

TEST BANK



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Financial Accounting

15th edition



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 as do 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, while 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 must always equal total liabilities plus total owners' equity.

True False

11. A cash flows 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 must equal 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 with 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 flows 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 the Sarbanes-Oxley Act of 2002, 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 reasonably 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 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 users 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. \$270,000.
- D. Cannot be determined from the information given.

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. \$120,000.
- D. Cannot be determined from the information given.

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 corporation 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 costs \$575,000. The market value of his residence is \$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 business organizations are separate legal entities.

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. Owners' 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 operations 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 of the financial 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. 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.

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. 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. 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. 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. 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. 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. 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. 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. 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. 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. 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. 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. If the Notes 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. If the Cash balance at December 31, 2011 is \$67,500, the Notes Payable balance is:

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

95. 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 of 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. If 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. If 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, 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 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:

- * 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. What amount of net income will be reported on an income statement for the month of August?

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

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

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

110. For the month of August, 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 oversee 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 officer and the chief financial officer to certify the accuracy of their company's financial statements.

During the month of August, the Boyce Company had the following transactions:

- * Revenues of \$120,000 were earned and received in cash.
- * Bank loans of \$18,000 were paid off.
- * Equipment of \$40,000 was purchased with cash.
- * Expenses of \$73,600 were paid.
- * Stockholders purchased additional shares for \$44,000 cash.

112. A statement of cash flows for August, would report net cash flows from operating activities of:

- A. \$26,000.
- B. \$32,400.
- C. \$40,000.
- D. \$46,400.

113. A statement of cash flows for August, would report net cash flows from financing activities of:

- A. \$26,000.
- B. \$32,400.
- C. \$40,000.
- D. \$46,400.

114. A statement of cash flows for August, would report net cash flows from investing activities of:

- A. \$26,000.
- B. \$32,400.
- C. \$40,000.
- D. \$46,400.

115. A statement of cash flows for August, would report an increase in cash of:

- A. \$26,000.
- B. \$32,400.
- C. \$40,000.
- D. \$46,400.

Waldorf Co. had the following transactions during the month of October:

- * Cash received from bank loans was \$60,000.
- * Dividends of \$18,500 were paid to stockholders in cash.
- * Revenues earned and received in cash amounted to \$100,500.
- * Expenses incurred and paid were \$78,000.

116. What amount of net income will be reported on an income statement for the month of October?

- A. \$18,500.
- B. \$22,500.
- C. \$78,000.
- D. \$100,500.

117. At the beginning of October, owners' equity in Waldorf was \$480,000. Given the transactions of October, 2011, what will owners' equity be at the end of the month?

- A. \$480,000.
- B. \$484,000.
- C. \$502,500.
- D. \$580,500.

118. For the month of October, net cash flows from operating activities for Waldorf were:

- A. \$18,500.
- B. \$22,500.
- C. \$78,000.
- D. \$100,500.

During the month of February, the Fadness Company had the following transactions:

- * Revenues of \$225,000 were earned and received in cash.
- * Bank loans of \$18,000 were paid off.
- * New bank loans of \$15,000 were incurred.
- * Equipment of \$40,000 was purchased with cash.
- * Equipment was sold for its book value of \$36,000. Cash was received.
- * Expenses of \$171,400 were paid.
- * Stockholders purchased additional shares for \$50,000 cash.

119. A statement of cash flows for February, would report net cash flows from operating activities of:

- A. \$4,000.
- B. \$47,000.
- C. \$53,600.
- D. \$96,600.

120. A statement of cash flows for February, would report net cash flows from financing activities of:

- A. \$4,000.
- B. \$47,000.
- C. \$53,600.
- D. \$96,600.

121. A statement of cash flows for February, would report net cash flows from investing activities of:

- A. \$4,000.
- B. \$47,000.
- C. \$53,600.
- D. \$96,600.

122. A statement of cash flows for February, would report an increase in cash of:

- A. \$4,000.
- B. \$47,000.
- C. \$53,600.
- D. \$96,600.

Essay Questions

123. 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.) $Assets = Liabilities + Owners' Equity$
- (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.

124. 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 the year, 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?

125. 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 operations 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.			

126. 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 operations 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 accounts receivable from purchaser of the monitor.			
H. Bought a small truck to be used in the business for \$29,000; paid cash in full.			

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

Capital Stock
Equipment
Accounts Receivable
Retained Earnings
Revenue
Accounts Payable
Cash
Rent Expense

128. 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 \$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 \$ _____

129. 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 land costing \$50,000 for \$60,000 cash.
- (4) The business paid \$50,000 of the note payable.

Compute the following at January 31, 2010:

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

130. 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

131. 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:		
	<u> </u>	Capital stock	\$100,000	
		Retained earnings	<u>26,200</u>	\$126,200
		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:		
	<u> </u>	Capital stock		
		Retained earnings		\$
		Total liabilities		
Total assets	<u>\$</u>	Owners' equity		<u>\$</u>

132. 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 were \$275,000 and dividends of \$70,000 were 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>

133. 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	\$835,000	owners' equity	\$?

134. 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													

135. 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													

136. 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.

137. 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

138. Financial statements

A set of financial statements 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.

139. 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.

140. 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.

141. Forms of Business Organization

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

Multiple Choice Questions

142. 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.

143. 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.

144. 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.

145. The balance sheet of Dotty 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.

146. 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.

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	<u>\$ 74,250</u>
Land	313,500	Total liabilities	<u>\$ 74,250</u>
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 \$37,950 of its accounts payable.

147. On January 6, total assets of the business amount to:

- A. \$826,650.
- B. \$994,950
- C. \$957,000.
- D. \$950,400.

148. On January 6, owners' equity amounts to:

- A. \$752,400.
- B. \$44,550.
- C. \$796,950.
- D. \$895,950.

149. On January 6, the accounts payable balance is:

- A. \$136,950.
- B. \$36,300.
- C. \$24,750.
- D. \$99,000.

150. On January 6, the accounts receivable balance is:

- A. \$24,750.
- B. \$38,775.
- C. \$77,550.
- D. \$63,525.

151. On January 6, the cash balance is:

- A. \$127,050.
- B. \$138,600.
- C. \$165,000.
- D. \$202,950

Essay Questions

152. 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	\$ 45,000
Land	190,000	Total liabilities	\$ 45,000
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 \$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.....	I	Total liabilities	\$
Equipment.....		Owners' equity:	
		Capital stock.....	
Total assets.....	<u>\$</u>	Total liabilities and owners' equity.....	<u>\$</u>

153. 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		<u> </u>
Total assets	<u>\$ </u>	Total liabilities and owners' equity		<u>\$375,000</u>

Multiple Choice Questions

154. 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.

155. 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.

156. Water world 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.

157. 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.

158. 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: $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$.
- 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.

159. 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.

160. 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.

161. 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.

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

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

TRUE

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

TRUE

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

Chapter 02 - Basic Financial Statements

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

TRUE

AACSB: Reflective Thinking

AICPA BB: Resource Management

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

FALSE

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Topic: Income Statement

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-07 Explain how the statement of financial position (balance sheet); income statement; and statement of cash flows relate to each other.

Topic: Relationships among Financial Statements

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-08 Explain common forms of business ownership—sole proprietorship; partnership; and corporation—and demonstrate how they differ in terms of their presentation in the statement of financial position.

Topic: Forms of Business Organization

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-08 Explain common forms of business ownership—sole proprietorship; partnership; and corporation—and demonstrate how they differ in terms of their presentation in the statement of financial position.

Topic: Forms of Business Organization

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

TRUE

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

11. A cash flows 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

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

13. Total assets plus total liabilities must equal total owners' equity.

FALSE

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

FALSE

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

FALSE

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-08 Explain common forms of business ownership—sole proprietorship; partnership; and corporation—and demonstrate how they differ in terms of their presentation in the statement of financial position.

Topic: Forms of Business Organization

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

FALSE

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

27. The cash flows 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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

Chapter 02 - Basic Financial Statements

28. According to the Sarbanes-Oxley Act of 2002, internal controls must be audited by the same accounting firm that audits the financial statements.

TRUE

AACSB: Ethics

AICPA BB: Legal

AICPA FN: Reporting

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-09 Discuss the importance of financial statements to a company and its investors and creditors and why management may take steps to improve the appearance of the company in its financial statements.

Topic: The Use of Financial Statements by External Parties

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

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-09 Discuss the importance of financial statements to a company and its investors and creditors and why management may take steps to improve the appearance of the company in its financial statements.

Topic: The Use of Financial Statements by External Parties

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

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-09 Discuss the importance of financial statements to a company and its investors and creditors and why management may take steps to improve the appearance of the company in its financial statements.

Topic: The Use of Financial Statements by External Parties

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Topic: Income Statement

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 reasonably 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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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 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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-07 Explain how the statement of financial position (balance sheet); income statement; and statement of cash flows relate to each other.

Topic: Relationships among Financial Statements

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 users 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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-01 Explain the nature and general purpose of financial statements.

Topic: Introduction to Financial Statements

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

Chapter 02 - Basic Financial Statements

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-07 Explain how the statement of financial position (balance sheet); income statement; and statement of cash flows relate to each other.

Topic: Relationships among Financial Statements

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. \$270,000.
- D. Cannot be determined from the information given.

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

AICPA FN: Reporting

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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. \$120,000.
- D. Cannot be determined from the information given.

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

54. Which of the following is correct when a corporation 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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

57. Bob Bertolucci, owner of Bob's Bazaar, also owns a personal residence that costs \$575,000. The market value of his residence is \$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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

- A.** Corporation.
- B. Sole proprietorship.
- C. Partnership.
- D. All business organizations are separate legal entities.

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-08 Explain common forms of business ownership—sole proprietorship; partnership; and corporation—and demonstrate how they differ in terms of their presentation in the statement of financial position.

Topic: Forms of Business Organization

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Topic: Income Statement

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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. Owners' equity will be greater than its assets.

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-07 Explain how the statement of financial position (balance sheet); income statement; and statement of cash flows relate to each other.

Topic: Relationships among Financial Statements

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

76. The balance sheet item that represents the portion of owners' equity resulting from profitable operations 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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

77. Retained earnings appears on:

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

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Bloom's: Understand

Difficulty: Easy

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-09 Discuss the importance of financial statements to a company and its investors and creditors and why management may take steps to improve the appearance of the company in its financial statements.

Topic: The Use of Financial Statements by External Parties

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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-09 Discuss the importance of financial statements to a company and its investors and creditors and why management may take steps to improve the appearance of the company in its financial statements.

Topic: The Use of Financial Statements by External Parties

80. 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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-09 Discuss the importance of financial statements to a company and its investors and creditors and why management may take steps to improve the appearance of the company in its financial statements.

Topic: The Use of Financial Statements by External Parties

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

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. 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.

$$\begin{aligned} &A/P (\$16,000) + N/P (\$190,000) + \text{Capital Stock } (\$260,000) + R.E. (\$160,000) = \$626,000 \\ &\text{Cash } (?) + A/R (\$40,000) + \text{Land } (\$240,000) + \text{Building } (\$180,000) + \text{Equipment } (\$120,000) \\ &= \$626,000 \text{ Cash} = \$46,000 \end{aligned}$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

83. 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.

A/P (\$16,000) + N/P (\$190,000) + Capital Stock (\$320,000) + R.E. (\$160,000) \$686,000
Total Assets = \$686,000

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

84. If Cash at December 31, 2009, is \$86,000, Capital Stock is:

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

Cash (\$86,000) + A/R (\$40,000) + Land (\$240,000) + Building (\$180,000) + Equipment (\$120,000) = \$666,000
A/P (\$16,000) + N/P (\$190,000) + Capital Stock (?) + R.E. (\$160,000) = \$666,000
Capital Stock = \$300,000

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

Chapter 02 - Basic Financial Statements

85. 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.

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

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

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

Total Owners' Equity = \$400,000

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

86. 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.

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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. 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

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

88. 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.

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

89. 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.

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

90. 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.

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

91. 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.

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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. 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

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

93. If the Notes 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.**

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

94. If the Cash balance at December 31, 2011 is \$67,500, the Notes Payable balance is:

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

Cash (\$67,500) + A/R (\$18,750) + Land (\$30,000) + Building (\$31,250) + Equipment (\$40,000) = \$187,500 A/P (\$2,500) + N/P (?) + Capital Stock (\$12,500) + R.E. (\$125,000) = \$187,500 Notes Payable = \$47,500

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

95. 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.

Cash (\$62,500) + A/R (\$18,750) + Land (\$30,000) + Building (\$31,250) + Equipment (\$40,000) = \$182,500

A/P (\$2,500) + N/P (?) + Capital Stock (\$12,500) + R.E. (\$125,000) = \$182,500

\$2,500 (Accounts Payable) + \$42,500 (Notes Payable) = \$45,000

Total Liabilities = \$45,000

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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.

$\$800,000 - \$720,000 = \$80,000$ (Liabilities)

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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.

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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.

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

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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 of 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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

Chapter 02 - Basic Financial Statements

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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

102. If 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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

103. If 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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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.

$$\$120,000 - \$72,000 = \$48,000 \quad \$246,000 - \$48,000 = \$198,000$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Apply

Difficulty: Hard

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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.

$$\$68,000 - \$118,000 = (\$50,000) \quad \$360,000 - (\$50,000) = \$410,000$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Apply

Difficulty: Hard

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

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.

$$\$175,000 + \$15,000 = \$190,000 \quad \$475,000 - \$190,000 = \$285,000$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

Bloom's: Apply

Difficulty: Hard

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

107. During the month of May, 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 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

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

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

- * 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. What amount of net income will be reported on an income statement for the month of August?

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

AICPA FN: Reporting

Bloom's: Analyze

Difficulty: Medium

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Topic: Income Statement

109. At the beginning of August, 2010, owners' equity in Astoria was \$160,000. Given the transactions of August, 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

AICPA FN: Reporting

Bloom's: Analyze

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

110. For the month of August, 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

AICPA FN: Reporting

Bloom's: Analyze

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

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 oversee 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 officer and the chief financial officer to certify the accuracy of their company's financial statements.

AACSB: Ethics

AICPA BB: Legal

AICPA FN: Reporting

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-09 Discuss the importance of financial statements to a company and its investors and creditors and why management may take steps to improve the appearance of the company in its financial statements.

Topic: The Use of Financial Statements by External Parties

During the month of August, the Boyce Company had the following transactions:

- * Revenues of \$120,000 were earned and received in cash.
- * Bank loans of \$18,000 were paid off.
- * Equipment of \$40,000 was purchased with cash.
- * Expenses of \$73,600 were paid.
- * Stockholders purchased additional shares for \$44,000 cash.

Chapter 02 - Basic Financial Statements

112. A statement of cash flows for August, would report net cash flows from operating activities of:

- A. \$26,000.
- B. \$32,400.
- C. \$40,000.
- D.** \$46,400.

Cash revenues \$120,000 - cash expenses \$73,600 = \$46,400

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

113. A statement of cash flows for August, would report net cash flows from financing activities of:

- A.** \$26,000.
- B. \$32,400.
- C. \$40,000.
- D. \$46,400.

Sale of stock \$44,000 - bank loan paid \$18,000 = \$26,000

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

Chapter 02 - Basic Financial Statements

114. A statement of cash flows for August, would report net cash flows from investing activities of:

- A. \$26,000.
- B. \$32,400.
- C. \$40,000.**
- D. \$46,400.

Equipment purchased \$40,000

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

115. A statement of cash flows for August, would report an increase in cash of:

- A. \$26,000.
- B. \$32,400.**
- C. \$40,000.
- D. \$46,400.

$$\$46,400 + \$26,000 - \$40,000 = \$32,400$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

Waldorf Co. had the following transactions during the month of October:

- * Cash received from bank loans was \$60,000.
- * Dividends of \$18,500 were paid to stockholders in cash.
- * Revenues earned and received in cash amounted to \$100,500.
- * Expenses incurred and paid were \$78,000.

Chapter 02 - Basic Financial Statements

116. What amount of net income will be reported on an income statement for the month of October?

- A. \$18,500.
- B. \$22,500.**
- C. \$78,000.
- D. \$100,500.

$$\$100,500 - \$78,000 = \$22,500$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Analyze

Difficulty: Medium

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Topic: Income Statement

117. At the beginning of October, owners' equity in Waldorf was \$480,000. Given the transactions of October, 2011, what will owners' equity be at the end of the month?

- A. \$480,000.
- B. \$484,000.**
- C. \$502,500.
- D. \$580,500.

$$\$480,000 + \$22,500 \text{ (Net income)} - \$18,500 \text{ (Dividends)} = \$484,000$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Analyze

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

118. For the month of October, net cash flows from operating activities for Waldorf were:

- A. \$18,500.
- B. \$22,500.**
- C. \$78,000.
- D. \$100,500.

$$\$100,500 - \$78,000 = \$22,500$$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Analyze

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

During the month of February, the Fadness Company had the following transactions:

- * Revenues of \$225,000 were earned and received in cash.
- * Bank loans of \$18,000 were paid off.
- * New bank loans of \$15,000 were incurred.
- * Equipment of \$40,000 was purchased with cash.
- * Equipment was sold for its book value of \$36,000. Cash was received.
- * Expenses of \$171,400 were paid.
- * Stockholders purchased additional shares for \$50,000 cash.

Chapter 02 - Basic Financial Statements

119. A statement of cash flows for February, would report net cash flows from operating activities of:

- A. \$4,000.
- B. \$47,000.
- C. \$53,600.**
- D. \$96,600.

Cash revenues \$225,000 - cash expenses \$171,400 = \$53,600

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

120. A statement of cash flows for February, would report net cash flows from financing activities of:

- A. \$4,000.
- B. \$47,000.**
- C. \$53,600.
- D. \$96,600.

Sale of stock \$50,000 + bank loan issued \$15,000 - bank loan paid 18,000 = \$47,000

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

Chapter 02 - Basic Financial Statements

121. A statement of cash flows for February, would report net cash flows from investing activities of:

- A.** \$4,000.
- B. \$47,000.
- C. \$53,600.
- D. \$96,600.

Equipment purchased \$40,000 - equipment sold \$36,000 = \$4,000 used

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

122. A statement of cash flows for February, would report an increase in cash of:

- A. \$4,000.
- B. \$47,000.
- C. \$53,600.
- D.** \$96,600.

$\$53,600 + \$47,000 - \$4,000 = \$96,600$

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Measurement

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Topic: Statement of Cash Flows

Essay Questions

123. 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.) $Assets = Liabilities + Owners' Equity$
- (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

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

124. 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 the year, 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.) \$990,000 increase

(B.) \$2,160,000

(C.) \$535,000

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

(B.) Total assets = 4(\$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

Bloom's: Analyze

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

125. 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 operations 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.			

Chapter 02 - Basic Financial Statements

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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: $Assets + Liabilities = Owners' Equity$.

Topic: A Starting Point: Statement of Financial Position

126. 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 operations 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 accounts receivable from purchaser of the monitor.			
H. Bought a small truck to be used in the business for \$29,000; paid cash in full.			

Chapter 02 - Basic Financial Statements

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 accounts 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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Topic: A Starting Point: Statement of Financial Position

127. List the following accounts in the order that they would appear in 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

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

128. 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 \$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 = \$995,000
(B.) Total liabilities = \$530,000
(C.) Owners' equity = \$465,000

Feedback: (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

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

129. 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 land costing \$50,000 for \$60,000 cash.

(4) The business paid \$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 = \$1,010,000

(B.) Total liabilities = \$450,000

(C.) Owners' equity = \$560,000

Feedback:

(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

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

130. 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

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

131. 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:		
	<u> </u>	Capital stock	\$100,000	
		Retained earnings	<u>26,200</u>	\$126,200
		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:		
	<u> </u>	Capital stock		
		Retained earnings		\$
		Total liabilities		
Total assets	<u>\$</u>	Owners' equity		<u>\$</u>

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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^d</u>	
Buildings	50,000		Total liabilities	\$ 42,800	
Office Equipment	31,800 ^c		Owners' equity:		
			Capital stock	\$115,000	
			Retained earnings	<u>26,200</u>	<u>\$141,200^e</u>
			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

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

132. 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 were \$275,000 and dividends of \$70,000 were 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 owners' equity	<u>\$620,000</u>
Total assets	<u>\$ _____</u>		

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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
		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

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

133. 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	\$835,000	owners' equity	\$?

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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
		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 plus 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

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

134. 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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

135. 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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

136. 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

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Topic: Income Statement

137. 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	61,250
Equipment	30,000	Total Liabilities	236,250
Land	125,000	Owners' Equity	
Building	I 50,000	Capital Stock	\$50,000
		Retained Earnings	53,250
		Total Liabilities	
Total Assets	<u>\$339,500</u>	& Owners' Equity	<u>\$339,500</u>

AACSB: Analytic

AICPA BB: Critical Thinking

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Topic: A Starting Point: Statement of Financial Position

138. Financial statements

A set of financial statements 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. The cash flows from three activities are presented on the statement. In order of presentation, they include: (1) operating activities; (2) investing activities; and (3) financing activities.

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-01 Explain the nature and general purpose of financial statements.

Topic: Introduction to Financial Statements

139. 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 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

Bloom's: Remember

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

140. 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

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Topic: A Starting Point: Statement of Financial Position

141. 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, and owner acts as manager.
- (2) Partnership—Two or more persons and owners are personally responsible for debts.
- (3) Corporation—Stockholders are owners, limited liability, ease of transfer of ownership, and separate entity under the law.

AACSB: Reflective Thinking

AICPA BB: Legal

AICPA FN: Reporting

Bloom's: Remember

Difficulty: Easy

Learning Objective: 02-08 Explain common forms of business ownership—sole proprietorship; partnership; and corporation—and demonstrate how they differ in terms of their presentation in the statement of financial position.

Topic: Forms of Business Organization

Multiple Choice Questions

142. 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.

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

143. 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.

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

Chapter 02 - Basic Financial Statements

144. 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.

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

145. The balance sheet of Dotty 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.

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

146. 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.

Learning Objective: 02-02 Explain certain accounting principles that are important for an understanding of financial statements and how professional judgment by accountants may affect the application of those principles.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Learning Objective: 02-05 Explain how the income statement reports an enterprise's financial performance for a period of time in terms of the relationship of revenues and expenses.

Learning Objective: 02-06 Explain how the statement of cash flows presents the change in cash for a period of time in terms of the company's operating; investing; and financing activities.

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 \$37,950 of its accounts payable.

147. On January 6, total assets of the business amount to:

A. \$826,650.

B. \$994,950

C. \$957,000.

D. \$950,400.

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Chapter 02 - Basic Financial Statements

148. On January 6, owners' equity amounts to:

- A. \$752,400.
- B. \$44,550.
- C. \$796,950.**
- D. \$895,950.

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

149. On January 6, the accounts payable balance is:

- A. \$136,950.
- B. \$36,300.
- C. \$24,750.
- D. \$99,000.**

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

150. On January 6, the accounts receivable balance is:

- A. \$24,750.**
- B. \$38,775.
- C. \$77,550.
- D. \$63,525.

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Chapter 02 - Basic Financial Statements

151. On January 6, the cash balance is:

A. \$127,050.

B. \$138,600.

C. \$165,000.

D. \$202,950

Learning Objective: 02-03 Demonstrate how certain business transactions affect the elements of the accounting equation: Assets + Liabilities = Owners' Equity.

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Essay Questions

152. 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	\$ 45,000
Land	190,000	Total liabilities	\$ 45,000
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 \$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.....	I	Total liabilities	\$
Equipment.....		Owners' equity:	
		Capital stock.....	
Total assets.....	<u>\$</u>	Total liabilities and owners' equity.....	<u>\$</u>

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^e</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: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

153. 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	<u> </u>
		Total liabilities and	
Total assets	<u>\$ </u>	owners' equity	<u>\$375,000</u>

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>	<u>\$239,400</u>
		Total liabilities and		
Total assets	<u>\$375,000^a</u>	owners' equity		<u>\$375,000</u>

Computations:

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

Learning Objective: 02-04 Explain how the statement of financial position; often referred to as the balance sheet; is an expansion of the basic accounting equation.

Multiple Choice Questions

154. 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.

155. 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.

156. Water world 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.

157. 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.

158. 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: $\text{Assets} = \text{Liabilities} + \text{Owners' Equity}$.
- 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.

159. 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.

160. 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.

161. 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.