes payable	\$
Land	135,000	Accounts payable	<u>45,600</u>
Building		Total liabilities.....	\$
Equipment.....	35,000	Owners' equity:	
		Capital Stock	\$
		Retained earnings	_____
Total assets.....	<u>\$ _____</u>	Total liabilities and owners' equity	<u>\$375,000</u>

CHAPTER 2 SELF-TEST QUESTIONS FROM TEXTBOOK

Note: In order to review as many chapter concepts as possible, some self-test questions include *more than one* correct answer. In these cases, you should indicate *all* of the correct answers.

- _____ 1 A set of financial statements:
- a Is intended to assist users in evaluating the financial position, profitability, and future prospects of an entity.
 - b Is intended to assist the IRS in determining the amount of income taxes owed by a business organization.
 - c Includes notes disclosing information necessary for the proper interpretation of the statements.
 - d Is intended to assist investors and creditors in making decisions involving the allocation of economic resources.
- _____ 2 Which of the following statements is *not* consistent with generally accepted accounting principles relating to asset valuation?
- a Many assets are originally recorded in accounting records at their cost to the business entity.
 - b Subtracting total liabilities from total assets indicates what the owner's equity in the business is worth under current market conditions.
 - c Accountants assume that assets such as office supplies, land, and buildings will be used in business operations, rather than being sold at current market prices.
 - d Accountants prefer to base the valuation of assets upon objective, verifiable evidence rather than upon appraisals or personal opinion.
- _____ 3 Waterworld Boat Shop purchased a truck for \$12,000, making a down payment of \$5,000 cash, and signing a \$7,000 note payable due in 60 days. As a result of this transaction:
- a Total assets increased by \$12,000.
 - b Total liabilities increased by \$7,000.
 - c From the viewpoint of a short-term creditor, this transaction makes the business more solvent.
 - d This transaction had no immediate effect upon the owner's equity in the business.
- _____ 4 A transaction caused a \$15,000 *decrease* in both total assets and total liabilities. This transaction could have been:
- a Purchase of a delivery truck for \$15,000 cash.
 - b An asset with a cost of \$15,000 was destroyed by fire.
 - c Repayment of a \$15,000 bank loan.
 - d Collection of a \$15,000 account receivable.

- _____ 5 Which of the following is (are) correct about a company's balance sheet?
- a It displays sources and uses of cash for the period.
 - b It is an expansion of the basic accounting equation: Assets = Liabilities + Owners' Equity.
 - c It is sometimes referred to as a statement of financial position.
 - d It is unnecessary if both an income statement and statement of cash flows are available.
- _____ 6 Which of the following would you expect to find in a correctly-prepared income statement?
- a Cash balance at the end of the period.
 - b Revenues earned during the period.
 - c Contributions by the owner during the period.
 - d Expenses incurred during the period to earn revenues.
- _____ 7 What information would you find in a statement of cash flows that you would not be able to get from the other two primary financial statements?
- a Cash provided by or used in financing activities.
 - b Cash balance at the end of the period.
 - c Total liabilities due to creditors at the end of the period.
 - d Net income.
- _____ 8 Which of the following statements relating to the role of professional judgment in the financial reporting process are valid?
- a Different accountants may evaluate similar situations differently.
 - b The determination of which items should be disclosed in notes to financial statements requires professional judgment.
 - c Once a complete list of generally accepted accounting principles is prepared, judgment need no longer enter into the financial reporting process.
 - d The possibility always exists that professional judgment later may prove to have been incorrect.

SOLUTIONS TO CHAPTER 2 10-MINUTE QUIZZES

QUIZ A

- 1 B
- 2 A
- 3 D
- 4 C
- 5 B

Learning Objective:
2, 4, 5, 6

QUIZ B

- 1 B
- 2 C
- 3 D
- 4 A
- 5 C

Learning Objective:
3, 4

QUIZ C

MANHATTAN FAMILY DENTISTRY

**Balance Sheet
January 4, 20__**

Assets		Liabilities & Owners' Equity	
Cash	\$ 100,000 ^a	Liabilities:	
Accounts receivable.....	15,000 ^b	Notes payable	\$ 60,000
Land	190,000	Accounts payable	<u>60,000^c</u>
Building	225,000	Total liabilities	\$ 120,000
Equipment.....	73,000 ^c	Owners' equity:	
	<hr/>	Capital stock	<u>483,000^d</u>
Total assets.....	<u>\$603,000</u>	Total liabilities and owners' equity	<u>\$603,000</u>

Computations

- a $\$20,000 + \$16,000$ (A/R collected) - $\$23,000$ (paid on A/P) + $\$60,000$ (borrowed) + $\$27,000$ (invested) = $\$100,000$
 - b $\$31,000 - \$16,000$ collected = $\$15,000$
 - c $\$35,000 + \$38,000$ (equipment purchased) = $\$73,000$
 - d $\$456,000 + \$27,000$ additional investment = $\$483,000$
 - e A/P $\$45,000 + \$38,000 - \$23,000$ (paid) = $\$60,000$
- Learning Objective: 4

QUIZ D

COUNTRYWIDE LEGAL SERVICES

**Balance Sheet
January 31, 20__**

Assets		Liabilities & Owners' Equity	
Cash	\$ 90,000	Liabilities:	
Accounts receivable.....	50,000 ^c	Notes payable	\$ 90,000 ^f
Land	135,000	Accounts payable	<u>45,600</u>
Building	65,000 ^b	Total liabilities.....	\$135,600
Equipment.....	35,000	Owners' equity:	
		Capital Stock	\$190,000 ^d
		Retained earnings	<u>49,400</u>
		Total liabilities and	<u>\$239,400</u>
Total assets.....	<u>\$375,000^a</u>	owners' equity	<u>\$375,000</u>

Computations

- a** Total assets must be equal to total liabilities & owners' equity of \$375,000.
- b** \$200,000 (cost of land and building) less \$135,000 for land = \$65,000 for building. (Appraised value of property ignored.)
- c** Accounts receivable must be \$50,000 to achieve total assets of \$375,000.
- d** \$140,000 (capital stock at January 1) plus \$50,000 (additional investment).
- e** Total liabilities must be \$135,600 to achieve total liabilities & owners' equity of \$375,000.
- f** Notes payable must be \$90,000 to achieve total liabilities of \$135,600.

Learning Objective: 4

SOLUTIONS TO CHAPTER 2 SELF-TEST QUESTIONS FROM TEXTBOOK

1. a, c, d 2. b 3. b, d 4. c 5. b, c 6. b, d 7. a 8. a, b, d