

***Financial Accounting: A Business Process Approach, 3e (Reimers)***  
**Chapter 1 Business: What's It All About?**

Learning Objective 1-1

1.1-1) The ownership structure of a business includes the following forms \_\_\_\_\_.

- A) individual, group, and corporate
- B) sole proprietorship, partnership, and corporation
- C) service, manufacturing, and financial
- D) debtors, creditors, and owners

Answer: B

Diff: 1

Objective: LO 1-1

1.1-2) Which of the following is true about a sole proprietorship?

- A) A sole proprietorship is a company owned by two or more individuals.
- B) The owner's liability is limited to the amounts invested in the business.
- C) Income from a sole proprietorship is distributed to the owner in the form of a dividend.
- D) The income from a sole proprietorship is taxed on the owner's personal income tax return.

Answer: D

Diff: 2

Objective: LO 1-1

1.1-3) A partnership agreement \_\_\_\_\_.

- A) exempts partners from unlimited liability
- B) establishes the partnership as a separate legal entity
- C) details how much work partners will do and how they will split up the profits
- D) defines how many shares of stock the partnership may sell to investors

Answer: C

Diff: 3

Objective: LO 1-1

1.1-4) The two types of merchandising businesses include \_\_\_\_\_.

- A) wholesale and retail
- B) service and financial
- C) manufacturing and retail
- D) service and wholesale

Answer: A

Diff: 2

Objective: LO 1-1

1.1-5) The inputs of a firm include \_\_\_\_\_.

- A) revenues
- B) liabilities
- C) inventory and supplies
- D) All of these are correct.

Answer: C

Diff: 1

Objective: LO 1-1

1.1-6) A corporation \_\_\_\_\_.

- A) is a legal entity separate from the owners
- B) is a manufacturer and not a service organization
- C) may cause unlimited liability for its shareholders
- D) provides goods or services for the sole purpose of helping people

Answer: A

Diff: 1

Objective: LO 1-1

1.1-7) Corporations are \_\_\_\_\_.

- A) for-profit businesses only
- B) manufacturers and not service organizations
- C) owned by shareholders
- D) exempt from legal liability

Answer: C

Diff: 1

Objective: LO 1-1

1.1-8) Advantages of the corporate form of business organization include \_\_\_\_\_.

- A) double taxation
- B) limited liability for shareholders
- C) separation of ownership and management
- D) Two or more of these are correct.

Answer: B

Diff: 3

Objective: LO 1-1

1.1-9) Disadvantages of the corporate form of business organization include \_\_\_\_\_.

- A) double taxation
- B) limited liability for shareholders
- C) separation of ownership and management
- D) two or more of these

Answer: D

Diff: 3

Objective: LO 1-1

1.1-10) Which of the following is legally a separate entity from its owner(s)?

- A) sole proprietorship
- B) partnership
- C) corporation
- D) Two of these are correct.

Answer: C

Diff: 1

Objective: LO 1-1

1.1-11) The outputs of a firm are its \_\_\_\_\_.

- A) capital contributions
- B) services provided to customers
- C) delivery of products to customers
- D) Two or more of these are correct.

Answer: D

Diff: 1

Objective: LO 1-1

1.1-12) A service company \_\_\_\_\_.

- A) is a wholesale business
- B) manufactures goods
- C) is a retail business
- D) None of these are correct.

Answer: D

Diff: 1

Objective: LO 1-1

1.1-13) The four types of business are \_\_\_\_\_.

- A) service, wholesale, retail, and financial
- B) for profit, nonprofit, wholesale, and retail
- C) service, merchandising, manufacturing, and financial services
- D) financial, manufacturing, service, and wholesale

Answer: C

Diff: 3

Objective: LO 1-1

1.1-14) A manufacturing business \_\_\_\_\_.

- A) will lend money to customers
- B) buys goods for resale
- C) provides services to its customers
- D) makes the products it sells

Answer: D

Diff: 1

Objective: LO 1-1

- 1.1-15) Financial services companies \_\_\_\_\_.
- A) deal in services related to money
  - B) sell insurance to their customers
  - C) lend money to consumers to pay for cars and houses
  - D) All of these are correct.

Answer: D

Diff: 1

Objective: LO 1-1

- 1.1-16) A business in the form of a sole proprietorship \_\_\_\_\_.
- A) is separate and distinct from its owner
  - B) is a separate legal entity
  - C) files its own tax return
  - D) is a company with a single owner

Answer: D

Diff: 1

Objective: LO 1-1

- 1.1-17) A partnership \_\_\_\_\_.
- A) is a business owned by two or more individuals
  - B) has owners who are legally liable for everything the company does
  - C) may be organized under a partnership agreement
  - D) is all of these

Answer: D

Diff: 2

Objective: LO 1-1

- 1.1-18) The owners of a corporation are called \_\_\_\_\_.
- A) shareholders
  - B) partners
  - C) stockholders
  - D) two or more of these

Answer: D

Diff: 1

Objective: LO 1-1

- 1.1-19) Which of the following is true about a corporation?
- A) Corporations must have a minimum of two or more shareholders.
  - B) Each individual shareholder has individual legal responsibility for the corporation's actions.
  - C) Corporations are exempt from taxes; however, the shareholders are required to pay taxes on dividends received.
  - D) Managers of corporations can be held responsible for the actions of the corporation.

Answer: D

Diff: 3

Objective: LO 1-1

1.1-20) Stock sold for the first time is called \_\_\_\_\_.

- A) issued
- B) traded
- C) capital
- D) dividends

Answer: A

Diff: 2

Objective: LO 1-1

1.1-21) Stock may be purchased \_\_\_\_\_.

- A) on a stock exchange
- B) on the internet
- C) from a stockbroker
- D) from more than one of these

Answer: D

Diff: 2

Objective: LO 1-1

1.1-22) The stock market is \_\_\_\_\_.

- A) located in New York City
- B) the general term used to refer to all stock exchanges
- C) where the IRS is located
- D) where businesses become incorporated

Answer: B

Diff: 2

Objective: LO 1-1

1.1-23) The law firm of Doolittle and Baroque is an example of a \_\_\_\_\_ firm.

- A) service
- B) merchandising
- C) manufacturing
- D) financial services

Answer: A

Diff: 1

Objective: LO 1-1

1.1-24) The governmental agency that monitors the stock market and the financial reporting of firms that trade in the market is the \_\_\_\_\_.

- A) Financial Accounting Standards Board (FASB)
- B) Internal Revenue Service (IRS)
- C) Public Company Accounting Oversight Board (PCAOB)
- D) Securities and Exchange Commission (SEC)

Answer: D

Diff: 2

Objective: LO 1-1

1.1-25) A business form in which the partners are not personally liable for the malpractice of any of the other partners is called a \_\_\_\_\_.

- A) corporation
- B) limited liability partnership
- C) modified sole proprietorship
- D) partnership

Answer: B

Diff: 2

Objective: LO 1-1

1.1-26) Huntington Bank is an example of a \_\_\_\_\_ firm.

- A) service
- B) merchandising
- C) manufacturing
- D) financial services

Answer: D

Diff: 1

Objective: LO 1-1

1.1-27) Target is an example of a \_\_\_\_\_ firm.

- A) service
- B) merchandising
- C) manufacturing
- D) financial services

Answer: B

Diff: 1

Objective: LO 1-1

1.1-28) Toyota is an example of a \_\_\_\_\_ firm.

- A) service
- B) merchandising
- C) manufacturing
- D) financial services

Answer: C

Diff: 1

Objective: LO 1-1

1.1-29) Dell Inc.'s distribution of earnings to owners is called dividends. Dell must be a \_\_\_\_\_.

- A) sole proprietorship
- B) partnership
- C) corporation
- D) sole proprietorship or partnership

Answer: C

Diff: 2

Objective: LO 1-1

1.1-30) For which organization is there double taxation?

- A) sole proprietorship
- B) partnership
- C) corporation
- D) sole proprietorship, partnership and corporation

Answer: C

Diff: 1

Objective: LO 1-1

1.1-31) For which organization is ownership represented by shares of stock?

- A) sole proprietorship
- B) partnership
- C) corporation
- D) sole proprietorship and partnership

Answer: C

Diff: 1

Objective: LO 1-1

1.1-32) For which organization are the personal assets of the owners at risk?

- A) sole proprietorship
- B) partnership
- C) corporation
- D) sole proprietorship and partnership

Answer: D

Diff: 1

Objective: LO 1-1

1.1-33) For which organization are owners typically separate from managers and not involved in the day-to-day operations, sometimes resulting in managers making decisions that are not in the best interest of the owner(s)?

- A) sole proprietorship
- B) partnership
- C) corporation
- D) sole proprietorship and partnership

Answer: C

Diff: 2

Objective: LO 1-1

1.1-34) Ira Roth, CPA, is an example of a \_\_\_\_\_.

- A) sole proprietorship
- B) partnership
- C) corporation
- D) not-for-profit

Answer: A

Diff: 1

Objective: LO 1-1

1.1-35) Target is an example of a \_\_\_\_\_.

- A) sole proprietorship
- B) partnership
- C) corporation
- D) not-for-profit

Answer: C

Diff: 1

Objective: LO 1-1

1.1-36) Doolittle & Daley, attorneys at law, is an example of a \_\_\_\_\_.

- A) sole proprietorship
- B) partnership
- C) corporation
- D) not-for-profit

Answer: B

Diff: 1

Objective: LO 1-1

1.1-37) The United Way is an example of a \_\_\_\_\_.

- A) sole proprietorship
- B) partnership
- C) corporation
- D) not-for-profit

Answer: D

Diff: 1

Objective: LO 1-1

1.1-38) Which of these businesses pays federal income taxes on its income?

- A) corporation
- B) partnership
- C) sole proprietorship
- D) Two of these are correct.

Answer: A

Diff: 1

Objective: LO 1-1

1.1-39) Which type of business organization exposes its owner(s) to unlimited liability?

- A) corporation
- B) partnership
- C) sole proprietorship
- D) Two of these are correct.

Answer: D

Diff: 2

Objective: LO 1-1



1.1-40) Which type of business organization finds it easiest to raise large amounts of capital?

- A) corporation
- B) partnership
- C) sole proprietorship
- D) Two of these are correct.

Answer: A

Diff: 2

Objective: LO 1-1

1.1-41) When starting a business you should first \_\_\_\_\_.

- A) write a business plan
- B) borrow from creditors
- C) purchase inventory
- D) become incorporated

Answer: A

Diff: 2

Objective: LO 1-1

1.1-42) Double taxation occurs because businesses pay \_\_\_\_\_.

- A) sales tax and income tax
- B) property taxes and income taxes
- C) taxes on net income, and owners pay taxes on the remaining net income distributed as dividends
- D) social security taxes for employees, and employees also pay the same amount for themselves

Answer: C

Diff: 3

Objective: LO 1-1

1.1-43) Limited legal liability for owners is a characteristic of \_\_\_\_\_.

- A) sole proprietorships
- B) partnerships
- C) corporations
- D) not-for-profits

Answer: C

Diff: 1

Objective: LO 1-1

1.1-44) Which organization should keep its financial records separate from the personal financial affairs of the owner(s)?

- A) sole proprietorship
- B) partnership
- C) corporation
- D) All of these are correct.

Answer: D

Diff: 1

Objective: LO 1-1

1.1-45) In which of the following are the owners' or owner's personal assets at risk if the business does not have enough money to pay its liabilities?

- A) sole proprietorship
- B) partnership
- C) corporation
- D) Two of these are correct.

Answer: D

Diff: 1

Objective: LO 1-1

1.1-46) The stock exchange is \_\_\_\_\_.

- A) where companies may issue stock
- B) regulated by the Securities and Exchange Commission (SEC)
- C) where buyers and sellers exchange their shares of stock.
- D) All of these are correct.

Answer: D

Diff: 1

Objective: LO 1-1

1.1-47) In 2012, Baroque, Inc., a U. S. corporation, earned profits of \$200,000 before taxes. After paying federal income taxes of 30%, all of Baroque's after-tax income was paid to its only shareholder. The federal income tax rate on corporate dividends is 15%. How much tax will Baroque's shareholder pay on these dividends?

- A) \$21,000
- B) \$30,000
- C) \$60,000
- D) \$102,000

Answer: A

Diff: 3

Objective: LO 1-1

1.1-48) Use this financial statement to answer the following question:

Cash	\$ 3,000	Liabilities	\$ 2,500
Accounts receivable	2,000		
Inventory	<b>A</b>	Common stock	<b>B</b>
Supplies	<u>1,000</u>	Retained earnings	<u>500</u>
Total	\$10,000	Total	<b>C</b>

This business must be organized as a \_\_\_\_\_.

- A) sole proprietorship
- B) partnership
- C) corporation
- D) Two of these are possible.

Answer: C

Diff: 2

Objective: LO 1-1

1.1-49) Profit is the difference between assets and liabilities.

Answer: FALSE

Diff: 1

Objective: LO 1-1

1.1-50) All businesses are formed to create something of value from scratch.

Answer: FALSE

Diff: 1

Objective: LO 1-1

1.1-51) A business is formed to provide goods or services for the purpose of making a profit for its owner or owners.

Answer: TRUE

Diff: 1

Objective: LO 1-1

1.1-52) A sole proprietorship is a company with a single owner.

Answer: TRUE

Diff: 1

Objective: LO 1-1

1.1-53) A corporation must be owned by two or more people.

Answer: FALSE

Diff: 1

Objective: LO 1-1

1.1-54) Profit is the difference between sales and revenues.

Answer: FALSE

Diff: 1

Objective: LO 1-1

1.1-55) Profit is the difference between revenues and expenses.

Answer: TRUE

Diff: 1

Objective: LO 1-1

1.1-56) The Internal Revenue Service (IRS) is the governmental agency that monitors the stock market and the financial reporting of publicly held companies.

Answer: FALSE

Diff: 2

Objective: LO 1-1

1.1-57) The Securities and Exchange Commission (SEC) is the governmental agency that monitors the stock market and the financial reporting of publicly held companies.

Answer: TRUE

Diff: 2

Objective: LO 1-1

1.1-58) The main purpose of a not-for-profit business is to add value to a product or service in order to make a profit.

Answer: FALSE

Diff: 2

Objective: LO 1-1

1.1-59) Wal-Mart is an example of a merchandising corporation.

Answer: TRUE

Diff: 1

Objective: LO 1-1

1.1-60) Wal-Mart is an example of a service corporation.

Answer: FALSE

Diff: 1

Objective: LO 1-1

1.1-61) A sole proprietorship has more than one owner.

Answer: FALSE

Diff: 1

Objective: LO 1-1

1.1-62) Identify the three forms of business organization.

Answer: The three forms of business organization are sole proprietorship, partnership, and corporation.

Diff: 1

Skill: Communication abilities

Objective: LO 1-1

1.1-63) What is the purpose of a business?

Answer: Generally, a business is formed to provide goods or services to customers in order to earn a profit for the owners of the business.

Diff: 1

Skill: Communication abilities

Objective: LO 1-1

1.1-64) Match each of the following terms with the appropriate definition. Each term is to be used only once.

- a. Capital
- b. Securities and Exchange Commission (SEC)
- c. Stock
- d. For-profit company
- e. Dividends
- f. Not-for-profit organization
- g. Stock exchange

- \_\_\_\_\_ 1. Distribution of earnings to the owners of the corporation
- \_\_\_\_\_ 2. The financial resources to start a business
- \_\_\_\_\_ 3. Units of ownership in a corporation
- \_\_\_\_\_ 4. A market place where buyers and sellers of shares of stock exchange their shares
- \_\_\_\_\_ 5. Governmental agency that monitors the stock market and the financial reporting of the firms that trade in the market
- \_\_\_\_\_ 6. An organization that exists to provide goods and services to a target group at a reduced cost or no cost
- \_\_\_\_\_ 7. A company with the goal of maximizing the owners' wealth

Answer: e, a, c, g, b, f, d

Diff: 2

Objective: LO 1-1

1.1-65) Match each of the following terms with the appropriate definition. Each term is to be used only once.

- a. Partnership
- b. For-profit company
- c. Not-for-profit organization
- d. Sole proprietorship
- e. Corporation

- \_\_\_\_\_ 1. A company with a single owner
- \_\_\_\_\_ 2. The owners of this type of organization are taxed when distributions to shareholders are again taxed as individual income
- \_\_\_\_\_ 3. A company owned by two or more individuals
- \_\_\_\_\_ 4. An organization that exists to provide goods and services to a target group at a reduced cost or no cost
- \_\_\_\_\_ 5. A company with the goal of maximizing the owners' wealth

Answer: d, e, a, c, b

Diff: 2

Objective: LO 1-1

1.1-66) Match each of the following businesses with the appropriate type of business. Each type is used only once.

- a. Sole proprietorship
- b. Partnership
- c. Corporation

- \_\_\_\_\_ 1. Doolittle & Baroque Legal Services
- \_\_\_\_\_ 2. B. Rich's Grocery Store
- \_\_\_\_\_ 3. Sony, Inc.

Answer: b, a, c

Diff: 1

Objective: LO 1-1

1.1-67) Match each of the following firms with the one type of business it is considered to be. Each firm can be only one type of business.

- a. Service
- b. Merchandising
- c. Manufacturing
- d. Financial services

- \_\_\_\_\_ 1. Bug-a-boo Pest Control
- \_\_\_\_\_ 2. Toyota
- \_\_\_\_\_ 3. American Express
- \_\_\_\_\_ 4. Huntington Bank
- \_\_\_\_\_ 5. Abercrombie & Fitch
- \_\_\_\_\_ 6. Merry Maids

Answer: a, c, d, d, b, a

Diff: 2

Objective: LO 1-1

1.1-68) Match each of the following firms with the one type of business it is considered to be. Each firm can be only one type of business.

- a. Service
- b. Merchandising
- c. Manufacturing
- d. Financial services

- \_\_\_\_\_ 1. Patel Dry Cleaners
- \_\_\_\_\_ 2. American Express
- \_\_\_\_\_ 3. Honda
- \_\_\_\_\_ 4. Kmart
- \_\_\_\_\_ 5. Boeing

Answer: a, d, c, b, c

Diff: 2

Objective: LO 1-1

1.1-69) Indicate which form of organization is associated with each of the following by putting an "X" in the appropriate column. More than one form may apply to each.

	Characteristics:	Sole Proprietorship	Partnership	Corporation
1.	Owners are typically separate from managers and not involved in the day-to-day operations. Thus, managers may make decisions that are not in the best interest of the owner(s).			
2.	There is double taxation.			
3.	Ownership is represented by shares of stock.			
4.	The personal assets of the owners are at risk.			
5.	The company's distribution of earnings to owners is called dividends.			

Answer:

	Characteristics:	Sole Proprietorship	Partnership	Corporation
1.	Owners are typically separate from managers and not involved in the day-to-day operations. Thus, managers may make decisions that are not in the best interest of the owner(s).			X
2.	There is double taxation.			X
3.	Ownership is represented by shares of stock.			X
4.	The personal assets of the owners are at risk.	X	X	
5.	The company's distribution of earnings to owners is called dividends.			X

Diff: 2

Objective: LO 1-1

1.1-70) Indicate the form of organization with which each of the following characteristics is associated by putting an "X" in the appropriate column. More than one form of organization may apply to each.

	Characteristic:	Sole Proprietorship	Partnership	Corporation
1.	The ownership is represented by shares of common stock.			
2.	The business pays federal income taxes.			
3.	The business exposes the owner(s) to unlimited liability.			

Answer:

	Characteristic:	Sole Proprietorship	Partnership	Corporation
1.	The ownership is represented by shares of common stock.			X
2.	The business pays federal income taxes.			X
3.	The business exposes the owner(s) to unlimited liability.	X	X	

Diff: 2

Objective: LO 1-1



## Learning Objective 1-2

1.2-1) A person who starts his own business is considered \_\_\_\_\_.

- A) a manager
- B) an entrepreneur
- C) a shareholder
- D) a capitalist

Answer: B

Diff: 2

Objective: LO 1-2

1.2-2) The cost of borrowing money is called \_\_\_\_\_.

- A) a financing activity
- B) principal
- C) interest
- D) an investing activity

Answer: C

Diff: 2

Objective: LO 1-2

1.2-3) Team Shirts, Inc. pays \$5,000 cash for T-shirts from a supplier. This transaction \_\_\_\_\_.

- A) is a financing activity
- B) causes an increase in total assets
- C) is an operating activity
- D) is an investing activity

Answer: C

Diff: 2

Skill: Analytic skills

Objective: LO 1-2

1.2-4) Sara contributes \$5,000 of her own money to start her business, Team Shirts, Inc. From Team Shirts' perspective, it \_\_\_\_\_.

- A) gets cash and gives up stock
- B) gets stock and gives up cash
- C) gets ownership and gives up contributed capital
- D) is an operating activity

Answer: A

Diff: 3

Skill: Analytic skills

Objective: LO 1-2

1.2-5) Transactions can only occur between businesses.

Answer: FALSE

Diff: 3

Objective: LO 1-2

1.2-6) Businesses receive contributed capital when customers pay for goods or services.

Answer: FALSE

Diff: 2

Objective: LO 1-2

1.2-7) When a company repays a loan, both the principal and interest paid are financing activities.

Answer: FALSE

Diff: 3

Objective: LO 1-2

1.2-8) The balance sheet shows the revenues and expenses for the period.

Answer: FALSE

Diff: 3

Objective: LO 1-2

1.2-9) Morris Lest began his business, Graters, Inc. with \$10,000 of his savings. Graters borrowed \$5,000 from Baroque Bank. Graters bought \$3,000 worth of graters. The rent for the store is \$1,000 per month. The first month's sales were \$4,000 for inventory valued at \$2,500. All of the transactions were in cash. Identify the get/give transactions above, and determine if there is an increase or decrease in assets, liabilities, or shareholders' equity.

Get Ex. Cash	Give Ownership	Total Assets +10,000	Total Liabilities	Shareholders' Equity	
				Contributed capital +10,000	Retained earnings

Answer:

Get Ex. Cash	Give Ownership	Total Assets +10,000	Total Liabilities	Shareholders' Equity	
				Contributed capital +10,000	Retained earnings
Cash	IOU	+5,000	+5,000		
Inventory	Cash	+3,000 - 3,000			
Use of store	Cash	-1,000			-1,000
Cash	Inventory	+4,000 -2,500			+4,000 -2,500

Diff: 2

Skill: Analytic skills

Objective: LO 1-2

1.2-10) Identify and describe the three types of business activities.

Answer: The three types of business activities are called operating, investing, and financing. Operating activities are the day-to-day transactions involved in running a business. Investing activities involve the acquisition and disposal of assets used to run a business. Financing activities involve raising money from outside of a business and repaying it.

Diff: 2

Skill: Communication abilities

Objective: LO 1-2

1.2-11) Match each of the following transactions with the appropriate business activity.

- a. Operating activity
- b. Investing activity
- c. Financing activity

- \_\_\_\_\_ 1. Purchase of equipment.
- \_\_\_\_\_ 2. Sale of used equipment.
- \_\_\_\_\_ 3. Sale of T-shirts to a customer.
- \_\_\_\_\_ 4. Payment of advertising.
- \_\_\_\_\_ 5. Issuance of stock.
- \_\_\_\_\_ 6. Payment of dividends.

Answer: b, b, a, a, c, c

Diff: 2

Objective: LO 1-2

Learning Objective 1-3

1.3-1) Revenues include \_\_\_\_\_.

- A) the amount earned from providing goods to customers
- B) the amount received from borrowing
- C) the amount earned from providing services to customers
- D) two or more of these

Answer: D

Diff: 1

Objective: LO 1-3

1.3-2) Audited financial statements have been examined by \_\_\_\_\_.

- A) owners
- B) Certified Public Accountants (CPAs)
- C) Internal Revenue Service (IRS) agents
- D) Securities and Exchange Commission (SEC) examiners

Answer: B

Diff: 3

Objective: LO 1-3

1.3-3) The stock exchange is \_\_\_\_\_.

- A) where all companies must register to exchange goods and services
- B) regulated by the Securities and Exchange Commission (SEC)
- C) regulated by the Internal Revenue Service (IRS)
- D) regulated by the Public Company Accounting Oversight Board (PCAOB)

Answer: B

Diff: 1

Objective: LO 1-3

1.3-4) CPA stands for Certified Private Accountant.

Answer: FALSE

Diff: 2

Objective: LO 1-3

1.3-5) The Sarbanes-Oxley Act of 2002 required a new independent board called the Public Company Accounting Oversight Board to be formed to oversee the auditing profession and the audits of public companies.

Answer: TRUE

Diff: 2

Objective: LO 1-3

1.3-6) The Public Company Accounting Oversight Board is required to oversee the Internal Revenue Service.

Answer: FALSE

Diff: 2

Objective: LO 1-3

1.3-7) Generally Accepted Accounting Principles (GAAP) are the rules companies must follow when they prepare their income tax returns.

Answer: FALSE

Diff: 2

Objective: LO 1-3

1.3-8) The Financial Accounting Oversight Board is the group that oversees the audits of publicly traded companies.

Answer: FALSE

Diff: 3

Objective: LO 1-3

1.3-9) All liabilities represent the costs incurred to generate revenues.

Answer: FALSE

Diff: 1

Objective: LO 1-3

1.3-10) To be considered useful, financial information must be relevant and reliable.

Answer: TRUE

Diff: 2

Objective: LO 1-3

1.3-11) To be useful, information must be accurate and reliable.

Answer: TRUE

Diff: 1

Objective: LO 1-3

1.3-12) Only Internal Revenue Service (IRS) agents may conduct audits of financial statements.

Answer: FALSE

Diff: 2

Objective: LO 1-3

1.3-13) The Securities and Exchange Commission (SEC) requires all publicly traded companies to have a fiscal yearend of December 31.

Answer: FALSE

Diff: 1

Objective: LO 1-3

1.3-14) The International Accounting Standards Board (IASB) is responsible for setting the International Financial Reporting Standards (IFRS).

Answer: TRUE

Diff: 1

Skill: Dynamics of the global economy

Objective: LO 1-3

1.3-15) The Securities and Exchange Commission (SEC) is responsible for overseeing all publicly-traded companies from all countries.

Answer: FALSE

Diff: 2

Skill: Dynamics of the global economy

Objective: LO 1-3

1.3-16) Describe who needs information about a business and why they may need it.

Answer: Users of financial information include managers who need information to plan, control, and evaluate the operation of a business. Regulators and government agencies such as the SEC and IRS require information to monitor compliance with government regulations such as payment of taxes. Creditors require information about the financial health of a company before they will lend money to a business.

Diff: 3

Skill: Communication abilities, Use of information technology

Objective: LO 1-3

1.3-17) Match the following terms with the appropriate definitions. Each term is to be used only once.

- a. Audit
- b. FASB
- c. Certified Public Accountant (CPA)
- d. Creditors
- e. IASB
- f. Internal Revenue Service (IRS)
- g. XBRL

- \_\_\_\_\_ 1. The governmental agency responsible for tax collection.
- \_\_\_\_\_ 2. An independent examination of a company's financial statements and the accounting system that produced the statements.
- \_\_\_\_\_ 3. Professional accountant, licensed by states to perform audits.
- \_\_\_\_\_ 4. People and firms who lend money.
- \_\_\_\_\_ 5. A group of professional business people, accountants, and scholars who have the responsibility of setting current accounting standards in the U.S.
- \_\_\_\_\_ 6. A group of professional business people, accountants, and scholars who have the responsibility of setting current accounting standards internationally.
- \_\_\_\_\_ 7. Standardized, interactive format used for filing reports with the SEC.

Answer: f, a, c, d, b, e, g

Diff: 2

Skill: Dynamics of the global economy

Objective: LO 1-3

1.3-18) Match the following terms with the appropriate definitions. Each term is to be used only once.

- a. Accounting period
- b. Operating cycle
- c. Expenses
- d. Revenues
- e. Dividends

- \_\_\_\_\_ 1. A period beginning with cash, conversion of cash to inventory, sales of inventory, and receipt of cash from sales.
- \_\_\_\_\_ 2. The amount a company has earned from providing goods or services to customers.
- \_\_\_\_\_ 3. The costs incurred to generate revenue.
- \_\_\_\_\_ 4. Distribution of earnings to the owners of the corporation.
- \_\_\_\_\_ 5. Any length of time that a company uses to evaluate its performance.

Answer: b, d, c, e, a

Diff: 2

Objective: LO 1-3

## Learning Objective 1-4

1.4-1) Team Shirts, Inc. pays \$600 for insurance. This transaction \_\_\_\_\_.

- A) causes total assets to increase and total liabilities to increase
- B) causes total liabilities to increase and retained earnings to decrease
- C) is an investing activity
- D) is an operating activity

Answer: D

Diff: 3

Skill: Analytic skills

Objective: LO 1-4

1.4-2) A balance sheet \_\_\_\_\_.

- A) describes the financial situation of a company at a specific point in time
- B) is a summary of all of the revenues minus all of the expenses for an accounting period
- C) shows the changes that took place in the amount of shareholders' equity during a period
- D) is a list of all the cash collected and cash paid during a period

Answer: A

Diff: 1

Objective: LO 1-4

1.4-3) An income statement \_\_\_\_\_.

- A) describes the financial situation of a company at a specific point in time
- B) is a summary of all of the revenues minus all of the expenses for an accounting period
- C) shows the changes that took place in the amount of shareholders' equity during a period
- D) is a list of all the cash collected and cash paid during a period

Answer: B

Diff: 1

Objective: LO 1-4

1.4-4) The statement of changes in shareholders' equity \_\_\_\_\_.

- A) describes the financial situation of a company at a specific point in time
- B) is a summary of all of the revenues minus all of the expenses for an accounting period
- C) shows the changes that took place in the amount of shareholders' equity during a period
- D) is a list of all the cash collected and cash paid during a period

Answer: C

Diff: 1

Objective: LO 1-4

1.4-5) The statement of cash flows \_\_\_\_\_.

- A) describes the financial situation of a company at a specific point in time
- B) is a summary of all of the revenues minus all of the expenses for an accounting period
- C) shows the changes that took place in the amount of shareholders' equity during a period
- D) is a list of all the cash collected and cash paid during a period

Answer: D

Diff: 1

Objective: LO 1-4

1.4-6) Team Shirts' Statement of Cash Flows for October showed the following:

Cash from operating activities	\$ 3,000
Cash for investing activities	\$(2,000)
Cash from financing activities	\$ _____?
Net change in cash	\$ 5,000

Cash flows from financing activities were \_\_\_\_\_.

- A) \$5,000
- B) \$(1,000)
- C) \$4,000
- D) \$6,000

Answer: C

Diff: 2

Objective: LO 1-4

1.4-7) Wok N Roll, Inc. shows \$300,000 of assets and \$60,000 of shareholders' equity on its balance sheet. Liabilities must equal \_\_\_\_\_.

- A) \$360,000
- B) \$300,000
- C) \$240,000
- D) \$60,000

Answer: C

Diff: 1

Objective: LO 1-4

1.4-8) A single-step income statement \_\_\_\_\_.

- A) is the preferred method of reporting revenues, expenses, and cash because of the ease of preparation
- B) groups all revenues together and shows all expenses deducted from total revenue
- C) includes the subtotal Gross profit in the presentation
- D) is preferred by business owners because the information presented is timely, and thus useful

Answer: B

Diff: 2

Objective: LO 1-4



1.4-9) The four financial statements used to report a company's financial condition include \_\_\_\_\_.

A) balance sheet, income statement, statement of changes in shareholders' equity, and statement of cash flows

B) changes in balance sheet, statement of flows, statement of changes in balances, and statement of cash flows

C) balance sheet, statement of earnings, statement of changes in shareholders' equity, and statement of budgets

D) income sheet, balance of earnings, statement of changes in shareholders' equity, and statement of cash flows

Answer: A

Diff: 2

Objective: LO 1-4

1.4-10) Team Shirts, Inc. repays a \$2,000 loan. This transaction \_\_\_\_\_.

A) causes total assets to increase

B) causes total liabilities to decrease

C) is an investing activity

D) causes total shareholders' equity to increase

Answer: B

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

1.4-11) The Team Shirts' balance sheet has assets of \$6,500 and liabilities of \$4,000. Its shareholders' equity is \_\_\_\_\_.

A) \$10,500

B) \$2,500

C) \$6,500

D) \$4,000

Answer: B

Diff: 2

Objective: LO 1-4

1.4-12) For the month of June, Team Shirts, Inc., received \$6,000 in contributed capital, \$3,000 in sales revenue, paid \$2,000 in expenses, and \$500 in dividends. Its net income was \_\_\_\_\_.

A) \$9,000

B) \$7,000

C) \$1,000

D) \$500

Answer: C

Diff: 3

Skill: Analytic skills

Objective: LO 1-4

1.4-13) On March 1, Team Shirts had a beginning balance in retained earnings of \$1,200. During March, Team Shirts paid \$200 in dividends and had net income of \$2,000. The March 31 balance in retained earnings was \_\_\_\_\_.

- A) \$3,000
- B) \$3,200
- C) \$3,400
- D) \$1,200

Answer: A

Diff: 2

Objective: LO 1-4

1.4-14) The purpose of the financial statements is to provide financial information needed by \_\_\_\_\_.

- A) investor and creditors
- B) regulators
- C) vendors and customers
- D) all of these

Answer: D

Diff: 1

Objective: LO 1-4

1.4-15) How many of a company's four financial statements report information about the company at a specific point in time?

- A) one
- B) two
- C) three
- D) four

Answer: A

Diff: 1

Objective: LO 1-4

1.4-16) How many of a company's four financial statements report information about the company over a specific period of time?

- A) one
- B) two
- C) three
- D) four

Answer: C

Diff: 1

Objective: LO 1-4

1.4-17) Dividends are \_\_\_\_\_.

- A) the same as expenses
- B) a reduction in retained earnings
- C) owners' contributions to the firm
- D) another term for each partner's share of partnership income

Answer: B

Diff: 2

Objective: LO 1-4

1.4-18) Net income flows from \_\_\_\_\_.

- A) the income statement to the statement of changes in shareholders' equity
- B) the income statement to the balance sheet
- C) the balance sheet to the statement of cash flows
- D) the statement of cash flows to the income statement

Answer: A

Diff: 1

Objective: LO 1-4

1.4-19) Which financial statement shows Inventory?

- A) balance sheet
- B) income statement
- C) statement of changes in shareholders' equity
- D) statement of cash flows

Answer: A

Diff: 1

Objective: LO 1-4

1.4-20) Comparative balance sheets \_\_\_\_\_.

- A) include balances of two consecutive years
- B) include gross profit and operating income
- C) report financial ratios for the current year which are compared to the prior year's
- D) report revenues for both the current and previous years

Answer: A

Diff: 1

Objective: LO 1-4

1.4-21) Which of the following increases retained earnings?

- A) issuance of stock
- B) revenues
- C) purchase of inventory
- D) dividends

Answer: B

Diff: 1

Objective: LO 1-4

1.4-22) Mia Hero, Inc. had a retained earnings balance of \$7,000 on December 31, 2011. For the year 2012, sales revenues are \$15,000 and expenses are \$13,000. If no dividend is declared or paid in 2012, retained earnings at December 31, 2012 equals \_\_\_\_\_.

- A) \$9,000
- B) \$10,000
- C) \$35,000
- D) some other amount

Answer: A

Diff: 2

Objective: LO 1-4

1.4-23) Team Shirts, Inc. had the following balances on its balance sheet:

	Assets	Liabilities
December 31, 2011	\$300,000	\$250,000
December 31, 2012	\$400,000	\$320,000

During 2012, Team Shirts had revenues of \$500,000 and expenses of \$420,000. No new stock was issued. The amount of dividends for 2012 was \_\_\_\_\_.

- A) \$130,000
- B) \$50,000
- C) \$10,000
- D) \$80,000

Answer: B

Diff: 3

Skill: Analytic skills

Objective: LO 1-4

1.4-24) Team Shirts, Inc. had the following balances on its balance sheet:

	Assets	Liabilities
December 31, 2011	\$500,000	\$300,000
December 31, 2012	\$700,000	\$400,000

During 2012, Team Shirts had revenues of \$500,000, expenses of \$420,000, and issued \$20,000 of new stock. The amount of dividends for 2012 was \_\_\_\_\_.

- A) \$130,000
- B) \$50,000
- C) \$0
- D) \$60,000

Answer: C

Diff: 3

Skill: Analytic skills

Objective: LO 1-4

1.4-25) Team Shirts, Inc. had the following balances on its balance sheet:

	Assets	Liabilities
December 31, 2011	\$500,000	\$300,000
December 31, 2012	\$700,000	\$400,000

During 2012, Team Shirts issued \$20,000 of new stock and paid \$10,000 of dividends. The amount of net income for 2012 was \_\_\_\_\_.

- A) \$290,000
- B) \$310,000
- C) \$90,000
- D) \$10,000

Answer: C

Diff: 3

Objective: LO 1-4

1.4-26) Tim's Tots, Inc.  
September 30, 2012

Cash	\$ 5,000	Accounts Payable	\$3,200
Accounts receivable	\$ 3,500	Notes payable	\$6,500
<b>Inventory</b>		Common stock	\$5,000
<b>Equipment</b>	<b>\$10,500</b>	<b>Retained earnings</b>	<b>\$7,300</b>
<b>Total assets</b>		<b>Total liabilities &amp; shareholders' equity</b>	

What is the name of the financial statement above?

- A) income statement
- B) balance sheet
- C) statement of cash flows
- D) statement of changes in shareholders' equity

Answer: B

Diff: 1

Objective: LO 1-4

1.4-27)

Tim's Tots, Inc.  
September 30, 2012

Cash	\$ 5,000	Accounts Payable	\$3,200
Accounts receivable	\$ 3,500	Notes payable	\$6,500
<b>Inventory</b>		Common stock	\$5,000
<b>Equipment</b>	<b>\$10,500</b>	<b>Retained earnings</b>	<b>\$7,300</b>
<b>Total assets</b>		<b>Total liabilities &amp; shareholders' equity</b>	

Using the above financial statement, calculate the missing amount of Inventory.

- A) \$3,000
- B) \$19,000
- C) \$22,000
- D) \$1,500

Answer: A

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

1.4-28) The Mane Event, Inc. began by selling \$200,000 of common stock to its owners in exchange for cash. The effect of this transaction on the accounting equation is:

A) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Increase	No effect	Increase	No effect

B) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Decrease	No effect	No effect	Decrease

C) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	No effect	Decrease	No effect	Increase

D) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Increase	No effect	No effect	Increase

Answer: A

Diff: 1

Skill: Analytic skills

Objective: LO 1-4

1.4-29) Daily Grind, Inc. began by selling \$15,000 of common stock to its owners in exchange for cash. The effect of this transaction on the accounting equation is:

A) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	15,000 cash	No effect	No effect	15,000 revenue

B) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	15,000 cash	No effect	15,000 common stock	No effect

C) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	No effect	15,000 cash	15,000 cash	No effect

D) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	15,000 cash	15,000 cash	No effect	Increase

Answer: B  
 Diff: 1  
 Skill: Analytic skills  
 Objective: LO 1-4

1.4-30) Mercy, Inc. purchased a truck for \$50,000 cash. The effect of this transaction on the accounting equation is:

A) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Increase	No effect	No effect	Increase

B) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Decrease	No effect	No effect	Decrease

C) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	No effect	No effect	No effect	No effect

D) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Increase	No effect	Increase	No effect

Answer: C  
 Diff: 2  
 Skill: Analytic skills  
 Objective: LO 1-4



1.4-31) Mercy, Inc. purchased equipment for \$5,000 cash. The effect of this transaction on the accounting equation is:

A) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	(5,000) cash	No effect	No effect	(5,000) equipment expense

B) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	5,000 cash (5,000) equipment	No effect	No effect	No effect

C) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	5,000 equipment (5,000) cash	No effect	No effect	No effect

D) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	5,000 equipment	No effect	Increase	5,000 cash

Answer: C  
 Diff: 2  
 Skill: Analytic skills  
 Objective: LO 1-4

1.4-32) Stackables, Inc. paid \$8,000 cash for inventory. The effect of this transaction on the accounting equation is:

A) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Increase	No effect	No effect	Increase

B) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Decrease	No effect	No effect	Decrease

C) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	No effect	No effect	No effect	No effect

D) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Increase	No effect	Increase	No effect

Answer: C  
 Diff: 2  
 Skill: Analytic skills  
 Objective: LO 1-4

1.4-33) Stackables, Inc. paid \$2,000 cash for inventory. The effect of this transaction on the accounting equation is:

A) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	(2,000) cash	No effect	No effect	(2,000) inventory

B) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	(2,000) inventory	No effect	No effect	(2,000) cash

C) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	(2,000) cash	(2,000) inventory	No effect	No effect

D) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	2,000 inventory (2,000) cash	No effect	No effect	No effect

Answer: D  
 Diff: 2  
 Skill: Analytic skills  
 Objective: LO 1-4

1.4-34) Squid Roe, Inc. paid \$1,000 cash for janitorial services. The effect of this transaction on the accounting equation is:

A) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Increase	No effect	Increase	No effect

B) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Decrease	No effect	No effect	Decrease

C) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	No effect	Decrease	No effect	Increase

D) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Decrease	No effect	Decrease	No effect

Answer: B  
 Diff: 2  
 Skill: Analytic skills  
 Objective: LO 1-4

1.4-35) Squid Roe, Inc. paid \$500 cash for janitorial services. The effect of this transaction on the accounting equation is:

A) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	(500) cash	No effect	No effect	(500) expense

B) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	500 supplies (500) cash	No effect	No effect	No effect

C) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	(500) cash	(500) expense	No effect	No effect

D) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	No effect	(500) expense	No effect	(500) cash

Answer: A  
 Diff: 2  
 Skill: Analytic skills  
 Objective: LO 1-4

1.4-36) Poe, Inc. made \$7,000 of cash sales to customers. The effect of this transaction on the accounting equation is:

A) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Increase	No effect	Increase	No effect

B) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Decrease	No effect	No effect	Decrease

C) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	No effect	Decrease	No effect	Increase

D) Total shareholders' equity

	Total assets	Total liabilities	Contributed capital	Retained earnings
	Increase	No effect	No effect	Increase

Answer: D  
 Diff: 2  
 Skill: Analytic skills  
 Objective: LO 1-4

1.4-37) During the year, The Mane Event, Inc. had sales of \$300,000 and had expenses of \$240,000. The owners were paid \$20,000 in dividends. Net income for the year equals

- \_\_\_\_\_.
- A) \$90,000
  - B) \$60,000
  - C) \$50,000
  - D) \$40,000
- Answer: B  
 Diff: 2  
 Skill: Analytic skills  
 Objective: LO 1-4

1.4-38) Assume 2011 is the company's first year of business and there were no dividends declared in 2011.

	<u>For the year ended December 31, 2011</u>
Revenues	\$ 300
Expenses	<b>1.</b> \$ _____
Net Income	<b>2.</b> \$ _____

  

	<u>December 31, 2011</u>
Assets	\$ 1,000
Liabilities	<b>3.</b> \$ _____
Contributed capital	\$ 300
Retained earnings	\$ 200

Determine the missing amounts, 1. Expenses. 2. Net income and 3. Liabilities, in the condensed income statement and balance sheet for the year ended December 31, 2011.

- A) 1. Expenses of \$(100); 2. Net income of \$200; 3. Liabilities of \$500
- B) 1. Expenses of \$(200); 2. Net income of \$500; 3. Liabilities of \$1,500
- C) 1. Expenses of \$(200); 2. Net income of \$100; 3. Liabilities of \$500
- D) 1. Expenses of \$(500); 2. Net income of \$200; 3. Liabilities of \$500

Answer: A

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

1.4-39) Assume 2011 is the company's first year of business. There were no dividends declared in 2011 and \$100 of dividends declared in 2012.

	<u>For the year ended December 31, 2011</u>		<u>For the year ended December 31, 2012</u>
Revenues	\$ 300		\$ 2,500
Expenses	\$ _____		\$ (1,400)
Net Income	\$ _____	<b>1.</b>	\$ _____
	<u>December 31, 2011</u>		<u>December 31, 2012</u>
Assets	\$ 1,000		\$ 2,500
Liabilities	\$ _____	<b>2.</b>	\$ _____
Contributed capital	\$ 300		\$ 300
Retained earnings	\$ _____	<b>3.</b>	\$ _____

Determine the missing amounts, 1. Net income, 2. Liabilities of \$200, and 3. Retained earnings of \$1,400, in the condensed income statement and balance sheet for the year ended December 31, 2012.

- A) 1. Net income of \$1,100; 2. Liabilities of \$200; 3. Retained earnings of \$1,400
- B) 1. Net income of \$3,900; 2. Liabilities of \$1,000; 3. Retained earnings of \$1,300
- C) 1. Net income of \$1,100; 2. Liabilities of \$1,000; 3. Retained earnings of \$1,200
- D) 1. Net income of \$1,100; 2. Liabilities of \$200; 3. Retained earnings of \$1,200

Answer: C

Diff: 2

Skill: Analytic skills

Objective: LO 1-4



1.4-40) It is Dives, Inc.'s first year of business. Dives' net income for its first year is \$200,000. Dives declared and paid dividends of \$50,000. The balance in retained earnings at the end of the first year equals:

- A) \$200,000.
- B) \$50,000.
- C) \$150,000.
- D) \$250,000.

Answer: C

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

Lox Stock & Bagel Company			
a. _____			
April 30, 2012			
Cash	b. \$ _____	Accounts payable	\$ 3,000
Inventory	1,610	Notes payable	15,000
Supplies	300		
Land	10,000	Common stock	10,000
Building (net)	<u>25,000</u>	Retained earnings	c. _____
	<u>\$39,910</u>		<u>\$39,910</u>

1.4-41) The missing name (a.) of Lox Stock & Bagel Company's financial statement above is the \_\_\_\_\_.

- A) Balance sheet
- B) Income statement
- C) Statement of changes in shareholders' equity
- D) Statement of cash flows

Answer: A

Diff: 1

Objective: LO 1-4

1.4-42) The Cash balance (b.) in Lox Stock & Bagel Company's financial statement above is \_\_\_\_\_.

- A) the same as the retained earnings
- B) \$39,910
- C) \$3,000
- D) \$10,910

Answer: C

Diff: 1

Skill: Analytic skills

Objective: LO 1-4

1.4-43) The Retained earnings balance (c.) in Lox Stock & Bagel Company's is \_\_\_\_\_.

A) the same as the Cash balance

B) \$21,910

C) \$10,910

D) \$11,910

Answer: D

Diff: 1

Objective: LO 1-4

1.4-44) Using Lox Stock & Bagel Company's financial statement above, determine the amount of the creditors' claims to the company's resources.

A) \$10,910

B) \$38,910

C) \$18,000

D) \$28,910

Answer: C

Diff: 2

Objective: LO 1-4

1.4-45) Using Lox Stock & Bagel Company's financial statement above, determine the amount of the company's largest resource.

A) \$11,910

B) \$39,910

C) \$18,000

D) \$25,000

Answer: D

Diff: 2

Objective: LO 1-4

1.4-46) Using Lox Stock & Bagel Company's financial statement above, determine the amount of the owners' claims that have been contributed to the company.

A) \$10,000

B) \$39,910

C) \$11,910

D) \$21,910

Answer: A

Diff: 2

Objective: LO 1-4

1.4-47) Using Lox Stock & Bagel Company's financial statement above, determine the amount that represents the earnings kept in the company.

- A) the Cash balance
- B) \$21,910
- C) \$10,910
- D) \$11,910

Answer: D

Diff: 1

Objective: LO 1-4

1.4-48) Use this financial statement to answer the following question:

Cash	\$ 3,000	Liabilities	\$ 2,500
Accounts receivable	2,000		
Inventory	<b>A</b>	Common stock	<b>B</b>
Supplies	<u>1,000</u>	Retained earnings	<u>500</u>
Total	\$11,000	Total	<b>C</b>

The Inventory balance (A above) equals \_\_\_\_\_.

- A) \$17,000
- B) \$13,000
- C) \$ 5,000
- D) \$ 6,000

Answer: C

Diff: 2

Objective: LO 1-4

Use this financial statement to answer the following question(s):

Cash	\$ 3,000	Liabilities	\$ 2,500
Accounts receivable	2,000		
Inventory	<b>A</b>	Common stock	<b>B</b>
Supplies	<u>1,000</u>	Retained earnings	<u>500</u>
Total	\$10,000	Total	<b>C</b>

1.4-49) Refer to the financial statement above. The Common stock balance (B above) equals \_\_\_\_\_.

- A) \$10,000
- B) \$ 7,000
- C) \$13,000
- D) \$ 3,000

Answer: B

Diff: 2

Objective: LO 1-4

50) Refer to the financial statement above. The total shareholders' equity equals \_\_\_\_\_.

- A) \$13,000
- B) \$10,000
- C) \$ 7,500
- D) \$ 9,000

Answer: C

Diff: 3

Objective: LO 1-4

1.4-51) Refer to the financial statement above. This financial statement is a(n) \_\_\_\_\_.

- A) income statement
- B) statement of changes in shareholders' equity
- C) balance sheet
- D) statement of cash flows

Answer: C

Diff: 2

Objective: LO 1-4

1.4-52) Refer to the financial statement above. Assume that this is the company's first year of business. During the year, the company paid \$1,000 in dividends to its owner. Net income for the year must have been \_\_\_\_\_.

- A) \$500
- B) \$2,000
- C) \$1,500
- D) \$3,000

Answer: C

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

1.4-53) The financial statement above shows \_\_\_\_\_.

- A) the company's financial position at a single point in time
- B) the changes that took place in the company's cash account during the period
- C) the changes that took place in shareholders' equity during the period
- D) expenses matched with revenues earned for a period of time

Answer: A

Diff: 2

Objective: LO 1-4

1.4-54) Dividends are a type of expense shown on the balance sheet.

Answer: FALSE

Diff: 2

Objective: LO 1-4

1.4-55) Net income on the income statement will always be greater than net income on the statement of changes in shareholders' equity.

Answer: FALSE

Diff: 1

Objective: LO 1-4

1.4-56) The change in cash on the statement of cash flows will always equal net income on the statement of changes in shareholders' equity.

Answer: FALSE

Diff: 2

Objective: LO 1-4

1.4-57) The notes to financial statements (also called footnotes) are an integral part of the financial statements and help users to understand what is in the statements.

Answer: TRUE

Diff: 1

Objective: LO 1-4

1.4-58) Revenues minus cost of goods sold equals net income.

Answer: FALSE

Diff: 3

Objective: LO 1-4

1.4-59) Cash flows from financing activities include contributions from owners.

Answer: TRUE

Diff: 2

Objective: LO 1-4

1.4-60) In a corporation, dividends distributed to owners are treated as expenses.

Answer: FALSE

Diff: 3

Objective: LO 1-4

1.4-61) An income statement lists assets, liabilities, and shareholders' equity.

Answer: FALSE

Diff: 2

Objective: LO 1-4

1.4-62) The statement of cash flows is divided into three sections: assets, liabilities, and shareholders' equity.

Answer: FALSE

Diff: 2

Objective: LO 1-4

1.4-63) The statement of cash flows is divided into three sections: operating, investing, and financing.

Answer: TRUE

Diff: 2

Objective: LO 1-4

1.4-64) Retained earnings and cash on the balance sheet will always be equal.

Answer: FALSE

Diff: 3

Objective: LO 1-4

1.4-65) Explain the purpose of each financial statement and the type of information found in each statement.

Answer: The four financial statements are called the balance sheet, income statement, statement of changes in shareholders' equity, and statement of cash flows. The purpose of the balance sheet is to present the financial situation of a company as of a specific date. It lists the assets, or what a business owns; the liabilities, or the amount owed to creditors; and shareholder's equity, the residual ownership, or what the owners of a business own free and clear.

The income statement is also called a profit and loss statement. It lists the sales revenues of a business. Then expenses incurred to run the business are subtracted from sales revenues. The result is either a profit or loss from running the business.

The statement of changes in shareholder's equity describes the changes in shareholder's equity during an accounting period. There are two sections: one which shows the change in contributed capital and the other which starts with beginning retained earnings then adds net income and subtracts distributions to owners to arrive at an ending retained earnings.

The statement of cash flows presents all of the cash coming into a business and all of the cash going out of a business during an accounting period. The cash transactions are grouped into operating, investing, and financing activities. Operating activities are the day-to-day activities involved in running a business. Investing activities involve the buying or selling of equipment used to run the business. Financing activities involve raising money from outside the business, such as borrowing money from a bank and repaying these amounts. Taken together, these financial statements provide business owners with a picture of how well their business is doing financially.

Diff: 2

Skill: Communication abilities

Objective: LO 1-4

1.4-66) Describe the format of the balance sheet.

Answer: The balance sheet is composed of assets and claims on assets. The claims on assets are called liabilities and shareholders' equity.

Diff: 1

Skill: Communication abilities

Objective: LO 1-4

1.4-67) Describe the format of the income statement.

Answer: The income statement is composed of revenues earned from the sales of goods and services. Expenses incurred in generating sales are subtracted from revenues. The result is either a profit or loss.

Diff: 1

Skill: Communication abilities

Objective: LO 1-4

1.4-68) Describe the format of the statement of changes in shareholders' equity.

Answer: The statement of changes in shareholders' equity starts with a beginning balance of retained earnings. Net income is added or net loss is subtracted, and dividends are then subtracted in order to determine the ending balance. The statement also shows changes in contributed capital.

Diff: 1

Skill: Communication abilities

Objective: LO 1-4

1.4-69) Describe the format of the statement of cash flows.

Answer: The statement of cash flows shows all the cash collected and all the cash disbursed during an accounting period. The transactions are grouped according to operating, investing, and financing activities.

Diff: 1

Skill: Communication abilities

Objective: LO 1-4

1.4-70) What are the four financial statements? What information does each provide?

Answer: The four financial statements are the balance sheet, income statement, statement of changes in shareholders' equity, and statement of cash flows. The balance sheet shows assets, liabilities and shareholders' equity at a specific point in time. The income statement presents revenues minus expenses for an accounting period. The statement of changes in shareholders' equity explains the change in the shareholders' equity balances. It presents the beginning balance of retained earnings, to which net income is added or net loss is subtracted, then dividends are subtracted in order to determine the ending balance. It also shows changes in contributed capital. The statement of cash flows shows the amounts of cash coming into or going out of a business. Transactions are organized into operating, investing, and financing activities.

Diff: 2

Skill: Communication abilities

Objective: LO 1-4 & LO 1-5

1.4-71) Wok 'N' Roll, Inc., has assets of \$500,000 and liabilities of \$350,000. Calculate the amount of shareholder's equity.

Answer:  $\$500,000 - \$350,000 = \$150,000$

Diff: 1

Objective: LO 1-4

1.4-72) Up Against the Wall, Inc., has liabilities of \$350,000 and \$300,000 worth of shareholders' equity. Calculate the value of its assets.

Answer:  $\$350,000 + \$300,000 = \$650,000$

Diff: 1

Objective: LO 1-4



1.4-73) Sea the World Cruises has assets of \$450,000 and shareholders' equity of \$300,000. Calculate the amount of its liabilities.

Answer:  $\$450,000 - \$300,000 = \$150,000$

Diff: 1

Objective: LO 1-4

1.4-74) Shelby's Music reported net income of \$35,000 for the year. During the year, it received \$125,000 in revenues. Calculate the amount of expenses for the year.

Answer:  $\$125,000 - \$35,000 = \$90,000$

Diff: 1

Objective: LO 1-4

1.4-75) Seminole Company had a net cash inflow of \$80,000 from operating activities. It spent \$40,000 on investing activities. Seminole received \$50,000 in cash from issuing stock. Given no other cash activity, calculate the net increase or decrease in cash.

Answer:  $\$80,000 - \$40,000 + \$50,000 = \$90,000$

Diff: 1

Objective: LO 1-4 & LO 1-5

1.4-76) At the beginning of the year, Anudu had \$220,000 in liabilities. During the year, assets increased by \$150,000, and at year-end they totaled \$450,000. Liabilities decreased \$20,000 during the year. Calculate the amount of both the beginning and ending value of shareholders' equity.

Answer:	Assets	=Liabilities	+ Shareholders' Equity
Beginning	\$300,000	\$220,000	<b>\$80,000</b>
Change	+\$150,000	-\$20,000	+\$170,000
Ending	\$450,000	\$200,000	<b>\$250,000</b>

Diff: 3

Skill: Analytic skills

Objective: LO 1-4

1.4-77) Fill in the missing income statement amounts in the spaces below:

	Company 1	Company 2	Company 3
Revenues	\$920	<b>2. \$ _____</b>	\$2,750
Expenses	\$380	\$775	\$2,980
Net income (Net loss)	<b>1. \$ _____</b>	\$300	<b>3. \$ _____</b>

Answer: 1. \$540, 2. \$1,075, 3. \$(230)

Diff: 1

Skill: Analytic skills

Objective: LO 1-4

1.4-78) For each of the following transactions, determine whether there is an increase, decrease, or no change in net income.

- a. Purchased inventory for \$8,700.
- b. Earned \$15,000 in sales for the month.
- c. The cost of inventory sold was \$6,000.
- d. Dividends paid to shareholders were \$1,000.
- e. Paid employees \$1,300.

Answer: a. No change, b. Increase, c. Decrease, d. No change, e. Decrease

Diff: 3

Skill: Analytic skills

Objective: LO 1-4

1.4-79) For each of the following transactions, determine whether or not there is an increase, decrease, or no change in total assets.

- a. The owners each contributed \$4,000 to start the business.
- b. Paid monthly rent of \$1,200.
- c. Received \$11,300 in cash from sales.
- d. Recorded a decrease in inventory of \$4,500 for the amounts sold.
- e. Purchased equipment worth \$7,500 with cash.
- f. Borrowed \$9,000 from the bank.
- g. Paid employees \$860.
- h. Purchased \$4,400 worth of inventory for cash.

Answer: a. Increase, b. Decrease, c. Increase, d. Decrease, e. No change, f. Increase, g. Decrease, h. No change

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

1.4-80) Identify the effects of each transaction on total assets, total liabilities, and total shareholders' equity by writing increase or decrease.

**Shareholders' equity**

	<b>Transaction</b>	<b>Total assets</b>	<b>Total liabilities</b>	<b>Contributed capital</b>	<b>Retained earnings</b>
a.	Received cash and issued common stock.				
b.	Purchased inventory for cash.				
c.	Purchased supplies for cash.				
d.	Sold inventory to customers for cash.				
e.	Paid advertising for the month.				

Answer:

**Shareholders' equity**

	<b>Total assets</b>	<b>Total liabilities</b>	<b>Contributed capital</b>	<b>Retained earnings</b>
a.	Increase		Increase	
b.	Increase Decrease			
c.	Increase Decrease			
d.	Increase Decrease			Increase Decrease
e.	Decrease			Decrease

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

1.4-81) Analyze each of the following cash transactions and show the effect of each transaction on the accounting equation by writing the dollar amounts and account titles in the appropriate columns. If amount is negative put the amount in "(" or put a "-" in front of the amount.

		<b>Shareholders' equity</b>			
	<b>Transaction</b>	<b>Total assets</b>	<b>Total liabilities</b>	<b>Contributed capital</b>	<b>Retained earnings</b>
a.	Issued \$10,000 of stock.				
b.	Paid \$11,000 for inventory.				
c.	Paid \$2,500 in advertising expense.				
d.	Earned \$18,000 in sales revenues.				
e.	The cost of the goods sold in d. was \$10,000.				

Answer:

		<b>Shareholders' equity</b>			
	<b>Total assets</b>	<b>Total liabilities</b>	<b>Contributed capital</b>	<b>Retained earnings</b>	
a.	10,000 Cash		10,000 Common stock		
b.	(11,000) Cash 11,000 Inventory				
c.	(2,500) Cash			(2,500) Adv. exp.	
d.	18,000 Cash			18,000 Sales	
e.	(10,000) Inventory			(10,000) Cost of goods sold	

Diff: 3

Skill: Analytic skills

Objective: LO 1-4

1.4-82) Review the following balance sheet and answer the following questions.

Barry Rich, CPA			
Balance Sheet			
April 30, 2012			
	Assets		Liabilities
Cash	\$2,430	Note Payable	\$3,000
Supplies	1,690	Shareholders' equity	
Equipment	<u>7,500</u>	Contributed capital	\$5,000
		Retained Earnings	<u>3,620</u>
		Total Shareholders' equity	<u>8,620</u>
Total assets	\$11,620	Total liabilities and shareholders' equity	<u>\$11,620</u>

1. Is this business a sole proprietorship, partnership, or corporation? How do you know?
2. Who has claims to the assets owned by the business and how much are they?
3. Assume that April is the first month of operations and no dividends were given to the owner. How much net income was earned during April?
4. Using this balance sheet, describe what Barry Rich did during the first month of running his business.

Answer:

1. This is a corporation. Only corporations have retained earnings and shareholders' equity.
2. Creditors have claims to \$3,000, and Barry has claim to \$8,620.
3. Since this is the first month of operations, the business started with a zero balance in retained earnings. Therefore, the amount of retained earnings indicates that the business earned \$3,620 since there were no dividends.
4. Barry started the business by investing \$5,000 of his own money. He also borrowed \$3,000. He purchased \$7,500 worth of equipment. In running the business, he ended up with \$2,430 in cash and \$1,690 in supplies. He made a profit of \$3,620.

Diff: 3

Skill: Communication abilities

Objective: LO 1-2, LO 1-3, & LO 1-4

1.4-83) Below is a balance sheet for Daily Grind Coffee Shop. Fill in the missing amounts.

Daily Grind Coffee Shop  
Balance Sheet  
September 30, 2012

	Assets		Liabilities and shareholders' equity
Cash	\$350,000	Accounts payable	b. _____
Inventory	a. _____	Salaries payable	\$50,000
Supplies	25,000	Total liabilities	\$250,000
Equipment	500,000	Contributed capital	c. _____
		Total shareholders' equity	d. _____
Total assets	\$950,000	Total liabilities and shareholders' equitye.	_____

Answer:

a.  $\$950,000 - 350,000 - 25,000 - 500,000 = \$75,000$

b.  $\$250,000 - 50,000 = \$200,000$

c.  $\$700,000 - 230,000 = \$470,000$

d.  $\$950,000 - 250,000 = \$700,000$

e.  $\$950,000$  (= Total assets)

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

1.4-84) Mia Hero started her own catering business called Hero's Catering. Analyze each of the following transactions for the first month of business. Prepare an income statement for the month of March.

- Mia contributed \$10,000 of her own money to start Mia's catering.
- The business borrowed another \$5,000 from the local bank.
- The business rented a kitchen for \$1,500 for the month.
- The business spent \$1,200 on food, spices and other supplies used during the month.
- The business hired Betty Foit as an assistant chef and paid her \$500 for the month.
- The business earned \$7,000 in revenues during the month.

Answer: Hero's Catering  
Income Statement  
For the Month Ended March 31, 2012

Revenues		\$7,000
Expenses		
Rent	\$ 1,500	
Supplies	1,200	
Wages	<u>500</u>	
Total expenses		<u>\$3,200</u>
Net income		<u>\$3,800</u>

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

1.4-85) Mia Hero started her own catering business called Hero's Catering. Analyze each of the following transactions for the first month of business. Prepare the balance sheet at March 31.

- Mia contributed \$10,000 of her own money to start Mia's catering.
- The business borrowed another \$5,000 from the local bank.
- The business rented a kitchen for \$1,500 for the month.
- The business spent \$1,200 on food, spices and other supplies used during the month.
- The business hired Betty Foit as an assistant chef and paid her \$500 for the month.
- The business earned \$7,000 in revenues during the month.

Answer: Hero's Catering  
Statement of Changes in Shareholders' Equity  
For the Month of March 31, 2012

Beginning contributed capital	\$ 0	
Add: Common stock issued during the month	<u>10,000</u>	
Ending contributed capital		\$10,000
Beginning retained earnings	\$ 0	
Add: Net income for the month	<u>3,800</u>	
Ending retained earnings		<u>3,800</u>
Total shareholders' equity		<u>\$13,800</u>

Diff: 2

Skill: Analytic skills

Objective: LO 1-4

1.4-86) Mia Hero started her own catering business called Hero's Catering. Analyze each of the following transactions for the first month of business. Prepare the statement of cash flows for the month of March.

Answer:

Hero's Catering  
Statement of Changes in Shareholders' Equity  
For the Month of March 31, 2012

Cash from operating activities		
Cash collected from customers	\$ 7,000	
Cash paid for rent	(1,500)	
Cash paid for supplies	(1,200)	
Cash paid for wages	<u>(500)</u>	
Total cash from operating activities		\$ 3,800
Cash from investing activities		0
Cash from financing activities		
Contribution by owner	\$ 10,000	
Proceeds from loan	<u>5,000</u>	
Total cash from financing		<u>15,000</u>
Net increase in cash		<u><b>\$18,800</b></u>

Diff: 3

Skill: Analytic skills

Objective: LO 1-4

1.4-87) Mia Hero started her own catering business called Hero's Catering. Analyze each of the following transactions for the first month of business. Prepare the statement of changes in shareholders' equity for the month of March.

Answer:

Hero's Catering Balance Sheet March 31, 2012			
	Assets		Liabilities
Cash	\$18,800	Note Payable	\$5,000
		Shareholders' equity	
		Common stock	\$10,000
		Retained Earnings	<u>3,800</u>
		Total Shareholders' equity	<u>13,800</u>
Total assets	<u>\$18,800</u>	Total liabilities and shareholders' equity	<u>\$18,800</u>

Diff: 3

Skill: Analytic skills

Objective: LO 1-4



1.4-88) Eddie Bells started her own catering business called Delectable Edibles. Analyze each of the following transactions for the first month of business. Prepare a complete set of financial statements for the month of March (Income Statement, Statement of Changes in Shareholders' Equity, Statement of Cash Flows and Balance Sheet). Eddie contributed \$13,000 of her own money to start Delectable Edibles, which is organized as a corporation.

Answer: Delectable Edibles  
Income Statement

For the Month Ended March 31, 2012

Revenues		\$7,940
Expenses		
Rent	\$ 1,500	
Supplies	1,200	
Wages	<u>500</u>	
Total expenses		<u>\$3,260</u>
Net income		<u>\$4,680</u>

Delectable Edibles  
Statement of Changes in Shareholders' Equity  
For the Month of March 31, 2012

Beginning contributed capital	\$ 0	
Add: Common stock issued	<u>13,000</u>	
Ending contributed capital		\$13,000
Beginning retained earnings	\$ 0	
Add: Net income	<u>4,680</u>	
Ending retained earnings		<u>4,680</u>
Total shareholder's equity		<u>\$17,680</u>

Delectable Edibles  
Statement of Cash Flows  
For the Month of March 31, 2012

Cash from operating activities		
Cash collected from customers	\$ 7,940	
Cash paid for rent	(1,500)	
Cash paid for supplies	(1,260)	
Cash paid for wages	<u>(500)</u>	
Total cash from operating activities		\$ 4,680
Cash for investing activities		0
Cash from financing activities		
Contribution by owner	\$ 13,000	
Proceeds from loan	<u>5,500</u>	
Total cash from financing		<u>18,500</u>
Net increase in cash		<u>\$23,180</u>

Delectable Edibles  
Balance Sheet  
March 31, 2012

	Assets		Liabilities
Cash	\$23,180	Note Payable	\$5,500
		Shareholders' equity	
		Common stock	\$13,000
		Retained Earnings	4,680
		Total Shareholders' equity	<b><u>17,680</u></b>
<b>Total assets</b>	<b><u>\$23,180</u></b>	<b>Total liabilities and shareholders' equity</b>	<b><u>\$23,180</u></b>

Diff: 3

Skill: Analytic skills

Objective: LO 1-4

1.4-89) Match each of the following with the appropriate definitions.

- a. Statement of cash flows
- b. Balance sheet
- c. Income statement
- d. Statement of changes in shareholders' equity

- \_\_\_\_\_ 1. A financial statement that presents assets, liabilities, and shareholders' equity.
- \_\_\_\_\_ 2. A financial statement that presents revenues minus expenses to show either a profit or loss.
- \_\_\_\_\_ 3. A financial statement that presents the changes in shareholder's equity for an accounting period.
- \_\_\_\_\_ 4. A financial statement that presents all the cash collected and all the cash disbursed during an accounting period.
- \_\_\_\_\_ 5. A financial statement that reports the financial position of the company at a point in time.

Answer: b, c, d, a, b

Diff: 2

Objective: LO 1-4

1.4-90) Match each of the following accounts with the appropriate financial statement.  
(Remember that certain accounts may be found on more than one statement.)

- a. Balance sheet
- b. Income statement
- c. Statement of changes in shareholders' equity
- d. Statement of cash flows

- \_\_\_\_\_ 1. Cash
- \_\_\_\_\_ 2. Dividends
- \_\_\_\_\_ 3. Advertising expense
- \_\_\_\_\_ 4. Inventory
- \_\_\_\_\_ 5. Contributed capital
- \_\_\_\_\_ 6. Revenues

Answer: a and d, c and d, b, a, a and c, b

Diff: 2

Objective: LO 1-4

1.4-91) Match each of the following accounts with the appropriate financial statement.  
(Remember that certain accounts may be found on more than one statement.)

- a. Balance sheet
- b. Income statement
- c. Statement of changes in shareholders' equity
- d. Statement of cash flows

- \_\_\_\_\_ 1. Sales revenue
- \_\_\_\_\_ 2. Retained earnings
- \_\_\_\_\_ 3. Rent expense
- \_\_\_\_\_ 4. Cash
- \_\_\_\_\_ 5. Contributed capital

Answer: b, a and c, b, a and d, a and c

Diff: 2

Objective: LO 1-4

1.4-92) Classify the following accounts according to the appropriate balance sheet category.

- a. Assets
- b. Liabilities
- c. Shareholders' equity

- \_\_\_\_\_ 1. Common stock
- \_\_\_\_\_ 2. Retained earnings
- \_\_\_\_\_ 3. Notes payable
- \_\_\_\_\_ 4. Cash
- \_\_\_\_\_ 5. Inventory
- \_\_\_\_\_ 6. Land

Answer: c, c, b, a, a, a

Diff: 2

Objective: LO 1-4

Learning Objective 1-5

1.5-1) Which of the following statements reports the line item Gross profit?

- A) the single-step income statement
- B) the multistep income statement
- C) the single-step balance sheet
- D) the multistep balance sheet

Answer: B

Diff: 1

Objective: LO 1-5

1.5-2) An audit opinion \_\_\_\_\_.

- A) is a report prepared by a Certified Public Accountant (CPA) indicating the financial statements have been examined
- B) is required by the Securities and Exchange Commission to accompany the financial statements of publicly-traded companies
- C) is a report prepared by the Internal Revenue Service (IRS)
- D) is two or more of these

Answer: D

Diff: 1

Objective: LO 1-5

1.5-3)

Lox Stock & Bagel Company

a. _____			
April 30, 2012			
Cash	b. \$ _____	Accounts payable	\$ 2,000
Inventory	1,610	Notes payable	15,000
Supplies	300		
Land	10,000	Common stock	10,000
Building (net)	<u>25,000</u>	Retained earnings	c. _____
	<u>\$39,910</u>		<u>\$39,910</u>

From Lox Stock & Bagel Company's financial statement above, determine what form of organization it is.

- A) Sole proprietorship
- B) Partnership
- C) Corporation
- D) There is not enough information to tell.

Answer: C

Diff: 1

Objective: LO 1-5

1.5-4) The Securities and Exchange Commission (SEC) requires all publicly-traded corporations to file their 10-K reports using XBRL (Extensible Business Reporting Language).

Answer: TRUE

Diff: 2

Objective: LO 1-5

1.5-5) The Securities and Exchange Commission (SEC) requires all publicly traded companies to file a report called the 10-K after the end of each company's fiscal year.

Answer: TRUE

Diff: 3

Skill: Use of information technology

Objective: LO 1-5

1.5-6) Many of the largest CPA firms are global and perform audits all over the world. Foreign countries have different accounting and auditing rules than the United States. If the CPA firm is performing an audit of a foreign company that trades its stock on a U.S. stock exchange, should the financial statements and the audit conform to U.S. generally accepted accounting principles and auditing rules or the foreign county's rules?

Answer: If a foreign company's stock is traded on a U.S. stock exchange, then the financial statements and the audits of the financial statements should conform to the U.S. rules. Otherwise, it would be very difficult for investors to understand the financial statements and to make comparisons with other U.S. companies.

Diff: 3

Skill: Communication abilities, Dynamics of the global economy

Objective: LO 1-5

1.5-7) Review the following income statement for Up Against the Wall, a wallpaper store. Then answer the following questions.

Up Against the Wall  
Income Statement  
For the Month Ended July 31, 2012

Revenues	\$17,440	
Cost of goods sold	<u>(6,975)</u>	
Gross profit		\$10,465
Expenses		
Rent	\$ 1,650	
Wages	1,369	
Advertising	<u>830</u>	
Total expenses		<u>(3,840)</u>
Net income		<u>\$6,625</u>

- a. What does gross profit represent?
  - b. Can you tell whether or not the expenses are reasonable compared to the amount of income?
  - c. Ms. Machier, the owner of Up Against the Wall, is looking for a partner. As a potential investor, does this income statement present a favorable or unfavorable impression of the success of the business?
  - d. What other information would you require before you invested in this business?
- Answer: a. Gross profit is the first profit. It is calculated by subtracting cost of goods sold from revenues. It represents the markup on the cost of inventory sold.
- b. No.
  - c. This income statement presents a favorable impression.
  - d. Investors would ask to see a balance sheet, statement of cash flows, and a statement of changes in shareholders' equity in order to evaluate the success of a business more fully.

Diff: 3

Skill: Analytic skills

Objective: LO 1-5

1.5-8) Adam Key started a lock service out of his house. It is profitable, but the latest statement of changes in shareholders' equity shows a decrease. Review the statement and advise Adam on what the business should do.

Adam Key's Locks  
Statement of Changes in Shareholders' Equity  
For the Month of September 30, 2012

Beginning contributed capital	\$40,000
Add: Capital contributed during the month	<u>0</u>
Ending contributed capital	\$40,000
Beginning retained earnings	\$27,000
Add: Net income	3,000
Less: dividends	<u>(3,500)</u>
Ending retained earnings	<u>\$26,500</u>

Answer: Adam is drawing more money out of the business than he is making in profit. If he wants to grow the business, he will have to take out less than the business makes.

Diff: 1

Skill: Analytic skills

Objective: LO 1-5

1.5-9) Tina is worried about the current financial state of Team Shirts, Inc. Her latest statement of cash flows shows a net decrease in cash. Review and analyze the following summary statement. Is Tina's business in trouble? Should she be worried? What should she do to improve the cash flow situation?

Team Shirts, Inc.  
Statement of Cash Flows  
For the Month of March 31, 2012

Cash from operating activities:	\$ 1,200
Cash used for investing activities:	(1,650)
Cash used for financing activities:	<u>(2,000)</u>
Net decrease in cash	<u><u>\$(2,450)</u></u>

Answer: Cash from operating activities is positive. This means that Team Shirts is generating more in cash sales than it is spending to run the business. This is a sign of a healthy business. Cash used for investing is negative. This shows that Team Shirts is investing in the future by spending money on new equipment used to run the business. This is a sign that the business is growing. Cash used for financing means that Team Shirts has either paid off a debt or paid dividends to shareholders. Repayment of debt is a healthy business practice. Paying dividends to investors is also a good business practice.

This cash flow picture is normal for a new business. However, to conserve cash, Team Shirts should consider using credit to buy new equipment or postponing such purchases until the business has more cash. It could also forgo paying cash dividends until more cash is generated from operating activities.

Diff: 3

Skill: Analytic skills

Objective: LO 1-5



1.5-10) Examine the balance sheet for Out of Africa. Make any changes that you believe are necessary for a proper presentation, and then prepare a corrected balance sheet.

Out of Africa  
Balance Sheet  
For the Month Ended October 31, 2012

Assets		Liabilities	
Accounts payable	\$ 1,850	Accounts receivable	\$2,700
Retained earnings	21,650		
Store equipment	15,000	Shareholders' equity	
Inventory	8,950	Cash	6,850
		Contributed capital	<u>10,000</u>
Total assets	25,800	Total liabilities and shareholders' equity	<u>19,550</u>

Answer:

Out of Africa  
Balance Sheet  
October 31, 2012

Assets		Liabilities	
Cash	\$ 6,850	Accounts payable	\$1,850
Accounts receivable	2,700		
Inventory	8,950	Shareholders' equity	
Store equipment	15,000	Common stock	\$10,000
		Retained earnings	<u>21,650</u>
		Total Shareholders' equity	<u>\$31,650</u>
Total assets	<u>\$33,500</u>	Total liabilities and shareholders' equity	<u>\$33,500</u>

Diff: 3

Skill: Analytic skills, Dynamics of the global economy

Objective: LO 1-5

1.5-11) Review the income statement and make any corrections that you feel are necessary.

Bank, Rupp & Baroque, Inc.		
Income Statement		
For the Month Ended November 30, 2012		
Revenues		
Sales	\$38,000	
Accounts receivable	<u>5,800</u>	
Total revenues		\$43,800
Expenses		
Rent	\$ 3,000	
Accounts payable	7,500	
Salaries	3,750	
Maintenance	<u>850</u>	
Total expenses		<u>15,100</u>
Net income (loss)		<u>\$28,700</u>

Answer: Bank, Rupp & Baroque, Inc.

Income Statement		
For the Month Ended November 30, 2012		
Sales revenue		\$38,000
Expenses		
Rent	\$ 3,000	
Salaries	3,750	
Maintenance	<u>850</u>	
Total expenses		<u>7,600</u>
Net income (loss)		<u>\$30,400</u>

Diff: 2

Skill: Analytic skills

Objective: LO 1-5

1.5-12) Below is an income statement for Daily Kneads. Fill in the missing amounts.

Daily Kneads  
Income Statement  
For the Month Ended September 30, 2012

Sales	a. _____
Cost of goods sold	\$100,000
Gross profit	\$200,000
Administrative expenses	b. _____
Operating income	\$80,000
Interest expense	c. _____
Earnings before taxes	\$70,000
Income taxes (rate 35%)	d. _____
Net income	e. _____

Answer:

a.  $\$200,000 + 100,000 = \$300,000$

b.  $\$200,000 - 80,000 = \$120,000$

c.  $\$80,000 - 70,000 = \$10,000$

d.  $\$70,000 \times .35 = \$24,500$

e.  $\$70,000 - 24,500 = \$45,500$

Diff: 2

Skill: Analytic skills

Objective: LO 1-5

1.5-13) **Part A:** Record the transactions below by filling in the amount and the account title from the list of accounts. Use "(" or "-" to show the amounts that are negative:

<i>Account - abbreviation</i>	<i>Account - abbreviation</i>	<i>Account - abbreviation</i>
Cash	Inventory - inv	Rent expense - Rent exp
Common stock - CS	Interest expense - Int exp	Sales revenue - Sales
Cost of goods sold - COGS	Notes payable - NP	Wages expense - Wages exp
Dividends - Div		

During the month of May 2012, Wursthaus, Inc.:		Assets		Liabilities	Shareholders' equity	
		Cash	Other assets		Contributed capital	Retained earnings
1	began by issuing \$3,000 of stock to its sole owner, Sue Aige, in exchange for cash.					
2	received a \$2,000 cash loan from the bank.					
3	paid \$3,000 cash for hot dogs and buns inventory.					
4	paid \$500 cash at the end of the month to a student who cooked and delivered hot dogs to its customers.					
5	sold \$1,000 of its inventory for total cash revenues of \$2,400. Record the sale and the cost of the sale.					
6	paid \$50 to rent a steamer for the month of May.					
7	paid \$20 interest on the bank loan for the month of May.					
8	repaid \$800 of the bank loan.					
9	paid a \$200 cash dividend to its owner.					
	Totals					

**Part B:** Using the transactions from Part A, fill in the missing information on the following financial statements:

Wursthaus, Inc.	
1. _____	
2. _____	
3. _____	3. \$ _____
4. _____	4. \$ _____
Gross profit	5. \$ _____
6. _____	6. \$ _____
7. _____	7. \$ _____
Operating income	8. \$ _____
9. _____	9. \$ _____
Net income	10. \$ _____

Wursthaus, Inc.	
11. _____	
12. _____	
Beginning contributed capital	\$ 0
Stock issued	13. \$ _____
Ending contributed capital	14. \$ _____
Beginning retained earnings	\$ 0
15. _____	15. \$ _____
16. _____	16. \$ _____
Ending retained earnings	17. \$ _____
Total shareholders' equity	18. \$ _____

Wursthaus, Inc.	
19. _____	
20. _____	
<b>Cash from operating activities:</b>	
Cash collected from customers	21. \$ _____
Cash paid for inventory	22. \$ _____
Cash paid for wages	23. \$ _____
Cash paid for rent	24. \$ _____
Cash paid for interest	25. \$ _____
Total cash from operating activities	26. \$ _____
<b>Cash from investing activities:</b>	\$ 0
<b>Cash from financing activities:</b>	
Issue of stock	27. \$ _____
Proceeds from loan	28. \$ _____
Repayment of loan (principal)	29. \$ _____
Dividends paid	30. \$ _____
Total cash from financing	31. \$ _____
Net change in cash	32. \$ _____

Wursthaus, Inc.			
33. _____			
34. _____			
Cash	35. \$ _____	38. _____	38. \$ _____
36. _____	36. \$ _____	Common stock	39. \$ _____
		Retained earnings	40. \$ _____
Total	37. \$ _____	Total	41. \$ _____

**Part C:** Using the transactions and financial statements from Parts A and B, answer the following questions:

1	What is the amount of the company's resources?	\$
2	Was the company profitable?	
3	What is the amount of the creditors' claims to the company's resources?	\$
4	What is the amount of owners' claims to the company's resources?	\$
5	What is the amount of owners' claims that has been contributed to the company?	\$
6	Did the company retain all of its earnings for the period?	
7	What is the amount of owners' claims that the company has earned and kept in the business?	\$

**Part D:** Put an "X" in the column of the financial statement where the following information is found. There is only one best answer for each. IS stands for income statement, SE for statement of changes in shareholders' equity, SOCF for statement of cash flows, and BS for balance sheet.

Which financial statement reports:		IS	SE	SOCF	BS
1	the amount sold during May?				
2	the amount left to sell as of May 31?				
3	activity in stock and retained earnings during May?				
4	economic resources owned?				
5	creditors claims to the company's resources?				

**Answer: Part A:**

	Assets		Liabilities	Shareholders' equity	
	Cash	O. assets		CC	RE
1	3,000			3,000	CS
2	2,000		2,000	NP	
3	(3,000)	3,000	Inv		
4	(500)				(500) Wages exp
5	2,400	(1,000)	Inv		2,400 Sales (1,000) COGS
6	(50)				(50) Rent exp
7	(20)				(20) Int exp
8	(800)		(800)	NP	
9	(200)				(200) Div

**Part B:**

Wursthaus, Inc.	
1. Income Statement	
2. For the Month Ended May 31, 2012	
3. Sales	3. \$2,400
4. Cost of goods sold	4. <u>\$1,000</u>
Gross profit	5. \$1,400
6. Wages expense	6. \$ 500
7. Rent expense	7. <u>\$ 50</u>
Operating income	8. \$ 850
9. Interest expense	9. <u>\$ 20</u>
Net income	10. <u>\$ 830</u>

Wursthaus, Inc.	
11. Statement of Changes in Shareholders' Equity	
12. For the Month Ended May 31, 2012	
Beginning contributed capital	\$ 0
Stock issued	13. <u>\$ 3,000</u>
Ending contributed capital	14. \$ 3,000
Beginning retained earnings	\$ 0
15. Net income	15. \$ 830
16. Dividends	16. \$ (200)
Ending retained earnings	17. <u>\$ 630</u>
Total shareholders' equity	18. <u>\$ 3,630</u>

Wursthaus, Inc.	
19. Statement of Cash Flows	
20. For the Month Ended May 31, 2012	
<b>Cash from operating activities:</b>	
Cash collected from customers	21. \$ 2,400
Cash paid for inventory	22. \$(3,000)
Cash paid for wages	23. \$ (500)
Cash paid for rent	24. \$ (50)
Cash paid for interest	25. <u>\$ (20)</u>
Total cash from operating activities	26. \$(1,170)
<b>Cash from investing activities:</b>	\$ 0
<b>Cash from financing activities:</b>	
Issue of stock	27. \$ 3,000
Proceeds from loan	28. \$ 2,000
Repayment of loan (principal)	29. \$ (800)
Dividends paid	30. <u>\$ (200)</u>
Total cash from financing	31. \$ 4,000
Net change in cash	32. <u>\$ 2,830</u>

Wursthaus, Inc.			
33. Balance Sheet			
34. May 31, 2012			
Cash	35. \$2,830	38. Notes payable	38. \$1,200
36. Inventory	36. <u>\$2,000</u>	Common stock	39. \$3,000
		Retained earnings	40. <u>\$ 630</u>
Total	37. <u>\$4,830</u>	Total	41. <u>\$4,830</u>

**Part C:**

1	\$4,830
2	Yes
3	\$1,200
4	\$3,630
5	\$3,000
6	No, dividends
7	\$630

**Part D:**

	IS	SE	SOCF	BS
1	X			
2				X
3		X		
4				X
5				X

Diff: 3

Skill: Analytic skills, Use of information technology

Objective: LO 1-1, LO 1-2, LO 1-3, LO 1-4, & LO 1-5



1.5-14) Team Instructions: *Divide the class into teams of three or four people. Each team member should work the following problem separately outside of class. Then give the students time in class to compare answers with their teammates and put together a final correct copy of the problem. Each team should turn in only one copy of the problem for grading. All team members will receive the same grade.*

**Part A:** Record the transactions in the following accounting equation worksheet by filling in the amount using "(" if the amounts are negative. Also fill in the account title from the list of accounts below (use the abbreviations given):

<i>Account - abbreviation</i>	<i>Account - abbreviation</i>	<i>Account - abbreviation</i>
Cash	Inventory - inv	Rent expense - Rent exp
Common stock - CS	Interest expense - Int exp	Sales revenue - Sales
Cost of goods sold - COGS	Net income - NI	Wages expense - Wages exp
Dividends - Div	Note payable - NP	

<i>The following events took place in the month of January, 2012.</i>		Assets		Liabilities	Shareholders' equity	
		Cash	Other assets		Contributed capital	Retained earnings
1	Tim's Tams, Inc. began business by issuing \$6,000 of common stock to its owners in exchange for cash.					
2	Tim's Tams borrowed \$3,000 cash on a one-month, 6% note. One month's interest and the note are due at the end of the month.					
3	Tim's Tams paid \$6,000 cash for 1,000 caps at \$6 each.					
4	Tim's Tams paid \$500 cash for January's rent of a booth.					
5	Tim's Tams sold 800 of its caps to customers for \$8,000 cash. <i>Record the a) sale and the b) cost of goods sold.</i>					
6	Tim's Tams paid its employee, Tom, \$400 for the work he performed in January.					
7	Tim's Tams paid \$15 interest on the note payable and paid off the \$3,000 note as well.					
8	Tim's Tams paid a \$30 cash dividend to its owners.					
	Totals					

**Part B:** Using the information from Part A, fill in the missing information on the following financial statements.

Tim's Tams, Inc.		Tim's Tams, Inc.	
1. _____		16. _____	
2. _____		17. _____	
3. _____	4. \$ _____	Beginning contributed capital	\$ 0
5. _____	6. \$ _____	Stock issued	18. \$ _____
Gross profit	7. \$ _____	Ending contributed capital	19. \$ _____
8. _____	9. \$ _____	Beginning retained earnings	\$ 0
10. _____	11. \$ _____	20. _____	21. \$ _____
Operating income	12. \$ _____	22. _____	23. \$ _____
13. _____	14. \$ _____	Ending retained earnings	24. \$ _____
Net income	15. \$ _____	Total shareholders' equity	25. \$ _____

Tim's Tams, Inc.	
26. _____	
27. _____	
<b>Cash from operating activities:</b>	
Cash collected from customers	28. \$ _____
Cash paid for inventory	29. \$ _____
Cash paid for rent	30. \$ _____
Cash paid for wages	31. \$ _____
Cash paid for interest	32. \$ _____
Total cash from operations	33. \$ _____
<b>Cash from investing activities:</b>	\$ 0
<b>Cash from financing activities:</b>	
Issue of stock	34. \$ _____
Proceeds from loan	35. \$ _____
Repayment of loan	36. \$ _____
Dividends paid	37. \$ _____
Total cash from financing	38. \$ _____
Net change in cash	39. \$ _____

Tim's Tams, Inc.			
40. _____			
41. _____			
Cash	42. \$ _____	Common stock	45. \$ _____
Inventory	43. \$ _____	Retained earnings	46. \$ _____
Total assets	44. \$ _____	Total liabilities and shareholders' equity	47. \$ _____

**Part C:** Using the transactions and financial statements from Parts A and B, answer the following questions:

1	What is the amount of the company's resources?	\$
2	What is the amount of the creditors' claims to the company's resources?	\$
3	What is the amount of owners' claims to the company's resources?	\$
4	What is the amount of owners' claims that has been contributed to the company?	\$
5	Did the company retain all of its earnings and how do you know?	

**Part D:** Write the name of the one financial statement where the following information is found.

Which financial statement reports:		Financial Statement
1	economic resources owned by Tim's Tams, Inc.?	
2	creditors' claims to Tim's Tams' resources?	
3	activity in stock and retained earnings during January?	
4	how much Tim's Tams' sales were during January?	
5	how much Tim's Tams has left to sell as of January 31?	

Answer: **Part A:**

		Assets		Liabilities	Shareholders' equity	
		Cash	Other assets		Contributed capital	Retained earnings
1	Tim's Tams, Inc. began business by issuing \$6,000 of common stock to its owners in exchange for cash.	6,000			6,000 CS	
2	Tim's Tams borrowed \$3,000 cash on a one-month, 6% note. One month's interest and the note are due at the end of the month.	3,000		3,000 NP		
3	Tim's Tams paid \$6,000 cash for 1,000 caps at \$6 each.	(6,000)	6,000 Inv			
4	Tim's Tams paid \$500 cash for January's rent of a booth.	(500)				(500) Rent exp
5	Tim's Tams sold 800 of its caps to customers for \$8,000 cash. <i>Record the a) sale and the b) cost of goods sold.</i>	8,000	(4,800) Inv			8,000 Sales (4,800) COGS
6	Tim's Tams paid its employee, Tom, \$400 for the work he performed in January.	(400)				(400) Wages exp
7	Tim's Tams paid \$15 interest on the note payable and paid off the \$3,000 note as well.	(3,015)		(3,000) NP		(15) Int exp
8	Tim's Tams paid a \$30 cash dividend to its owners.	(30)				(30) Div

**Part B:**

Tim's Tams, Inc.

Tim's Tams, Inc.

**1. Income Statement**

**16. Statement of Changes in Shareholders' Equity**

**2. Month ended January 31, 2012**

**17. Month ended January 31, 2012**

<b>3. Sales</b>	<b>4. \$8,000</b>
<b>5. COGS</b>	<b>6. \$4,800</b>
Gross profit	<b>7. \$3,200</b>
<b>8. Rent exp</b>	<b>9. \$ 500</b>
<b>10. Wages exp</b>	<b>11. \$ 400</b>
Operating income	<b>12. \$2,300</b>
<b>13. Int exp</b>	<b>14. \$ 15</b>
Net income	<b>15. \$2,285</b>

Beginning contributed capital	\$ 0
Stock issued	<b>18. \$6,000</b>
Ending contributed capital	<b>19. \$6,000</b>
Beginning retained earnings	\$ 0
<b>20. Net income</b>	<b>21. \$2,285</b>
<b>22. Div</b>	<b>23. \$ 30</b>
Ending retained earnings	<b>24. \$2,255</b>
Total shareholders' equity	<b>25. \$8,255</b>

Tim's Tams, Inc.

**26. Statement of Cash Flows**

**27. Month ended January 31, 2012**

**Cash from operating activities:**

Cash collected from customers	<b>28. \$ 8,000</b>
Cash paid for inventory	<b>29. \$(6,000)</b>
Cash paid for rent	<b>30. \$ (500)</b>
Cash paid for wages	<b>31. \$ (400)</b>
Cash paid for interest	<b>32. \$ (15)</b>
Total cash from operations	<b>33. \$ 1,085</b>

**Cash from investing activities:**

\$ 0

**Cash from financing activities:**

Issue of stock	<b>34. \$ 6,000</b>
Proceeds from loan	<b>35. \$ 3,000</b>
Repayment of loan	<b>36. \$ (3,000)</b>
Dividends paid	<b>37. \$ (30)</b>
Total cash from financing	<b>38. \$ 5,970</b>
Net change in cash	<b>39. \$ 7,055</b>

Tim's Tams, Inc.

**40. Balance Sheet**

**41. January 31, 2012**

Cash	<b>42. \$7,055</b>	Common stock	<b>45. \$6,000</b>
Inventory	<b>43. \$1,200</b>	Retained earnings	<b>46. \$2,255</b>
Total	<b>44. \$8,255</b>	Total	<b>47. \$8,255</b>

**Part C:**

1	What is the amount of the company's resources?	\$ 8,255
2	What is the amount of the creditors' claims to the company's resources?	\$0
3	What is the amount of owners' claims to the company's resources?	\$8,255
4	What is the amount of owners' claims that has been contributed to the company?	\$6,000
5	Did the company retain all of its earnings?	No



**Part D:**

		Financial Statement
1	economic resources owned by Tim's Tams, Inc.?	Balance sheet
2	creditors' claims to Tim's Tams' resources?	Balance sheet
3	activity in stock and retained earnings during January?	SOSE
4	how much Tim's Tams' sales were during January?	Income statement
5	how much Tim's Tams has left to sell as of January 31?	Balance sheet

Diff: 3

Skill: Analytic skills, Team

Objective: LO 1-1, LO 1-2, LO 1-4, &amp; LO 1-5

1.5-15) Match the following terms with the appropriate definitions. Each term is to be used only once.

- a. Interest
- b. Contribution or contributed capital
- c. Entrepreneur
- d. Principal
- e. Retained earnings
- f. Comparative balance sheets
- g. Multistep income statement

- \_\_\_\_\_ 1. A person who starts a business.
- \_\_\_\_\_ 2. A statement that reports two consecutive fiscal years.
- \_\_\_\_\_ 3. The cost of borrowing money.
- \_\_\_\_\_ 4. Reports gross profit on sales (or gross margin) and operating income as subtotals.
- \_\_\_\_\_ 5. The equity that results from doing business that is kept in the company.
- \_\_\_\_\_ 6. The amount of money borrowed.
- \_\_\_\_\_ 7. An owner's investment in a company.

Answer: c, f, a, g, e, d, b

Diff: 2

Objective: LO 1-2, LO 1-4, &amp; LO 1-5

## Learning Objective 1-6

1.6-1) Good business planning involves the identification of risks such as operating risks and financial risks.

Answer: TRUE

Diff: 2

Objective: LO 1-6

1.6-2) Managers are required to maximize shareholders' equity in the business, which often requires them to "cook the books."

Answer: FALSE

Diff: 1

Skill: Ethical understanding and reasoning abilities

Objective: LO 1-6

1.6-3) A control is an activity performed to minimize or eliminate risk.

Answer: TRUE

Diff: 1

Skill: Use of information technology

Objective: LO 1-6

1.6-4) Bea Rich is enthusiastic about starting her catering business. She feels confident that she has a great concept and can handle the day-to-day details of running a business. However, this is her first attempt at running her own business. Advise Bea on the risks associated with starting a business.

Answer: All businesses are exposed to risk. A risk is anything that exposes a business to a potential injury or loss. For example, Bea could serve clients meals that could cause severe allergic reactions. She could purchase and serve food that had hazardous bacteria, such as salmonella. However, people start a business because the potential rewards outweigh the potential risks.

Risks can be classified into the following four categories: general strategic risks, operating risks, financial risks, and information risks. A good business plan will take into account strategies for covering these risks. General strategic risks for Bea's business would include the quality of food and allergies of customers. Operating risks would include breakdown of equipment, availability of quality ingredients, and transportation problems. Financial risks include the ability to pay off debt and having enough cash to pay bills. Information risks include keeping proper business records and keeping track of bills.

Business owners manage risk through the process of control, in which risks are determined and methods are adopted to minimize those risks.

Diff: 3

Skill: Analytic skills, Use of information technology

Objective: LO 1-6



1.6-5) Doug Depp is the manager at Chutes, Inc. that sells parachutes. Management's next year's bonus is based on the current year's net income. In an effort to increase his bonus, Doug decides to buy the pull-cord used in making the company's parachutes from a less reputable supplier. The supplier's prices are lower, but the pull-cords are less reliable in successfully opening the parachute.

- a. Explain how net income will be higher if the cheaper pull-cord is used in the parachutes sold to Chutes, Inc.'s customers.
- b. Discuss whether Doug is acting in the best interest of the company and its owners.
- c. Discuss the ethical issue and what the consequences of Doug's actions may be.

Answer: a. Cost of goods sold will be less thus net income will be greater.

b. Doug is acting in his best interest but not necessarily the company's and its owners' in the long-run. Doug's decision will help Chutes, Inc.'s net income in the short-run, but the decision may hurt the company in the long-run.

c. The reputation of the company could be harmed in the long-run especially if a customer were to be injured due to the failure of the parachute.

Diff: 3

Skill: Communication abilities, Ethical understanding and reasoning abilities

Objective: LO 1-6

1.6-6) Ima Broke is the sole owner of Miracles, Inc. Ima needs another loan from a bank to expand her business. In order to improve the chances of receiving a loan, she decides to report the principal of one of Miracles, Inc.'s loans as contributed capital instead of a liability on the balance sheet. Discuss the ethical issue with Ima's treatment of the loan.

Answer: Ima Broke is misrepresenting the company's financial position. The principal of loans has to be paid back when due, but the company has no obligation to give money back to its owners. A potential creditor will be misled and may decide to lend the money only to find out later that the company does not have the ability to pay back its loans when due.

Diff: 2

Skill: Communication abilities, Ethical understanding and reasoning abilities

Objective: LO 1-1 & LO 1-6

1.6-7) Team Instructions: *Divide the class into teams of three or four people. Each team member should work the following problem separately outside of class. Then give the students time in class to compare answers with their teammates and put together a final correct copy of the problem. Each team should turn in only one copy of the problem for grading. All team members will receive the same grade.*

Doug Depp is your manager at Chutes, Inc. which sells parachutes. Management's next year's bonus is based on the current year's net income. In an effort to increase his bonus, Doug decides to buy the pull-cord used in making the company's parachutes from a less reputable supplier. The supplier's prices are lower, but the pull-cords are less reliable in successfully opening the parachute. Discuss with your team members the pros and cons of buying the cheaper pull-cord. As a team, decide what the president of the company could do in the future to avoid having the company face this type of scenario.

Answer: The pros: Cost of goods sold will be less thus net income will be greater. The price of the company's stock may rise. The cons: The reputation of the company could be harmed in the long-run especially if a customer were to be injured due to the failure of the parachute. The company could change its incentive plan. Currently a manager is focused solely on net income and not on the long-run reputation of the company. The president could use other measurements such as customer complaints and defect rates to determine bonuses for management.

Diff: 3

Skill: Team, Communication abilities, Ethical understanding and reasoning abilities

Objective: LO 1-6

1.6-8) Team Instructions: *Divide the class into teams of three or four people. Each team member should work the following problem separately outside of class. Then give the students time in class to compare answers with their teammates and put together a final correct copy of the problem. Each team should turn in only one copy of the problem for grading. All team members will receive the same grade.*

Search the internet for information about the WorldCom Inc. fraud in 2002. With your group, write a brief description of the fraud and discuss the ethical issue.

Answer: WorldCom Inc. executives were found guilty of hiding the company's increasing expenses by improperly shifting costs from operating to capital accounts (i.e. expenses were classified as assets). Management should always put good ethical behavior above "cooking the books" in order to make the company look more profitable than it is.

Diff: 2

Skill: Team, Communication abilities, Ethical understanding and reasoning abilities

Objective: LO 1-6

1.6-9) Provide students with copies of real merchandising companies' annual reports, or give students the Web addresses of real merchandising companies and ask them to print out the annual reports. All team members should work with the same company's annual report. Each team should in hand in only one copy of the answers, along with its annual report.

Answer the following questions using the annual report assigned to your group:

1	What is the name of your company?	
2	What is the company's form of ownership?	
3	What is the date of the company's most recent fiscal yearend?	
4	What is the amount of the company's total cost of goods sold?	\$
5	Was the company profitable?	
6	How much are the company's total liabilities?	\$
7	What term does the company use for owner's equity?	
8	What is the name of the financial statement that shows revenues and expenses?	
9	For the two most recent years shown, which year had the higher net income?	
10	For the two most recent years shown, which year had the higher net income?	
11	Who might be interested in these financial statements?	

Answer:

1	
2	Corporation
3	See date on financial statements
4	Cost of goods sold on the income statement (look to see if \$ in 000,s or 000,000's).
5	Profitable, if net income is positive.
6	Liabilities on the balance sheet (look to see if \$ in 000's or 000,000's).
7	Most likely owner's equity is called Shareholders' equity.
8	Consolidated statement of income or earnings.
9	Consolidated balance sheets.
10	The year with the higher net income on the income statement.
11	Owners, creditors, investors, employees, suppliers, SEC.

Diff: 2

Skill: Analytic skills, Team

Objective: LO 1-1, LO 1-3, LO 1-4, LO 1-5, & LO 1-6

1.6-10) Match each of the following with the appropriate definition. Each term is to be used only once.

- a. Financing activities
- b. Risk
- c. Investing activities
- d. Retained earnings
- e. Control
- f. Operating activities

- \_\_\_\_\_ 1. An activity performed to minimize or eliminate a risk.
- \_\_\_\_\_ 2. Anything that exposes a company to potential injury or loss.
- \_\_\_\_\_ 3. Cash transactions that relate to the routine operations needed to run a business.
- \_\_\_\_\_ 4. Transactions involving the sale and purchase of long-term assets used in a business.
- \_\_\_\_\_ 5. Transactions related to obtaining resources from long-term borrowing and from issuing stock.
- \_\_\_\_\_ 6. The earnings kept by the company.

Answer: e, b, f, c, a, d

Diff: 2

Objective: LO 1-1, LO 1-2, LO 1-4, & LO 1-6