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Financial Accounting Sixth Edition

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Chapter 02

Investing and Financing Decisions and the Balance Sheet

True / False Questions

1. A balance sheet format reports that assets equal liabilities plus stockholders' equity.
True False

2. Liability accounts are reported on the income statement as they represent goods or services consumed or used.
True False

3. A primary objective of accounting is to disclose the fair market value of assets on the balance sheet so investors and creditors know their current value.
True False

4. Under the separate entity assumption, it is assumed that a business will continue to operate into the foreseeable future.
True False

5. The historical cost principle measures assets and liabilities at the historical cash-equivalent amounts.
True False

6. Liabilities are listed on the balance sheet in the order of their maturity, meaning how soon they are due to be paid.
True False

7. An "account" is a standardized format used to accumulate the effects of transactions on each financial statement item.

True False

8. The payment of a liability in cash will decrease stockholders' equity.

True False

9. The purchase of equipment for cash has no effect on total assets.

True False

10. The duality of effects means that every transaction must affect both sides of the accounting equation.

True False

11. When a business borrows money from a bank, both the left and right sides of the accounting equation increase.

True False

12. It is not possible for the left side of the accounting equation to both increase and decrease as a result of the same transaction.

True False

13. A T-account shows total debits of \$26,000 and total credits of \$20,000; therefore, it has a \$6,000 debit balance.

True False

14. Debits always increase and credits always decrease an account.

True False

15. The chart of accounts of a company is the complete listing of all accounts and accounts numbers.

True False

16. If you want to know the balance of the supplies account, that information would be found in the general ledger.

True False

17. The normal balance for an asset account is a debit and the normal balance for a liability account is a credit.

True False

18. The financial leverage ratio is computed by dividing average total assets by average stockholders' equity.

True False

19. When a company borrows money from a bank, it leads to a cash inflow from an investing activity.

True False

20. When a loan is repaid to the bank it leads to an inflow of cash from a financing activity.

True False

Multiple Choice Questions

21. Which of the following statements about stockholders' equity is not correct?
- A. Stockholders' equity is the shareholders' residual interest in the company resulting from the difference in assets and liabilities.
 - B. Stockholders' equity accounts are increased with credits.
 - C. Stockholders' equity results only from contributions of the owners.
 - D. The purchase of land for cash has no effect on stockholders' equity.
22. All liabilities appear on the
- A. Balance sheet.
 - B. Income statement.
 - C. Statement of stockholders' equity.
 - D. Statement of cash flows.
23. Morgan Company owes Regan Company \$1,000, Morgan would reflect this on its
- A. statement of cash flows.
 - B. income statement.
 - C. balance sheet.
 - D. statement of stockholders' equity.
24. The assumption that a business can continue to remain in operation into the future is the
- A. historical cost principle.
 - B. unit-of-measure assumption.
 - C. continuity assumption.
 - D. separate-entity assumption.

25. Assets are defined as

- A. resources with possible future economic benefits owed by an entity as a result of past transactions.
- B. resources with probable future economic benefits owned by an entity as a result of past transactions.
- C. resources with probable future economic benefits owned by an entity as a result of future transactions.
- D. resources with possible future economic benefits owed by an entity as a result of future transactions.

26. The assumption that the assets and liabilities of the business are accounted for on the books of the company but not included in the records of the owner is the

- A. unit-of-measure assumption.
- B. continuity assumption.
- C. historical cost principle.
- D. separate entity assumption.

27. Liabilities are defined as

- A. possible debts or obligations of an entity as a result of future transactions which will be paid with assets or services.
- B. possible debts or obligations of an entity as a result of past transactions which will be paid with assets or services.
- C. probable debts or obligations of an entity as a result of future transactions which will be paid with assets or services.
- D. probable debts or obligations of an entity as a result of past transactions which will be paid with assets or services.

28. Stockholders' equity is

- A. probable debts or obligations of an entity as a result of past transactions which will be paid with assets or services.
- B. assets minus liabilities.
- C. probable future economic benefits owned by an entity as a result of past transactions.
- D. the financing provided by the creditors of a business.

29. Chad Jones is the sole owner and manager of Jones Glass Repair Shop. In 2009, Jones purchases a truck for \$30,000 to be used in the business. Which of the following fundamentals requires Jones to record the truck at the price paid to buy it?

- A. Separate-entity assumption.
- B. Revenue principle.
- C. Full disclosure.
- D. Historical cost principle.

30. On a balance sheet, assets are listed in the order of

- A. dollar amount (largest first).
- B. date of acquisition (earliest first).
- C. ease of conversion to cash.
- D. importance to the operation of the business.

31. In what order would the assets of Mertz Company be listed on their balance sheet?

- A. Cash, Accounts Receivable, Inventory, Plant and Equipment
- B. Cash, Inventory, Accounts Receivable, Plant and Equipment
- C. Cash, Accounts Receivable, Marketable Securities, Inventory
- D. None of these are in correct order

32. We would report changes in stockholders' equity caused by operating activities

- A. in an asset account.
- B. in a contributed capital account.
- C. in a liability account.
- D. in the retained earnings account.

33. Which of the following events will cause retained earnings to increase?

- A. Dividends declared by the Board of Directors.
- B. Net income reported for the period.
- C. Net loss reported for the period.
- D. Issuance of stock in the business

34. Which of the following transactions would cause retained earnings to increase?
- A. Collection of a customer's account.
 - B. Loan from a bank.
 - C. Sale of service to a customer.
 - D. Wage costs owed to employees.
35. The primary objective of financial accounting is to
- A. provide information about a business to internal parties.
 - B. provide information about a business' future business strategies.
 - C. provide useful economic information about a business to help external parties make sound financial decisions.
 - D. provide predictions of future stock price.
36. Which of the following would not be considered a current liability?
- A. Accounts Payable
 - B. Prepaid Expenses
 - C. Taxes Payable
 - D. Utilities Payable
37. Which of the following would not be considered a current asset?
- A. Inventories
 - B. Prepaid Expenses
 - C. Land
 - D. Accounts Receivable
38. "Accounts Payable" refers to
- A. an amount owed to a business.
 - B. an amount a business owes to a third party.
 - C. the bottom line on the income statement.
 - D. the total cash paid by a business during the year.

39. Which of the following is not a liability?

- A. Accounts payable.
- B. Retained earnings.
- C. Notes payable.
- D. Unearned Revenue.

40. Which of the following liability accounts is usually not satisfied by payment of cash?

- A. Accounts payable
- B. Unearned revenues
- C. Taxes payable
- D. All of these are satisfied by paying cash

41. An example of an external exchange would be

- A. the purchase of inventory on credit from a supplier.
- B. cash received from a credit customer.
- C. cash paid for wages to employees.
- D. all answers show external exchanges.

42. Michael Corporation received \$200,000 cash invested by its owners. The effect on the accounting equation was

- A. assets and liabilities each increased by \$200,000.
- B. assets and revenues each increased by \$200,000.
- C. stockholders' equity and revenues each increased by \$200,000.
- D. stockholders' equity and assets each increased by \$200,000.

43. WindNet Corporation purchased factory equipment for \$38,000 cash. Which of the following statements regarding this purchase is incorrect?

- A. The net income for Mika will be reduced by the \$38,000 expense of the factory equipment.
- B. The total amount of assets on Mika's balance sheet will not change.
- C. The total liabilities will not change.
- D. The amount of the stockholders' equity on Mika's balance sheet will not change.

44. Which of the following direct effects on the accounting equation is not possible as a result of transaction analysis?

- A. Increase a liability and decrease an asset.
- B. Increase stockholders' equity and increase an asset.
- C. Increase an asset and decrease an asset.
- D. Decrease stockholders' equity and decrease an asset.

45. Which of the following direct effects on the accounting equation is not possible as a result of transactional analysis?

- A. An increase in an asset and a decrease in another asset.
- B. A decrease in a liability and an increase in an asset.
- C. A decrease in stockholders' equity and a decrease in an asset.
- D. An increase in an asset and an increase in stockholders' equity.

46. Assume a company's January 1, 2009, financial position was: Assets, \$150,000 and Liabilities, \$60,000. During January 2009, the company completed the following transactions: (A) paid on a note payable \$10,000 (no interest was paid); (B) collected an accounts receivable, \$9,000; (C) paid an accounts payable, \$5,000; and (D) purchased a truck, \$5,000 cash, and a \$20,000 note payable from a bank. The company's January 31, 2009 financial position is

	Assets	Liabilities	Stockholders' Equity
A.	\$150,000	\$60,000	\$90,000
B.	\$155,000	\$65,000	\$90,000
C.	\$160,000	\$75,000	\$85,000
D.	\$170,000	\$100,000	\$70,000

47. The purchase of equipment with a note payable would

- A. increase cash.
- B. decrease cash.
- C. increase a liability.
- D. decrease a liability.

48. The purchase of supplies for cash would

- A. not change total assets.
- B. increase total assets.
- C. increase liabilities.
- D. decrease liabilities.

49. Payment of a liability would

- A. decrease stockholders' equity.
- B. decrease assets.
- C. not affect assets.
- D. increase stockholders' equity.

50. The collection of an account receivable from a customer would

- A. increase liabilities.
- B. decrease liabilities.
- C. not affect liabilities.
- D. decrease stockholders' equity.

51. The Mariah Company has an \$80,000 debit in its assets, a \$36,000 credit in its liabilities, and a \$12,000 credit in retained earnings. What is the balance in the contributed capital account?

- A. \$44,000 credit.
- B. \$32,000 credit.
- C. \$48,000 credit
- D. \$44,000 debit.

52. The duality (or duality of effects) concept states

- A. there is more than one way of looking at any situation.
- B. every transaction has good and bad ramifications.
- C. there are two entities involved in every transaction.
- D. every transaction has at least two effects on the accounting equation.

53. Which of the following will not result in recording a transaction?
- A. Signing a contract to have an outside cleaning service clean offices nightly.
 - B. Paying employees their wages.
 - C. Selling stock to investors.
 - D. Buying equipment and agreeing to pay a note payable and interest at the end of a year.
54. Which of the following transactions will cause both the left and right side of the accounting equation to decrease?
- A. We collect cash from a customer who owed us money.
 - B. We pay a supplier for inventory we previously bought on account.
 - C. We borrow money from the bank.
 - D. We purchase equipment for cash.
55. When a company buys equipment for \$150,000 and pays for one third in cash and the other two thirds is financed by a note payable, the following are the effects on the accounting equation:
- A. cash decreases by \$50,000.
 - B. equipment increases by \$100,000.
 - C. liabilities increase by \$150,000.
 - D. total assets increase by \$200,000.
56. The effect on total assets of the purchase of land for cash is
- A. an increase in total assets.
 - B. a decrease in total assets.
 - C. total assets remain unchanged.
 - D. an increase in total assets and total liabilities.
57. Which of the following is not one of the three steps in the transaction analysis process?
- A. Identify the accounts affected and classify them by type of account.
 - B. Determine the direction of the effect on each account.
 - C. Transfer the effects of the transaction to the balance sheet.
 - D. Verify that the accounting equation remains in balance.

58. Sale of stock to investors for \$300,000 cash would

- A. increase cash by a debit and increase contributed capital by a credit.
- B. increase cash by a credit and increase contributed capital by a debit.
- C. increase retained earnings by a debit and increase cash by a credit.
- D. increase cash by a debit and increase retained earnings by a credit.

59. Borrowing \$100,000 of cash from First National Bank would

- A. increase cash by a credit and increase notes payable by a debit.
- B. increase notes payable by a debit and increase cash by a debit.
- C. increase notes payable by a credit and increase cash by a debit.
- D. decrease cash by a debit and decrease notes payable by a credit.

60. Water Corporation was organized on October 1, 2009. Water Corporation issued shares of capital stock to each of the five owners who paid in a total of \$250,000. On the basis of transactional analysis, the following entry should be recorded.

- A. A debit (increase) to cash for \$250,000 and a credit (increase) to revenue for \$250,000.
- B. A credit (decrease) to cash for \$250,000 and a debit (increase) to retained earnings for \$250,000.
- C. A credit (decrease) to cash for \$250,000 and a debit (decrease) to contributed capital for \$250,000.
- D. A debit (increase) to cash for \$250,000 and a credit (increase) to contributed capital for \$250,000.

61. Cadet Company paid an accounts payable of \$1,000. This transaction should be recorded as follows on the payment date.

	Accounts payable	1,000	
A.	Cash		1,000
	Cash	1,000	
B.	Accounts Payable		1,000
	Notes Payable	1,000	
C.	Cash		1,000
	Cash	1,000	
D.	Cost of Goods Sold		1,000

62. The word credit means

- A. an increase to an account.
- B. a decrease to an account.
- C. an entry to the right side of an account.
- D. an entry to the left side of an account.

63. Which of the following is true?

- A. Assets increase on their right side because they are on the right side of the accounting equation.
- B. Liabilities increase on their right side because they are on the right side of the accounting equation.
- C. Stockholders' equity accounts increase on their left side because they are on the left side of the accounting equation.
- D. The accounting equation only has to be in balance whenever financial statements are being prepared.

64. The accounts payable account has a beginning balance of \$12,000 and we purchased \$50,000 of inventory on credit during the month. The ending balance was \$10,000. How much did we pay our creditors during the month?

- A. \$50,000
- B. \$52,000
- C. \$60,000
- D. \$62,000

65. Which of the following statements concerning the debit-credit feature of the accounting equation is correct?

- A. Debits are entered on the right and credits are entered on the left.
- B. A debit entry will decrease a liability account and increase an asset account.
- C. Stock sold to investors increases stockholders' equity and is recorded as a debit.
- D. A liability account should be credited upon payment of an account payable.

66. The financial leverage ratio is computed by taking
- A. total assets divided by total liabilities.
 - B. average total assets divided by average stockholders' equity.
 - C. average total assets divided by average total liabilities.
 - D. total assets divided by total stockholders' equity.
67. The usefulness of the financial leverage ratio is that it allows interested parties to assess
- A. how the company finances its assets.
 - B. the relative risk assumed by the company caused by the use of debt financing.
 - C. whether the company should expand its use of debt to finance assets.
 - D. All of these are uses of the ratio.
68. When a company has a financial leverage ratio close to 1 to 1,
- A. the company is primarily using debt financing for acquisition of its assets.
 - B. the creditors of the company would be very unlikely to give a loan to the company since debt is high.
 - C. the return to stockholders is lower than it would be if the ratio was higher.
 - D. actual earnings are equal to the estimated earnings.
69. The financial leverage ratio for a company was 2.54 in 2003 while its competitor's ratio was 1.26 for the same year. The higher ratio for the first company indicates
- A. it uses less debt than equity financing to acquire its assets.
 - B. the competitor finances more of its assets using equity rather than debt.
 - C. the first company has a lower level of financial risk than its competitor.
 - D. None of these statements are true.
70. Which of the following transactions would cause cash inflow from a financing activity for Boeing Corporation?
- A. Sold shares of stock in Boeing Corp.
 - B. Sold shares of Mobil Corporation stock.
 - C. Sold used equipment, which had been used in the production of aircraft.
 - D. Both A and C create financing cash inflow.

71. An example of an investing transaction would be

- A. purchasing equipment for cash.
- B. buying inventory from a supplier on credit.
- C. selling stock to investors for cash.
- D. All of these are investing transactions.

72. An example of an operating activity would be

- A. purchasing equipment for cash.
- B. buying inventory from a supplier on credit.
- C. selling stock to investors for cash.
- D. repaying the principle on a bank loan.

73. Financing activities

- A. primarily deal with securing money by bank loans or selling stock to investors.
- B. primarily are connected to the income producing activities of the company as reported on the income statement.
- C. primarily deal with buying and building facilities used over many years by the business.
- D. primarily deal with selling facilities once used by the business.

74. Burger Palace Corporation reports a net cash used for investing activities of \$3.4 million and a net cash provided by financing activities of \$1.6 million. If cash increased by \$1.1 million during the year, what was the net cash flow provided from operating activities?

- A. \$0.7 million
- B. \$2.9 million
- C. \$3.9 million
- D. \$6.1 million

75. Which of the following would cause a cash outflow connected to investing activities?

- A. Purchased shares of stock in another company.
- B. Paid a dividend to our stockholders.
- C. Issued more shares of our company's stock.
- D. Cash sales of our company's products.

76. When a new business is just starting up, it must first
- A. generate positive cash flow through successful operations.
 - B. acquire the assets both long-lived and short-lived so they can operate.
 - C. acquire financing from issuance of stock and borrowing from creditors.
 - D. These activities all occur simultaneously and not sequentially.

Essay Questions

77. Why is the continuity assumption so important for balance sheet reporting?

78. Why is the separate-entity assumption so important for balance sheet reporting?

79. Why is the historical cost principle so important for balance sheet reporting?

80. (A) Complete the following schedule for Red Eye Company.

Transaction	Assets	Liabilities	Stockholders' Equity
Beginning financial position	\$200,000	\$80,000	\$120,000
Borrowed \$20,000 cash using a note payable, face amount \$20,000.			
Collected accounts receivable for cash, \$7,000.			
Paid accounts payable, \$8,000 cash.			
Purchased office supplies on credit, \$2,000.			
Sold stock to new investors for \$20,000 of cash.			
Paid \$12,000 income taxes payable.			
Ending financial position.			

(B) How much did cash change during the period?

81. For each of the following accounts, indicate whether the account is an asset (A), liability (L), or stockholders' equity (SE) and whether the account usually has a debit (Dr) or credit (Cr) balance.

Retained Earnings

Inventory

Contributed Capital

Accounts payable

Accounts receivable

Property and equipment

Wages payable

Prepaid expenses

82. For each financial statement element listed, indicate whether a debit or a credit is used to increase the account's balance.

Assets

Liabilities

Contributed Capital

Retained Earnings

83. For each of the accounts listed below, indicate whether the typical or normal balance is a debit or credit.

- A. Inventory
- B. Notes payable
- C. Retained earnings
- D. Equipment
- E. Prepaid insurance
- F. Accounts receivable
- G. Land
- H. Contributed capital
- I. Accounts payable
- J. Unearned revenue

84. Al, Bill and Chad organized the ABC Corporation on January 1, 2009. Each of these owners invested \$100,000 cash and received shares of stock. Below are selected transactions that were completed during January.

(A.) Give the entry on ABC's books for each transaction:

Sold stock to the owners.

Borrowed \$80,000 on one-year note payable.

Purchased land by signing a \$70,000 note payable.

Paid \$10,000 of accounts payable.

Purchased two service vehicles, \$24,000 each; paid cash.

Purchased \$2,000 of supplies on credit.

(B.) Calculate total assets, total liabilities and total stockholders' equity based only on the 6 transactions above:

85. The accounts with identification letters for PlayWorld, Inc. are listed below.

Letter	Account Title
A	Cash
B	Accounts Receivable
C	Office supplies
D	Equipment
E	Land
F	Accounts Payable
G	Notes Payable
H	Contributed Capital
I	Retained Earnings

During 2010, the company completed the transactions given below. You are to indicate the appropriate journal entry for each transaction by giving the account letter and amount. Some entries may need three letters. The first transaction is given as an example.

Transaction		Debit		Credit	
		Letter	Amount	Letter	Amount
A.	Borrowed \$50,000 and signed a note.	A	\$50,000	G	\$50,000
B.	Purchased equipment for \$50,000. Paid \$10,000 cash, signed \$40,000 note payable.				
C.	Collected \$15,000 accounts receivable.				
D.	Paid \$12,000 of accounts payable.				
E.	Issued capital stock in exchange for \$60,000 cash.				
F.	Purchased \$5,000 office supplies (an asset) on credit.				
G.	Paid for the office supplies in (F).				

86. In what two places do amounts for transactions appear in the accounting system or "the books"? Describe them.

87. On January 1, 2009, Dr. Beth Hill started a new professional corporation, Beth Hill, P.C., to practice medicine with an initial investment of \$100,000. On June 30, 2009, the accounting records showed the following amounts:

Accounts Payable	\$2,000
Accounts Receivable	6,200
Cash	48,100
Contributed Capital	100,000
Office Equipment	60,000
Office Supplies	3,500
Retained Earnings	5,800
Notes Payable	10,000

Prepare a balance sheet at June 30, 2009.

88. For each of the transactions listed below, indicate whether it is an investing (I) or financing (F) activity on the statement of cash flows. Also, indicate if the transaction increases (+) or decreases (-) cash.

	Transaction	Type of Activity	Effect on Cash
Ex.	Paid dividends to the owners	F	-
A.	Purchased equipment to use in the business.		
B.	Issued stock for cash.		
C.	Borrowed money at the bank.		
D.	Sold a piece of land adjacent to the plant.		
E.	Paid the principal balance of a note payable.		

89. Match the terminology with the description.

Decreases assets and increases owners' equity::Credits

An exchange between an entity and another party::Transaction

Normal balances for assets::Debits

Accounting assumption that requires assets to be recorded at their cash equivalent cost::Historical cost principle

Cumulative earnings that have not been distributed to the owners::Retained earnings

A debt owed by the entity::Liability

Statement of financial position::Balance Sheet

Account for a business separate from its owners::Separate-entity assumption

Dating of the income statement::For the period ended December 31, 2011

Dating of the balance sheet::December 31, 2011

90. For each of the following events, which ones result in an exchange transaction for the O'Brien Company (Y for Yes and N for No)?

Purchased land for cash and a note payable::Yes

Agreed to purchase one million inventory parts from a new supplier::No

Paid the utilities for the month::Yes

One of our stockholders sells her shares to a new investor::No

Received inventory from a supplier under the new contract::Yes

Entered into a contract with a new cleaning service:: No

91. The Alex Company, a consulting firm, recorded the following business transactions during May, 2009. Indicate whether each transaction would increase, decrease, or have no effect on the total assets of the company.

Issued capital stock in exchange for cash contributed by owners::Increase

Purchased office supplies for cash::No effect

Purchased office supplies on credit::Increase

Paid cash on accounts payable to a supplier::Decrease

Collected cash on accounts receivable::No effect

Borrowed money from the bank on a promissory note payable::Increase

Loaned money to a trusted employee::No effect

92. Classify the following balance sheet accounts for CleanRight Service. Use the following code: CA = current assets, NCA = noncurrent assets, CL = current liabilities, NCL = noncurrent liabilities and SE = stockholders' equity

Building::Noncurrent asset

Retained Earnings::Stockholders' Equity

Notes Payable due in 3 months::Current liability

Land::Noncurrent asset

Prepaid Expenses::Current asset

Supplies::Current asset

Contributed Capital::Stockholder's Equity

Notes Payable due in 5 years::Noncurrent liability

Income Taxes Payable::Current liability

Chapter 02 Investing and Financing Decisions and the Balance Sheet **Answer Key**

True / False Questions

1. A balance sheet format reports that assets equal liabilities plus stockholders' equity.

TRUE

AACSB Tag: Communications

Difficulty: Easy

Learning Objective: 1

2. Liability accounts are reported on the income statement as they represent goods or services consumed or used.

FALSE

AACSB Tag: Communications

Difficulty: Easy

Learning Objective: 1

3. A primary objective of accounting is to disclose the fair market value of assets on the balance sheet so investors and creditors know their current value.

FALSE

AACSB Tag: Communications

Difficulty: Medium

Learning Objective: 1

4. Under the separate entity assumption, it is assumed that a business will continue to operate into the foreseeable future.

FALSE

AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 1

5. The historical cost principle measures assets and liabilities at the historical cash-equivalent amounts.

TRUE

AACSB Tag: Communications
Difficulty: Medium
Learning Objective: 1

6. Liabilities are listed on the balance sheet in the order of their maturity, meaning how soon they are due to be paid.

TRUE

AACSB Tag: Communications
Difficulty: Easy
Learning Objective: 1

7. An "account" is a standardized format used to accumulate the effects of transactions on each financial statement item.

TRUE

AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 2

8. The payment of a liability in cash will decrease stockholders' equity.

FALSE

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 3

9. The purchase of equipment for cash has no effect on total assets.

TRUE

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 3

10. The duality of effects means that every transaction must affect both sides of the accounting equation.

FALSE

AACSB Tag: Reflective Thinking

Difficulty: Hard

Learning Objective: 3

11. When a business borrows money from a bank, both the left and right sides of the accounting equation increase.

TRUE

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 3

12. It is not possible for the left side of the accounting equation to both increase and decrease as a result of the same transaction.

FALSE

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 3

13. A T-account shows total debits of \$26,000 and total credits of \$20,000; therefore, it has a \$6,000 debit balance.

TRUE

*AACSB Tag: Analytic
Difficulty: Easy
Learning Objective: 3*

14. Debits always increase and credits always decrease an account.

FALSE

*AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 4*

15. The chart of accounts of a company is the complete listing of all accounts and accounts numbers.

TRUE

*AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 4*

16. If you want to know the balance of the supplies account, that information would be found in the general ledger.

TRUE

*AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 4*

17. The normal balance for an asset account is a debit and the normal balance for a liability account is a credit.

TRUE

*AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 4*

18. The financial leverage ratio is computed by dividing average total assets by average stockholders' equity.

TRUE

*AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 5*

19. When a company borrows money from a bank, it leads to a cash inflow from an investing activity.

FALSE

*AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 6*

20. When a loan is repaid to the bank it leads to an inflow of cash from a financing activity.

FALSE

*AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 6*

Multiple Choice Questions

21. Which of the following statements about stockholders' equity is not correct?

- A. Stockholders' equity is the shareholders' residual interest in the company resulting from the difference in assets and liabilities.
- B. Stockholders' equity accounts are increased with credits.
- C.** Stockholders' equity results only from contributions of the owners.
- D. The purchase of land for cash has no effect on stockholders' equity.

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 1

22. All liabilities appear on the

- A.** Balance sheet.
- B. Income statement.
- C. Statement of stockholders' equity.
- D. Statement of cash flows.

AACSB Tag: Communications

Difficulty: Easy

Learning Objective: 1

23. Morgan Company owes Regan Company \$1,000, Morgan would reflect this on its

- A. statement of cash flows.
- B. income statement.
- C.** balance sheet.
- D. statement of stockholders' equity.

AACSB Tag: Analytic

Difficulty: Medium

Learning Objective: 1

24. The assumption that a business can continue to remain in operation into the future is the
- A. historical cost principle.
 - B. unit-of-measure assumption.
 - C.** continuity assumption.
 - D. separate-entity assumption.

AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 1

25. Assets are defined as
- A. resources with possible future economic benefits owed by an entity as a result of past transactions.
 - B.** resources with probable future economic benefits owned by an entity as a result of past transactions.
 - C. resources with probable future economic benefits owned by an entity as a result of future transactions.
 - D. resources with possible future economic benefits owed by an entity as a result of future transactions.

AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 1

26. The assumption that the assets and liabilities of the business are accounted for on the books of the company but not included in the records of the owner is the
- A. unit-of-measure assumption.
 - B. continuity assumption.
 - C. historical cost principle.
 - D.** separate entity assumption.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 1

27. Liabilities are defined as

- A. possible debts or obligations of an entity as a result of future transactions which will be paid with assets or services.
- B. possible debts or obligations of an entity as a result of past transactions which will be paid with assets or services.
- C. probable debts or obligations of an entity as a result of future transactions which will be paid with assets or services.
- D.** probable debts or obligations of an entity as a result of past transactions which will be paid with assets or services.

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 1

28. Stockholders' equity is

- A. probable debts or obligations of an entity as a result of past transactions which will be paid with assets or services.
- B.** assets minus liabilities.
- C. probable future economic benefits owned by an entity as a result of past transactions.
- D. the financing provided by the creditors of a business.

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 1

29. Chad Jones is the sole owner and manager of Jones Glass Repair Shop. In 2009, Jones purchases a truck for \$30,000 to be used in the business. Which of the following fundamentals requires Jones to record the truck at the price paid to buy it?

- A. Separate-entity assumption.
- B. Revenue principle.
- C. Full disclosure.
- D.** Historical cost principle.

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 1

30. On a balance sheet, assets are listed in the order of
- A. dollar amount (largest first).
 - B. date of acquisition (earliest first).
 - C.** ease of conversion to cash.
 - D. importance to the operation of the business.

AACSB Tag: Communications
Difficulty: Medium
Learning Objective: 1

31. In what order would the assets of Mertz Company be listed on their balance sheet?
- A.** Cash, Accounts Receivable, Inventory, Plant and Equipment
 - B. Cash, Inventory, Accounts Receivable, Plant and Equipment
 - C. Cash, Accounts Receivable, Marketable Securities, Inventory
 - D. None of these are in correct order

AACSB Tag: Communications
Difficulty: Medium
Learning Objective: 1

32. We would report changes in stockholders' equity caused by operating activities
- A. in an asset account.
 - B. in a contributed capital account.
 - C. in a liability account.
 - D.** in the retained earnings account.

AACSB Tag: Communications
Difficulty: Medium
Learning Objective: 1

33. Which of the following events will cause retained earnings to increase?
- A. Dividends declared by the Board of Directors.
 - B.** Net income reported for the period.
 - C. Net loss reported for the period.
 - D. Issuance of stock in the business

AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 1

34. Which of the following transactions would cause retained earnings to increase?

- A. Collection of a customer's account.
- B. Loan from a bank.
- C.** Sale of service to a customer.
- D. Wage costs owed to employees.

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 1

35. The primary objective of financial accounting is to

- A. provide information about a business to internal parties.
- B. provide information about a business' future business strategies.
- C.** provide useful economic information about a business to help external parties make sound financial decisions.
- D. provide predictions of future stock price.

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 1

36. Which of the following would not be considered a current liability?

- A. Accounts Payable
- B.** Prepaid Expenses
- C. Taxes Payable
- D. Utilities Payable

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 1

37. Which of the following would not be considered a current asset?

- A. Inventories
- B. Prepaid Expenses
- C. Land**
- D. Accounts Receivable

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 1

38. "Accounts Payable" refers to

- A. an amount owed to a business.
- B. an amount a business owes to a third party.**
- C. the bottom line on the income statement.
- D. the total cash paid by a business during the year.

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 2

39. Which of the following is not a liability?

- A. Accounts payable.
- B. Retained earnings.**
- C. Notes payable.
- D. Unearned Revenue.

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 2

40. Which of the following liability accounts is usually not satisfied by payment of cash?

- A. Accounts payable
- B. Unearned revenues**
- C. Taxes payable
- D. All of these are satisfied by paying cash

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 2

41. An example of an external exchange would be
- A. the purchase of inventory on credit from a supplier.
 - B. cash received from a credit customer.
 - C. cash paid for wages to employees.
 - D.** all answers show external exchanges.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 2

42. Michael Corporation received \$200,000 cash invested by its owners. The effect on the accounting equation was
- A. assets and liabilities each increased by \$200,000.
 - B. assets and revenues each increased by \$200,000.
 - C. stockholders' equity and revenues each increased by \$200,000.
 - D.** stockholders' equity and assets each increased by \$200,000.

AACSB Tag: Analytic
Difficulty: Medium
Learning Objective: 3

43. WindNet Corporation purchased factory equipment for \$38,000 cash. Which of the following statements regarding this purchase is incorrect?
- A.** The net income for Mika will be reduced by the \$38,000 expense of the factory equipment.
 - B. The total amount of assets on Mika's balance sheet will not change.
 - C. The total liabilities will not change.
 - D. The amount of the stockholders' equity on Mika's balance sheet will not change.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 3

44. Which of the following direct effects on the accounting equation is not possible as a result of transaction analysis?

- A.** Increase a liability and decrease an asset.
- B. Increase stockholders' equity and increase an asset.
- C. Increase an asset and decrease an asset.
- D. Decrease stockholders' equity and decrease an asset.

AACSB Tag: Reflective Thinking
Difficulty: Hard
Learning Objective: 3

45. Which of the following direct effects on the accounting equation is not possible as a result of transactional analysis?

- A. An increase in an asset and a decrease in another asset.
- B.** A decrease in a liability and an increase in an asset.
- C. A decrease in stockholders' equity and a decrease in an asset.
- D. An increase in an asset and an increase in stockholders' equity.

AACSB Tag: Reflective Thinking
Difficulty: Hard
Learning Objective: 3

46. Assume a company's January 1, 2009, financial position was: Assets, \$150,000 and Liabilities, \$60,000. During January 2009, the company completed the following transactions: (A) paid on a note payable \$10,000 (no interest was paid); (B) collected an accounts receivable, \$9,000; (C) paid an accounts payable, \$5,000; and (D) purchased a truck, \$5,000 cash, and a \$20,000 note payable from a bank. The company's January 31, 2009 financial position is

	Assets	Liabilities	Stockholders' Equity
A.	\$150,000	\$60,000	\$90,000
B.	\$155,000	\$65,000	\$90,000
C.	\$160,000	\$75,000	\$85,000
D.	\$170,000	\$100,000	\$70,000

AACSB Tag: Analytic
Difficulty: Hard
Learning Objective: 3

47. The purchase of equipment with a note payable would
- A. increase cash.
 - B. decrease cash.
 - C.** increase a liability.
 - D. decrease a liability.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 3

48. The purchase of supplies for cash would
- A.** not change total assets.
 - B. increase total assets.
 - C. increase liabilities.
 - D. decrease liabilities.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 3

49. Payment of a liability would
- A. decrease stockholders' equity.
 - B.** decrease assets.
 - C. not affect assets.
 - D. increase stockholders' equity.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 3

50. The collection of an account receivable from a customer would
- A. increase liabilities.
 - B. decrease liabilities.
 - C.** not affect liabilities.
 - D. decrease stockholders' equity.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 3

51. The Mariah Company has an \$80,000 debit in its assets, a \$36,000 credit in its liabilities, and a \$12,000 credit in retained earnings. What is the balance in the contributed capital account?

- A. \$44,000 credit.
- B.** \$32,000 credit.
- C. \$48,000 credit
- D. \$44,000 debit.

AACSB Tag: Analytic
Difficulty: Medium
Learning Objective: 3

52. The duality (or duality of effects) concept states

- A. there is more than one way of looking at any situation.
- B. every transaction has good and bad ramifications.
- C. there are two entities involved in every transaction.
- D.** every transaction has at least two effects on the accounting equation.

AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 3

53. Which of the following will not result in recording a transaction?

- A.** Signing a contract to have an outside cleaning service clean offices nightly.
- B. Paying employees their wages.
- C. Selling stock to investors.
- D. Buying equipment and agreeing to pay a note payable and interest at the end of a year.

AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 3

54. Which of the following transactions will cause both the left and right side of the accounting equation to decrease?

- A. We collect cash from a customer who owed us money.
- B.** We pay a supplier for inventory we previously bought on account.
- C. We borrow money from the bank.
- D. We purchase equipment for cash.

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 3

55. When a company buys equipment for \$150,000 and pays for one third in cash and the other two thirds is financed by a note payable, the following are the effects on the accounting equation:

- A.** cash decreases by \$50,000.
- B. equipment increases by \$100,000.
- C. liabilities increase by \$150,000.
- D. total assets increase by \$200,000.

AACSB Tag: Analytic

Difficulty: Medium

Learning Objective: 3

56. The effect on total assets of the purchase of land for cash is

- A. an increase in total assets.
- B. a decrease in total assets.
- C.** total assets remain unchanged.
- D. an increase in total assets and total liabilities.

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 3

57. Which of the following is not one of the three steps in the transaction analysis process?

- A. Identify the accounts affected and classify them by type of account.
- B. Determine the direction of the effect on each account.
- C.** Transfer the effects of the transaction to the balance sheet.
- D. Verify that the accounting equation remains in balance.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 3

58. Sale of stock to investors for \$300,000 cash would

- A.** increase cash by a debit and increase contributed capital by a credit.
- B. increase cash by a credit and increase contributed capital by a debit.
- C. increase retained earnings by a debit and increase cash by a credit.
- D. increase cash by a debit and increase retained earnings by a credit.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 3

59. Borrowing \$100,000 of cash from First National Bank would

- A. increase cash by a credit and increase notes payable by a debit.
- B. increase notes payable by a debit and increase cash by a debit.
- C.** increase notes payable by a credit and increase cash by a debit.
- D. decrease cash by a debit and decrease notes payable by a credit.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 3

60. Water Corporation was organized on October 1, 2009. Water Corporation issued shares of capital stock to each of the five owners who paid in a total of \$250,000. On the basis of transactional analysis, the following entry should be recorded.

- A. A debit (increase) to cash for \$250,000 and a credit (increase) to revenue for \$250,000.
- B. A credit (decrease) to cash for \$250,000 and a debit (increase) to retained earnings for \$250,000.
- C. A credit (decrease) to cash for \$250,000 and a debit (decrease) to contributed capital for \$250,000.
- D.** A debit (increase) to cash for \$250,000 and a credit (increase) to contributed capital for \$250,000.

*AACSB Tag: Analytic
Difficulty: Medium
Learning Objective: 4*

61. Cadet Company paid an accounts payable of \$1,000. This transaction should be recorded as follows on the payment date.

	1,000	
<u>A.</u> Cash		1,000
Cash	1,000	
B. Accounts Payable		1,000
Notes Payable	1,000	
C. Cash		1,000
Cash	1,000	
D. Cost of Goods Sold		1,000

*AACSB Tag: Analytic
Difficulty: Easy
Learning Objective: 4*

62. The word credit means

- A. an increase to an account.
- B. a decrease to an account.
- C.** an entry to the right side of an account.
- D. an entry to the left side of an account.

*AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 4*

63. Which of the following is true?

- A. Assets increase on their right side because they are on the right side of the accounting equation.
- B.** Liabilities increase on their right side because they are on the right side of the accounting equation.
- C. Stockholders' equity accounts increase on their left side because they are on the left side of the accounting equation.
- D. The accounting equation only has to be in balance whenever financial statements are being prepared.

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 4

64. The accounts payable account has a beginning balance of \$12,000 and we purchased \$50,000 of inventory on credit during the month. The ending balance was \$10,000. How much did we pay our creditors during the month?

- A. \$50,000
- B.** \$52,000
- C. \$60,000
- D. \$62,000

AACSB Tag: Analytic

Difficulty: Medium

Learning Objective: 4

65. Which of the following statements concerning the debit-credit feature of the accounting equation is correct?

- A. Debits are entered on the right and credits are entered on the left.
- B.** A debit entry will decrease a liability account and increase an asset account.
- C. Stock sold to investors increases stockholders' equity and is recorded as a debit.
- D. A liability account should be credited upon payment of an account payable.

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 4

66. The financial leverage ratio is computed by taking
- A. total assets divided by total liabilities.
 - B.** average total assets divided by average stockholders' equity.
 - C. average total assets divided by average total liabilities.
 - D. total assets divided by total stockholders' equity.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 5

67. The usefulness of the financial leverage ratio is that it allows interested parties to assess
- A. how the company finances its assets.
 - B. the relative risk assumed by the company caused by the use of debt financing.
 - C. whether the company should expand its use of debt to finance assets.
 - D.** All of these are uses of the ratio.

AACSB Tag: Reflective Thinking
Difficulty: Hard
Learning Objective: 5

68. When a company has a financial leverage ratio close to 1 to 1,
- A. the company is primarily using debt financing for acquisition of its assets.
 - B. the creditors of the company would be very unlikely to give a loan to the company since debt is high.
 - C.** the return to stockholders is lower than it would be if the ratio was higher.
 - D. actual earnings are equal to the estimated earnings.

AACSB Tag: Reflective Thinking
Difficulty: Hard
Learning Objective: 5

69. The financial leverage ratio for a company was 2.54 in 2003 while its competitor's ratio was 1.26 for the same year. The higher ratio for the first company indicates
- A. it uses less debt than equity financing to acquire its assets.
 - B.** the competitor finances more of its assets using equity rather than debt.
 - C. the first company has a lower level of financial risk than its competitor.
 - D. None of these statements are true.

AACSB Tag: Analytic
Difficulty: Hard
Learning Objective: 5

70. Which of the following transactions would cause cash inflow from a financing activity for Boeing Corporation?
- A.** Sold shares of stock in Boeing Corp.
 - B. Sold shares of Mobil Corporation stock.
 - C. Sold used equipment, which had been used in the production of aircraft.
 - D. Both A and C create financing cash inflow.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 6

71. An example of an investing transaction would be
- A.** purchasing equipment for cash.
 - B. buying inventory from a supplier on credit.
 - C. selling stock to investors for cash.
 - D. All of these are investing transactions.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 6

72. An example of an operating activity would be

- A. purchasing equipment for cash.
- B.** buying inventory from a supplier on credit.
- C. selling stock to investors for cash.
- D. repaying the principle on a bank loan.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 6

73. Financing activities

- A.** primarily deal with securing money by bank loans or selling stock to investors.
- B. primarily are connected to the income producing activities of the company as reported on the income statement.
- C. primarily deal with buying and building facilities used over many years by the business.
- D. primarily deal with selling facilities once used by the business.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 6

74. Burger Palace Corporation reports a net cash used for investing activities of \$3.4 million and a net cash provided by financing activities of \$1.6 million. If cash increased by \$1.1 million during the year, what was the net cash flow provided from operating activities?

- A. \$0.7 million
- B.** \$2.9 million
- C. \$3.9 million
- D. \$6.1 million

AACSB Tag: Analytic
Difficulty: Hard
Learning Objective: 6

75. Which of the following would cause a cash outflow connected to investing activities?

- A.** Purchased shares of stock in another company.
- B. Paid a dividend to our stockholders.
- C. Issued more shares of our company's stock.
- D. Cash sales of our company's products.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 6

76. When a new business is just starting up, it must first

- A. generate positive cash flow through successful operations.
- B. acquire the assets both long-lived and short-lived so they can operate.
- C.** acquire financing from issuance of stock and borrowing from creditors.
- D. These activities all occur simultaneously and not sequentially.

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 6

Essay Questions

77. Why is the continuity assumption so important for balance sheet reporting?

The continuity assumption is also known as the going-concern assumption. It is important for balance sheet reporting because of valuation issues. If a business is expected to operate into the foreseeable future, amounts presented on the balance sheet for assets and liabilities are based on the historical cost principle. If the continuity assumption is not followed, assets and liabilities might be reported at liquidation values as if they are going out of business

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 1

78. Why is the separate-entity assumption so important for balance sheet reporting?

The separate-entity assumption is important for balance sheet reporting because a business should present only its own assets and liabilities on the balance sheet. A business is a separate accounting entity from its owners. Therefore, the owners' assets and liabilities would appear on their own (personal) financial statement.

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 1

79. Why is the historical cost principle so important for balance sheet reporting?

The historical cost principle is important for balance sheet reporting because of valuation issues. The cash-equivalent cost is verifiable. If it were not for the historical cost principle, assets and liabilities could be reported at more subjective values. This could lead to manipulation of balance sheet amounts.

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 1

80. (A) Complete the following schedule for Red Eye Company.

Transaction	Assets	Liabilities	Stockholders' Equity
Beginning financial position	\$200,000	\$80,000	\$120,000
Borrowed \$20,000 cash using a note payable, face amount \$20,000.			
Collected accounts receivable for cash, \$7,000.			
Paid accounts payable, \$8,000 cash.			
Purchased office supplies on credit, \$2,000.			
Sold stock to new investors for \$20,000 of cash.			
Paid \$12,000 income taxes payable.			
Ending financial position.			

(B) How much did cash change during the period?

(A)

Transaction	Assets	Liabilities	Stockholders' Equity
Beginning financial position	\$200,000	\$80,000	\$120,000
Borrowed \$20,000 cash using a note payable, face amount \$20,000.	+20,000	+20,000	
Collected accounts receivable for cash, \$7,000.	+7,000 -7,000		
Paid accounts payable, \$8,000 cash.	-8,000	-8,000	
Purchased office supplies on credit, \$2,000.	+2,000	+2,000	
Sold stock to new investors for \$20,000 of cash.	+20,000		+20,000
Paid \$12,000 income taxes payable.	-12,000	-12,000	
Ending financial position.	222,000	\$82,000	\$140,000

(B) Cash increase, \$27,000 (+20,000 + 7,000 – 8,000 + 20,000 – 12,000)

AACSB Tag: Analytic
 Difficulty: Hard
 Learning Objective: 3

81. For each of the following accounts, indicate whether the account is an asset (A), liability (L), or stockholders' equity (SE) and whether the account usually has a debit (Dr) or credit (Cr) balance.

Retained Earnings

Inventory

Contributed Capital

Accounts payable

Accounts receivable

Property and equipment

Wages payable

Prepaid expenses

1. SE, Cr

2. A, Dr

3. SE, Cr

4. L, Cr

5. A, Dr

6. A, Dr

7. L, Cr

8. A, Dr

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 4

82. For each financial statement element listed, indicate whether a debit or a credit is used to increase the account's balance.

Assets

Liabilities

Contributed Capital

Retained Earnings

1. Assets, Debit

2. Liabilities, Credit

3. Contributed Capital, Credit

4. Retained Earnings, Credit

AACSB Tag: Reflective Thinking

Difficulty: Easy

Learning Objective: 4

83. For each of the accounts listed below, indicate whether the typical or normal balance is a debit or credit.

- A. Inventory
- B. Notes payable
- C. Retained earnings
- D. Equipment
- E. Prepaid insurance
- F. Accounts receivable
- G. Land
- H. Contributed capital
- I. Accounts payable
- J. Unearned revenue

- A. Inventory, Debit
- B. Notes payable, Credit
- C. Retained earnings, Credit
- D. Equipment, Debit
- E. Prepaid insurance, Debit
- F. Accounts receivable, Debit
- G. Land, Debit
- H. Contributed capital, Credit
- I. Accounts payable, Credit
- J. Unearned revenue, Credit

AACSB Tag: Reflective Thinking
Difficulty: Medium
Learning Objective: 4

84. Al, Bill and Chad organized the ABC Corporation on January 1, 2009. Each of these owners invested \$100,000 cash and received shares of stock. Below are selected transactions that were completed during January.

(A.) Give the entry on ABC's books for each transaction:

Sold stock to the owners.

Borrowed \$80,000 on one-year note payable.

Purchased land by signing a \$70,000 note payable.

Paid \$10,000 of accounts payable.

Purchased two service vehicles, \$24,000 each; paid cash.

Purchased \$2,000 of supplies on credit.

(B.) Calculate total assets, total liabilities and total stockholders' equity based only on the 6 transactions above:

Chapter 02 - Investing and Financing Decisions and the Balance Sheet

(A.)			
1.	Cash (\$100,000 x 3) (A)	300,000	
	Contributed capital (SE)		300,000
	Investment by owners		
2.	Cash (A)	80,000	
	Note payable (L)		80,000
	Borrowed \$80,000 on a one-year note.		
3.	Land (A)	70,000	
	Note payable (L)		70,000
	Purchased land by signing a \$70,000 note payable.		
4.	Accounts payable (L)	10,000	
	Cash (A)		10,000
	Paid \$10,000 of accounts payable.		
5.	Equipment (A)	48,000	
	Cash (A)		48,000
	Purchased two service vehicles, \$24,000 each (paid cash)		
6.	Supplies (A)	2,000	
	Accounts Payable (L)		2,000
	Purchased \$2,000 of supplies on credit.		

(B.)		
Assets		\$442,000
Liabilities		142,000
Stockholders' equity		300,000

AACSB Tag: Analytic
 Difficulty: Medium
 Learning Objective: 4

85. The accounts with identification letters for PlayWorld, Inc. are listed below.

Letter	Account Title
A	Cash
B	Accounts Receivable
C	Office supplies
D	Equipment
E	Land
F	Accounts Payable
G	Notes Payable
H	Contributed Capital
I	Retained Earnings

During 2010, the company completed the transactions given below. You are to indicate the appropriate journal entry for each transaction by giving the account letter and amount. Some entries may need three letters. The first transaction is given as an example.

Transaction		Debit		Credit	
		Letter	Amount	Letter	Amount
A.	Borrowed \$50,000 and signed a note.	A	\$50,000	G	\$50,000
B.	Purchased equipment for \$50,000. Paid \$10,000 cash, signed \$40,000 note payable.				
C.	Collected \$15,000 accounts receivable.				
D.	Paid \$12,000 of accounts payable.				
E.	Issued capital stock in exchange for \$60,000 cash.				
F.	Purchased \$5,000 office supplies (an asset) on credit.				
G.	Paid for the office supplies in (F).				

Transaction		Debit		Credit	
		Letter	Amount	Letter	Amount
A.	Borrowed \$50,000 and signed a note.	A	\$50,000	G	\$50,000
B.	Purchased equipment for \$50,000. Paid \$10,000 cash, signed \$40,000 note payable.	D	50,000	A G	10,000 40,000
C.	Collected \$15,000 accounts receivable.	A	15,000	B	15,000
D.	Paid \$12,000 of accounts payable.	F	12,000	A	12,000
E.	Issued capital stock in exchange for \$60,000 cash.	A	60,000	H	60,000
F.	Purchased \$5,000 office supplies (an asset) on credit.	C	5,000	F	5,000
G.	Paid for the office supplies in (F).	F	5,000	A	5,000

*AACSB Tag: Analytic
Difficulty: Medium
Learning Objective: 4*

86. In what two places do amounts for transactions appear in the accounting system or "the books"? Describe them.

Transactions are first recorded in the journal. This is known as the book of original entry. Transactions are entered chronologically in a debit-credit format. After transactions are journalized, the amounts are posted to the ledger (the book of final entry). The ledger contains accounts for each financial statement element so that balances can be determined.

*AACSB Tag: Reflective Thinking
Difficulty: Easy
Learning Objective: 4*

87. On January 1, 2009, Dr. Beth Hill started a new professional corporation, Beth Hill, P.C., to practice medicine with an initial investment of \$100,000. On June 30, 2009, the accounting records showed the following amounts:

Accounts Payable	\$2,000
Accounts Receivable	6,200
Cash	48,100
Contributed Capital	100,000
Office Equipment	60,000
Office Supplies	3,500
Retained Earnings	5,800
Notes Payable	10,000

Prepare a balance sheet at June 30, 2009.

Beth Hill, P.C.
Balance Sheet
As of June 30, 2009

Assets:

Cash		\$ 48,100
Accounts receivable		6,200
Office supplies		3,500
Office equipment		<u>60,000</u>
Total assets		<u>\$117,800</u>

Liabilities:

Accounts payable	\$ 2,000	
Notes payable	<u>10,000</u>	
Total liabilities		\$ 12,000
Stockholders' equity		
Contributed capital	\$100,000	
Retained earnings	<u>5,800</u>	
Total Stockholders' equity		<u>\$105,800</u>
Total Liabilities and Stockholders' equity		<u>\$117,800</u>

AACSB Tag: Analytic
Difficulty: Medium
Learning Objective: 5

88. For each of the transactions listed below, indicate whether it is an investing (I) or financing (F) activity on the statement of cash flows. Also, indicate if the transaction increases (+) or decreases (-) cash.

	Transaction	Type of Activity	Effect on Cash
Ex.	Paid dividends to the owners	F	-
A.	Purchased equipment to use in the business.		
B.	Issued stock for cash.		
C.	Borrowed money at the bank.		
D.	Sold a piece of land adjacent to the plant.		
E.	Paid the principal balance of a note payable.		

	Transaction	Type of Activity	Effect on Cash
A.	Purchased equipment to use in the business.	I	-
B.	Issued stock for cash.	F	+
C.	Borrowed money at the bank.	F	+
D.	Sold a piece of land adjacent to the plant.	I	+
E.	Paid the principal balance of a note payable.	F	-

*AACSB Tag: Analytic
Difficulty: Medium
Learning Objective: 6*

89. Match the terminology with the description.

Decreases assets and increases owners' equity::Credits

An exchange between an entity and another party::Transaction

Normal balances for assets::Debits

Accounting assumption that requires assets to be recorded at their cash equivalent cost::Historical cost principle

Cumulative earnings that have not been distributed to the owners::Retained earnings

A debt owed by the entity::Liability

Statement of financial position::Balance Sheet

Account for a business separate from its owners::Separate-entity assumption

Dating of the income statement::For the period ended December 31, 2011

Dating of the balance sheet::December 31, 2011

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 1

90. For each of the following events, which ones result in an exchange transaction for the O'Brien Company (Y for Yes and N for No)?

Purchased land for cash and a note payable::Yes

Agreed to purchase one million inventory parts from a new supplier::No

Paid the utilities for the month::Yes

One of our stockholders sells her shares to a new investor::No

Received inventory from a supplier under the new contract::Yes

Entered into a contract with a new cleaning service:: No

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 2

91. The Alex Company, a consulting firm, recorded the following business transactions during May, 2009. Indicate whether each transaction would increase, decrease, or have no effect on the total assets of the company.

Issued capital stock in exchange for cash contributed by owners::Increase

Purchased office supplies for cash::No effect

Purchased office supplies on credit::Increase

Paid cash on accounts payable to a supplier::Decrease

Collected cash on accounts receivable::No effect

Borrowed money from the bank on a promissory note payable::Increase

Loaned money to a trusted employee::No effect

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 3

92. Classify the following balance sheet accounts for CleanRight Service. Use the following code: CA = current assets, NCA = noncurrent assets, CL = current liabilities, NCL = noncurrent liabilities and SE = stockholders' equity

Building::Noncurrent asset

Retained Earnings::Stockholders' Equity

Notes Payable due in 3 months::Current liability

Land::Noncurrent asset

Prepaid Expenses::Current asset

Supplies::Current asset

Contributed Capital::Stockholder's Equity

Notes Payable due in 5 years::Noncurrent liability

Income Taxes Payable::Current liability

AACSB Tag: Reflective Thinking

Difficulty: Medium

Learning Objective: 1