

Testbank

to accompany

Accounting 8th Edition

by

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Chapter 2: Financial statements for decision making

Multiple Choice

1. The statement of changes in equity
 - a. Indicates the ability of the entity to generate cash flow
 - b. Shows the selling price of the entity's assets
 - c. Shows how profit was determined
 - d. Serves as a connecting link between the income statement and the balance sheet.

ANSWER D

Section 2.1

2. A balance sheet:
 - a. Is classified into operating, investing and financing activities
 - b. Must always be prepared in the account or 'T' format
 - c. Shows how profit was determined
 - d. Lists assets, liabilities and equity at a specific point in time

ANSWER D

Section 2.1

3. Assume you are examining a financial statement headed 'As at the 31 December 2011'. The heading indicates the statement is the:
 - a. Balance sheet
 - b. Income statement
 - c. Statement of changes in equity
 - d. Cash flow statement

ANSWER A

Section 2.1

4. The statement concerning the income statement that is not true is:
 - a. The heading must indicate the length of time the report covers
 - b. It shows the change in the entity's cash balance for the period
 - c. If expenses exceed income then a loss has been incurred for the period
 - d. An alternative name is the statement of financial performance

ANSWER B

Section 2.1

5. The statement concerning equity that is true is:
 - a. It is the owner's claim to the assets of the entity after deducting liabilities
 - b. It is fixed at the amount initially contributed when the business was established
 - c. It is decreased by profit
 - d. $\text{Assets} + \text{liabilities} = \text{equity}$

ANSWER A

Section 2.1

6. The expression of the accounting equation that is correct is:
- a. Assets + Liabilities = Equity
 - b. Liabilities = Assets + Equity
 - c. Assets = Liabilities + Equity
 - d. Assets = Equity – Liabilities

ANSWER C

Section 2.1

7. If there are no drawings and no contributions of capital, a profit could be earned in any accounting period if and only if:
- a. Total assets exceed total liabilities
 - b. Total assets increase during the period
 - c. Total liabilities increase during the period
 - d. Net assets increase during the period

ANSWER D

Section 2.1

8. AK Distributors had these assets and liabilities: Equity is:

	\$
Cash in hand	4 000
Bank overdraft	11 000
Sundry creditors	3 000
Inventory	2 700
Sundry debtors	8 100
Office furniture	4 500
Loan from P & S Ltd	15 000
Motor vehicles	12 000
a.	\$2 300
b.	\$31 000
c.	\$5 300
d.	\$13 300

ANSWER A

Section 2.1

9. These balances were taken from the accounts of P Enterprises

	31 Dec 2010	31 Dec 2011
Assets	\$220 000	\$460 000
Liabilities	100 000	130 000

Assuming there were no drawings or contributions of capital, profit for 2011 must have been:

- a. \$240 000
- b. \$120 000
- c. \$330 000
- d. \$210 000

ANSWER D

Net assets at end less net assets at start.

Section 2.1

10. The assets of Quinn's business increased by \$40 000 and the liabilities increased by \$5000 during the current year. If the profit for this period was \$25 000, what additional contribution or withdrawal was made by the owner? (Assume only a withdrawal or a contribution was made).
- a. Drawings \$10 000
 - b. Contribution \$10 000
 - c. Contribution \$5000
 - d. Drawings \$5000

ANSWER B

Section 2.1

11. Z Company reports the following balance sheet information for 2011:
- | | 1 January 2011 | 31 December 2011 |
|-------------|----------------|------------------|
| Assets | \$60 000 | \$70 000 |
| Liabilities | \$12 000 | \$14 000 |
- Assuming the capital contribution made by the owners during 2011 was \$3000 and withdrawals were \$12 000, profit for 2011 must have been:
- a. \$17 000
 - b. \$14 000
 - c. \$16 000
 - d. \$12,000

ANSWER A

Net assets at end less net assets at start less capital contribution plus drawings

Section 2.1

12. Which statement is not correct?
- a. Information in the cash flow statement is useful in assessing the ability of an entity to pay its debts as they fall due
 - b. A comparison of the cash flow statement and the income statement can indicate to what extent the profit is represented by cash inflows
 - c. The cash flow statement classifies cash flows into operating investing and financing groupings
 - d. Operating activities is concerned with activities involving the sales and purchases of fixed assets.

ANSWER D

Section 2.1

13. The statement concerning the cash flow statement that is correct is:
- a. It summarises the cash flows into and out of an entity
 - b. It provides the connecting link between the income statement and the balance sheet
 - c. An alternative name is the statement of changes in equity
 - d. It includes cash and non-cash items

ANSWER A

Section 2.1

14. Which assumption is the basis upon which the personal assets of the owner are excluded from the businesses balance sheet?
- a. Going concern
 - b. Accounting entity
 - c. Limited liability
 - d. Accrual basis

ANSWER B

Section 2.2

15. The assumption which requires transactions to be recognised in the accounting reports when they occur and not when the cash is received or paid is:
- a. Accrual basis
 - b. Accounting entity
 - c. Materiality
 - d. Accounting period

ANSWER A

Section 2.2

16. The assumption which assumes that the entity will not be liquidated in the near future is the:
- a. Accounting entity
 - b. Going concern
 - c. Economic substance
 - d. Accounting period

ANSWER B

Section 2.2

17. In order to prepare financial information for interested parties Chambers Company divides the economic activity of the firm into three-month segments and prepares financial statements at the end of each segment. Which accounting assumption is Chambers applying?
- a. Accounting period
 - b. Materiality
 - c. Accounting entity
 - d. Going concern

ANSWER A

Section 2.2

18. A business transaction creating an inflow of net assets resulting from the sale of goods or services is a(n):
- Expense transaction
 - Income transaction
 - Cash disbursement
 - Capital transaction

ANSWER B

Section 2.1

19. On 2 January 2011 Fife Corp sells goods to O'Brien who agrees to pay for them within 60 days. On the balance sheet for Fife Corp at 2 January 2011 the amount owing by O'Brien would be reported as the asset:
- Accounts payable
 - Accounts receivable
 - Advance payment by a customer
 - Cash at bank

ANSWER B

Section 2.1

20. Junction Plants had the following transactions during August. Which transaction represents an expense for August under the accrual basis of accounting?
- Purchased a computer for \$3000 cash
 - Paid \$3300 in settlement of a loan obtained three months earlier
 - Paid a service station \$500 for repair work performed on its delivery truck in June
 - Purchased \$30 of petrol on credit for the delivery truck. The account will be paid during September

ANSWER D

Section 2.1

21. Jane is an osteopath operating as a sole proprietor. In January she purchases for \$540 some new furniture for her waiting room. The purchase is made on credit. The effect of this transaction on the accounting equation is:
- Increase in the asset furniture \$540 increase in the liability accounts payable \$540
 - Increase in the asset furniture \$540 decrease in the asset accounts receivable \$540
 - Increase in the asset furniture \$540 increase in equity \$540
 - Increase in the asset furniture \$540 increase in the asset accounts receivable \$540

ANSWER A

Section 2.1

22. Jane is an osteopath operating as a sole proprietor. On 1 February she pays \$800 rent in cash on her business premises for the month. The effect of this transaction on the accounting equation is:
- a. Decrease in cash at bank \$800 decrease in liability accounts payable \$800
 - b. Decrease in cash at bank \$800 increase in liability accounts payable \$800
 - c. Decrease in cash at bank \$800 increase in equity \$800
 - d. Decrease in cash at bank \$800 decrease in equity \$800

ANSWER D

Section 2.1

23. Which of these is not an alternative term for equity?
- a. Proprietorship
 - b. Shareholder's funds
 - c. Bank account balance
 - d. Capital

ANSWER C

Section 2.1

24. The true statement is:
- a. The profit of an entity is always represented by an increase in cash of the same amount.
 - b. A withdrawal of cash for private use by the owner is shown in the income statement as an expense.
 - c. Equity can be thought of as the owner's claim to the assets of the entity after deducting all liabilities.
 - d. Profit can be calculated as; Net assets at the end of the year less net assets at the beginning of the year less drawings.

ANSWER C

Section 2.1

25. From the point of view of an entity, a person or business entity to whom a debt is owed is known as a:
- a. debtor
 - b. creditor
 - c. debitor
 - d. bank

ANSWER B

Section 2.1

26. For accounting purposes the life of an entity is divided into arbitrary time intervals of equal length, which are called:
- a. years
 - b. months
 - c. accounting periods
 - d. accounting entities

ANSWER C

Section 2.2

27. Accountants divide the life of the business into arbitrary time periods of equal length:
- In order to prepare a balance sheet
 - In order to calculate comparable profit results
 - In order to prepare an income statement
 - Because of the accounting entity assumption

ANSWER B

Section 2.2

28. Which of these effects of a single transaction on the accounting equation is not possible?
- Increase in assets at the same time as an equal increase in equity
 - Decrease in assets at the same time as an equal decrease in liabilities
 - Increase in liabilities at the same time as an equal decrease in liabilities
 - Decrease in liabilities and at the same time an equal decrease in equity

ANSWER D

Section 2.3

29. The _____ concept is useful in ensuring that users of financial reports are not overwhelmed with too much detail.
- Materiality
 - Going concern
 - Relevance
 - Understandability

ANSWER A

Section 2.2

30. Liz, after qualifying at university and having several years experience decides to set up her own dental practice. . On 1 March she deposits \$25,000 into a bank account she has opened for the practice. The effect of this transaction on the accounting equation is:
- Increase in assets of \$ 25 000; increase in equity of \$ 25 000.
 - Increase in assets of \$25 000; decrease in equity of \$25 000.
 - Increase in assets of \$25 000; increase in liabilities of \$25 000.
 - Decrease in assets of \$25 000; increase in equity of \$25 000.

ANSWER A

Section 2.3

31. The income statement reports:
- the financial position of an entity at a specific period of time
 - the financial performance of an entity over a specified period of time
 - the financial position of an entity over a specified period of time
 - the financial performance of an entity at a specific period of time

ANSWER B

Section 2.1

32. The system where every transaction affects at least two components of the accounting equation is known as:
- historical cost accounting
 - the going concern system
 - the accounting entity system
 - double-entry accounting

ANSWER D

Section 2.2

33. Jane is an osteopath operating as a sole proprietor. On 1 February she treats a patient who pays her \$120 in cash. The effect of this transaction on the accounting equation is:
- Increase in cash at bank \$120, decrease in liability accounts payable \$120
 - Increase in cash at bank \$120, increase in liability accounts payable \$120
 - Increase in cash at bank \$120, increase in asset accounts receivable \$120
 - Increase in cash at bank \$120, increase in equity \$120

ANSWER D

Section 2.3

34. Jane is an osteopath operating as a sole proprietor. On 1 February she treats a patient on credit who she invoices for \$120. The effect of this transaction on the accounting equation is:
- Increase in cash at bank \$120, decrease in liability accounts payable \$120
 - Increase in equity \$120, increase in liability accounts payable \$120
 - Increase in asset accounts receivable \$120, increase in equity \$120
 - Increase in cash at bank \$120, increase in equity \$120

ANSWER C

Section 2.3

35. Jane is an osteopath operating as a sole proprietor. On 1 February she treats a patient on credit whom she invoices for \$120. On 10th of February the patient pays his account and Jane banks the \$120. The effect of the receipt of cash transaction on the accounting equation for Jane's practice is:
- Increase in cash at bank \$120, decrease in asset accounts receivable \$120
 - Increase in cash at bank \$120, increase in equity \$120
 - Increase in cash at bank \$120, increase in asset accounts receivable \$120
 - Increase in cash at bank \$120, decrease in accounts payable \$120

ANSWER A

Section 2.3

Fill in the blank

1. The statement of cash flows reports separately on operating, _____ and financing cash flows.

ANSWER investing
Section 2.1

2. The sum of the assets of an entity is always equal to the sum of its _____ plus equity.

ANSWER liabilities
Section 2.1

3. A _____ statement is an additional accounting report that complements the information in the income statement, balance sheet and statement of changes in equity.

ANSWER cash flow
Section 2.1

4. The present obligations of an entity arising from past events the settlement of which is expected to result in an outflow of resources embodying economic benefits are known as _____

ANSWER Liabilities
Section 2.1

5. I _____ is an increase in equity normally resulting from the sale of goods or the performance of services.

ANSWER Income
Section 2.1

6. The _____ assumption assumes that an existing business will continue to operate in the future.

ANSWER going concern
Section 2.2

7. The quality of information which exists when information is able to influence economic decisions is known as r _____.

ANSWER relevance
Section 2.2

8. The purchase of a vehicle by a business for \$20 000 decreases the asset cash at bank and increases the _____ motor vehicles.

ANSWER asset
Section 2.1

9. Income less expenses = p_____.

ANSWER profit
Section 2.1

10. The qualitative characteristic that assures the user that the information in the financial reports represents faithfully without undue bias or error the underlying transactions and events of the entity is r_____.

ANSWER reliability
Section 2.2