

Horngren's Accounting, 10e, Global Edition (Nobles/Mattison/Matsumura)

Chapter 1 Accounting and the Business Environment

Learning Objective 1-1

1) Accounting is the information system that measures business activities, processes the information into reports, and communicates the results to decision makers.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

2) Accounting is referred to as the language of business because it is the method of communicating business information to stakeholders.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

3) Managerial accounting focuses on information for external decision makers.

Answer: FALSE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

4) Stockholders primarily use managerial accounting information for decision-making purposes.

Answer: FALSE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

5) A creditor is a person who owes money to the business.

Answer: FALSE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

6) Local, state, and federal governments use accounting information to calculate income tax.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

7) Financial accounting focuses on information for decision makers outside of the business, such as creditors and taxing authorities.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

8) Business owners use accounting information to set goals, evaluate progress toward those goals, and make adjustments when needed.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

9) Outside investors would ordinarily use managerial accounting information to decide whether or not to invest in a business.

Answer: FALSE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

10) A creditor is any person who has an ownership interest in a business.

Answer: FALSE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

11) Different users of financial statements focus on the different parts of the financial statements for the information they need.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

12) Any person or business to whom a business owes money is called the business's creditor.

Answer: TRUE

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

13) Managerial accounting provides information to:

A) internal decision makers.

B) outside investors and lenders.

C) auditors.

D) taxing authorities.

Answer: A

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

14) Which of the following statements best defines financial statements?

A) Financial statements are the information systems that record monetary and nonmonetary business transactions.

B) Financial statements are the verbal statements made to business news organizations by chief financial officers.

C) Financial statements are documents that report on a business in monetary terms, providing information to help people make informed business decisions.

D) Financial statements are plans and forecasts for future time periods based on information from past financial periods.

Answer: C

Diff: 2

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

15) The field of accounting that focuses on providing information for external decision makers is:

A) managerial accounting.

B) financial accounting.

C) cost accounting.

D) nonmonetary accounting.

Answer: B

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

16) The field of accounting that focuses on providing information for internal decision makers is:

- A) managerial accounting.
- B) financial accounting.
- C) nonmonetary accounting.
- D) governmental accounting.

Answer: A

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

17) Which of the following users would rely on management accounting information for decision-making purposes?

- A) potential investors
- B) creditors
- C) customers
- D) company managers

Answer: D

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

18) Which of the following is an external user of a business' financial information?

- A) customers
- B) cost accountant
- C) company manager
- D) the board of directors

Answer: A

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

19) _____ are professional accountants who serve the general public, not one particular company.

- A) Certified public accountants
- B) Certified management accountants
- C) Cost accountants
- D) Controllers

Answer: A

Diff: 1

LO: 1-1

AACSB: Concept

AICPA Functional: Measurement

Learning Objective 1-2

1) As per the economic entity assumption, an organization and its owner should be seen as the same entity.

Answer: FALSE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

2) The guidelines for accounting information are called Generally Accepted Accounting Principles (GAAP).

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

3) IFRS is the main U.S. accounting rule book and is currently created and governed by the FASB.

Answer: FALSE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

4) A publicly traded company in the United States does not come under SEC regulations as long as it follows the rules of GAAP.

Answer: FALSE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

5) International Financial Reporting Standards (IFRS) are the international accounting rules that U.S. companies must follow for their international operations.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

6) IFRS are comparatively more specific and more rule based than U.S. GAAP.

Answer: FALSE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

7) The Public Company Accounting Oversight Board is a watchdog agency that monitors the work of independent accountants who audit public companies.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

8) An examination of a company's financial statements and records is called an audit.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

9) The Sarbanes-Oxley Act (SOX) requires companies to review internal control and take responsibility for the accuracy and completeness of their financial reports.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

10) In a sole proprietorship, the owner is personally liable for the debts of the business.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

11) The most that the owner of a sole proprietorship can lose, as a result of business debts or lawsuits, is the amount he/she has invested in the business.

Answer: FALSE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

12) Members of a limited-liability company (LLC) are not personally liable for the debts of the business.

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

13) A business can be organized as a sole proprietorship, partnership, corporation, or limited-liability company (LLC).

Answer: TRUE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

14) In a limited-liability company (LLC), the members are personally liable for the debts of the business.

Answer: FALSE

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

15) The Sarbanes-Oxley Act (SOX) made it a criminal offense to:

A) transfer shares of stock.

B) issue debentures.

C) declare bankruptcy.

D) falsify financial information.

Answer: D

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

16) Which of the following organizations requires publicly owned companies to be audited by independent accountants (CPAs)?

A) Securities and Exchange Commission (SEC)

B) Public Company Accounting Oversight Board (PCAOB)

C) Financial Accounting Standards Board (FASB)

D) American Institute of Certified Public Accountants (AICPA)

Answer: A

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

17) Which of the following organizations is responsible for the creation and governance of accounting standards in the United States?

- A) Financial Accounting Standards Board
- B) Institute of Management Accountants
- C) American Institute of Certified Public Accountants
- D) Securities and Exchange Commission

Answer: A

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

18) GAAP are the rules that govern accounting in the United States. The acronym GAAP in this statement refers to:

- A) Globally Accepted and Accurate Policies.
- B) Global Accommodation Accounting Principles.
- C) Generally Accredited Accounting Policies.
- D) Generally Accepted Accounting Principles.

Answer: D

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

19) The formation of a partnership firm requires a minimum of:

- A) four partners.
- B) three partners.
- C) one partner.
- D) two partners.

Answer: D

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

20) Corporate ownership is a very popular type of ownership in the United States. Which of the following is a major reason that corporate ownership is popular?

- A) Stockholders have limited liability for the debts of the corporation.
- B) Most corporations are small or medium-sized.
- C) The life of a corporation is limited by the death of the owner.
- D) A corporation is usually managed by the owners.

Answer: A

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

21) Which of the following is a characteristic of a corporation?

- A) A corporation is owned by stockholders.
- B) Lenders of a corporation do not have the right to claim the corporation's assets to satisfy their obligations.
- C) All shares of a corporation must be held by a single individual.
- D) Each stockholder has the authority to commit the corporation to a binding contract through his actions.

Answer: A

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

22) Which of the following statements is true of a sole proprietorship?

- A) A sole proprietorship joins two or more individuals as co-owners.
- B) The sole proprietor is personally liable for the liabilities of the business.
- C) A sole proprietorship is taxed separately from the owner.
- D) A sole proprietorship does not terminate at the choice or death of the owner.

Answer: B

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

23) Which of the following is a characteristic of a limited-liability company (LLC)?

- A) An LLC's life is terminated at any member's choice or death.
- B) Each member of an LLC is liable only for his or her own actions.
- C) An LLC must have more than five members.
- D) The income of members from an LLC is not taxed.

Answer: B

Diff: 2

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

24) Caleb Brown is the sole owner of a bicycle sales and repair shop from several years. Which of the following business types would limit Caleb's personal liability exposure to the entity's debts?

- A) Partnership
- B) Limited-liability company
- C) Sole proprietorship
- D) Limited-liability partnership

Answer: B

Diff: 2

LO: 1-2

AACSB: Application

AICPA Functional: Measurement

25) David has decided to open an auto-detailing business. He will pick up an automobile from the client, take it to his parents' garage, detail it, and return it to the client. If he does all of the work himself and takes no legal steps to form a special organization, which type of business organization, in effect, has he chosen?

- A) Limited-liability company
- B) Partnership
- C) Corporation
- D) Sole proprietorship

Answer: D

Diff: 2

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

26) In a limited-liability company:

- A) the members are personally liable to pay the entity's debts.
- B) tax on earnings is paid by the business.
- C) the members are liable for each other's actions.
- D) the members pay tax on their share of earnings.

Answer: D

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

27) From a legal perspective, a sole proprietorship:

- A) is an entity separate from its proprietor.
- B) must have at least two owners.
- C) is not a distinct entity from its proprietor.
- D) is subject to strict regulation of the SEC.

Answer: C

Diff: 2

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

28) The taxable income of a sole proprietorship is:

- A) combined with the personal income of the proprietor.
- B) not combined with the proprietor's personal income.
- C) not taxable.
- D) handled similarly to that of a corporation.

Answer: A

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

29) Gunnie Inc., located in Texas, records business transactions in dollars and disregards changes in the value of a dollar over time. Which of the following accounting assumptions does this represent?

- A) economic entity assumption
- B) going concern assumption
- C) accounting period assumption
- D) monetary unit assumption

Answer: D

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

30) According to the _____, the acquired assets should be recorded at the amount actually paid rather than at the estimated market value.

- A) going concern assumption
- B) economic entity concept
- C) cost principle
- D) monetary unit assumption

Answer: C

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

31) As per the _____, the entity will remain in operation for the foreseeable future.

- A) economic entity concept
- B) monetary unit assumption
- C) going concern assumption
- D) cost principle

Answer: C

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

32) Joshua Thomas is the owner of Nexus Inc., a manufacturer and retailer of computer hardware. Joshua recently bought a new car as a gift for his daughter. Since Joshua paid for the car from the earnings of the business, he recorded it in the books of Nexus as an asset. Which of the following concepts or principles of accounting is Joshua violating?

- A) monetary unit assumption
- B) economic entity assumption
- C) cost principle
- D) going concern assumption

Answer: B

Diff: 2

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

33) Lorna Smith decided to start her own CPA practice as a professional corporation, Smith CPA PC. Her corporation purchased an office building for \$35,000 that her real estate agent said was worth \$50,000 in the current market. The corporation records the building as a \$50,000 asset because Lorna believes that is the real value of the building. Which of the following concepts or principles of accounting is being violated?

- A) cost principle
- B) economic entity assumption
- C) monetary unit assumption
- D) going concern assumption

Answer: A

Diff: 1

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

34) 30 years ago, Star Grocer Corporation had purchased a building for its grocery store by paying \$30,000. Based on inflation estimates, the amount of the building has been adjusted in the accounting records. The building is now reported at \$75,000 in the financial statements of Star Grocer. Which of the following concepts or principles of accounting is being violated?

- A) going concern assumption
- B) monetary unit assumption
- C) economic entity assumption
- D) cost principle

Answer: B

Diff: 2

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

35) The Public Company Accounting Oversight Board (PCAOB) was created by the:

- A) Sarbanes-Oxley Act (SOX)
- B) International Accounting Standards Board (IASB)
- C) Institute of Management Accountants (IMA)
- D) American Institute of Certified Public Accountants (AICPA)

Answer: A

Diff: 2

LO: 1-2

AACSB: Concept

AICPA Functional: Measurement

Learning Objective 1-3

1) Liabilities represent creditors' claims on the business's assets.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

2) The left side of the accounting equation measures the amount that the business owes to creditors and to the owner.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

3) The total of amount of assets that a business possesses, may or may not equal the total of liabilities and equity of the business.

Answer: FALSE

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

4) Equity increases when revenues are earned.

Answer: TRUE

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

5) Equity decreases with expenses and revenues.

Answer: FALSE

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

6) Owner's withdrawals are the expenses of a business.

Answer: FALSE

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

7) A debt that a business owes to an outside party is called:

- A) an asset.
- B) a liability.
- C) stockholders' equity.
- D) revenue.

Answer: B

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

8) Viva Inc. produces and sells coffee beans. This month it earned \$500 by selling coffee beans to Jeffery Inc. The \$500 received by Viva is its:

- A) revenue.
- B) equity.
- C) gain.
- D) debt.

Answer: A

Diff: 1

LO: 1-3

AACSB: Application

AICPA Functional: Measurement

9) The owner's claim to the assets of the business is called:

- A) return on assets.
- B) expenses.
- C) equity.
- D) debt.

Answer: C

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

10) The economic resources of a business such as furniture, building, and land are its:

- A) liabilities.
- B) revenues.
- C) assets.
- D) withdrawals.

Answer: C

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

11) Which of the following is the correct accounting equation?

- A) Assets + Liabilities = Equity
- B) Assets = Liabilities + Equity
- C) Assets + Revenues = Equity
- D) Assets + Revenues = Liabilities + Expenses

Answer: B

Diff: 1

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

12) Scott's Camera Shop started the year with total assets of \$80,000 and total liabilities of \$40,000. During the year, the business earned revenues of \$120,000 and incurred expenses of \$70,000. Scott made no additional capital contributions during the year, but did make withdrawals of \$60,000. What is the amount of owner's equity at the end of the year?

- A) \$70,000
- B) \$120,000
- C) \$30,000
- D) \$60,000

Answer: C

Explanation: C) Equity (ending balance) = Owner's Capital (beginning balance) - Owner's withdrawals + Revenues - Expenses

$$\text{Equity} = (\$80,000 - \$40,000) - \$60,000 + \$120,000 - \$70,000 = \$30,000$$

Diff: 3

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

13) Scott's Camera Shop started the year with total assets of \$80,000 and total liabilities of \$40,000. During the year, the business earned revenues of \$120,000 and incurred expenses of \$70,000. Scott made no additional capital contributions during the year, but did make withdrawals of \$60,000.

Calculate Scott's net income for the year.

- A) \$50,000
- B) \$120,000
- C) \$70,000
- D) \$80,000

Answer: A

Explanation: A) Net income = Revenues - Expenses

$$\text{Net income} = \$120,000 - \$70,000 = \$50,000$$

Diff: 2

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

14) Scott's Camera Shop started the year with total assets of \$100,000 and total liabilities of \$50,000. During the year, the business earned revenues of \$200,000 and incurred expenses of \$60,000. Scott made no capital contributions during the year, but did make withdrawals of \$75,000.

Calculate the amount of increase/decrease in Scott's equity for the year.

- A) \$65,000 increase
- B) \$115,000 increase
- C) \$50,000 decrease
- D) \$75,000 increase

Answer: A

Explanation: A) Equity (at the beginning of the year) = \$100,000 - \$50,000 = \$50,000

Equity (at the end of the year) = Owner's Capital - Owner's withdrawals + Revenues - Expenses

Equity (at the end of the year) = \$50,000 - \$75,000 + \$200,000 - \$60,000 = \$115,000

Change in owner's equity for the year = \$50,000 - \$115,000 = \$65,000 increase

Diff: 2

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

15) The net income of a business is \$29,000. The beginning and ending capital balances were \$34,000 and \$55,000, respectively. No capital contributions were made by the owner during the year.

Calculate the amount of owner's withdrawals.

- A) \$18,000
- B) \$8,000
- C) \$5,000
- D) \$60,000

Answer: B

Explanation: B) Equity (at the beginning of the year) = \$34,000

Equity (at the end of the year) = Owner's Capital (beginning balance) - Owner's withdrawals + Revenues - Expenses

\$55,000 = \$34,000 - Owner's withdrawals + \$29,000

Owner's withdrawals = \$34,000 + \$29,000 - \$55,000 = \$8,000

Diff: 2

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

16) Glorious Gloria, a florist, had the following transactions in August: Earned \$2,000 as revenues on account; collected \$4,000 from a customer for goods sold last month; incurred \$600 of repair expense and paid cash; paid \$200 to a supplier that it owed from the previous month. What is the net income in August?

- A) \$500
- B) \$5,700
- C) \$2,700
- D) \$1,400

Answer: D

Explanation: D) Net income = Revenue - Expenses = \$2,000 - \$600 = \$1,400.

Diff: 3

LO: 1-3

AACSB: Concept

AICPA Functional: Measurement

Learning Objective 1-4

1) A business owner starts a new business and invests \$6,000 of capital. This transaction results in an increase in the assets of the business.

Answer: TRUE

Diff: 1

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

2) For an accounting equation to balance, a transaction must affect both the sides of the equation.

Answer: FALSE

Diff: 1

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

3) John contributes cash in exchange for capital for his business, Bubble Wraps Inc. The two accounts involved in this transaction are:

- A) Bubble Wraps, Capital account and the Cash account.
- B) the Cash account and John, Capital account.
- C) John, Payables account and the Capital account.
- D) Bubble Wraps, Capital account and John, Payables account.

Answer: B

Diff: 1

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

4) Lush Lawns earned \$1,000 for lawn mowing services rendered. The customer promised to pay at a later time. Which of the following accounts increased as a result of this transaction?

- A) Accounts payable
- B) Supplies
- C) Cash
- D) Accounts receivable

Answer: D

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

5) A sole proprietor makes a cash withdrawal from his company. How does this transaction affect the accounting equation?

- A) Assets, liabilities, and equity remain the same.
- B) Assets decrease; equity decreases.
- C) Assets increase; liabilities decrease.
- D) Assets decrease; equity increases.

Answer: B

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

6) Hamilton Lawn Service incurred \$800 as repair expense and paid the repair company in cash. This will:

- A) decrease the Owner's capital.
- B) increase the assets of the business.
- C) increase the liabilities of the business.
- D) decrease the liabilities of the business.

Answer: A

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

7) Hamilton Lawn Service incurred \$500 as labor expense and promised to pay the labor agency within 30 days. Which of the following accounts would increase as a result of this transaction?

- A) Accounts Receivable
- B) Cash
- C) Accounts Payable
- D) Owner's Capital

Answer: C

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

8) Lush Lawns incurred \$1,500 labor expense and promised to pay the labor agency within 30 days. Which of the following would decrease as a result of this transaction?

- A) Assets
- B) Owner's Capital
- C) Liabilities
- D) Revenues

Answer: B

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

9) Martin Supply Service paid \$350 cash to a materials supplier that it owed from the previous month. Which of the following accounts decreases?

- A) Accounts Receivable
- B) Accounts Payable
- C) Owner's Capital
- D) Office Supplies

Answer: B

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

10) Martin Supply Service received \$1,000 cash from a customer which was owed to the business from the previous month. What is the effect of the cash receipt on the accounts of the business?

- A) Accounts Receivable decreases; Martin, Capital decreases.
- B) Cash account increases; Accounts receivable decreases.
- C) Accounts Payable increases; Martin, Capital decreases.
- D) Cash increases; Accounts Payable decreases.

Answer: B

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

11) Martin Supply Service received \$1,000 cash from a customer which was owed to the business from the previous month. Which of the following accounts would decrease as a result of this transaction?

- A) Cash
- B) Equity
- C) Accounts Payable
- D) Accounts Receivable

Answer: D

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

12) Ace Inc. had the following transactions in June: Sold goods for \$4,000 on account; received cash on account, \$5,000; paid \$800 for repair expense; paid \$2,000 to a supplier that it owed from the previous month. What is the combined effect on Cash of the June transactions?

- A) \$2,200 increase
- B) \$2,200 decrease
- C) \$5,000 increase
- D) \$2,800 decrease

Answer: A

Explanation: A) Cash = \$5,000 - \$800 - \$2,000 = \$2,200 increase

Diff: 3

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

13) The equity of Autumn Company is \$150,000 and the total liabilities are \$90,000. Its total assets would be:

- A) \$300,000.
- B) \$180,000.
- C) \$60,000.
- D) \$240,000.

Answer: D

Explanation: D) Assets = Liabilities + Equity

Assets = \$90,000 + \$150,000 = \$240,000

Diff: 1

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

14) Venus Inc. paid \$5,000 for account payable. How does this transaction affect the accounting equation of Venus?

- A) Assets decrease by \$5,000 and equity increases by \$5,000.
- B) Assets decrease by \$5,000 and liabilities decrease by \$5,000.
- C) Assets increase by \$5,000 and equity decreases by \$5,000.
- D) Assets increase by \$5,000 and liabilities increase by \$5,000.

Answer: B

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

15) The assets of Moon Company are \$150,000 and liabilities are \$90,000. The equity will be:

A) \$180,000.

B) \$300,000.

C) \$240,000.

D) \$60,000.

Answer: D

Explanation: D) Assets - Liabilities = Equity

$\$150,000 - \$90,000 = \$60,000$

Diff: 1

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

16) The assets of Sunlight Company are \$270,000 and equity is \$90,000. Liabilities will be:

A) \$60,000.

B) \$360,000.

C) \$270,000.

D) \$180,000.

Answer: D

Explanation: D) Assets - Equity = Liabilities

$\$270,000 - \$90,000 = \$180,000$

Diff: 1

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

17) Lush Lawns performs lawn mowing services for its customers. The payments for the current month's services are expected to be received next month. How does this transaction affect the accounting equation of Lush Lawn?

A) Liabilities increase; equity decreases.

B) Assets increase; equity increases.

C) Assets decrease; equity decreases.

D) Liabilities increase; equity increases.

Answer: B

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

18) A business receives a bill from one of its suppliers for services received. The business will pay the supplier next month. How does the receipt of the bill from the supplier affect the accounting equation of the business?

- A) Assets decrease; equity decrease.
- B) Liabilities increase; equity decrease.
- C) Assets increase; liabilities increase.
- D) Liabilities increase; equity increase.

Answer: B

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

19) A business settles a liability by making a payment in cash. How does paying this liability affect the accounting equation of the business?

- A) Assets decrease; liabilities decrease.
- B) Liabilities decrease; equity increases.
- C) Assets increase; liabilities increase.
- D) Assets increase; equity decreases.

Answer: A

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

20) Land was originally purchased for \$20,000. It is sold for \$20,000 in cash. How does the sale affect the accounting equation?

- A) Assets increase by \$20,000; liabilities decrease by \$20,000.
- B) Assets increase by \$20,000; liabilities increase by \$20,000.
- C) Assets increase by \$20,000; equity increases by \$20,000.
- D) Assets increase by \$20,000; assets decrease by \$20,000.

Answer: D

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

21) Land is purchased by a business for \$100,000. The company pays for the land by a cash payment of \$20,000 and promised to pay the remaining amount at a later period. What is net effect of this transaction on the business's accounting equation?

- A) Assets increase by \$100,000; liabilities decrease by \$20,000.
- B) Assets increase by \$100,000; liabilities decrease by \$80,000.
- C) Assets increase by \$80,000; equity increases by \$80,000.
- D) Assets increase by \$80,000; liabilities increase by \$80,000.

Answer: D

Diff: 3

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

22) A business collects \$5,000 from its customer which was owed since a previous month. How does this affect the accounting equation of the business?

- A) Assets increase by \$5,000; liabilities decrease by \$5,000.
- B) Assets increase by \$5,000; assets decrease by \$5,000.
- C) Assets increase by \$5,000; liabilities increase by \$5,000.
- D) Assets increase by \$5,000; equity increases by \$5,000.

Answer: B

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

23) Star Homes Inc. just recorded a transaction in its books of accounts. If this transaction increased the total liabilities by \$7,000:

- A) assets must increase, or equity must decrease by \$7,000.
- B) assets or equity must decrease by \$7,000.
- C) both assets and equity must each decrease by \$3,500.
- D) assets must decrease by \$7,000.

Answer: A

Diff: 3

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

24) If a transaction increased an asset of a business. Which of the following can be an effect of the transaction for the accounting equation to balance?

- A) There is an equal decrease in another asset.
- B) There is an equal decrease in equity.
- C) There is an equal decrease in a liability account.
- D) Both liabilities and equity decreases.

Answer: A

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

25) Sharon Samson owns Reliable Waterworks which provides plumbing service. Transactions of Reliable Waterworks during the first year of operations are given below:

- A) Sharon contributed \$14,000 into a new checking account for the business and recorded capital contribution.
- B) Paid \$2,000 for equipment to be used for plumbing repairs.
- C) Borrowed \$15,000 from a local bank and deposited the money in the checking account.
- D) Paid \$600 as rent for the year.
- E) Paid \$500 for plumbing supplies to be used on various jobs in the future.
- F) Completed a plumbing repair project for a local lawyer and received \$3,500.

Calculate the amount of total assets balance at the end of the first year.

A) \$2,500

B) \$2,000

C) \$29,000

D) \$31,900

Answer: D

Explanation: D)

| | |
|----------------------------|----------|
| Bank (\$14,000 + \$15,000) | \$29,000 |
|----------------------------|----------|

| | |
|--|-----|
| Cash (\$3,500 - \$2,000 - \$600 - \$500) | 400 |
|--|-----|

| | |
|-----------|-------|
| Equipment | 2,000 |
|-----------|-------|

| | |
|----------|------------|
| Supplies | <u>500</u> |
|----------|------------|

| | |
|--------------|-----------------|
| Total assets | <u>\$31,900</u> |
|--------------|-----------------|

Diff: 3

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

26) Sharon Samson starts a plumbing service called Reliable Waterworks. Transactions of Reliable Waterworks during the first year of operations are given below:

- A) Sharon deposited \$14,000 into a new checking account for the business and recorded the capital contribution.
- B) Paid \$2,000 cash for equipment to be used for plumbing repairs.
- C) Borrowed \$15,000 from a local bank and deposited the money in the checking account.
- D) Paid \$600 rent for the year.
- E) Purchased \$900 of office supplies by cash.
- F) Completed a plumbing repair project for a local lawyer and received \$3,500 cash.

Calculate the amount of total liabilities at the end of the first year.

- A) \$15,000
- B) \$14,000
- C) \$27,000
- D) \$3,500

Answer: A

Explanation: A) Borrowings from bank = \$15,000

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

27) Robinson starts a plumbing service named Crusoe Waterworks. Transactions of Crusoe Waterworks during the first year of operations are given below:

- A) Robinson deposited \$7,000 into a new checking account for the business and recorded the capital contribution.
- B) Paid \$4,000 cash for equipment to be used for plumbing repairs.
- C) Borrowed \$30,000 from a local bank and deposited the money in the checking account.
- D) Paid \$800 rent for the year.
- E) Purchased \$900 of office supplies on account.
- F) Completed a plumbing repair project for a local lawyer and received \$3,500 cash.

Calculate the amount of total owner's equity after recording the transactions.

- A) \$9,700
- B) \$3,500
- C) \$7,000
- D) \$30,000

Answer: A

Explanation: A) Equity (at the end of the year) = Owner's Capital - Owner's withdrawals + Revenues - Expenses

Equity $\$7,000 + \$3,500 - \$800 = \$9,700$

Diff: 3

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

28) Sharon Samson starts a plumbing service named Reliable Waterworks. Selected transactions are described as follows:

- A) Sharon deposited \$8,000 into a new checking account for the business and recorded the capital contribution.
- B) Paid \$5,000 cash for equipment to be used for plumbing repairs.
- C) Borrowed \$10,000 from a local bank and deposited the money in the checking account.
- D) Paid \$800 rent for the year.
- E) Paid \$300 cash for plumbing supplies to be used in future.
- F) Completed a plumbing repair project for a local lawyer and received \$4,000 cash.

Calculate the net income.

- A) \$2,900
- B) \$3,700
- C) \$4,000
- D) \$3,200

Answer: D

Explanation: D) Net income = Revenues - Expenses

Net income = \$4,000 - \$800 = \$3,200

Diff: 3

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

29) Following is an extract of account balances of Wilson Mowing Service as of December 31 of the first year of operation:

| | |
|---------------------|---------|
| Accounts receivable | \$5,000 |
| Accounts payable | 4,000 |
| Salary expense | 5,000 |
| Repairs expense | 1,000 |
| Truck | 10,000 |
| Equipment | 8,000 |
| Notes payable | 8,200 |
| Cash | 7,500 |
| Supplies expense | 1,600 |
| Service revenue | 32,000 |
| Gasoline expense | 3,800 |
| Salary payable | 200 |

At the end of the year, what is the amount of total assets?

A) \$15,000

B) \$30,500

C) \$18,000

D) \$25,500

Answer: B

Explanation: B)

| | |
|---------------------|---------|
| Accounts receivable | \$5,000 |
|---------------------|---------|

| | |
|-------|--------|
| Truck | 10,000 |
|-------|--------|

| | |
|-----------|-------|
| Equipment | 8,000 |
|-----------|-------|

| | |
|------|--------------|
| Cash | <u>7,500</u> |
|------|--------------|

| | |
|--------------|-----------------|
| Total assets | <u>\$30,500</u> |
|--------------|-----------------|

Diff: 1

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

30) Following is a list of account balances of Wilson Mowing Service as of December 31 of the first year of operation:

| | |
|---------------------|---------|
| Accounts receivable | \$5,000 |
| Accounts payable | 4,000 |
| Salary expense | 5,000 |
| Repairs expense | 1,000 |
| Truck | 10,000 |
| Equipment | 8,000 |
| Notes payable | 8,200 |
| Cash | 7,500 |
| Supplies expense | 1,600 |
| Service revenue | 32,000 |
| Gasoline expense | 3,800 |
| Salary payable | 200 |

At the end of the year, what is the amount of total liabilities?

A) \$12,400

B) \$24,100

C) \$21,200

D) \$12,200

Answer: A

Explanation: A)

Accounts payable \$4,000

Notes payable 8,200

Salary payable 200

Total liabilities 12,400

Diff: 1

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

31) Following is a list of account balances of Wilson Mowing Service as of December 31 of the first year of operation:

| | |
|---------------------|---------|
| Accounts receivable | \$2,500 |
| Accounts payable | 3,500 |
| Salary expense | 4,500 |
| Repairs expense | 800 |
| Truck | 8,500 |
| Equipment | 6,300 |
| Notes payable | 8,200 |
| Cash | 6,800 |
| Supplies expense | 1,600 |
| Service revenue | 31,900 |
| Gasoline expense | 3,800 |
| Salary payable | 200 |

Calculate the net income.

A) \$21,200

B) \$11,900

C) \$12,200

D) \$24,100

Answer: A

Explanation: A)

Service revenue \$31,900

Salary expense (4,500)

Repairs expense (800)

Supplies expense (1,600)

Gasoline expense (3,800)

Net income \$21,200

Diff: 2

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

32) The total assets and the total liabilities of Samantha Financial Services, are shown below. There were no capital contributions and withdrawals during the year.

| | Assets | Liabilities |
|-------------------|-----------|-------------|
| Beginning of year | \$425,000 | \$280,000 |
| End of year | 500,000 | 325,000 |

What was the amount of net income for the year?

- A) \$75,000
- B) \$45,000
- C) \$30,000
- D) \$120,000

Answer: C

Explanation: C) Calculations:

| | Assets | Liabilities |
|------------------------------|------------------|------------------|
| End of year total | \$500,000 | \$325,000 |
| Less beginning of year total | <u>(425,000)</u> | <u>(280,000)</u> |
| Increase or (decrease) | <u>\$75,000</u> | <u>\$45,000</u> |

Net increase or (decrease) = \$75,000 - \$45,000 = \$30,000

Diff: 3

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

33) _____ represents the right to receive cash in the future from customers for goods sold or for services performed.

- A) Accounts receivable
- B) Accounts payable
- C) Equity
- D) Expenses

Answer: A

Diff: 1

LO: 1-4

AACSB: Concept

AICPA Functional: Measurement

Learning Objective 1-5

1) The balance sheet of a business summarizes an entity's revenues and expenses.

Answer: FALSE

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

2) By looking at a statement of owner's equity, the effect of withdrawals on the ending balance in owner's equity can be evaluated.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

3) Financial statements are business documents that are used to communicate information needed to make business decisions.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

4) The income statement is also called the statement of financial position.

Answer: FALSE

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

5) The heading of a balance sheet will show the date as a specific date, not a period of time.

Answer: TRUE

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

6) The balance of owner's capital at the beginning of the year and the end of the year was \$50,000 and \$67,000, respectively. No additional capital was introduced during the year. Withdrawals were \$23,000. What was the net income or loss for the year?

A) Net income of \$90,000

B) Net loss of \$90,000

C) Net loss of \$40,000

D) Net income of \$40,000

Answer: D

Explanation: D)

| | |
|---|----------|
| Owner's contribution at the end of the year | \$67,000 |
|---|----------|

| | |
|------------------------|---------------|
| Add owner's withdrawal | <u>23,000</u> |
|------------------------|---------------|

90,000

| | |
|--|-----------------|
| Less owner's contribution at the beginning of the year | <u>(50,000)</u> |
|--|-----------------|

| | |
|------------|-----------------|
| Net income | <u>\$40,000</u> |
|------------|-----------------|

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

7) The net income of Edwards Inc. amounted to \$74,000 for this year. The beginning balance of Owner's Capital account was \$32,000 and the ending balance was \$75,000. No additional contributions to capital were made during the year. What was the amount of his withdrawals during the year?

- A) \$75,000
- B) \$31,000
- C) \$149,000
- D) \$32,000

Answer: B

Explanation: B)

| | |
|---|----------|
| Owner's contribution at the beginning of the year | \$32,000 |
|---|----------|

Add:

| | |
|--------------------------------------|---|
| Owner's contribution during the year | - |
|--------------------------------------|---|

| | |
|------------|--------|
| Net income | 74,000 |
|------------|--------|

| | |
|---|-----------------|
| Less ending balance in Owner's contribution | <u>(75,000)</u> |
|---|-----------------|

| | |
|--------------------|-----------------|
| Owner's withdrawal | <u>\$31,000</u> |
|--------------------|-----------------|

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

8) Financial statements are prepared after an entity's transactions are analyzed and recorded. Which of the following reports is one of the required financial statements?

- A) Statement of cash flows
- B) Statement of return on assets
- C) Statement of withdrawals
- D) Expense statement

Answer: A

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

9) The statement of owner's equity shows the changes in Owner's capital. Which one of these statements is true?

- A) Decreases in Owner's equity result from additional owner investments.
- B) Decreases in Owner's equity result from net losses.
- C) Decreases in Owner's equity result from net income.
- D) Decreases in Owner's equity result from revenues earned.

Answer: B

Diff: 2

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

10) The income statement presents a summary of an entity's revenues and expenses for a period of time. Which of the following statements is true of an income statement?

- A) There is net income when total revenues are lesser than total expenses.
- B) There is a net loss when total expenses are lesser than total revenue.
- C) There is a net loss when total expenses are greater than total liabilities.
- D) There is net income when total revenues are greater than total expenses.

Answer: D

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

11) The balance sheet is a snapshot of the entity. Which of the following items are included on the balance sheet?

- A) revenues
- B) expenses
- C) assets
- D) withdrawals

Answer: C

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

12) Which of the following items is included in the headings of the financial statements?

- A) date and time of filing tax returns
- B) place and time of preparation of the statement
- C) name of the preparer of the statement
- D) name of the business

Answer: D

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

13) Which of the following financial statements reports expenses in decreasing order of their amounts, by stating the largest expense first?

- A) statement of cash flows
- B) income statement
- C) statement of owner's equity
- D) balance sheet

Answer: B

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

14) The amount of net income is transferred from _____ to _____.

- A) the income statement; the statement of owner's equity
- B) the balance sheet; the statement of cash flow
- C) the balance sheet; the income statement
- D) the income statement; the statement of expenditures

Answer: A

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

15) Which of the following financial statements reports that total assets are equal to total liabilities plus total owner's equity?

- A) statement of owner's equity
- B) statement of cash flows
- C) income statement
- D) balance sheet

Answer: D

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

16) Which of the following financial statements reports cash receipts and cash payments during a period of time?

- A) statement of cash flows
- B) balance sheet
- C) cash receipts budget
- D) statement of owner's equity

Answer: A

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

17) Which of the following financial statements reports an increase or decrease in net cash during the time period covered?

- A) income statement
- B) statement of owner's equity
- C) statement of cash flows
- D) cash budget

Answer: C

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

18) Which of the following is the correct order of preparation of financial statements?

- A) income statement → statement of owner's equity → balance sheet → statement of cash flows
- B) statement of owner's equity → balance sheet → income statement → statement of cash flows
- C) balance sheet → statement of owner's equity → income statement → statement of cash flows
- D) balance sheet → income statement → statement of owner's equity → statement of cash flows

Answer: A

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

19) Which of the following amounts appears on both the income statement and statement of owner's equity?

- A) ending capital
- B) total revenues
- C) net income
- D) withdrawals

Answer: C

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

20) Which of the following amounts appears on both the statement of owner's equity and the balance sheet?

- A) ending owner's equity
- B) total assets
- C) total revenues
- D) net income

Answer: A

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

21) Which of the following will be categorized as an operating activity on the statement of cash flows?

- A) cash received by selling old equipment
- B) cash paid for purchase of new machinery
- C) cash paid for purchase of raw materials
- D) cash received from issue of shares

Answer: C

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

22) Which of the following will be categorized as a financing activity on the statement of cash flows?

- A) cash received by selling old equipment
- B) cash paid for purchase of new machinery
- C) cash paid for purchase of raw materials
- D) cash received from issue of shares

Answer: D

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

23) Which of the following will be categorized as an investing activity on the statement of cash flows?

- A) depreciation expense on production equipment for the year
- B) cash paid for purchase of new machinery
- C) cash paid for purchase of raw materials
- D) cash received from issue of shares

Answer: B

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

24) Which of the following financial statements shows the changes in owner's capital during a period of time?

- A) income statement
- B) statement of owner's equity
- C) statement of cash flows
- D) balance sheet

Answer: B

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

25) Which of the following financial statements lists the entity's assets, liabilities, and owner's equity as of a specific date?

- A) balance sheet
- B) statement of owner's equity
- C) income statement
- D) statement of cash flows

Answer: A

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

26) Which of the following is shown on the balance sheet as well as the statement of cash flows?

- A) Owner's equity (ending balance)
- B) Net income
- C) Total assets
- D) Cash (ending balance)

Answer: D

Diff: 1

LO: 1-5

AACSB: Concept

AICPA Functional: Measurement

27) On May 1, 2015, Deborah Merchant started Deborah's Launderette by investing \$20,000. On May 3, the business borrowed \$5,000 from a creditor and executed a note payable with the principal and interest to be due in one year. On May 7, the business purchased \$15,000 of equipment for cash. On May 8, Deborah's Launderette rendered service to its first client and earned \$3,000 in cash. On May 12, Deborah incurred repair expense of \$1,800 and promised to pay the repair contractor the following month. On May 18, Deborah rendered service to a new client in the amount of \$8,000 on account, as the client promised to pay the following month. At the end of May, Deborah took a withdrawal of \$1,500. Prepare an income statement for the month of May, a statement of owner's equity for the month of May, and a balance sheet as of May 31, 2015.

Answer: Deborah's Launderette
Income Statement
Month Ended May 31, 2015

| | | |
|-----------------|--------------|----------------|
| Revenues: | | |
| Service Revenue | | \$11,000 |
| Expenses: | | |
| Repair Expense | <u>1,800</u> | |
| Total Expenses | | <u>1,800</u> |
| Net Income | | <u>\$9,200</u> |

Deborah's Launderette
Statement of Owner's Equity
Month Ended May 31, 2015

| | |
|--------------------------------|-----------------|
| Deborah, Capital, May 1, 2015 | 0 |
| Owner's contribution | \$20,000 |
| Net income for the month | <u>9,200</u> |
| 29,200 | |
| Owner's withdrawal | <u>(1,500)</u> |
| Deborah, Capital, May 31, 2015 | <u>\$27,700</u> |

Deborah's Launderette
Balance Sheet
May 31, 2015

| Assets | | Liabilities | |
|--------------------|-----------------|--------------------------------------|-----------------|
| Cash | \$11,500 | Accounts payable | \$1,800 |
| Account receivable | 8,000 | Note payable | <u>5,000</u> |
| Equipment | 15,000 | Total liabilities | 6,800 |
| | | Owner's Equity | |
| | | Deborah, capital | <u>27,700</u> |
| Total assets | <u>\$34,500</u> | Total liabilities and owner's equity | <u>\$34,500</u> |

Note:

Calculation of cash balance, May 31, 2015:

| | |
|----------------------------|-----------------|
| Owner's contribution | \$20,000 |
| Borrowing from creditor | 5,000 |
| Service fees received | <u>3,000</u> |
| Receipts | 28,000 |
| Less payments: | |
| Purchase of equipment | (15,000) |
| Owner's withdrawal | <u>(1,500)</u> |
| Cash balance, May 31, 2015 | <u>\$11,500</u> |

Diff: 3

LO: 1-5

AACSB: Application

AICPA Functional: Measurement

28) Donald started Donald Designers and invested \$25,000 into the business on June 1, 2015. He rendered services to three clients on account with total revenues earned of \$9,000. He then incurred advertising expense on four different websites and promised to pay a total of \$1,200 at a later date. On June 13, he purchased \$1,000 of office supplies for cash. On June 22, he received \$2,000 in cash payment from his first client and deposited it into the business account. On June 23, he incurred \$1,300 for legal expense and paid cash. On June 30, he made a payment of \$500 to one of the websites that he owed for advertising provided earlier in the month. No withdrawals were made during the month. For the month of June, prepare an income statement, a statement of owner's equity, and a balance sheet.

Answer: Donald Designers
Income Statement
Month Ended June 30, 2015

| | |
|---------------------|-----------------------|
| Revenues: | |
| Service Revenue | \$9,000 |
| Expenses: | |
| Advertising Expense | 1,200 |
| Legal Expense | <u>1,300</u> |
| Total Expenses | <u>2,500</u> |
| Net Income | <u><u>\$6,500</u></u> |

Donald Designers
Statement of Owner's Equity
Month Ended June 30, 2015

| | |
|--------------------------------|------------------------|
| Donald, Capital, June 1, 2015 | 0 |
| Owner's contribution | \$25,000 |
| Net income for the month | <u>6,500</u> |
| | 31,500 |
| Owner's withdrawal | <u>0</u> |
| Donald, Capital, June 30, 2015 | <u><u>\$31,500</u></u> |

Donald Designers
Balance Sheet
June 30, 2015

| Assets | | Liabilities | |
|--------------------|------------------------|-------------------|------------------------|
| Cash | \$24,200 | Accounts Payable | \$700 |
| Account Receivable | 7,000 | | |
| Office Supplies | 1,000 | | |
| | | Owner's Equity | |
| | | Donald, Capital | <u>31,500</u> |
| Total Assets | <u><u>\$32,200</u></u> | Total Liabilities | <u><u>\$32,200</u></u> |

Note:

Calculation of cash balance, June 30, 2015:

| | |
|-----------------------------|------------------------|
| Owner's contribution | \$25,000 |
| Service fees received | <u>2,000</u> |
| Receipts | 27,000 |
| Less payments: | |
| Legal expense | (1,300) |
| Office supplies | <u>(1,000)</u> |
| Advertising expenses | (500) |
| Cash balance, June 30, 2015 | <u>\$24,200</u> |

Diff: 3

LO: 1-5

AACSB: Application

AICPA Functional: Measurement

Learning Objective 1-6

1) The income statement shows whether or not a business can generate enough cash to pay its liabilities.

Answer: FALSE

Diff: 1

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

2) The balance sheet shows whether or not a business is earning profits.

Answer: FALSE

Diff: 1

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

3) The statement of owner's equity informs users about how much of the earnings were kept and reinvested in the company.

Answer: TRUE

Diff: 1

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

4) The relative proportion of economic resources and obligations would be shown by the balance sheet.

Answer: TRUE

Diff: 2

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

5) The statement of cash flows informs users about how much of the earnings were kept and reinvested in the company.

Answer: FALSE

Diff: 1

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

6) Which of the following statements helps analyze the business performance in terms of profitability?

A) income statement

B) balance sheet

C) statement of cash flows

D) statement of owner's equity

Answer: A

Diff: 1

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

7) Which of the following financial statements is used to analyze the economic resources, debt, and overall financial position of a company?

A) income statement

B) balance sheet

C) statement of cash flows

D) statement of owner's equity

Answer: B

Diff: 1

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

8) The explanation of why the net income differs from the change in cash balance for the period is explained in the:

A) income statement.

B) balance sheet.

C) statement of owner's equity.

D) statement of cash flows.

Answer: D

Diff: 1

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

9) Which of the following statements would be most useful if an analyst wants to know the likelihood of repayment of his debts?

- A) income statement
- B) balance sheet
- C) statement of owner's equity
- D) statement of cash flows

Answer: B

Diff: 2

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

10) Which of the following statements would be most useful if an analyst wants to know the profitability of a company?

- A) income statement
- B) balance sheet
- C) statement of owner's equity
- D) statement of cash flows

Answer: A

Diff: 2

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

11) The return on assets is calculated by:

- A) subtracting net income from average total assets.
- B) adding net income and average total assets.
- C) dividing net income by average total assets.
- D) multiplying net income and average total assets.

Answer: C

Diff: 2

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

12) Which of the following formulae is used to calculate average total assets for the return on assets ratio?

- A) Average total assets = (Beginning total assets + Ending total assets) \times 2
- B) Average total assets = (Beginning total assets - Ending total assets) \times 2
- C) Average total assets = (Beginning total assets - Ending total assets) \div 2
- D) Average total assets = (Beginning total assets + Ending total assets) \div 2

Answer: D

Diff: 2

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement

13) Assume MetAmbit Inc. had net income of \$2,500 for the year ending December, 2014. Its beginning and ending total assets were \$35,500 and \$20,500, respectively. Calculate MetAmbit's return on assets (ROA). (Round your percentage answer to two decimal places.)

A) 12.57%

B) 5.85%

C) 8.93%

D) 9.50%

Answer: C

Explanation: C) Return on assets (ROA) = $\$2,500 \div [(\$35,500 + \$20,500) \div 2] = 8.93\%$

Diff: 2

LO: 1-6

AACSB: Concept

AICPA Functional: Measurement