

Fundamental Financial Accounting Concepts, 10e (Edmonds)

Chapter 1 An Introduction to Accounting

1) Which of the following groups has the primary responsibility for establishing generally accepted accounting principles for business entities in the United States?

- A) Securities and Exchange Commission
- B) U.S. Congress
- C) International Accounting Standards Board
- D) Financial Accounting Standards Board

Answer: D

Explanation: The Financial Accounting Standards Board is a privately funded group charged with establishing accounting standards for the U.S. It is not a branch of the U.S. government.

Difficulty: 1 Easy

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Legal

2) The Heritage Company is a manufacturer of office furniture. Which term best describes Heritage's role in society?

- A) Conversion agent
- B) Regulatory agency
- C) Consumer
- D) Resource owner

Answer: A

Explanation: Businesses serve as conversion agents in the marketplace, transforming basic resources provided by resource owners into goods and services that consumers demand.

Regulatory agencies set policies that affect the way that businesses operate.

Difficulty: 2 Medium

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Industry

3) Which resource providers lend financial resources to a business with the expectation of repayment with interest?

- A) Consumers
- B) Creditors
- C) Investors
- D) Owners

Answer: B

Explanation: Businesses borrow money from creditors, and repay the amount borrowed, plus an additional fee known as interest. Investors, in contrast, provide financial resources in exchange for ownership interest in the business. Consumers demand goods and services from businesses.

Difficulty: 1 Easy

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

4) Which type of accounting information is intended to satisfy the needs of external users of accounting information?

- A) Cost accounting
- B) Managerial accounting
- C) Tax accounting
- D) Financial accounting

Answer: D

Explanation: Financial accounting is intended to satisfy the needs of external users of accounting information. Managerial accounting, including cost accounting, is intended for the needs of internal users, or managers, of a business. Tax accounting is specifically intended for tax regulatory agencies.

Difficulty: 1 Easy

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

5) Which of the following statements is **false** regarding managerial accounting information?

- A) It is often used by investors.
- B) It is more detailed than financial accounting information.
- C) It can include nonfinancial information.
- D) It focuses on divisional rather than overall profitability.

Answer: A

Explanation: Managerial accounting provides information primarily for internal users, or managers, of businesses. Managers require more detailed information about a business than do external users, and sometimes that information is nonfinancial in nature. Managerial accounting information focuses on divisional rather than overall profitability and is not typically made available to external users, such as investors.

Difficulty: 2 Medium

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Industry

6) Financial accounting standards are known collectively as GAAP. What does that acronym stand for?

- A) Generally Accepted Accounting Principles
- B) Generally Applied Accounting Procedures
- C) Governmentally Approved Accounting Practices
- D) Generally Authorized Auditing Principles

Answer: A

Explanation: Generally Accepted Accounting Principles are established by the Financial Accounting Standards Board.

Difficulty: 1 Easy

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

7) International accounting standards are formulated by the IASB. What does that acronym stand for?

- A) Internationally Accepted Standards Board
- B) International Accounting Standards Board
- C) International Accountability Standards Bureau
- D) International Accounting and Sustainability Board

Answer: B

Explanation: The International Accounting Standards Board establishes accounting standards for most countries outside of the U.S.

Difficulty: 1 Easy

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement; BB Global

8) Which of the following is an example of revenue?

- A) Cash received as a result of a bank loan
- B) Cash received from investors from the sale of common stock
- C) Cash received from customers at the time services were provided
- D) Cash received from the sale of land for its original selling price

Answer: C

Explanation: Cash received from providing services to customers is an example of revenue, and is an asset source transaction. Cash received from the result of a bank loan results in a liability, notes payable. Cash investments made by owners increase the stockholders' equity account common stock. Cash received from the sale of land for its original selling price is an asset exchange transaction that decreases one asset, land, and increases another asset, cash.

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

9) Which of the following is **not** an element of the financial statements?

- A) Net income
- B) Revenue
- C) Assets
- D) Cash

Answer: D

Explanation: Cash is not an element of the financial statements. It is an account that is part of the element assets.

Difficulty: 2 Medium

Topic: Elements of Financial Statements

Learning Objective: 01-03 Identify the components of the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

10) Algonquin Company reported assets of \$50,000, liabilities of \$22,000 and common stock of \$15,000. Based on this information only, what is the amount of the company's retained earnings?

- A) \$7,000.
- B) \$57,000.
- C) \$13,000.
- D) \$87,000.

Answer: C

Explanation: $\text{Assets} = \text{Liabilities} + \text{Equity}$; Equity includes common stock and retained earnings.
 $\$50,000 = \$22,000 + \$15,000 + \text{Retained earnings}$; Retained earnings = \$13,000

Difficulty: 3 Hard

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

11) Stosch Company's balance sheet reported assets of \$40,000, liabilities of \$15,000 and common stock of \$12,000 as of December 31, Year 1. Retained earnings on the December 31, Year 2 balance sheet is \$18,000 and Stosch paid a \$14,000 dividend during Year 2. What is the amount of net income for Year 2?

- A) \$17,000
- B) \$19,000
- C) \$13,000
- D) \$21,000

Answer: B

Explanation: If assets on December 31, Year 1 totaled \$40,000, total claims (including liabilities, common stock, and retained earnings) on that date must have also been \$40,000. If liabilities were \$15,000 and common stock was \$12,000, retained earnings on December 31, Year 1 must have been \$13,000. At the end of Year 2, the company reported \$18,000 in retained earnings, a \$5,000 increase. During Year 2, Stosch paid a \$14,000 cash dividend, which reduced retained earnings. Therefore, Year 2 net income must have been \$5,000 greater than the dividend paid. $\$14,000 + \$5,000 = \$19,000$.

Difficulty: 3 Hard

Topic: Role of Accounting In Society

Learning Objective: 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

12) Hazeltine Company issued common stock for \$200,000 cash. What happened as a result of this event?

- A) Assets increased.
- B) Equity increased.
- C) Claims increased.
- D) Assets, claims, and equity all increased.

Answer: D

Explanation: Issuing common stock increases both assets (cash) and equity (common stock).

Equity and liabilities collectively make up claims in the accounting equation.

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

13) Ballard Company reported assets of \$500 and liabilities of \$200. What amount will Ballard's report for stockholders' equity?

- A) \$300
- B) \$500
- C) \$700
- D) Cannot be determined

Answer: A

Explanation: In the accounting equation, assets equal claims (liabilities + equity). If assets are \$500, total claims must also be \$500. Therefore, stockholders' equity must be $\$500 - \200 , or \$300.

Difficulty: 1 Easy

Topic: Elements of Financial Statements

Learning Objective: 01-03 Identify the components of the accounting equation.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

14) A company's total assets increased during the period while its liabilities and common stock were unchanged. No dividends were declared or paid during the period. Which of the following would explain this situation?

- A) Revenues were greater than expenses during the period.
- B) Retained earnings were less than net income during the period.
- C) No dividends were paid during the period.
- D) The company must have purchased assets with cash during the period.

Answer: A

Explanation: $\text{Assets} = \text{Liabilities} + \text{Stockholders' equity}$

$\text{Assets} = \text{Liabilities} + \text{Common stock} + \text{Retained earnings}$

If a company's total assets increased while liabilities and common stock were unchanged, retained earnings must have increased. In order for retained earnings to increase, the company must have reported net income. In other words, its revenues must have been greater than its expenses.

Difficulty: 3 Hard

Topic: Elements of Financial Statements

Learning Objective: 01-03 Identify the components of the accounting equation.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

15) Li Company paid cash to purchase land. What happened as a result of this business event?

- A) Total assets decreased.
- B) Total assets were unaffected.
- C) Total equity decreased.
- D) Both assets and total equity decreased.

Answer: B

Explanation: Paying cash for land is an asset exchange transaction that increases one asset (land) and decreases another asset (cash). The result is no overall change in total assets.

Difficulty: 1 Easy

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

16) Turner Company reported assets of \$20,000 (including cash of \$9,000), liabilities of \$8,000, common stock of \$7,000, and retained earnings of \$5,000. Based on this information, what can be concluded?

- A) 25% of Turner's assets are the result of prior earnings.
- B) \$5,000 is the maximum dividend that can be paid to shareholders.
- C) 40% of Turner's assets are the result of borrowing from creditors.
- D) 25% of Turner's assets are from prior earnings, \$5,000 is the maximum possible dividend, and 40% of assets are the result of borrowed resources.

Answer: D

Explanation: Retained earnings of \$5,000 is equal to 25% of the company's assets, indicating that 25% of Turner's assets are from prior earnings. \$8,000, or 40%, of Turner's assets are liabilities, indicating that those assets are the result of borrowed resources. A company can pay out no more in dividends than it has in its Retained Earnings account.

Difficulty: 3 Hard

Topic: Interpreting Information Shown in the Accounting Equation

Learning Objective: 01-05 Interpret information shown in an accounting equation.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

17) At the time of liquidation, Fairchild Company reported assets of \$200,000, liabilities of \$120,000, common stock of \$70,000 and retained earnings of \$10,000). What is the maximum amount of Fairchild's assets that the shareholders are entitled to receive?

- A) \$200,000
- B) \$80,000
- C) \$90,000
- D) \$100,000

Answer: B

Explanation: Creditors receive first priority in asset distribution during a business liquidation. Therefore, creditors would collect the \$120,000 owed to them, leaving the shareholders with the remaining \$80,000 (\$70,000 common stock + \$10,000 retained earnings).

Difficulty: 2 Medium

Topic: Interpreting Information Shown in the Accounting Equation

Learning Objective: 01-05 Interpret information shown in an accounting equation.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: FN Measurement; BB Resource Management

18) As of December 31, Year 2, Bristol Company had \$100,000 of assets, \$40,000 of liabilities and \$25,000 of retained earnings. What percentage of Bristol's assets were obtained through investors?

- A) 60%
- B) 25%
- C) 40%
- D) 35%

Answer: D

Explanation: If assets total \$100,000, claims must also total \$100,000. Claims include liabilities, common stock and retained earnings. Because liabilities and retained earnings equal \$65,000, common stock must be \$35,000. The common stock account represents the assets that were obtained through investors. \$35,000 is 35% of \$100,000.

Difficulty: 2 Medium

Topic: Interpreting Information Shown in the Accounting Equation

Learning Objective: 01-05 Interpret information shown in an accounting equation.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

19) On January 1, Year 2, Chavez Company had beginning balances as follows: total assets of \$12,500, total liabilities of \$4,500, and common stock of \$3,000. During Year 2, Chavez paid dividends to its stockholders of \$2,000. Given that retained earnings amounted to \$6,000 at the end of Year 2, what was Chavez's net income for Year 2?

- A) \$3,000
- B) \$5,000
- C) \$7,000
- D) \$2,000

Answer: A

Explanation: On January 1, Year 2:

Assets = Liabilities + Common Stock + Retained Earnings

\$12,500 = \$4,500 + \$3,000 + Retained Earnings

Retained Earnings = \$5,000

During Year 2:

Beginning retained earnings + Net income – Dividends = Ending retained earnings

\$5,000 + Net Income – \$2,000 = \$6,000

Net Income = \$3,000

Difficulty: 3 Hard

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

20) When a business provides services for cash, which elements of the accounting equation are affected?

- A) Revenue and Expense
- B) Cash and Revenue
- C) Cash and Expense
- D) Cash and Dividends

Answer: B

Explanation: Providing services for cash increases a company's assets (cash) and equity (revenue, which closes to retained earnings).

Difficulty: 1 Easy

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

21) During Year 2, Millstone Company provided \$6,500 of services for cash, paid cash dividends of \$1,000 to owners, and paid \$4,000 cash for expenses. Liabilities were unchanged. Which of the following statements accurately describes the effect of these events on the elements of the company's financial statements?

- A) Assets increased by \$6,500.
- B) Assets increased by \$1,500.
- C) Equity increased by \$2,500.
- D) Assets increased by \$5,500.

Answer: B

Explanation: Cash, an asset, increased by \$1,500 (calculated as receipts of \$6,500 – payment of \$1,000 – payment of \$4,000). Equity also increased by \$1,500 (calculated as revenue of \$6,500 – dividends of \$1,000 – expenses of \$4,000).

Difficulty: 3 Hard

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: FN Measurement; BB Resource Management

22) At the end of Year 2, retained earnings for the Baker Company was \$3,500. Revenue earned by the company in Year 2 was \$1,500, expenses paid during the period were \$800, and dividends paid during the period were \$500. Based on this information alone, what was the amount of retained earnings at the beginning of Year 2?

- A) \$3,300
- B) \$3,700
- C) \$2,800
- D) \$3,800

Answer: A

Explanation: Beginning Retained Earnings + Revenue - Expenses - Dividends = Ending Retained Earnings

Beginning Retained Earnings + \$1,500 - \$800 - \$500 = \$3,500

Beginning Retained Earnings = \$3,300

Difficulty: 3 Hard

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: FN Measurement; BB Resource Management

23) Which of the following is **not** an example of an asset use transaction?

- A) Paying cash dividends
- B) Paying cash expenses
- C) Paying off the principal of a loan
- D) Paying cash to purchase land

Answer: D

Explanation: Paying cash to purchase land is an asset exchange transaction.

Difficulty: 1 Easy

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

24) Borrowing cash from the bank is an example of which type of transaction?

- A) Asset source
- B) Claims exchange
- C) Asset use
- D) Asset exchange

Answer: A

Explanation: Borrowing cash is an asset source transaction that increases a business's assets (cash) and increases its liabilities (notes payable).

Difficulty: 1 Easy

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

25) Which of the following could describe the effects of an asset exchange transaction on the elements of a company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmnt of Cash Flows |
|----|--------|---|-------|---|--------|------|---|------|---|----------|---------------------|
| A. | NA | = | NA | + | NA | NA | - | NA | = | NA | +OA |
| B. | + | = | NA | + | + | NA | - | NA | = | NA | +FA |
| C. | - | = | NA | + | - | NA | - | NA | = | NA | NA |
| D. | + | = | + | + | NA | NA | - | NA | = | NA | +FA |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: A

Explanation: An asset exchange transaction is one that increases one asset account and decreases another, resulting in no net change in assets. There are no changes to the company's liabilities and equity either. If one of the asset accounts affected is cash, there will be an effect on cash flows.

Difficulty: 1 Easy

Topic: The Horizontal Financial Statements Model; Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

26) Which of the following does **not** describe the effects of an asset use transaction on the elements of a company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmnt of Cash Flows |
|----|--------|---|-------|---|--------|------|---|------|---|----------|---------------------|
| A. | - | = | - | + | NA | NA | - | NA | = | NA | -OA |
| B. | - | = | - | + | NA | NA | - | NA | = | NA | -FA |
| C. | - | = | NA | + | - | NA | - | + | = | - | -OA |
| D. | NA | = | + | + | NA | + | - | + | = | - | NA |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: D

Explanation: Asset use transactions decrease the total amount of assets and the total amount of claims.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model; Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

27) Which of the following cash transactions would **not** affect total assets?

- A) Borrowing cash from a bank
- B) Issuing common stock for cash
- C) Purchasing land for cash
- D) Providing services for cash

Answer: C

Explanation: Purchasing land for cash is an asset exchange transaction that does not affect total assets. Issuing stock to owners is an asset source transaction that increases assets. Borrowing cash from a bank is an asset source transaction that increases assets. Expense transactions do not increase assets.

Difficulty: 1 Easy

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

28) Which of the following appears in the investing activities section of the statement of cash flows?

- A) Cash inflow from interest revenue
- B) Cash inflow from the issuance of common stock
- C) Cash outflow for the payment of dividends
- D) Cash outflow for the purchase of land

Answer: D

Explanation: Purchasing land (a long-lived asset) for cash is an investing activity. Issuing common stock and paying dividends are both financing activities. Cash inflow from interest revenue is an operating activity.

Difficulty: 2 Medium

Topic: Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

29) Jackson Company had a net increase in cash from operating activities of \$10,000 and a net decrease in cash from financing activities of \$2,000. If the beginning and ending cash balances for the company were \$4,000 and \$11,000, what was the net cash change from investing activities?

- A) An outflow or decrease of \$1,000
- B) An inflow or increase of \$2,000
- C) An inflow or increase of \$1,000
- D) Zero

Answer: A

Explanation: $\text{Beginning cash balance} + \text{Increase from operating activities} - \text{Decrease from financing activities} \pm \text{Increase or decrease from investing activities} = \text{Ending cash balance}$
 $\$4,000 + \$10,000 - \$2,000 \pm \text{Increase or decrease from investing activities} = \$11,000$
 $\$1,000 = \text{Decrease from investing activities}$

Difficulty: 3 Hard

Topic: Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: FN Measurement; BB Resource Management

[The following information applies to the questions displayed below.]

The financial statements of Calloway Company prepared at the end of the current year contained the following elements and corresponding amounts: Assets = \$50,000; Liabilities = ?; Common Stock = \$15,000; Revenue = \$22,000; Dividends = \$1,500; Beginning Retained Earnings = \$3,500; Ending Retained Earnings = \$7,500.

30) Based on this information, what was the amount of expenses reported on Calloway's income statement for the current year?

- A) \$18,500
- B) \$13,000
- C) \$16,500
- D) \$10,000

Answer: C

Explanation: Beginning retained earnings + Revenue – Expenses – Dividends = Ending retained earnings

$$\$3,500 + \$22,000 - \text{Expenses} - \$1,500 = \$7,500$$

$$\text{Expenses} = \$16,500$$

Difficulty: 3 Hard

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

31) What was the amount of total liabilities reported on the balance sheet as of the end of the current year?

- A) \$27,500
- B) \$31,500
- C) \$35,000
- D) \$42,500

Answer: A

Explanation: Assets = Liabilities + Common Stock + Ending Retained Earnings

$$\$50,000 = \text{Liabilities} + \$15,000 + \$7,500$$

$$\text{Liabilities} = \$27,500$$

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

32) Which of the following financial statements provides information about a company as of a specific point in time?

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

Answer: B

Explanation: The balance sheet provides information about a company as of a specific point in time, the other three statements provide information about a period of time such as a month, a quarter, or a year.

Difficulty: 1 Easy

Topic: Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

33) Which of the following is a (are) permanent account(s)?

- A) The Retained Earnings account
- B) All income statement accounts
- C) The Dividend account
- D) All balance sheet accounts and the Dividends account

Answer: A

Explanation: The balance sheet accounts are permanent accounts; they contain information carried forward from one accounting period to the next (that is, the ending account balance of one period becomes the beginning account balance of the next period). Temporary accounts are used to collect retained earnings data applicable to only the current accounting period (that is, revenue, expenses, and distributions). The Dividend account is a temporary account; it collects distributions during the current account period only.

Difficulty: 2 Medium

Topic: The Closing Process

Learning Objective: 01-09 Close revenue, expense, and dividend accounts.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

34) In which section of a statement of cash flows would the payment of cash dividends be reported?

- A) Investing activities.
- B) Operating activities.
- C) Financing activities.
- D) Dividends are not reported on the statement of cash flows.

Answer: C

Explanation: Paying cash dividends, and any cash exchanged between a company and its stockholders, is a financing activity.

Difficulty: 1 Easy

Topic: Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

35) Which financial statement matches asset increases from operating a business with asset decreases from operating the business?

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

Answer: C

Explanation: The income statement matches asset increases from operations (revenues) with asset decreases from operations (expenses).

Difficulty: 2 Medium

Topic: Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

36) Chow Company earned \$1,500 of cash revenue, paid \$1,200 for cash expenses, and paid a \$200 cash dividend to its owners. Which of the following statements is **true**?

- A) The net cash inflow from operating activities was \$100.
- B) The net cash outflow for investing activities was \$200.
- C) The net cash inflow from operating activities was \$300.
- D) The net cash outflow for investing activities was \$100.

Answer: C

Explanation: Cash revenue and cash expenses are operating activities. Paying dividends is a financing activity. $\$1,500 \text{ revenue} - \$1,200 \text{ expense} = \$300 \text{ cash inflow from operating activities.}$

Difficulty: 2 Medium

Topic: Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

37) Yi Company provided services to a customer for \$5,500 cash. Based on this information alone, which of the following statements is **true**?

- A) Total assets increased and total equity decreased.
- B) Total assets were unchanged.
- C) Liabilities decreased and net income increased.
- D) Total assets increased and net income increased.

Answer: D

Explanation: Providing services to a customer for cash increases assets and equity on the balance sheet. It also increases revenue, and therefore, net income on the income statement.

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

38) During Year 2, Chico Company earned \$1,950 of cash revenue, paid \$1,600 of cash expenses, and paid a \$150 cash dividend to its owners. Based on this information alone, which of the following statements is **not** true?

- A) Net income amounted to \$350.
- B) Total assets increased by \$200.
- C) Cash inflow from operating activities was \$350.
- D) Cash inflow from operating activities was \$200.

Answer: D

Explanation: Revenue minus expenses equal net income of \$350 (calculated as $\$1,950 - \$1,600$). Total assets increased by \$200 (calculated as $\$1,950 - \$1,600 - \$150$). Cash from operating activities increased by \$350 (calculated as $\$1,950 - \$1,600$).

Difficulty: 3 Hard

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

39) Glavine Company repaid a bank loan with cash. How should the cash flow from this event be shown on the horizontal statements model?

- A) An operating activity that decreases cash, decreases equity, and decreases net income
- B) A financing activity that decreases cash and decreases liabilities
- C) A financing activity that decreases cash, decreases equity, and decreases net income
- D) An investing activity that decreases cash and decreases liabilities

Answer: B

Explanation: Repaying a bank loan is a cash outflow for financing activities that decreases assets (cash) and decreases liabilities (notes payable).

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

40) Retained earnings at the beginning and ending of the accounting period were \$300 and \$800, respectively. Revenues of \$1,100 and dividends paid to stockholders of \$200 were reported during the period. What was the amount of expenses reported for the period?

- A) \$500
- B) \$400
- C) \$900
- D) \$700

Answer: B

Explanation: Beginning retained earnings + Revenues – Expenses – Dividends = Ending retained earnings

$$\$300 + \$1,100 - \text{Expenses} - \$200 = \$800$$

$$\text{Expenses} = \$400$$

Difficulty: 3 Hard

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

[The following information applies to the questions displayed below.]

Yowell Company began operations on January 1, Year 1. During Year 1, the company engaged in the following cash transactions:

- 1) issued stock for \$40,000
- 2) borrowed \$25,000 from its bank
- 3) provided consulting services for \$39,000
- 4) paid back \$15,000 of the bank loan
- 5) paid rent expense for \$9,000
- 6) purchased equipment costing \$12,000
- 7) paid \$3,000 dividends to stockholders
- 8) paid employees' salaries, \$21,000

41) What is Yowell's net cash flow from operating activities?

- A) Inflow of \$6,000
- B) Inflow of \$9,000
- C) Inflow of \$18,000
- D) Inflow of \$30,000

Answer: B

Explanation: $\$39,000$ inflow from consulting services – $\$9,000$ outflow for rent expense – $\$21,000$ outflow for salaries expense = $\$9,000$ inflow

Difficulty: 2 Medium

Topic: Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

42) What is Yowell's ending notes payable balance?

- A) \$0
- B) \$25,000
- C) (\$15,000)
- D) \$10,000

Answer: D

Explanation: Beginning notes payable balance $\$0$ + $\$25,000$ loan – $\$15,000$ repayment = $\$10,000$ ending balance

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

43) What is Yowell's net income?

- A) \$9,000
- B) \$30,000
- C) \$18,000
- D) \$6,000

Answer: A

Explanation: $\$39,000$ revenue – $\$9,000$ rent expense – $\$21,000$ salaries expense = $\$9,000$ net income

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

[The following information applies to the questions displayed below.]

Packard Company engaged in the following transactions during Year 1, its first year of operations: (Assume all transactions are cash transactions.)

- 1) Acquired \$950 cash from the issue of common stock.
- 2) Borrowed \$420 from a bank.
- 3) Earned \$650 of revenues.
- 4) Paid expenses of \$250.
- 5) Paid a \$50 dividend.

During Year 2, Packard engaged in the following transactions: (Assume all transactions are cash transactions.)

- 1) Issued an additional \$325 of common stock.
- 2) Repaid \$220 of its debt to the bank.
- 3) Earned revenues of \$750.
- 4) Incurred expenses of \$360.
- 5) Paid dividends of \$100.

44) What is Packard Company's net cash flow from financing activities for Year 2?

- A) \$220 outflow
- B) \$320 outflow
- C) \$5 inflow
- D) \$225 inflow

Answer: C

Explanation: Net cash flow from financing activities = \$325 inflow from stock – \$220 outflow for loan repayment – \$100 outflow for dividends = \$5

Difficulty: 3 Hard

Topic: Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

45) What was the balance of Packard's Retained Earnings account **before** closing in Year 1?

- A) \$400
- B) \$0
- C) \$350
- D) \$450

Answer: B

Explanation: Retained Earnings in the first year of operations is zero until revenues, expenses and dividends are closed to retained earnings.

Difficulty: 2 Medium

Topic: The Closing Process

Learning Objective: 01-09 Close revenue, expense, and dividend accounts.

Bloom's: Understand

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

46) What is the amount of total stockholders' equity that will be reported on Packard's balance sheet at the end of Year 1?

- A) \$1,350
- B) \$900
- C) \$250
- D) \$1,300

Answer: D

Explanation: Stockholders' equity = Common stock + Retained earnings

At end of Year 1:

Stockholders' equity = \$950 common stock issued + (\$0 beg. balance + \$650 revenue – \$250 expenses – \$50 dividend) = \$1,300

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

- 47) What is the after-closing amount of retained earnings that will be reported on Packard's balance sheet at the end of Year 2? (Assume that closing entries have been passed).
- A) \$640
 - B) \$800
 - C) \$290
 - D) \$740

Answer: A

Explanation: $\$350 \text{ beg. balance} + \$750 \text{ revenue} - \$360 \text{ expenses} - \$100 \text{ dividends} = \640

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

- 48) What is the amount of assets that will be reported on Packard's balance sheet at the end of Year 2?
- A) \$2,115
 - B) \$440
 - C) \$2,215
 - D) \$395

Answer: A

Explanation: $\$1,720 \text{ beg. balance} + \$325 - \$220 + \$750 - \$360 - \$100 = \$2,115$

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

- 49) What is the net cash inflow from operating activities that will be reported on Packard's statement of cash flows for Year 1?
- A) \$400
 - B) \$650
 - C) \$350
 - D) \$820

Answer: A

Explanation: $\$650 \text{ inflow from revenue} - \$250 \text{ outflow for expenses} = \400 inflow

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

50) Which of the following would be reported in the cash flow from financing activities section of a statement of cash flows?

- A) Paid cash for dividends
- B) Received cash for common stock
- C) Sold land for cash
- D) Paying cash for dividends and receiving cash from common stock

Answer: D

Explanation: Paying cash for dividends and receiving cash for common stock are financing activities. Selling land for cash is an investing activity.

Difficulty: 2 Medium

Topic: Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

51) Santa Fe Company was started on January 1, Year 1, when it acquired \$9,000 cash by issuing common stock. During Year 1, the company earned cash revenues of \$4,500, paid cash expenses of \$3,750, and paid a cash dividend of \$250. Which of the following is true based on this information?

- A) The December 31, Year 1 balance sheet would show total equity of \$8,750.
- B) The Year 1 income statement would show net income of \$500.
- C) The Year 1 statement of cash flows would show net cash inflow from operating activities of \$4,500.
- D) The Year 1 statement of cash flows would show a net cash inflow from financing activities of \$8,750.

Answer: D

Explanation: $\$9,000 \text{ cash inflow from issuing stock} - \$250 \text{ cash outflow for dividends} = \$8,750$ net cash inflow from financing activities

Difficulty: 2 Medium

Topic: Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

52) Robertson Company paid \$1,850 cash for rent expense. What happened as a result of this business event?

- A) Total equity decreased.
- B) Liabilities decreased.
- C) The net cash flow from operating activities decreased.
- D) Both total equity and net cash flow for operating activities decreased.

Answer: D

Explanation: Paying cash for rent expense decreases assets (cash) and decreases equity (expense decreases retained earnings). Liabilities are not affected. It is reported as a cash outflow for operating activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

53) Mayberry Company paid \$30,000 cash to purchase land. What happened as a result of this business event?

- A) Total equity was not affected.
- B) The net cash flow from investing activities decreased.
- C) Total assets were not affected.
- D) Total assets and total equity were not affected, and net cash flow from investing activities decreased.

Answer: D

Explanation: Paying cash to purchase land is an asset exchange transaction that decreases one asset (cash) and increases another asset (land); therefore, there is no overall effect on total assets, total liabilities, or total equity. It is reported as a cash outflow for investing activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation; Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.; 01-04 Show how business events affect the accounting equation.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

[The following information applies to the questions displayed below.]

Lexington Company engaged in the following transactions during Year 1, its first year in operation: *(Assume all transactions are cash transactions)*

- Acquired \$6,000 cash from issuing common stock.
- Borrowed \$4,400 from a bank.
- Earned \$6,200 of revenues.
- Incurred \$4,800 in expenses.
- Paid dividends of \$800.

Lexington Company engaged in the following transactions during Year 2: *(Assume all transactions are cash transactions)*

- Acquired an additional \$1,000 cash from the issue of common stock.
- Repaid \$2,600 of its debt to the bank.
- Earned revenues, \$9,000.
- Incurred expenses of \$5,500.
- Paid dividends of \$1,280.

54) What was the net cash flow from financing activities reported on Lexington's statement of cash flows for Year 2?

- A) \$2,880 outflow
- B) \$2,880 inflow
- C) \$1,000 outflow
- D) \$1,000 inflow

Answer: A

Explanation: \$1,000 cash inflow from issuing stock – \$2,600 cash outflow for loan repayment – \$1,280 cash outflow for dividends = \$2,880 cash outflow for financing activities

Difficulty: 3 Hard

Topic: Preparing a Statement of Cash Flows

Learning Objective: 01-08 Prepare a statement of cash flows.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

55) What is the amount of total assets that will be reported on Lexington's balance sheet at the end of Year 1?

- A) \$11,000
- B) \$12,000
- C) \$1,600
- D) \$7,600

Answer: A

Explanation: $\$0 \text{ beginning balance} + \$6,000 \text{ (cash)} + \$4,400 \text{ (cash)} + \$6,200 \text{ (cash)} - \$4,800 \text{ (cash)} - \$800 \text{ (cash)} = \$11,000$

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation; Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

56) What was the amount of retained earnings that will be reported on Lexington's balance sheet at the end of Year 1?

- A) \$6,200
- B) \$5,400
- C) \$1,400
- D) \$600

Answer: D

Explanation: $\$0 \text{ beginning balance} + \$6,200 \text{ revenue} - \$4,800 \text{ expense} - \$800 \text{ dividends} = \600

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation; Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

57) What was the amount of liabilities on Lexington's balance sheet at the end of Year 2?

- A) \$1,000.
- B) \$1,800.
- C) (\$2,600).
- D) \$480.

Answer: B

Explanation: $\$4,400 \text{ beginning balance} - \$2,600 \text{ loan repayment} = \$1,800$

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation; Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

58) As of December 31, Year 1, Mason Company had \$500 cash. During Year 2, Mason earned \$1,200 of cash revenue and paid \$800 of cash expenses. What is the amount of cash that will be reported on the balance sheet at the end of Year 2?

- A) \$900
- B) \$400
- C) \$1,700
- D) \$2,500

Answer: A

Explanation: $\$500 \text{ beginning balance} + \$1,200 \text{ revenue} - \$800 \text{ expenses} = \$900$

Difficulty: 1 Easy

Topic: Recording Business Events Under the Accounting Equation; Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Apply

AACSB: Knowledge Application

AICPA: BB Critical Thinking; FN Measurement

59) Expenses are reported on which of the following financial statement(s)?

- A) Income statement
- B) Balance sheet
- C) Statement of changes in stockholders' equity
- D) Income statement and statement of changes in stockholders' equity

Answer: A

Explanation: Expenses and revenues are reported on the income statement. Only permanent accounts are reported on the balance sheet. Net income is reported on the statement of stockholders' equity, but expenses are not.

Difficulty: 1 Easy

Topic: Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

60) Dividends paid by a company are reported on which of the following financial statement(s)?

- A) Income statement
- B) Statement of changes in stockholders' equity
- C) Statement of cash flows
- D) Statement of changes in stockholders' equity and statement of cash flows

Answer: D

Explanation: Although the dividends account is a temporary account, dividends are not included on the income statement. They are, however, reported as a deduction from retained earnings on the statement of changes in stockholders' equity and as a cash outflow for financing activities on the statement of cash flows.

Difficulty: 1 Easy

Topic: Preparing a Statement of Cash Flows; Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-08 Prepare a statement of cash flows.; 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

61) Liabilities are reported on which of the following financial statement(s)?

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

Answer: B

Explanation: Liabilities is an element on the balance sheet. As such, liabilities do not appear on the income statement, statement of cash flows, or the statement of changes in stockholders' equity.

Difficulty: 1 Easy

Topic: Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

62) Frank Company earned \$15,000 of cash revenue. Which of the following accurately reflects how this event affects the company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmt of Cash Flows |
|----|--------|---|--------|---|--------|--------|---|------|---|----------|--------------------|
| A. | 15,000 | = | NA | + | 15,000 | NA | - | NA | = | NA | 15,000 OA |
| B. | 15,000 | = | NA | + | 15,000 | 15,000 | - | NA | = | 15,000 | NA |
| C. | 15,000 | = | NA | + | 15,000 | 15,000 | - | NA | = | 15,000 | 15,000 OA |
| D. | 15,000 | = | 15,000 | + | NA | 15,000 | - | NA | = | 15,000 | 15,000 OA |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: C

Explanation: Earning cash revenue increases assets (cash) and equity (retained earnings) on the balance sheet. It increases both revenue and net income on the income statement and is reported as a cash inflow for operating activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

63) Jackson Company paid \$500 cash for salary expenses. Which of the following accurately reflects how this event affects the company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmt of Cash Flows |
|----|---------------|----------|--------------|----------|---------------|-------------|----------|-------------|----------|-----------------|---------------------------|
| A. | NA | = | 500 | + | (500) | NA | - | 500 | = | (500) | NA |
| B. | (500) | = | NA | + | (500) | NA | - | 500 | = | (500) | (500) OA |
| C. | (500) | = | NA | + | (500) | NA | - | NA | = | NA | (500) OA |
| D. | (500) | = | NA | + | (500) | NA | - | 500 | = | (500) | (500) IA |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: B

Explanation: Paying cash for expenses decreases assets (cash) and decreases equity (retained earnings) on the balance sheet. It increases expenses which decreases net income on the income statement, and is reported as a cash outflow for operating activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

64) Perez Company paid a \$300 cash dividend. Which of the following accurately reflects how this event affects the company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmt of Cash Flows |
|----|---------------|----------|--------------|----------|---------------|-------------|----------|-------------|----------|-----------------|---------------------------|
| A. | NA | = | 300 | + | (300) | NA | - | 300 | = | (300) | NA |
| B. | (300) | = | NA | + | (300) | NA | - | 300 | = | (300) | (300) FA |
| C. | (300) | = | NA | + | (300) | NA | - | NA | = | NA | (300) FA |
| D. | (300) | = | NA | + | (300) | NA | - | NA | = | NA | (300) OA |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: C

Explanation: Paying cash dividends decreases assets (cash) and decreases equity (retained earnings) on the balance sheet. It does not affect the income statement, but is reported as a cash outflow for financing activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

65) Garrison Company acquired \$23,000 by issuing common stock. Which of the following accurately reflects how this event affects the company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmt of Cash Flows |
|----|---------------|----------|--------------|----------|---------------|-------------|----------|-------------|----------|-----------------|---------------------------|
| A. | 23,000 | = | NA | + | 23,000 | NA | - | NA | = | NA | 23,000 FA |
| B. | 23,000 | = | NA | + | 23,000 | 23,000 | - | NA | = | 23,000 | 23,000 FA |
| C. | 23,000 | = | 23,000 | + | NA | 23,000 | - | NA | = | NA | 23,000 FA |
| D. | 23,000 | = | 23,000 | + | NA | 23,000 | - | NA | = | 23,000 | 23,000 OA |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: A

Explanation: Issuing common stock increases assets (cash) and equity (common stock). It does not affect the income statement, but is reported as a cash inflow for financing activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

66) Tandem Company borrowed \$32,000 of cash from a local bank. Which of the following accurately reflects how this event affects the company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmt of Cash Flows |
|----|--------|---|--------|---|--------|--------|---|------|---|----------|--------------------|
| A. | 32,000 | = | 32,000 | + | NA | 32,000 | - | NA | = | 32,000 | 32,000 FA |
| B. | 32,000 | = | NA | + | 32,000 | NA | - | NA | = | NA | 32,000 FA |
| C. | 32,000 | = | NA | + | 32,000 | 32,000 | - | NA | = | 32,000 | 32,000 FA |
| D. | 32,000 | = | 32,000 | + | NA | NA | - | NA | = | NA | 32,000 FA |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: D

Explanation: Borrowing cash increases assets (cash) and increases liabilities (notes payable). It does not affect the income statement, but is reported as a cash inflow for financing activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

67) Zimmerman Company sold land for \$25,000 cash. The original cost of the land was \$25,000. Which of the following accurately reflects how this event affects the company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | – | Exp. | = | Net Inc. | Stmt of Cash Flows |
|----|----------------|---|--------|---|----------|------|---|------|---|----------|--------------------|
| A. | NA | = | NA | + | NA | NA | – | NA | = | NA | 25,000 IA |
| B. | (25,000) | = | NA | + | (25,000) | NA | – | NA | = | NA | (25,000) IA |
| C. | 25,000 | = | 25,000 | + | NA | NA | – | NA | = | NA | 25,000 FA |
| D. | None of these. | | | | | | | | | | |

A) Option A

B) Option B

C) Option C

D) Option D

Answer: A

Explanation: Selling land for cash increases one asset (cash) and decreases another asset (land), so it does not affect overall assets, liabilities or equity. It does not affect the income statement, but is reported as a cash inflow for investing activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

68) Which of the following could represent the effects of an asset source transaction on a company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmt of Cash Flows |
|----|---|---|-------|---|--------|------|---|------|---|----------|--------------------|
| A. | + | = | NA | + | + | NA | - | NA | = | NA | +OA |
| B. | + | = | + | + | NA | NA | - | + | = | - | +IA |
| C. | + | = | NA | + | + | + | - | NA | = | + | +OA |
| D. | None of these could represent the effects of an asset source transaction. | | | | | | | | | | |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: C

Explanation: An asset source transaction increases assets and can either increase liabilities (in the case of borrowing cash) or equity (in the case of issuing stock or earning revenue). It may or may not affect revenue and net income. If the asset that increases is cash, it is reported as a cash inflow on the statement of cash flows, and can be either an operating or a financing activity.

Difficulty: 3 Hard

Topic: The Horizontal Financial Statements Model; Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

69) Which of the following could represent the effects of an asset exchange transaction on a company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmnt of Cash Flows |
|----|---|---|-------|---|--------|------|---|------|---|----------|---------------------|
| A. | NA | = | NA | + | NA | NA | - | NA | = | NA | -IA |
| B. | NA | = | + | + | NA | NA | - | + | = | + | NA |
| C. | - | = | NA | + | - | NA | - | NA | = | NA | -OA |
| D. | None of these could represent the effects of an asset exchange transaction. | | | | | | | | | | |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: A

Explanation: An asset exchange transaction increases one asset and decreases another, so it does not affect total assets, liabilities or equity. It does not affect the income statement, and can be reported as a cash inflow or outflow on the statement of cash flow as either an operating or an investing activity.

Difficulty: 3 Hard

Topic: The Horizontal Financial Statements Model; Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

70) Which of the following describes the effects of an asset use transaction on the elements of a company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmnt of Cash Flows |
|----|---|---|-------|---|--------|------|---|------|---|----------|---------------------|
| A. | - | = | NA | + | - | NA | - | NA | = | NA | -FA |
| B. | - | = | - | + | NA | NA | - | + | = | - | -IA |
| C. | - | = | NA | + | - | - | - | NA | = | - | -OA |
| D. | None of these could represent the effects of an asset source transaction. | | | | | | | | | | |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: A

Explanation: An asset use transaction decreases assets and decreases either liabilities (in the case of repaying debt) or equity (in the case of paying dividends or expenses). It may or may not increase expenses and decrease net income. If the asset that decreased is cash, it will be reported as an outflow for financing or operating activities on the statement of cash flows.

Difficulty: 3 Hard

Topic: Recap: Types of Transactions; The Horizontal Financial Statements Model

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-10

Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

71) Reynolds Company experienced an accounting event that affected its financial statements as indicated below:

| Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmt of Cash Flows |
|---------------|----------|--------------|----------|---------------|-------------|----------|-------------|----------|-----------------|---------------------------|
| + | | NA | | + | + | | NA | | + | +OA |

Which of the following accounting events could have caused these effects on the elements of Reynolds' statements?

- A) Paid a cash dividend.
- B) Earned cash revenue.
- C) Borrowed money from a bank.
- D) The information provided does not represent a completed event.

Answer: B

Explanation: Earning cash revenue must have been the event that affected the financial statements as indicated because it increased revenue and net income on the income statement and was reported as a cash inflow for operating activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

72) Chico Company experienced an accounting event that affected its financial statements as indicated below:

| Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmt of Cash Flow |
|---------------|----------|--------------|----------|---------------|-------------|----------|-------------|----------|-----------------|--------------------------|
| + | | NA | | + | NA | | NA | | NA | +FA |

Which of the following accounting events could have caused these effects on the elements of Chico's financial statements?

- A) Issued common stock
- B) Earned cash revenue
- C) Borrowed money from a bank
- D) Paid a cash dividend

Answer: A

Explanation: Issuing common stock would increase assets (cash) and increase equity (common stock). It would not affect net income, but would be reported as a cash inflow from financing activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

73) Delta Company experienced an accounting event that affected its financial statements as indicated below:

| Asset | = | Liab. | + | Equity | Rev. | - | Exp | = | Net Inc. | Stmt of Cash Flow |
|--------------|----------|--------------|----------|---------------|-------------|----------|------------|----------|-----------------|--------------------------|
| - | | NA | | - | NA | | + | | - | +OA |

Which of the following accounting events could have caused these effects on the elements of Delta's statements?

- A) Paid a cash dividend
- B) Incurred a cash expense
- C) Borrowed money from a bank
- D) Earned cash revenue

Answer: B

Explanation: Incurring a cash expense would decrease assets (cash) and decrease equity (retained earnings). It would increase expenses and decrease net income, and would be reported as a cash outflow for operating activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

[The following information applies to the questions displayed below.]

Northern Corporation invested \$800 cash in South Company stock.

74) Which of the following describes the effects of this transaction on the elements of Northern Corporation's books?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmt of Cash Flows |
|----|--------|---|-------|---|--------|------|---|------|---|----------|--------------------|
| A. | - | = | + | + | NA | NA | - | - | = | - | -IA |
| B. | + | = | NA | + | + | NA | - | NA | = | NA | +FA |
| C. | NA | = | NA | + | NA | + | - | NA | = | + | -FA |
| D. | +/- | = | NA | + | NA | NA | - | NA | = | NA | -IA |

A) Option A

B) Option B

C) Option C

D) Option D

Answer: D

Explanation: Investing in another company's stock would be an asset exchange transaction that would increase one asset (investments) and decrease another asset (cash). Therefore, it would have no net impact on assets. It would not affect the income statement, but would be reported as a cash outflow for investing activities on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

75) What happened as a result of this transaction?

- A) The balance in the Cash account on Northern's books decreased, while the balance in the Cash account on South Company's books increased.
- B) South Company has a cash inflow from investing activities.
- C) Northern Corporation has a cash outflow from financing activities.
- D) All of these statements are true.

Answer: A

Explanation: When Northern Corporation purchases stock in South Company, Northern's cash balance will decrease and South's cash balance will increase. North will report it as a cash outflow for investing activities, and South will report it as a cash inflow from financing activities.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model

Learning Objective: 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

76) Which of the following would not describe the effects of an asset source transaction on the elements of a company's financial statements?

| | Assets | = | Liab. | + | Equity | Rev. | - | Exp. | = | Net Inc. | Stmnt of Cash Flows |
|----|--------|---|-------|---|--------|------|---|------|---|----------|---------------------|
| A. | + | = | + | + | NA | NA | - | NA | = | NA | +FA |
| B. | + | = | NA | + | + | NA | - | NA | = | NA | +FA |
| C. | + | = | NA | + | + | + | - | NA | = | + | +OA |
| D. | NA | = | NA | + | NA | NA | - | NA | = | NA | -IA |

- A) Option A
- B) Option B
- C) Option C
- D) Option D

Answer: D

Explanation: An asset source transaction is any transaction that results in a net increase in assets. It could be accompanied by an increase in liabilities (as in the case of borrowing cash), an increase in equity with no effect on the income statement (as in the case of issuing common stock), or an increase in equity that does increase net income (as in the case of earning revenue). It could be reported as either a financing activity or an operating activity on the statement of cash flows.

Difficulty: 2 Medium

Topic: The Horizontal Financial Statements Model; Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.; 01-10 Record business events using a horizontal financial statements model.

Bloom's: Analyze

AACSB: Analytical Thinking

AICPA: BB Critical Thinking; FN Measurement

77) In a market, creditors are resource providers.

Answer: TRUE

Explanation: This is true. Resource providers include creditors and investors.

Difficulty: 1 Easy

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

78) In a market, a company that manufactures cars would be referred to as a conversion agent.

Answer: TRUE

Explanation: This is true. Conversion agents transform resources into goods and services, such as cars, that are desirable to consumers.

Difficulty: 1 Easy

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Industry

79) The value created by a business is created by its assets.

Answer: FALSE

Explanation: This is false. A business creates value by earning income, so earnings or income describe that value, not assets.

Difficulty: 2 Medium

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

80) The stockholders of a business have a priority claim to its assets in the event of liquidation.

Answer: FALSE

Explanation: This is false. Creditors have priority in business liquidations. This means the business uses its assets first to settle the obligations to the creditors. Any assets remaining after the creditors have been paid are then distributed to the investors.

Difficulty: 1 Easy

Topic: Interpreting Information Shown in the Accounting Equation

Learning Objective: 01-05 Interpret information shown in an accounting equation.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

81) The types of resources needed by a business are financial, physical, and labor resources.

Answer: TRUE

Explanation: This is true. The types of resources needed by a business are financial, physical, and labor resources.

Difficulty: 1 Easy

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

82) Financial accounting information is usually less detailed than managerial accounting information.

Answer: TRUE

Explanation: This is true. Financial accounting information is usually less detailed than managerial accounting information.

Difficulty: 2 Medium

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Industry

83) The Financial Accounting Standards Board is a privately funded organization with authority for establishing accounting standards for businesses in the US.

Answer: TRUE

Explanation: This is true. The Financial Accounting Standards Board is charged with establishing accounting standards for US businesses. It is not an agency of the US government, but rather a privately funded organization.

Difficulty: 2 Medium

Topic: Role of Accounting In Society

Learning Objective: 01-01 Identify the ways accounting benefits society.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

84) A business and the person who owns the business are separate reporting entities.

Answer: TRUE

Explanation: This is true. A business must report its income, assets, liabilities and equity separate from the owner of that business.

Difficulty: 1 Easy

Topic: Reporting Entities

Learning Objective: 01-02 Identify reporting entities.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

85) The information reported in financial statements is organized into ten categories known as accounts.

Answer: FALSE

Explanation: This is false. The information reported in financial statements is organized into ten categories known as elements. Detailed information about the elements is maintained in records commonly called accounts.

Difficulty: 1 Easy

Topic: Elements of Financial Statements

Learning Objective: 01-03 Identify the components of the accounting equation.

Bloom's: Remember

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

86) Liabilities are obligations of a business to relinquish assets, provide services, or accept other obligations.

Answer: TRUE

Explanation: This is true. Liabilities represent the future obligations of a business entity.

Difficulty: 2 Medium

Topic: Elements of Financial Statements

Learning Objective: 01-03 Identify the components of the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

87) Liabilities are not a source of assets for a business.

Answer: FALSE

Explanation: This is false. There are three sources of assets. First, a business can borrow assets from creditors. The second source of assets is investors. The third source of assets is operations.

Difficulty: 2 Medium

Topic: Elements of Financial Statements

Learning Objective: 01-03 Identify the components of the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

88) Retained earnings reduces a company's commitment to use its assets for the benefit of its stockholders.

Answer: FALSE

Explanation: This is false. If a business retains the assets, it commits to use those assets for the benefit of the stockholders. This increase in the business's commitments to its stockholders is normally called retained earnings.

Difficulty: 2 Medium

Topic: Elements of Financial Statements

Learning Objective: 01-03 Identify the components of the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

89) The historical cost concept requires that most assets be recorded at the amount paid for them, regardless of increases in market value.

Answer: TRUE

Explanation: This is true. Once an asset is recorded, it is not adjusted for increases in market value.

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

90) An asset source transaction increases a business's assets and the claims to assets.

Answer: TRUE

Explanation: This is true. An asset source transaction increases a business's assets and either liabilities or equity, which make up claims to assets.

Difficulty: 1 Easy

Topic: Recap: Types of Transactions

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

91) Borrowing money from the bank is an example of an asset source transaction.

Answer: TRUE

Explanation: This is true. Borrowing money from the bank is an example of an asset source transaction because the asset cash increases as well as the liability notes payable.

Difficulty: 1 Easy

Topic: Recap: Types of Transactions

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: FN Measurement; BB Resource Management

92) An asset use transaction does not affect the total amount of claims to a company's assets.

Answer: FALSE

Explanation: This is false. Because asset use transactions result in a decrease in total assets, total claims must decrease as well.

Difficulty: 2 Medium

Topic: Recording Business Events Under the Accounting Equation

Learning Objective: 01-04 Show how business events affect the accounting equation.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

93) The four financial statements prepared by a business bear no relationship to each other.

Answer: FALSE

Explanation: This is false. All four financial statements are interconnected.

Difficulty: 1 Easy

Topic: Preparing a Statement of Cash Flows; Preparing an Income Statement, a Statement of Changes in Stockholders' Equity and a Balance Sheet

Learning Objective: 01-08 Prepare a statement of cash flows.; 01-07 Prepare an income statement, a statement of changes in stockholders' equity, and a balance sheet.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement

94) All of a business's temporary accounts appear on the income statement.

Answer: FALSE

Explanation: This is false. A business's temporary accounts include revenues, expenses, and dividends. Dividends do not appear on the income statement.

Difficulty: 2 Medium

Topic: The Closing Process

Learning Objective: 01-09 Close revenue, expense, and dividend accounts.

Bloom's: Understand

AACSB: Reflective Thinking

AICPA: BB Critical Thinking; FN Measurement