

Chapter 02

Reporting Investing and Financing Results on the Balance Sheet

True / False Questions

1. A transaction is an exchange or event that directly affects the assets, liabilities, or stockholders' equity of a company.

True False

2. A transaction can cause only one account on the balance sheet to change.

True False

3. If a company uses \$100 million in cash to pay off debt, its stockholders' equity will rise \$100 million.

True False

4. General Motors (GM) signs a new labor agreement that its workers will receive a 5% wage increase next year. This is considered a transaction that affects GM's financial statements in the current year.

True False

5. All of a company's business activities have a direct economic effect on the company.

True False

6. If total assets increase, then either liabilities or stockholders' equity also must increase.

True False

7. Company X issues \$40 million in new stock for cash. This does not affect stockholders' equity because as new shares are sold the value of existing shares falls.

True False

8. Transactions are analyzed from the point of view of the company, not the company's owners.

True False

9. You are pleasantly surprised to discover that a popular actress appears on The Tonight Show wearing your company's jeans. Later, your company's sales increase by \$500,000 as a result. When the actress appeared on TV, you would have recorded an asset because the TV appearance was expected to bring future economic benefits to your company.

True False

10. If the total dollar value of credits to an account exceeds the total dollar value of debits to that account, the ending balance of the account will be a debit balance.

True False

11. A company signed an agreement to rent store space from another company. This is an example of a recordable transaction.

True False

12. Retained earnings is the cumulative earnings of a company which have not been distributed to owners.

True False

13. An internal accounting report called a Trial Balance checks whether recorded debits equal recorded credits.

True False

14. The journal is a chronological record of transactions using a debit/credit framework.

True False

15. The ledger consists of all of the accounts used by a business.

True False

16. A business is obliged to repay debt and equity financing.

True False

17. The list of names and reference numbers that the company will use when accounting for transactions is called the Chart of Accounts.

True False

18. Journal entries show the effects of transactions on the elements of the accounting equation, as well as the amount of the account balances.

True False

19. The acquisition of equipment in an exchange for a company's stock would increase the current ratio of the company.

the accounts in this transaction is classified as current.

True False

20. The current ratio can be used to evaluate a company's ability to pay liabilities in the short-term, and in general, a lower ratio means better ability to pay.

True False

Multiple Choice Questions

21. How many of the following statements regarding the balance sheet are true?

- A "classified" balance sheet is one that contains privileged information.
- All liabilities require that the company sacrifice resources at some time in the future.
- All companies use an identical list of account names defined by the Financial Accounting Standards Board (FASB).

- A. None
- B. One
- C. Two
- D. Three

22. How many of the following statements regarding debits and credits are true?

- A decrease in assets will result in a credit to an asset account.
- Across all accounts, the total value of all debits must equal the total value of all credits.
- The total value of all debits to a particular account must equal the total value of all credits to that account.

- A. None
- B. One
- C. Two
- D. Three

23. How many of the following statements regarding the balance sheet are true?

- Any item on a balance sheet labeled payable is a liability of that company.
- Current Assets are listed on the balance sheet in order of how fast they are used up or can be turned into cash.
- The basic accounting equation must always balance.

- A. None
- B. One
- C. Two
- D. Three

24. How many of the following statements regarding posting and classification are true?

- Posting journal entries involves copying the dollar amounts from the journal into the ledger.
 - If a \$100 debit is erroneously posted to an account as a \$100 credit, the accounts will be out of balance by \$100.
 - If a \$5,000 liability is misclassified as stockholders' equity then the accounting equation will still balance.
- A. None
B. One
C. Two

25. How many of the following statements regarding the concepts underlying the balance sheet are true?

- A company buys land for \$5 million dollars in 1983. The land is now worth \$15 million. The company should increase the book value of this asset on its balance sheet to reflect its current value.
 - All events affecting the current value of a company are reported on the balance sheet.
 - According to the cost principle, assets are valued at their replacement cost.
- A. None
B. One
C. Two
D. Three

26. Which of the following would be listed as a long-term asset?

- A. Cash.
B. Supplies.
C. Buildings and equipment.
D. Total assets.

27. Which of the following would be listed as a current liability?

- A. Cash in the bank.
B. Notes payable due in two years.
C. Supplies.
D. Accounts payable.

28. A long-term liability is one that the company:

- A. has owed for over one year.
- B. has owed for over five years.
- C. will not pay off for over one year.
- D. will not pay off for over five years.

29. A current asset is one that:

- A. the company has owned for over one year.
- B. the company has owned for over five years.
- C. the company will use up or convert into cash in less than one year.
- D. the company will use up or convert into cash in less than five years.

30. At the start of the first year of operations, retained earnings on the balance sheet would be:

- A. equal to zero.
- B. equal to contributed capital.
- C. equal to stockholders' equity.
- D. equal to the negative of liabilities.

31. Account names in the chart of accounts are:

- A. general purpose and do not indicate the nature of the account.
- B. not consistent in their use throughout the records.
- C. linked to account numbers.
- D. the names mandated for use by the FASB.

PURRFECT PETS, INC.

BALANCE SHEET

AT JUNE 30, 2010

Assets		Liabilities	
Cash	\$732,600	Accounts Payable	\$349,200
Accounts Receivable	419,200	Notes Payable, due 2012	<u>268,900</u>
Supplies	58,400	Total Liabilities	<u>618,100</u>
Property, Plant and Equipment	118,500		
Other Assets	<u>69,400</u>	Stockholders' Equity	
		Contributed Capital	662,100
		Retained Earnings	<u>117,900</u>
		Total Equity	<u>780,000</u>
Total Assets	<u>\$1,398,100</u>	Total Liabilities and Stockholders' Equity	<u>\$1,398,100</u>

32. Which line items on the balance sheet would be classified as long term?

- A. Cash; Supplies; Accounts Payable.
- B. Property, Plant and Equipment; Notes Payable; Other Assets.
- C. Supplies; Property, Plant and Equipment; Notes Payable.
- D. Total Assets; Total Liabilities; Other Assets.

33. How much financing did the stockholders of Purrfect Pets, Inc., directly contribute to the company?

- A. \$117,900.
- B. \$662,100.
- C. \$780,000.
- D. \$1,398,100.

34. Which of the following is **not** an example of a liability?

- A. Interest receivable.
- B. Wages payable.
- C. Accounts payable
- D. Income tax payable

35. The local branch of the Universal Bank System (UBS) receives money from depositors and lends it to borrowers. Which of the following would be true about UBS's financial statements?

- A. UBS reports deposits as assets and loans as liabilities.
- B. UBS reports both deposits and loans as assets.
- C. UBS reports deposits as liabilities and loans as assets.
- D. UBS reports both deposits and loans as liabilities.

36. Which of the following is not an example of an asset?

- A. Notes receivable.
- B. Supplies.
- C. Prepaid expenses.
- D. Retained Earnings.

37. If a company borrows money from a bank and signs an agreement to repay the loan several years from now, in which account would the company report the amount borrowed?

- A. Contributed Capital.
- B. Accounts Payable.
- C. Notes Payable.
- D. Bonds Payable.

38. The Sweet Smell of Success Fragrance Company borrowed \$60,000 from the bank and used all of the money to re-design its new store. Sweet Smell's balance sheet would show this as

- A. \$60,000 under Furnishings & Equipment and \$60,000 under Notes Payable.
- B. \$60,000 under Supplies and \$60,000 under Accounts Payable.
- C. \$60,000 under Prepaid Expenses and \$60,000 under Accrued Liabilities.
- D. \$60,000 under Other Assets and \$60,000 under Other Liabilities.

39. The Buddy Burger Corporation owes \$1.5 million to the Texas Wholesale Meat Company from whom Buddy Burger buys its burger meat. Which account would Buddy Burger use to report the amount owed?

- A. Cash.
- B. Accounts Payable.
- C. Supplies.
- D. Accounts Receivable.

40. Which of the following describes the classification and normal balance of the retained earnings account?

- A. Asset, debit
- B. Stockholders' equity, credit
- C. Liability, credit
- D. Stockholders' equity, debit

41. If a company receives \$20,000 cash on accounts receivable and uses the cash to pay \$20,000 on accounts payable then:

- A. assets would increase by \$20,000 while liabilities would decrease by \$20,000.
- B. liabilities would decrease by \$20,000 while stockholders' equity would increase by \$20,000.
- C. assets would decrease by \$20,000 while liabilities would decrease by \$20,000.
- D. liabilities would decrease by \$20,000 while stockholders' equity would decrease by \$20,000.

42. In 1999, the Denim Company bought land that cost \$15,000. In 2010, a similar piece of land was bought for \$28,000 and the company's existing land was estimated to be worth \$18,000. On the balance sheet at the end of 2010, the land that was purchased in 1999 would be reported at:

- A. \$15,000.
- B. \$28,000.
- C. \$18,000.
- D. the average of the three prices.

43. What is the minimum number of accounts that must be involved in any transaction?

- A. One.
- B. Two.
- C. Three.
- D. No minimum.

44. Transactions include which **two** types of events?

- A. Direct events, indirect events.
- B. Monetary events, production events
- C. external exchanges, internal events
- D. past events, future events.

45. A company disposes of \$1 million of its assets. Which of the following could **not** be true?

- A. Assets remain the same, and liabilities and stockholders' equity both decrease by \$1 million.
- B. Assets decrease by \$1 million, liabilities decrease by \$1 million, and stockholders' equity is unchanged.
- C. Assets, liabilities, and stockholders' equity all remain the same.
- D. Assets decrease by \$1 million, and liabilities and stockholders' equity both decrease by \$500,000.

46. Your company orders and broadcasts a 30 second ad during the Super Bowl for \$1.2 million. It is legally obligated to pay for the ad but has not yet done so.

- A. This is an internal event and it does NOT affect the balance sheet.
- B. This is an external event and it does NOT affect the balance sheet.
- C. This is an internal event that affects the balance sheet.
- D. This is an external event that affects the balance sheet.

47. In part, a transaction affects the accounting equation as follows:

Assets	=	Liabilities	+	Stockholders' Equity
↓ Accounts receivable	=	No change	+	

Which of the following must be true for this transaction?

- A. If other assets are unchanged, stockholders' equity must be increasing.
- B. If other assets are unchanged, stockholders' equity must be decreasing.
- C. If stockholders' equity is unchanged, another asset must be decreasing.
- D. If stockholders' equity is unchanged, other assets must be unchanged.

48. A company buys equipment for \$500,000 and signs a promissory note for the full amount. How does this transaction affect the accounting equation?

- A. Assets: ↑ Property and equipment, ↓ Cash; Liabilities: no change; Stockholders' Equity: no change.
- B. Assets: ↑ Property and equipment; Liabilities: ↑ Notes payable; Stockholders' Equity: no change.
- C. Assets: ↑ Property and equipment; Liabilities: no change; Stockholders' Equity: ↓ Retained earnings.
- D. Assets: ↑ Property and equipment; Liabilities: no change; Stockholders' Equity: ↓ Contributed capital.

49. Your company pays back \$2 million on a loan it had received earlier from a bank.

- A. Assets are unchanged, liabilities and stockholders' equity both increased by \$2 million.
- B. Assets decrease by \$2 million, liabilities decrease by \$2 million, stockholders' equity is unchanged.
- C. Assets are unchanged, liabilities increase by \$2 million, contributed capital decreases by \$2 million.
- D. Assets decrease by \$2 million, liabilities are unchanged, contributed capital decreases by \$2 million.

50. A company issues \$20 million in new stock. It later uses the cash received to pay off promissory notes. How many different accounts and which account names are affected by these two transactions?

- A. 3 accounts involved: contributed capital, cash, and notes payable.
- B. 4 accounts involved: contributed capital, cash, liabilities, and accounts payable.
- C. 3 accounts involved: cash, assets, and accounts payable.
- D. 3 accounts involved: contributed capital, investments, and accounts payable.

51. A company borrows \$2 million from its bank. It then uses this money to buy equipment. How does this transaction affect the accounting equation?

- A. Assets and Liabilities both rise \$2 million.
- B. Assets and Stockholders' Equity both fall \$2 million.
- C. Assets, Liabilities, and Stockholders' Equity are unchanged.
- D. Stockholders' Equity rises \$2 million and Liabilities fall \$2 million.

52. A company receives \$100,000 cash from investors in exchange for stock. Several weeks later, the company buys a \$250,000 machine using all of the cash from the stock issue and signing a promissory note for the remainder. The accounts involved in these two transactions are:

- A. Long-term Investments; Cash; Equipment; and Accounts Payable.
- B. Contributed Capital; Cash; Long-term Investments; and Notes Payable.
- C. Contributed Capital; Cash; Equipment; and Notes Payable.
- D. Retained Earnings; Equipment; and Notes Payable.

53. A company purchases \$23,000 of supplies in the current month and promises to pay for them next month. How would the company record a liability for the supplies?

- A. This liability is not a recognized liability until the payment is due.
- B. \$23,000 would be journalized as a credit to Accounts Payable.
- C. \$23,000 would be journalized as a debit to Accounts Payable.
- D. \$23,000 would be journalized as a debit to Prepaid Expenses.

54. If total liabilities decreased by \$25,000 and stockholders' equity increased by \$5,000 during a period of time, then total assets must change by what amount and direction during the same time period?

- A. \$20,000 increase.
- B. \$20,000 decrease.
- C. \$30,000 increase.
- D. \$30,000 decrease.

55. The characteristic shared by all liabilities is that they:

- A. provide a future economic benefit.
- B. result in an inflow of resources to the company.
- C. always end in the word "payable."
- D. obligate the company to do something in the future.

56. A company issues \$20 million in new stock. The company later uses this money to acquire a building. How many accounts will be affected by these transactions and which particular account names are most likely to be used to record the effects of these transactions?

- A. 3 accounts affected: Contributed Capital, Cash, and Building.
- B. 4 accounts affected: Contributed Capital, Cash, Liabilities, and Building.
- C. 3 accounts affected: Cash, Property, Plant and Equipment, and Contributed Capital.
- D. 3 accounts affected: Contributed Capital, Investments, and Cash.

57. Park & Company was recently formed with a \$5,000 investment in the company by stockholders. The company then borrowed \$2,000 from a local bank, purchased \$1,000 of supplies on account, and also purchased \$5,000 of equipment by paying \$2,000 in cash and signing a promissory note for the balance. Based on these transactions, the company's total assets are:

- A. \$7,000.
- B. \$9,000.
- C. \$10,000.
- D. \$11,000.

58. The common characteristic possessed by all assets is

- A. long life.
- B. great financial value.
- C. physical substance.
- D. future economic benefit.

59. Current liabilities are expected to be

- A. converted to cash within one year.
- B. paid within one year.
- C. used in the business within one year.
- D. acquired within one year.

60. If Accounts Payable had a balance of \$18,200 at the beginning of the month, and the six amounts shown below were posted to this account, what should be the ending balance?

Three debits posted to Accounts Payable this month: \$4,700, \$11,300, and \$14,800.

Three credits posted to Accounts Payable this month: \$3,600, \$9,500, and \$12,700.

- A. \$13,200.
- B. \$5,000.
- C. \$23,200.
- D. \$49,000.

61. In a T-account, debits appear in what manner?

- A. They are on the left under assets but on the right under liabilities and stockholders' equity.
- B. They are always listed on the right.
- C. They are always listed on the left.
- D. They are on the right under assets but on the left under liabilities and stockholders' equity.

62. A company uses \$100,000 in cash to pay off \$100,000 in notes payable. This would result in a:

- A. \$100,000 credit to Cash and a \$100,000 debit to Notes Payable.
- B. \$100,000 credit to Cash and a \$100,000 credit to Notes Payable.
- C. \$100,000 debit to Cash and a \$100,000 credit to Notes Payable.
- D. \$100,000 debit to Cash and a \$100,000 debit to Notes Payable.

63. Purrfect Pets, Inc., uses \$10,000 in cash to pay \$10,000 on Accounts Payable. This would result in a:

- A. \$10,000 credit to Cash and a \$10,000 credit to Accounts Payable.
- B. \$10,000 debit to Cash and a \$10,000 debit to Accounts Payable.
- C. \$10,000 credit to Cash and a \$10,000 debit to Accounts Payable.
- D. \$10,000 debit to Cash and a \$10,000 credit to Accounts Payable.

64. The best interpretation of the word "*credit*" is the

- A. offset side of an account.
- B. increase side of an account.
- C. right side of an account.
- D. decrease side of an account.

65. Accounts Payable

- A. has a normal credit balance
- B. is increased by a debit
- C. is an asset
- D. is increased when a company receives cash from customers.

66. Accounts receivable

- A. has a normal credit balance.
- B. is increased by a debit.
- C. is a liability.
- D. is increased when a company receives cash from its customers.

Cash			
Beginning			
Balance	123,900		
(a)	14,700	(c)	6,000
(b)	38,300	(d)	5,800
		(e)	7,400
		(f)	12,000
		(g)	11,200

67. The final balance of the Cash account would be:

- A. \$219,300.
- B. \$113,300.
- C. \$28,500.
- D. \$134,500.

68. In the T-account above:

- A. (a) and (b) are credits.
- B. (c) through (g) are debits.
- C. if the sum of (a) and (b) is less than the sum of (c) through (g), the total cash will increase.
- D. (a) and (b) are increases.

69. A credit would make which of the following accounts decrease?

- A. Contributed Capital.
- B. Inventories.
- C. Notes Payable.
- D. Retained Earnings.

70. Your company buys a \$2 million warehouse paying \$300,000 in cash and issuing \$1.7 million in promissory notes. This will be posted as:

- A. \$2 million credited and \$300,000 debited to assets; \$1.7 million debited to liabilities.
- B. \$2 million debited to assets and \$2 million credited to liabilities.
- C. \$2 million debited and \$300,000 credited to assets; \$1.7 million credited to liabilities.
- D. \$2 million credited to assets and \$2 million debited to liabilities.

71. Cash had a beginning balance of \$68,900. During the month, Cash was credited for \$16,000 and debited for \$18,300. At the end of the month, the balance is:

- A. \$2,300.
- B. \$71,200.
- C. \$66,700.
- D. \$(2,300).

72. Which of the following is true?

- A. Assets have debit balances and liabilities have credit balances.
- B. Assets and liabilities have credit balances.
- C. Assets have credit balances and liabilities have debit balances.
- D. Assets and liabilities have debit balances.

73. The standard formatting for a journal entry:

- A. lists credits first and then debits, both aligned to the left.
- B. lists credits first and then debits, indented underneath.
- C. lists debits first and then credits, both aligned to the right.
- D. lists debits first and then credits, indented underneath.

74. The standard formatting for a journal entry lists the dollar amounts for:

- A. credits to the right of the dollar amounts for debits.
- B. debits and credits aligned equally to the right.
- C. debits to the right of the dollar amounts for credits.
- D. debits and credits aligned equally to the left.

75. Which of the following scenarios could explain the journal entry below?

<i>dr</i>	Equipment	10,000	
	<i>cr</i> Cash		4,000
	<i>cr</i> Notes payable		6,000

- A. The company buys \$10,000 of equipment for \$4,000 in cash and \$6,000 on credit.
- B. The company receives \$4,000 in cash and \$6,000 in notes payable for selling 10,000 of equipment.
- C. The company buys \$10,000 of equipment, for \$4,000 cash and a promise to cancel \$6,000 of debt owed to it.
- D. The company sells \$10,000 of equipment, for \$4,000 in cash and pays off \$6,000 it owes on the equipment.

76. Which of the following statements is true?

- A. Assets must always equal liabilities plus stockholders' equity.
- B. The total value of credits in all accounts must always equal the total value of debits in all accounts.
- C. The net changes in assets must always equal the sum of the net changes in liabilities and stockholders' equity.
- D. All of the above.

77. The normal balance of any account is the

- A. left side.
- B. right side.
- C. side which increases that account.
- D. side which decreases that account.

Accounts Receivable			
Beginning Balance	187,500		
	104,900		
	63,900	18,000	
		5,400	
		14,700	
		19,200	

Partial listing of account balances at the end of the year:

Cash		\$28,000
Accounts Receivable		?
Supplies		35,600
Other Current Assets		5,900

78. The amount of Total Current Assets that would be reported on the company's balance sheet at the end of the year would be

- A. \$180,800.
- B. \$368,500.
- C. \$145,700.
- D. \$298,800.

79. Which of the following is an accurate description of the economic events involving Accounts Receivable as documented in the T-Account above?

- A. There were more customers paying off balances than there were customers adding to their balances.
- B. There were more customers adding to their balances than paying off their balances.
- C. The company paid off its debt more than it incurred new debt.
- D. The company incurred more debt than it paid off.

80. According to the principle of conservatism, when faced with uncertainty about the value of an item, a company should use the measure that avoids:

- A. overstating assets and liabilities.
- B. overstating assets and understating liabilities.
- C. understating assets and overstating liabilities.
- D. understating assets and liabilities.

81. Which of the following would **not** be considered fraudulent financial reporting?

- A. Intentionally reporting long-term assets that include equipment ordered but not yet received.
- B. Intentionally reporting long-term assets that include equipment ordered and received but not yet paid for.
- C. Intentionally reporting long-term assets that include items paid for but not yet received.
- D. Intentionally reporting long-term assets that have been scrapped.

82. Your company's president donates a large amount of her own money to charity and receives significant publicity that includes the company's name. How would the benefits of this publicity appear on the balance sheet?

- A. It would appear as a current asset.
- B. It would appear as a liability.
- C. It would appear as a long-term asset.
- D. It would not appear on the balance sheet.

83. Which of the following would a company be most likely to overstate if the company was trying to mislead potential external investors or creditors?

- A. Accounts Receivable.
- B. Notes Payable.
- C. Salaries Expense.
- D. Accounts Payable.

84. Which of the following would not be recorded as an identifiable accounting transaction?

- A. Putting a deposit down on a new vehicle.
- B. Hiring a new employee.
- C. Obtaining a bank loan.
- D. Receiving a deposit from a customer.

85. Which concept should be applied when reporting a piece of land that was bought for \$50,000 five years ago, and which would probably now sell for \$80,000?

- A. The cost principle.
- B. The asset principle.
- C. The separate entity concept.
- D. The monetary concept.

86. Conservatism means:

- A. not underestimating asset values.
- B. not overestimating liabilities.
- C. using the least optimistic measurement when faced with uncertainty about the reported amounts of assets and liabilities.
- D. always recording an asset at the amount it originally cost.

87. The MegaBuck movie studio's name has become famous for adventure movies. Another studio once offered to buy the name for \$20 million, but MegaBuck turned down the offer.

The MegaBuck balance sheet will show:

- A. The company's name under Other Assets, valued at \$20 million.
- B. The company's name under Other Assets, valued conservatively at \$10 million.
- C. The company's name under Accounts Receivable, valued at \$20 million.
- D. The company's name will not be shown as an asset on the balance sheet.

88. Which of the following statements is FALSE?

- A. A transaction is an exchange or event that has a direct and measurable financial effect.
- B. Every transaction has at least 2 effects.
- C. Current assets are economic resources to be used or turned into cash within one year
- D. Notes payable is the account debited when money is borrowed from a bank using a promissory note.

A company entered into the following transactions:

- Borrowed \$5,000 from the bank by signing a promissory note
- Issued stock to owners for \$10,000
- Purchased \$1,000 of supplies, on account
- Paid \$400 to suppliers as payment on account for the supplies purchased

89. What is the amount of total assets?

- A. \$16,000
- B. \$5,600
- C. \$15,000
- D. \$15,600

90. What is the amount of total liabilities?

- A. \$6,000
- B. \$15,600
- C. \$16,000
- D. \$5,600

A company reported the following in its recent balance sheet

Accounts payable	\$19,207
Accounts receivable	\$81,336
Cash	\$73,324
Income tax payable	\$ 3,512
Inventories	\$25,816
Long-term liabilities	\$ 1,709
Property and equipment	\$54,128
Stockholders' equity	\$202,808
Supplies	\$ 5,512
Wages payable	\$12,880

91. What is the amount of Total Assets on the Balance Sheet?

- A. \$240,116
- B. \$259,323
- C. \$442,924
- D. \$234,604

92. What is the amount of Total Liabilities on the Balance Sheet?

- A. \$240,116
- B. \$37,308
- C. \$63,124
- D. \$118,644

93. What is the amount of the current ratio (round to two decimal places)?

- A. 2.02
- B. 5.00
- C. 5.22
- D. 1.00

94. What would be the effect on the current ratio if the company paid \$10,000 on its accounts payable?

- A. The current ratio would increase since it is now greater than 1 to 1.
- B. The current ratio would decrease since it is now greater than 1 to 1.
- C. This transaction would have no effect on the current ratio.
- D. The current ratio would change in the same direction whether the ratio were now greater than or less than 1 to 1.

95. B. Darin Company bought land at a cost of \$15,000 and planned to use it to construct a new storage facility on the property. A short time later, the company changed its plans and sold the property to S. Dee Company for \$15,000. S. Dee Company promised to pay cash in 60 days.

Which of the following would be part of the journal entry by B. Darin Company to record the sale of the property?

- A. Credit Accounts receivable
- B. Debit Cash
- C. Credit Land
- D. Debit Accounts payable

96. B. Darin Company issued stock to investors and received \$50,000. Choose the TRUE statement.

- A. This is an example of a cash inflow from an investing activity.
- B. The journal entry to record this transaction will include a credit to cash.
- C. This is an example of a cash outflow from a financing activity.
- D. The journal entry to record this transaction will include a credit to contributed capital.

97. A company started the year with a normal balance of \$68,000 in the Inventory account. During the year the following amounts were posted to the account: Debits of \$45,000 and credits of \$55,000. Choose the TRUE statement.

- A. After these amounts are posted, the balance in the Inventory account is a credit balance of \$58,000.
- B. The normal balance of the Inventory account is a credit balance.
- C. The inventory account is decreased by debits.
- D. The debits and credits posted to the Inventory account caused it to decrease by \$10,000.

98. Which of the following is not a recordable transaction?

- A. Issued shares of stock to investors in exchange for cash contributions of \$4,000.
- B. Ordered inventory from suppliers for \$3,000.
- C. Sold equipment to another company for \$3,000 and accepted a note from the company promising payment in 6 months.
- D. Borrowed money from the bank by signing a promissory note for \$2,000.

99. Choose the TRUE statement.

- A. All asset accounts have a normal debit balance with the exception of cash which has a normal credit balance.
- B. Contributed capital account is increased by debits.
- C. When payment is made on a liability such as accounts payable, the liability account is decreased with a credit.
- D. The total amount of debits to asset accounts must equal the total amount of credits to liability and stockholders' equity accounts.

100. A company entered into the following transaction: Purchased equipment for use in the business at a cost of \$12,000, one-fourth was paid in cash and the company signed a note for the balance. Choose the TRUE statement about the journal entry to record this transaction.

- A. The journal entry will include a debit to Notes receivable of \$3,000.
- B. The journal entry will include a debit to Cash of \$12,000.
- C. The journal entry will include a credit to Notes payable of \$9,000.
- D. The journal entry will include a credit to Equipment \$12,000.

101. The E. Flynn Company started business by obtaining financing through debt financing and equity financing. Which of the following statements is FALSE?

- A. Equity financing refers to the money obtained through owners' contributions and reinvestments of profit.
- B. Debt financing refers to the money obtained through loans.
- C. The business is obligated to repay debt financing.
- D. The business is obligated to repay equity financing.

102. Which of the following statements is TRUE?

- A. Transactions are analyzed from the standpoint of the owners.
- B. All business activities are considered accounting transactions.
- C. The transaction amount is determined for each exchange based on the cost of the items given and received.
- D. A business needs journal entries only to show how transactions affect the balance sheet.

103. Which of the following statements is FALSE about the current ratio?

- A. Instead of using the dollar amounts, the current ratio makes it easier to compare several companies.
- B. The current ratio is used to evaluate a company's ability to pay current obligations.
- C. Having more current assets than current liabilities will yield a current ratio less than 1.
- D. A high current ratio suggests good liquidity.

104. Conservatism is

- A. the requirement that businesses should intentionally understate assets.
- B. the requirement that businesses should intentionally overstate liabilities.
- C. the requirement that if an asset's value falls over time it will continue to be reported at its original cost.
- D. the requirement that when faced with uncertainty about the numbers to report, accountants must use the least optimistic measure.

105. Which of the following is NOT an asset?

- A. Cash
- B. Notes receivable
- C. Contributed capital
- D. Land

106. Which of the following is NOT true about liabilities?

- A. Liabilities are amounts owed by a business.
- B. Liability accounts have a normal credit balance.
- C. Financing activities will affect the amount of liabilities.
- D. Examples of liabilities include notes payable, contributed capital and income tax payable.

107. Assets are listed on a classified balance sheet in which of the following ways?

- A. In alphabetical order.
- B. From the largest dollar amount to the lowest dollar amount.
- C. Beginning with non-current assets and ending with current assets.
- D. Starting with cash.

108. If a company is trying to maximize its perceived value to external decision makers, the company is most likely to

- A. understate the current assets.
- B. understate the long-term liabilities.
- C. understate the retained earnings.
- D. understate the contributed capital.

109. Which of the following is a recordable transaction for the company, Bobby and Sandy Store?

- A. The company signed an agreement to rent store space at \$200 month.
- B. The vice president of the company spoke at a luncheon which contributed to enhancing the company's reputation as a responsible company.
- C. The company ordered supplies for \$500.
- D. The company lent \$500 to an employee.

A company was recently formed with \$60,000 cash contributed to the company by its owners. The company then borrowed \$30,000 from a bank and bought \$10,000 of inventory and paid cash for it. The company also purchased \$70,000 of equipment by paying \$10,000 in cash and issuing a note for the remainder.

110. What is the amount of the total assets to be reported on the balance sheet?

- A. \$150,000
- B. \$160,000
- C. \$90,000
- D. \$80,000

111. What is the amount of the total liabilities to be reported on the balance sheet?

- A. \$60,000
- B. \$0
- C. \$90,000
- D. \$80,000

A company reported the following information at December 31, 2010:

Accounts payable	\$ 4,500
Accounts receivable	\$ 9,350
Cash	\$23,490
Contributed capital	\$90,000
Equipment	\$49,500
Inventory	\$31,200
Notes payable, due 2012	\$ 2,500
Retained Earnings	\$14,090
Wages payable	\$ 2,450

112. What is the amount of current assets on the classified balance sheet?

- A. \$113,540
- B. \$64,040
- C. \$23,490
- D. \$37,580

113. What is the amount of current liabilities on the classified balance sheet?

- A. \$9,450
- B. \$6,950
- C. \$7,000
- D. \$4,500

114. What is the total of the CREDIT balance accounts?

- A. \$111,040
- B. \$104,090
- C. \$113,540
- D. \$108,590

115. Which of the following is a TRUE statement?

- A. Conservatism requires accountants to intentionally understate assets.
- B. Separate entity assumption in accounting requires that the financial activities of the owners of a company be reported on the company's balance sheet.
- C. The cost principle states that recording activities at cost will result in the balance sheet representing the true value of the company.
- D. A transaction is recorded in accounting if it has a measurable financial effect on the assets, liabilities or stockholders' equity of a business.

116. Which account would be increased by a debit?

- A. Retained earnings
- B. Accounts receivable
- C. Contributed capital
- D. Notes payable

117. Which account would be decreased by a credit?

- A. Cash
- B. Accounts payable
- C. Contributed capital
- D. Retained earnings

The classified balance sheet for a company reported current assets of \$1,623,850, total liabilities of \$799,540, contributed capital of \$1,000,000 and retained earnings of \$130,260. The current ratio was 2.5.

118. What is the total amount of non-current assets?

- A. \$493,590
- B. \$824,310
- C. \$649,540
- D. \$305,950

119. What is the total amount of current liabilities?

- A. \$649,540
- B. \$824,310
- C. \$305,950
- D. \$799,540

120. Which of the following is a FALSE statement?

- A. Total Assets are \$1,929,800.
- B. Total Stockholders' equity is \$1,130,260.
- C. Long-term liabilities are \$130,260.
- D. The amount of current assets are 2.5 times the amount of current liabilities.

121. A company purchased land costing \$27,000 by making a 25 percent cash down payment and signing a 90-day note for the balance. The entry to record this transaction would

- A. Increase total assets.
- B. Decrease total liabilities.
- C. Decrease contributed capital.
- D. Increase retained earnings.

122. Each account is assigned a number and this listing of all accounts is called a

- A. Trial Balance
- B. Journal
- C. Ledger
- D. Chart of Accounts

123. Which of the following would decrease stockholders' equity?

- A. Stock issued for cash.
- B. Repayment of notes payable.
- C. Land purchased for cash.
- D. Dividends paid to owners.

124. A Company has \$15,000 of retained earnings, \$26,000 of assets, and \$6,000 of liabilities. How much is contributed capital?

- A. \$36,000
- B. \$15,000
- C. \$5,000
- D. \$6,000

125. Stockholders' equity in a corporation consists of:

- A. Long-term assets.
- B. Current assets plus long-term assets.
- C. Assets plus liabilities.
- D. Contributed capital plus retained earnings.

126. Typical cash flows from investing activities include:

- A. Payments to purchase property and equipment.
- B. Repayment of loans.
- C. Proceeds from issuing notes payable.
- D. Receipts from cash sales.

127. On January 1, Kirk Corporation had total assets of \$850,000. During the month the following activities occurred:

- . Kirk Corporation acquired equipment costing \$6,000, promising to pay cash for it in 60 days.
- . Kirk Corporation purchased \$3,500 of supplies for cash.
- . Kirk Corporation sold land which it had acquired 2 years ago. The land had cost \$15,000 and it was sold for \$15,000 cash.
- . Kirk Corporation signed an agreement to rent additional storage space next month at a charge of \$1,000 per month.
- . The financial vice president of Kirk Corporation purchased a new vehicle for cash of \$35,000.

What is the amount of total assets of Kirk Corporation at the end of the month?

- A. \$859,500
- B. \$856,000
- C. \$821,000
- D. \$806,000

128. Which of the following statements is TRUE?

- A. Asset and liability accounts have a normal debit balance.
- B. To debit an account means to increase it.
- C. Contributed capital and retained earnings have a normal credit balance.
- D. To credit an account means to decrease it.

129. Which of the following would cause a trial balance to be out of balance?

- A. A transaction was recorded twice.
- B. A transaction was not recorded.
- C. A transaction was posted to the wrong accounts.
- D. Only the credit of a transaction was recorded.

130. When accounts receivable are collected

- A. Stockholders' equity increases,
- B. Total assets increase,
- C. Total assets decrease,
- D. The amount of total assets is unchanged.

131. The requirement that transactions be recorded at their exchange price at the transaction date is called the

- A. conservatism exception.
- B. separate entity assumption.
- C. cost principle.
- D. monetary unit assumption.

	<u>January 1, 2010</u>	<u>January 1, 2011</u>
Assets	\$24,250	?
Liabilities	8,500	?
Stockholders' equity	?	?

The following changes occurred in the year 2010: Assets decreased by \$3,500 and liabilities increased by \$2,800.

132. What is the amount of the change in stockholders' equity in the year 2010?

- A. \$5,750 increase
- B. \$700 decrease
- C. \$6,300 decrease
- D. \$550 increase

133. What is the amount of stockholders' equity at January 1, 2011?

- A. \$9,450
- B. \$15,750
- C. \$15,050
- D. \$14,450

134. Which of the following would not be classified as a current asset?

- A. Cash
- B. Accounts payable
- C. Supplies
- D. Inventory

135. Which of the following would be classified as a long-term liability on the balance sheet at December 31, 2010?

- A. Accounts payable, 30-day account.
- B. Notes payable, due November, 2011.
- C. Notes receivable, matures April, 2012.
- D. Mortgage payable, due January, 2013.

Essay Questions

136. Selected accounts for Moonbills Corporation appear below.

Instructions - For each account, indicate the following:

(A) In the first column at the right, indicate the nature of each account, using the following abbreviations:

Asset — A, Liability — L, Stockholders' Equity — SE.

(B) In the second column, indicate the normal balance by inserting *dr* or *cr*.

	(A) Type of Account	(B) Normal Balance
1. Supplies.....	_____	_____
2. Notes Payable	_____	_____
3. Income Tax Payable.....	_____	_____
4. Equipment	_____	_____
5. Accounts Payable.....	_____	_____
6. Accounts Receivable.....	_____	_____
7. Contributed Capital	_____	_____
8. Cash	_____	_____
9. Retained Earnings	_____	_____
10. Land	_____	_____

137. Prepare a classified balance sheet for Purrfect Pets, Inc., using the following data for June 30, 2010.

Accounts Payable	\$119,400	Retained Earnings	54,700
Property and Equipment	421,600	Notes Payable, due 2012	343,200
Contributed Capital	200,000	Accounts Receivable	202,500
Income Tax Payable	3,900	Cash	97,100

138. Stockholders contribute \$10,000 cash to a company. The company uses \$5,000 to buy new equipment and \$3,000 to pay off accounts payable. Show the effect of these transactions on the basic accounting equation. Then, show the journal entries that would be used to record the transactions.

139. The balance sheet for Purrrfect Pets, Inc., as of June 30, 2010 is shown below.

PURRFECT PETS, INC.			
BALANCE SHEET			
AT JUNE 30, 2010			
Assets		Liabilities	
Cash	\$732,600	Accounts Payable	\$349,200
Accounts Receivable	419,200	Notes Payable	<u>268,900</u>
Inventories	58,400	Total Liabilities	<u>618,100</u>
Property, Plant and Equipment	118,500		
Other Assets	<u>69,400</u>	Stockholders' Equity	
		Contributed Capital	662,100
		Retained Earnings	<u>117,900</u>
		Total Stockholders' Equity	<u>780,000</u>
Total Assets	<u>\$1,398,100</u>	Total Liabilities and Stockholders' Equity	<u>\$1,398,100</u>

During July, 2010, stockholders contribute \$300,000 cash for additional ownership shares. The company pays \$550,000 in cash and borrows \$150,000 from a bank to buy some new stores.

During July, 2010, stockholders contribute \$300,000 cash for additional ownership shares. The company pays \$550,000 in cash and borrows \$150,000 from a bank to buy some new stores.

- a) Show the journal entries and the effects of these transactions on the basic accounting equation.
- b) Show the new balance sheet as of July 31, 2010 after these transactions have occurred, assuming there was no other July activity.

140. During the month, a company enters into the following transactions:

- buys \$4,000 of supplies on account.
- pays \$5,000 cash for new equipment.
- pays off \$3,000 of accounts payable.
- pays off \$1,500 of notes payable.

Show the journal entries and analyze the effect of these transactions on the basic accounting equation.

141. If a purchase of supplies for \$400 was mistakenly recorded as a credit to Supplies, but the cash paid for the supplies was correctly recorded, what would be the effect on the accounting equation?

142. CheapBooks Incorporated (CI) had the following business activities, for which you are to prepare journal entries. *Reference each journal entry to the transaction number, shown below.*

1. Stockholders invest \$25,000 cash in the corporation.
2. CI purchased \$400 of office supplies on credit.
3. CI purchased office equipment for \$7,000, paying \$2,500 in cash and signing a 30-day note payable for the remainder.
4. CI paid \$200 cash on account for office supplies purchased in transaction 2.
5. CI purchased two acres of land for \$10,000, signing a 2-year note payable.
6. CI sold one acre of land at one-half of the total cost of the two acres, receiving the full amount or \$5,000 in cash.
7. CI made a payment of \$5,000 on its 2-year note.

Short Answer Questions

143. On January 1, 2010, NWK, Inc.'s assets were \$300,000 and its stockholders' equity was \$140,000. During the year, assets increased \$15,000 and liabilities decreased \$10,000. What was the stockholders' equity on December 31, 2010?

144. On March 3, 2010, your company pays \$4,000 to acquire supplies. Should this be a recognized accounting transaction? If so, what accounts are affected and by how much each?

145. Use the following information as of December 31, 2010 to calculate the amounts of cash and retained earnings. The company's total assets are \$36,000. This company doesn't have other accounts.

Accounts Payable	\$ 7,000
Accounts Receivable	8,000
Supplies	1,000
Furniture and Equipment	22,000
Contributed Capital	10,000
Cash	?
Retained Earnings	?

Matching Questions

146. For each of the following, indicate how the line item would be categorized on a classified balance sheet.

- | | | |
|------------------------------|------------------------|-------|
| 1. SE (stockholders' equity) | Property and Equipment | _____ |
| 2. SE (stockholders' equity) | Contributed Capital | _____ |
| 3. CA (current asset) | Supplies | _____ |
| 4. CL (current liability) | Retained Earnings | _____ |
| 5. CA (current asset) | Accounts Receivable | _____ |
| 6. LTL (long-term asset) | Accounts Payable | _____ |

147. Match the term and the explanation. There are more explanations than terms.

- | | | |
|---|--------------------------|-------|
| 1. The expression that assets must equal liabilities plus stockholders' equity | dr | _____ |
| 2. A method of recording a transaction in debit/credit format | cr. | _____ |
| 3. An exchange or event that has a direct impact on a company's balance sheet | Classified balance sheet | _____ |
| 4. The account credited when cash is received in exchange for stock issued | Contributed capital | _____ |
| 5. The abbreviation for an item posted on the left side of a T-account | Accounting equation | _____ |
| 6. A balance sheet that has assets and liabilities categorized as current vs. long-term | Transaction | _____ |
| 7. The abbreviation for an item posted on the right side of a T-account | Accounts payable | _____ |
| 8. Amounts owed to suppliers for goods or services bought on credit | Journal entry | _____ |

148. For each of the following, indicate how the event would most likely be categorized.

- | | | |
|---------------------------|---|-------|
| 1. EE (external exchange) | A company sells \$2 million in goods for immediate payment. | _____ |
| 2. NT (No transaction) | The company uses up office supplies. | _____ |
| 3. IE (internal event) | The stock market rises 10% and the value of a company's stock increases. | _____ |
| 4. NT (No transaction) | A company pays cash to an inventor for the legal rights to produce a new product. | _____ |
| 5. NT (No transaction) | Management promises to pay workers an overtime bonus as required by their union contract. | _____ |
| 6. IE (internal event) | A company uses up supplies to manufacture a product. | _____ |
| 7. EE (external exchange) | A company receives \$1 million in orders but no down payments. | _____ |

149. Listed below are components of several transactions. In the blank to the left indicate whether a debit (dr) or credit (cr) would be required to record the component of the transaction.

- | | | |
|-------|-------------------------------------|-------|
| 1. cr | Increase in Cash. | _____ |
| 2. dr | Increase in Accounts Payable. | _____ |
| 3. dr | Decrease in Notes Payable. | _____ |
| 4. cr | Increase in Inventory. | _____ |
| 5. cr | Increase in Contributed Capital. | _____ |
| 6. dr | Decrease in Property and Equipment. | _____ |

150. Match the term and the explanation. There are more explanations than terms.

- | | | |
|--|--------------------|-------|
| 1. A summary of account names and numbers | Duality of effects | _____ |
| 2. The principle that a company should use the least optimistic measure, when uncertainty exists | Journal entry | _____ |
| 3. An amount that is posted on the right side of a T-account | Posting | _____ |
| 4. Assets are initially recorded at their original cost to the company | Conservatism | _____ |
| 5. When journal entries are copied to the appropriate T-account | Debit | _____ |
| 6. The concept that any transaction must have at least two effects on the accounting equation | Chart of accounts | _____ |
| 7. An amount that is posted on the left side of a T-account or ledger | T-account | _____ |
| 8. A simplified version of an account in the General Ledger | Credit | _____ |
| 9. The mechanism used to record each transaction in the General Journal | Cost principle | _____ |

Chapter 02 Reporting Investing and Financing Results on the Balance Sheet

Answer Key

True / False Questions

1. A transaction is an exchange or event that directly affects the assets, liabilities, or stockholders' equity of a company.

TRUE

Transactions are events that affect the accounting equation.

*AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 1
Topic Area: Definition of transaction*

2. A transaction can cause only one account on the balance sheet to change.

FALSE

At least two accounts on the balance sheet must change so that assets continue to equal liabilities and stockholders' equity.

*AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Analyze transactions*

3. If a company uses \$100 million in cash to pay off debt, its stockholders' equity will rise \$100 million.

FALSE

Assets and liabilities would each decrease by \$100 million; stockholders' equity would not change.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 2

Topic Area: Analyze transactions

4. General Motors (GM) signs a new labor agreement that its workers will receive a 5% wage increase next year. This is considered a transaction that affects GM's financial statements in the current year.

FALSE

A promise to pay has been exchanged for a promise to work next year. There has not yet been a transaction; this event does not affect GM's financial statements in the current year.

*AACSB: analytic
AICPA BB: critical thinking
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Hard
Learning Objective: 1
Topic Area: Definition of transaction*

5. All of a company's business activities have a direct economic effect on the company.

FALSE

Some activities, such as signing an employment contract, only have an indirect economic effect.

*AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 5
Topic Area: Balance Sheet Concepts*

6. If total assets increase, then either liabilities or stockholders' equity also must increase.

TRUE

The accounting equation, $\text{Assets} = \text{liabilities} + \text{stockholders' equity}$ must balance.

*AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 2
Topic Area: Analyze transactions*

7. Company X issues \$40 million in new stock for cash. This does not affect stockholders' equity because as new shares are sold the value of existing shares falls.

FALSE

When new stock is issued for cash, the company has more cash and contributed capital. Assets and stockholders' equity both rise.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Analyze transactions

8. Transactions are analyzed from the point of view of the company, not the company's owners.

TRUE

When accounting for transactions, an event must be analyzed from the standpoint of the company being accounting for, not from the standpoint of a customer, investor, or creditor.

AACSB: analytic
AICPA BB: legal
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 2
Topic Area: Transaction analysis

9. You are pleasantly surprised to discover that a popular actress appears on The Tonight Show wearing your company's jeans. Later, your company's sales increase by \$500,000 as a result. When the actress appeared on TV, you would have recorded an asset because the TV appearance was expected to bring future economic benefits to your company.

FALSE

No asset would be recorded; the future economic benefits (or resources) were not assured on the date of the TV appearance. Further, no transaction occurred with the appearance. Your company's assets, liabilities, and stockholders' equity will not change until the jeans are produced and sold.

AACSB: reflective thinking
AICPA BB: critical thinking
AICPA FN: reporting
Bloom's: evaluation
Difficulty: Hard
Learning Objective: 5
Topic Area: Balance Sheet Concepts

10. If the total dollar value of credits to an account exceeds the total dollar value of debits to that account, the ending balance of the account will be a debit balance.

FALSE

If credits exceed debits, the account will have a credit balance.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

11. A company signed an agreement to rent store space from another company. This is an example of a recordable transaction.

FALSE

This is only an exchange of promises and there is no change in Assets, Liabilities or Stockholders' equity. This is not a transaction.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 1
Topic Area: Transaction definition

12. Retained earnings is the cumulative earnings of a company which have not been distributed to owners.

TRUE

Retained earnings is a component of stockholders' equity and is the cumulative amount of earnings retained in the business.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 5
Topic Area: Balance Sheet

13. An internal accounting report called a Trial Balance checks whether recorded debits equal recorded credits.

TRUE

The Trial Balance lists the balances in all the ledger accounts at a point in time. It shows whether debit balance accounts = credit balance accounts.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 3
Learning Objective: 4
Topic Area: Debit/credit framework

14. The journal is a chronological record of transactions using a debit/credit framework.

TRUE

The journal is used to record the effects of transactions as they occur using the debit/credit framework.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

15. The ledger consists of all of the accounts used by a business.

TRUE

All of the accounts used by the company, with debit or credit balances, represent the ledger of the company.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 3
Topic Area: Accounting records

16. A business is obliged to repay debt and equity financing.

FALSE

There is no requirement to pay back equity contributions. There is a legal requirement to pay back debt financing.

*AACSB: analytic
AICPA BB: legal
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 1
Topic Area: Investing and financing activities*

17. The list of names and reference numbers that the company will use when accounting for transactions is called the Chart of Accounts.

TRUE

The Chart of Accounts can be described as a table of contents for the possible accounts to be used in recording transactions.

*AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 2
Topic Area: Transaction analysis*

18. Journal entries show the effects of transactions on the elements of the accounting equation, as well as the amount of the account balances.

FALSE

Journal entries are entered into the journal using a debit/credit format. By themselves, journal entries show the effect of transactions, but they do not provide account balances. The entries are 'posted' to the ledger accounts which then show the balance of each of the accounts.

*AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework*

19. The acquisition of equipment in an exchange for a company's stock would increase the current ratio of the company.

the accounts in this transaction is classified as current.

FALSE

The current ratio is current assets divided by current liabilities. Neither of

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: analysis

Difficulty: Medium

Learning Objective: 4

Learning Objective: 5

Topic Area: Current Ratio and evaluating the balance sheet

20. The current ratio can be used to evaluate a company's ability to pay liabilities in the short-term, and in general, a lower ratio means better ability to pay.

FALSE

The current ratio is current assets divided by current liabilities. A lower ratio means that the excess of current assets over current liabilities is less and that does not indicate better ability to pay.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 4

Learning Objective: 5

Topic Area: Current Ratio and evaluating the balance sheet

Multiple Choice Questions

21. How many of the following statements regarding the balance sheet are true?

- A "classified" balance sheet is one that contains privileged information.
- All liabilities require that the company sacrifice resources at some time in the future.
- All companies use an identical list of account names defined by the Financial Accounting Standards Board (FASB).

A. None

B. One

C. Two

D. Three

A classified balance sheet separately classifies assets as current/noncurrent and reports liabilities according to when they will be settled in the future. The list of accounts used by one company is not the same for all companies.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 1

Learning Objective: 4

Topic Area: Balance Sheet Concepts

22. How many of the following statements regarding debits and credits are true?

- A decrease in assets will result in a credit to an asset account.
 - Across all accounts, the total value of all debits must equal the total value of all credits.
 - The total value of all debits to a particular account must equal the total value of all credits to that account.
- A. None
B. One
C. Two
D. Three

A decrease in an asset is a credit to the account. If an account has equal amounts of debits and credits then that account has a zero balance. Across all accounts, total debits must equal total credits which means that the accounting equation is in balance.

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 3

Topic Area: Debit/credit framework

23. How many of the following statements regarding the balance sheet are true?

- Any item on a balance sheet labeled payable is a liability of that company.
- Current Assets are listed on the balance sheet in order of how fast they are used up or can be turned into cash.
- The basic accounting equation must always balance.

- A. None
- B. One
- C. Two
- D.** Three

Payables are liabilities or obligations of the company. The classified balance sheet reports assets as either current or noncurrent which reflects when they will be used up or turned into cash. The basic accounting equation must always balance which means that $\text{Assets} = \text{Liabilities} + \text{Stockholders' equity}$.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 2

Learning Objective: 4

Topic Area: Transaction analysis and Classified Balance Sheet

24. How many of the following statements regarding posting and classification are true?

- Posting journal entries involves copying the dollar amounts from the journal into the ledger.
 - If a \$100 debit is erroneously posted to an account as a \$100 credit, the accounts will be out of balance by \$100.
 - If a \$5,000 liability is misclassified as stockholders' equity then the accounting equation will still balance.
- A. None
B. One
C. Two

Statement 1 is true: The journal and the ledger are both used to store effects of accounting transactions.

Statement 2 is false: If an error in posting is made so that a \$100 debit is entered as a credit to an account, the accounts will be out of balance by \$200.

Statement 3 is true: Since liabilities and stockholders' equity are on the same side of the accounting equation, the equation will remain in balance if an amount is erroneously reported as a liability instead of as stockholders' equity.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 3

Learning Objective: 4

Topic Area: Debit/credit framework and Balance Sheet concepts

25. How many of the following statements regarding the concepts underlying the balance sheet are true?

- A company buys land for \$5 million dollars in 1983. The land is now worth \$15 million. The company should increase the book value of this asset on its balance sheet to reflect its current value.
- All events affecting the current value of a company are reported on the balance sheet.
- According to the cost principle, assets are valued at their replacement cost.

- A. None
- B. One
- C. Two
- D. Three

Accounting is transaction-based so all events affecting the value of the company are not reported. The cost principle requires that assets be reported using exchange amounts at the time of the initial transaction.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 5
Topic Area: Balance Sheet Concepts

26. Which of the following would be listed as a long-term asset?

- A. Cash.
- B. Supplies.
- C. Buildings and equipment.
- D. Total assets.

Cash is a current asset. Supplies is a current asset. Buildings & equipment is classified as a long-term asset as it will not be used up or converted into cash within a year. Total assets = current assets + noncurrent assets.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 4
Topic Area: Classified Balance Sheet

27. Which of the following would be listed as a current liability?

- A. Cash in the bank.
- B. Notes payable due in two years.
- C. Supplies.
- D.** Accounts payable.

Cash in the bank is a current asset. Notes payable due in two years is a long-term liability. Supplies is a current asset. Accounts payable, which is an obligation that will be settled within one year, is a current liability.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 4
Topic Area: Classified Balance Sheet

28. A long-term liability is one that the company:

- A. has owed for over one year.
- B. has owed for over five years.
- C.** will not pay off for over one year.
- D. will not pay off for over five years.

Classification of a liability as long-term is based on when it is going to be settled. Any liability that is to be paid, settled or fulfilled within one year is a current liability.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 4
Topic Area: Classified Balance Sheet

29. A current asset is one that:

- A. the company has owned for over one year.
- B. the company has owned for over five years.
- C.** the company will use up or convert into cash in less than one year.
- D. the company will use up or convert into cash in less than five years.

Classification of an asset as current is based on when it is going to be used up or turned into cash. Any asset which is going to be used up or turned into cash within the year is classified as a current asset.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 4
Topic Area: Classified Balance Sheet

30. At the start of the first year of operations, retained earnings on the balance sheet would be:

- A.** equal to zero.
- B. equal to contributed capital.
- C. equal to stockholders' equity.
- D. equal to the negative of liabilities.

Retained earnings is the amount of earnings accumulated from prior years that have not been distributed as dividends. At the start of the first year of operations there would be no retained earnings.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 4
Topic Area: Balance Sheet Concepts

31. Account names in the chart of accounts are:
- A. general purpose and do not indicate the nature of the account.
 - B. not consistent in their use throughout the records.
 - C.** linked to account numbers.
 - D. the names mandated for use by the FASB.

The chart of accounts lists all the account names and the names are referenced to numbers. The names reflect the nature of the account. The names of accounts vary from company to company and across industries. The FASB does not establish the names of accounts that are to be used by a company.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 2
Topic Area: Analyze transactions

PURRFECT PETS, INC.
BALANCE SHEET
AT JUNE 30, 2010

Assets		Liabilities	
Cash	\$732,600	Accounts Payable	\$349,200
Accounts Receivable	419,200	Notes Payable, due 2012	<u>268,900</u>
Supplies	58,400	Total Liabilities	<u>618,100</u>
Property, Plant and Equipment	118,500		
Other Assets	<u>69,400</u>	Stockholders' Equity	
		Contributed Capital	662,100
		Retained Earnings	<u>117,900</u>
		Total Equity	<u>780,000</u>
Total Assets	<u>\$1,398,100</u>	Total Liabilities and Stockholders' Equity	<u>\$1,398,100</u>

32. Which line items on the balance sheet would be classified as long term?

- A. Cash; Supplies; Accounts Payable.
- B.** Property, Plant and Equipment; Notes Payable; Other Assets.
- C. Supplies; Property, Plant and Equipment; Notes Payable.
- D. Total Assets; Total Liabilities; Other Assets.

A classified balance sheet contains subcategories for assets and liabilities as current or noncurrent (long-term). Noncurrent assets are assets that will not be used up or converted to cash within the next year. Examples include Property, Plant & Equipment and Other Assets. Noncurrent or long-term liabilities are debts that will not be settled within the next year. Examples include Notes Payable due 2012.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 4
Topic Area: Classified Balance Sheet

33. How much financing did the stockholders of Purrfect Pets, Inc., directly contribute to the company?

- A. \$117,900.
- B.** \$662,100.
- C. \$780,000.
- D. \$1,398,100.

Stockholders' equity includes contributed capital which is the amount of owners' direct contributions.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 1
Topic Area: Financing activities

34. Which of the following is **not** an example of a liability?

- A. Interest receivable.
- B. Wages payable.
- C. Accounts payable
- D. Income tax payable

An account with 'payable' in the title is a liability account.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 1
Topic Area: Balance Sheet Concepts

35. The local branch of the Universal Bank System (UBS) receives money from depositors and lends it to borrowers. Which of the following would be true about UBS's financial statements?

- A. UBS reports deposits as assets and loans as liabilities.
- B. UBS reports both deposits and loans as assets.
- C. UBS reports deposits as liabilities and loans as assets.
- D. UBS reports both deposits and loans as liabilities.

Transactions are analyzed from the company's perspective. For USB, deposits from customers which are held by USB are liabilities of USB and loans made by USB are assets or receivables.

AACSB: analytic
AICPA BB: critical thinking
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Hard
Learning Objective: 2
Topic Area: Transaction analysis

36. Which of the following is not an example of an asset?

- A. Notes receivable.
- B. Supplies.
- C. Prepaid expenses.
- D.** Retained Earnings.

Assets are resources of the business. Examples are notes receivable, supplies and prepaid expenses. Retained earnings is not an asset. It is the amount of earnings retained in the business and is a component of stockholders' equity.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 1
Topic Area: Balance Sheet Concepts

37. If a company borrows money from a bank and signs an agreement to repay the loan several years from now, in which account would the company report the amount borrowed?

- A. Contributed Capital.
- B. Accounts Payable.
- C.** Notes Payable.
- D. Bonds Payable.

Debt financing refers to money obtained through loans. A formal loan with the bank is reported as notes payable.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 1
Topic Area: Financing and investing activities

38. The Sweet Smell of Success Fragrance Company borrowed \$60,000 from the bank and used all of the money to re-design its new store. Sweet Smell's balance sheet would show this as

- A.** \$60,000 under Furnishings & Equipment and \$60,000 under Notes Payable.
- B. \$60,000 under Supplies and \$60,000 under Accounts Payable.
- C. \$60,000 under Prepaid Expenses and \$60,000 under Accrued Liabilities.
- D. \$60,000 under Other Assets and \$60,000 under Other Liabilities.

Re-design of the store is an investment in Furnishings & equipment.
A bank loan, note payable, is a financing activity.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 1
Topic Area: Financing and investing activities

39. The Buddy Burger Corporation owes \$1.5 million to the Texas Wholesale Meat Company from whom Buddy Burger buys its burger meat. Which account would Buddy Burger use to report the amount owed?

- A. Cash.
- B.** Accounts Payable.
- C. Supplies.
- D. Accounts Receivable.

Accounts payable is used to report informal borrowing.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Transaction analysis

40. Which of the following describes the classification and normal balance of the retained earnings account?

- A. Asset, debit
- B. Stockholders' equity, credit**
- C. Liability, credit
- D. Stockholders' equity, debit

Retained earnings is a component of stockholders' equity and stockholders' equity accounts have a normal credit balance.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 2
Learning Objective: 3
Topic Area: Transaction analysis and debit/credit framework

41. If a company receives \$20,000 cash on accounts receivable and uses the cash to pay \$20,000 on accounts payable then:

- A. assets would increase by \$20,000 while liabilities would decrease by \$20,000.
- B. liabilities would decrease by \$20,000 while stockholders' equity would increase by \$20,000.
- C. assets would decrease by \$20,000 while liabilities would decrease by \$20,000.**
- D. liabilities would decrease by \$20,000 while stockholders' equity would decrease by \$20,000.

Receiving cash of \$20,000 from customers in payment of their accounts will cause one asset (cash) to increase and another asset (accounts receivable) to decrease. There is no change in the amount of total assets. Using the \$20,000 of cash received to pay off accounts payable will cause an asset (cash) to decrease and a liability (accounts payable) to decrease.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Transaction analysis

42. In 1999, the Denim Company bought land that cost \$15,000. In 2010, a similar piece of land was bought for \$28,000 and the company's existing land was estimated to be worth \$18,000. On the balance sheet at the end of 2010, the land that was purchased in 1999 would be reported at:

- A.** \$15,000.
- B. \$28,000.
- C. \$18,000.
- D. the average of the three prices.

The amount recorded and reported for assets is based on the cost principle which means that assets are recorded and reported at cost using the exchange amounts at the time of the initial transaction

AACSB: analytic
AICPA BB: legal
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 5
Topic Area: Balance Sheet Concepts

43. What is the minimum number of accounts that must be involved in any transaction?

- A. One.
- B.** Two.
- C. Three.
- D. No minimum.

The accounting equation (Assets = Liabilities + Stockholders' equity) must also remain in balance and this means that at least two accounts must be involved in any transaction.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 2
Topic Area: Transaction analysis

44. Transactions include which **two** types of events?

- A. Direct events, indirect events.
- B. Monetary events, production events
- C.** external exchanges, internal events
- D. past events, future events.

External exchanges are events with others outside the business and internal events occur within the company itself.

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: knowledge

Difficulty: Easy

Learning Objective: 1

Topic Area: Transaction definition

45. A company disposes of \$1 million of its assets. Which of the following could **not** be true?
- A.** Assets remain the same, and liabilities and stockholders' equity both decrease by \$1 million.
 - B. Assets decrease by \$1 million, liabilities decrease by \$1 million, and stockholders' equity is unchanged.
 - C. Assets, liabilities, and stockholders' equity all remain the same.
 - D. Assets decrease by \$1 million, and liabilities and stockholders' equity both decrease by \$500,000.

If a company disposes of assets, then assets would decrease, and if cash was received for the disposal(sale) and used to pay off debt, then liabilities would decrease. Stockholders' equity would be unchanged.

If the disposal (sale) was for cash, then assets in total are unchanged. Liabilities and stockholders' equity are not affected.

If a company disposes of assets for cash and uses that cash to pay off some debt and distributes dividends to owners, then assets would decrease by the amount of the disposed assets, liabilities would decrease by the amount of debt paid and stockholders' equity (retained earnings) would decrease by the amount of the dividend distributed.

If assets remain the same while liabilities and stockholders' equity both decrease, the accounting equation would not be in balance.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Hard

Learning Objective: 2

Topic Area: Transaction analysis

46. Your company orders and broadcasts a 30 second ad during the Super Bowl for \$1.2 million. It is legally obligated to pay for the ad but has not yet done so.

- A. This is an internal event and it does NOT affect the balance sheet.
- B. This is an external event and it does NOT affect the balance sheet.
- C. This is an internal event that affects the balance sheet.
- D.** This is an external event that affects the balance sheet.

Internal or external events do not affect the balance sheet if they are exchanges of promises only. This is an external exchange which is an accounting transaction and therefore does affect the balance sheet.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 1
Topic Area: Transaction definition

47. In part, a transaction affects the accounting equation as follows:

Assets	=	Liabilities	+	Stockholders' Equity
↓ Accounts receivable	=	No change	+	

Which of the following must be true for this transaction?

- A. If other assets are unchanged, stockholders' equity must be increasing.
- B.** If other assets are unchanged, stockholders' equity must be decreasing.
- C. If stockholders' equity is unchanged, another asset must be decreasing.
- D. If stockholders' equity is unchanged, other assets must be unchanged.

If assets (accounts receivable) decrease and there is no change in liabilities then stockholders' equity must decrease.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Transaction analysis

48. A company buys equipment for \$500,000 and signs a promissory note for the full amount. How does this transaction affect the accounting equation?

A. Assets: ↑ Property and equipment, ↓ Cash; Liabilities: no change; Stockholders' Equity: no change.

B. Assets: ↑ Property and equipment; Liabilities: ↑ Notes payable; Stockholders' Equity: no change.

C. Assets: ↑ Property and equipment; Liabilities: no change; Stockholders' Equity: ↓ Retained earnings.

D. Assets: ↑ Property and equipment; Liabilities: no change; Stockholders' Equity: ↓ Contributed capital.

Acquiring equipment by borrowing means that assets (equipment) will increase and liabilities (notes payable) will increase.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Transaction analysis

49. Your company pays back \$2 million on a loan it had received earlier from a bank.

A. Assets are unchanged, liabilities and stockholders' equity both increased by \$2 million.

B. Assets decrease by \$2 million, liabilities decrease by \$2 million, stockholders' equity is unchanged.

C. Assets are unchanged, liabilities increase by \$2 million, contributed capital decreases by \$2 million.

D. Assets decrease by \$2 million, liabilities are unchanged, contributed capital decreases by \$2 million.

Paying \$2million on a debt means that assets (cash) will decrease and liabilities (notes payable) will decrease.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Transaction analysis

50. A company issues \$20 million in new stock. It later uses the cash received to pay off promissory notes. How many different accounts and which account names are affected by these two transactions?

- A. 3 accounts involved: contributed capital, cash, and notes payable.
- B. 4 accounts involved: contributed capital, cash, liabilities, and accounts payable.
- C. 3 accounts involved: cash, assets, and accounts payable.
- D. 3 accounts involved: contributed capital, investments, and accounts payable.

Issuing stock for cash means that Cash and Contributed Capital are affected. Using the cash to pay off notes means that Cash and Notes Payable are affected.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Transaction analysis

51. A company borrows \$2 million from its bank. It then uses this money to buy equipment. How does this transaction affect the accounting equation?

- A. Assets and Liabilities both rise \$2 million.
- B. Assets and Stockholders' Equity both fall \$2 million.
- C. Assets, Liabilities, and Stockholders' Equity are unchanged.
- D. Stockholders' Equity rises \$2 million and Liabilities fall \$2 million.

This transaction involves an increase in an asset account (Equipment) and an increase in a liability account (Notes Payable). Cash is increased and decreased by equal amounts.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Transaction analysis

52. A company receives \$100,000 cash from investors in exchange for stock. Several weeks later, the company buys a \$250,000 machine using all of the cash from the stock issue and signing a promissory note for the remainder. The accounts involved in these two transactions are:

- A. Long-term Investments; Cash; Equipment; and Accounts Payable.
- B. Contributed Capital; Cash; Long-term Investments; and Notes Payable.
- C.** Contributed Capital; Cash; Equipment; and Notes Payable.
- D. Retained Earnings; Equipment; and Notes Payable.

Receiving cash in exchange for common stock affects the cash account and the contributed capital account. Buying a machine using cash for part of the purchase amount and borrowing the rest affects the Equipment account, the Cash account and the Notes Payable account.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Transaction analysis

53. A company purchases \$23,000 of supplies in the current month and promises to pay for them next month. How would the company record a liability for the supplies?

- A. This liability is not a recognized liability until the payment is due.
- B.** \$23,000 would be journalized as a credit to Accounts Payable.
- C. \$23,000 would be journalized as a debit to Accounts Payable.
- D. \$23,000 would be journalized as a debit to Prepaid Expenses.

Purchasing supplies on account is recorded by crediting Accounts Payable which is a liability account.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Learning Objective: 3
Topic Area: Transaction analysis and debit/credit framework

54. If total liabilities decreased by \$25,000 and stockholders' equity increased by \$5,000 during a period of time, then total assets must change by what amount and direction during the same time period?

- A. \$20,000 increase.
- B. \$20,000 decrease.**
- C. \$30,000 increase.
- D. \$30,000 decrease.

The accounting equation must remain in balance; so if liabilities decrease by \$25,000 and stockholders' equity increases by \$5,000, then assets must decrease by \$20,000.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 2
Topic Area: Transaction analysis

55. The characteristic shared by all liabilities is that they:

- A. provide a future economic benefit.
- B. result in an inflow of resources to the company.
- C. always end in the word "payable."
- D. obligate the company to do something in the future.**

All liabilities obligate the company to settle the debt in the future.

Not all liabilities have the word 'payable' in their name.

Providing economic benefits and inflow of resources do not describe liabilities.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 1
Topic Area: Financing and investing activities

56. A company issues \$20 million in new stock. The company later uses this money to acquire a building. How many accounts will be affected by these transactions and which particular account names are most likely to be used to record the effects of these transactions?

- A.** 3 accounts affected: Contributed Capital, Cash, and Building.
- B. 4 accounts affected: Contributed Capital, Cash, Liabilities, and Building.
- C. 3 accounts affected: Cash, Property, Plant and Equipment, and Contributed Capital.
- D. 3 accounts affected: Contributed Capital, Investments, and Cash.

The company received cash from the issuance of stock and used the cash to acquire a building. This will affect three accounts: cash, contributed capital and building.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Analyze transactions

57. Park & Company was recently formed with a \$5,000 investment in the company by stockholders. The company then borrowed \$2,000 from a local bank, purchased \$1,000 of supplies on account, and also purchased \$5,000 of equipment by paying \$2,000 in cash and signing a promissory note for the balance. Based on these transactions, the company's total assets are:

- A. \$7,000.
- B. \$9,000.
- C. \$10,000.
- D.** \$11,000.

\$11,000 = \$5,000 cash from stock issuance plus \$2,000 cash borrowed from the local bank plus \$1,000 of supplies purchased plus \$5,000 of equipment purchased minus \$2,000 cash paid.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: application
Difficulty: Hard
Learning Objective: 2
Topic Area: Analyze transactions

58. The common characteristic possessed by all assets is
- A. long life.
 - B. great financial value.
 - C. physical substance.
 - D. future economic benefit.**

Assets are resources which provide economic benefits. Not all assets have a long life, have physical substance or possess great financial value.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 1
Topic Area: Balance Sheet

59. Current liabilities are expected to be
- A. converted to cash within one year.
 - B. paid within one year.**
 - C. used in the business within one year.
 - D. acquired within one year.

Liabilities are reported as current liabilities if they are obligations that will be settled within the year.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 4
Topic Area: Classified Balance Sheet

60. If Accounts Payable had a balance of \$18,200 at the beginning of the month, and the six amounts shown below were posted to this account, what should be the ending balance?

Three debits posted to Accounts Payable this month: \$4,700, \$11,300, and \$14,800.

Three credits posted to Accounts Payable this month: \$3,600, \$9,500, and \$12,700.

- A. \$13,200.
- B. \$5,000.
- C. \$23,200.
- D. \$49,000.

Accounts payable is a liability account which means it has a normal credit balance and is increased by credits and decreased by debits. $\$18,200 - \$4,700 - \$11,300 - \$14,800 + \$3,600 + \$9,500 + \$12,700 = \$13,200$.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: application
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework

61. In a T-account, debits appear in what manner?

- A. They are on the left under assets but on the right under liabilities and stockholders' equity.
- B. They are always listed on the right.
- C. They are always listed on the left.
- D. They are on the right under assets but on the left under liabilities and stockholders' equity.

Debit is the left side of an account and credit is the right side of an account.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

62. A company uses \$100,000 in cash to pay off \$100,000 in notes payable. This would result in a:

- A.** \$100,000 credit to Cash and a \$100,000 debit to Notes Payable.
- B. \$100,000 credit to Cash and a \$100,000 credit to Notes Payable.
- C. \$100,000 debit to Cash and a \$100,000 credit to Notes Payable.
- D. \$100,000 debit to Cash and a \$100,000 debit to Notes Payable.

This transaction decreases cash (a credit) and decreases notes payable (a debit).

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Learning Objective: 3
Topic Area: Analyze transactions and debit/credit framework

63. Purrfect Pets, Inc., uses \$10,000 in cash to pay \$10,000 on Accounts Payable. This would result in a:

- A. \$10,000 credit to Cash and a \$10,000 credit to Accounts Payable.
- B. \$10,000 debit to Cash and a \$10,000 debit to Accounts Payable.
- C.** \$10,000 credit to Cash and a \$10,000 debit to Accounts Payable.
- D. \$10,000 debit to Cash and a \$10,000 credit to Accounts Payable.

This transaction decreases cash (a credit) and decreases accounts payable (a debit).

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Learning Objective: 3
Topic Area: Analyze transactions and debit/credit framework

64. The best interpretation of the word "*credit*" is the
- A. offset side of an account.
 - B. increase side of an account.
 - C.** right side of an account.
 - D. decrease side of an account.

Credit means the right side of an account.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

65. Accounts Payable
- A.** has a normal credit balance
 - B. is increased by a debit
 - C. is an asset
 - D. is increased when a company receives cash from customers.

Accounts payable is a liability account. All liability accounts have a normal credit balance and are increased by credits.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

66. Accounts receivable

A. has a normal credit balance.

B. is increased by a debit.

C. is a liability.

D. is increased when a company receives cash from its customers.

Accounts receivable is an asset and asset accounts have a normal debit balance and are increased by debits.

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: knowledge

Difficulty: Easy

Learning Objective: 3

Topic Area: Debit/credit framework

Cash			
Beginning			
Balance	123,900		
(a)	14,700	(c)	6,000
(b)	38,300	(d)	5,800
		(e)	7,400
		(f)	12,000
		(g)	11,200

67. The final balance of the Cash account would be:

- A. \$219,300.
- B. \$113,300.
- C. \$28,500.
- D.** \$134,500.

The beginning debit balance of \$123,900 is increased by debits (a) and (b) and decreased by credits (c) through (g).

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: application
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework

68. In the T-account above:

- A. (a) and (b) are credits.
- B. (c) through (g) are debits.
- C. if the sum of (a) and (b) is less than the sum of (c) through (g), the total cash will increase.
- D.** (a) and (b) are increases.

Debits are entries to the left side of an account and credits are entries to the right side of an account. Cash is an asset account and assets are increased by debits and decreased by credits.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework

69. A credit would make which of the following accounts decrease?

- A. Contributed Capital.
- B. Inventories.**
- C. Notes Payable.
- D. Retained Earnings.

Credits, entries to the right side of an account, will decrease asset accounts such as Inventories.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework

70. Your company buys a \$2 million warehouse paying \$300,000 in cash and issuing \$1.7 million in promissory notes. This will be posted as:

- A. \$2 million credited and \$300,000 debited to assets; \$1.7 million debited to liabilities.
- B. \$2 million debited to assets and \$2 million credited to liabilities.
- C. \$2 million debited and \$300,000 credited to assets; \$1.7 million credited to liabilities.**
- D. \$2 million credited to assets and \$2 million debited to liabilities.

Equipment increases (debit \$2 million) and cash decreases (credit \$300,000) and notes payable increases (credit \$1.7 million).

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Hard
Learning Objective: 2
Learning Objective: 3
Topic Area: Transaction analysis and debit/credit framework

71. Cash had a beginning balance of \$68,900. During the month, Cash was credited for \$16,000 and debited for \$18,300. At the end of the month, the balance is:

- A. \$2,300.
- B. \$71,200.**
- C. \$66,700.
- D. \$(2,300).

Cash is an asset account which has a normal debit balance. The beginning debit balance of \$68,900 is decreased by a credit of \$16,000 and increased by a debit of \$18,300 = \$71,200.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: application
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework

72. Which of the following is true?

- A. Assets have debit balances and liabilities have credit balances.**
- B. Assets and liabilities have credit balances.
- C. Assets have credit balances and liabilities have debit balances.
- D. Assets and liabilities have debit balances.

Assets = Liabilities + Stockholders' Equity means the bookkeeping framework is debits = credits. Assets, on the left of the equal sign, have debit balances and Liabilities, on the right side of the equal sign, have credit balances.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

73. The standard formatting for a journal entry:
- A. lists credits first and then debits, both aligned to the left.
 - B. lists credits first and then debits, indented underneath.
 - C. lists debits first and then credits, both aligned to the right.
 - D.** lists debits first and then credits, indented underneath.

The convention for the formatting of a journal entry is to list the debits first and then the credits indented to the right (both the words and the amounts).

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

74. The standard formatting for a journal entry lists the dollar amounts for:
- A.** credits to the right of the dollar amounts for debits.
 - B. debits and credits aligned equally to the right.
 - C. debits to the right of the dollar amounts for credits.
 - D. debits and credits aligned equally to the left.

Credits are listed underneath and indented to the right of the debits.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework

75. Which of the following scenarios could explain the journal entry below?

<i>dr</i>	Equipment	10,000	
	<i>cr</i>	Cash	4,000
	<i>cr</i>	Notes payable	6,000

- A. The company buys \$10,000 of equipment for \$4,000 in cash and \$6,000 on credit.
- B. The company receives \$4,000 in cash and \$6,000 in notes payable for selling 10,000 of equipment.
- C. The company buys \$10,000 of equipment, for \$4,000 cash and a promise to cancel \$6,000 of debt owed to it.
- D. The company sells \$10,000 of equipment, for \$4,000 in cash and pays off \$6,000 it owes on the equipment.

The journal entry is: Equipment is debited which increases the account and Cash is credited which decreases the account. Notes payable is credited which increases the account. This means: Equipment is increased for equipment acquired. Cash is decreased for cash paid in the acquisition. Notes payable is increased as a result of borrowing the balance of the equipment cost.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Learning Objective: 3
Topic Area: Analyze transactions and debit/credit framework

76. Which of the following statements is true?

- A. Assets must always equal liabilities plus stockholders' equity.
- B. The total value of credits in all accounts must always equal the total value of debits in all accounts.
- C. The net changes in assets must always equal the sum of the net changes in liabilities and stockholders' equity.
- D.** All of the above.

Assets = Liabilities + Stockholders' equity which means that total debits must equal total credits.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

77. The normal balance of any account is the

- A. left side.
- B. right side.
- C.** side which increases that account.
- D. side which decreases that account.

The side which increases an account is the normal balance of the account.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework

Accounts Receivable		
Beginning Balance	187,500	
	104,900	
	63,900	18,000
		5,400
		14,700
		19,200

Partial listing of account balances at the end of the year:

Cash		\$28,000
Accounts Receivable		?
Supplies		35,600
Other Current Assets		5,900

78. The amount of Total Current Assets that would be reported on the company's balance sheet at the end of the year would be

- A. \$180,800.
- B. \$368,500.**
- C. \$145,700.
- D. \$298,800.

The accounts listed are all current assets. Accounts receivable beginning balance is a debit of \$187,500 and is increased by debits (entries to the left side of the account) and is decreased by credits (entries to the right side of the account).

$$A/R = (187,500 + 104,900 + 63,900) - (18,000 + 5,400 + 14,700 + 19,200) = 299,000$$

$$\text{Total Current Assets} = 28,000 + 299,000 + 35,600 + 5,900 = 368,500$$

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: application

Difficulty: Hard

Learning Objective: 3

Learning Objective: 4

Topic Area: Debit/credit framework and classified balance sheet

79. Which of the following is an accurate description of the economic events involving Accounts Receivable as documented in the T-Account above?

- A. There were more customers paying off balances than there were customers adding to their balances.
- B.** There were more customers adding to their balances than paying off their balances.
- C. The company paid off its debt more than it incurred new debt.
- D. The company incurred more debt than it paid off.

The debits to the account were greater than the credits to the account. The debits are increases to the account and would arise from entries recording increases to customer accounts. The credits are decreases to the account and would arise from entries recording receipt of customer payments on their accounts.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Learning Objective: 3
Topic Area: Transaction analysis and debit/credit framework

80. According to the principle of conservatism, when faced with uncertainty about the value of an item, a company should use the measure that avoids:

- A. overstating assets and liabilities.
- B.** overstating assets and understating liabilities.
- C. understating assets and overstating liabilities.
- D. understating assets and liabilities.

Conservatism is the requirement to use the least optimistic measures when uncertainty exists about the value of an asset or liability.

AACSB: analytic
AICPA BB: legal
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 5
Topic Area: Balance Sheet Concepts

81. Which of the following would **not** be considered fraudulent financial reporting?
- A. Intentionally reporting long-term assets that include equipment ordered but not yet received.
 - B.** Intentionally reporting long-term assets that include equipment ordered and received but not yet paid for.
 - C. Intentionally reporting long-term assets that include items paid for but not yet received.
 - D. Intentionally reporting long-term assets that have been scrapped.

Ordering assets is not a recordable transaction in the accounting system. Assets not yet received or assets that have been scrapped are not long-term assets to be reported on the balance sheet.

AACSB: reflective thinking
AICPA BB: critical thinking
AICPA FN: reporting
Bloom's: evaluation
Difficulty: Hard
Learning Objective: 2
Learning Objective: 5
Topic Area: Analyze transactions and Balance Sheet concepts

82. Your company's president donates a large amount of her own money to charity and receives significant publicity that includes the company's name. How would the benefits of this publicity appear on the balance sheet?
- A. It would appear as a current asset.
 - B. It would appear as a liability.
 - C. It would appear as a long-term asset.
 - D.** It would not appear on the balance sheet.

This is not a transaction to be recorded in the accounting information system and reported on the balance sheet of the company.

AACSB: analytic
AICPA BB: critical thinking
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Learning Objective: 5
Topic Area: Definition of transaction and Balance Sheet concepts

83. Which of the following would a company be most likely to overstate if the company was trying to mislead potential external investors or creditors?

- A.** Accounts Receivable.
- B. Notes Payable.
- C. Salaries Expense.
- D. Accounts Payable.

Overstating assets such as Accounts receivable would increase the current ratio which is used to evaluate a company's ability to pay current obligations.

AACSB: ethics

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 4

Learning Objective: 5

Topic Area: Balance Sheet Evaluation

84. Which of the following would not be recorded as an identifiable accounting transaction?

- A. Putting a deposit down on a new vehicle.
- B.** Hiring a new employee.
- C. Obtaining a bank loan.
- D. Receiving a deposit from a customer.

Hiring a new employee is an activity that is not a transaction because no assets or services are exchanged at that time.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 1

Topic Area: Definition of transaction

85. Which concept should be applied when reporting a piece of land that was bought for \$50,000 five years ago, and which would probably now sell for \$80,000?

- A. The cost principle.
- B. The asset principle.
- C. The separate entity concept.
- D. The monetary concept.

The cost principle states that assets are recorded at the amounts that were measurable at the time the transaction occurred.

AACSB: analytic
AICPA BB: legal
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 5
Topic Area: Balance Sheet Concepts

86. Conservatism means:

- A. not underestimating asset values.
- B. not overestimating liabilities.
- C. using the least optimistic measurement when faced with uncertainty about the reported amounts of assets and liabilities.
- D. always recording an asset at the amount it originally cost.

Conservatism requires that when doubt exists about the amount at which assets and liabilities should be reported, the least optimistic measurement should be used.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Hard
Learning Objective: 5
Topic Area: Balance Sheet Concepts

87. The MegaBuck movie studio's name has become famous for adventure movies. Another studio once offered to buy the name for \$20 million, but MegaBuck turned down the offer.

The MegaBuck balance sheet will show:

- A. The company's name under Other Assets, valued at \$20 million.
- B. The company's name under Other Assets, valued conservatively at \$10 million.
- C. The company's name under Accounts Receivable, valued at \$20 million.
- D.** The company's name will not be shown as an asset on the balance sheet.

Only measurable exchanges are recorded.

AACSB: analytic

AICPA BB: critical thinking

AICPA FN: reporting

Bloom's: evaluation

Difficulty: Medium

Learning Objective: 1

Learning Objective: 5

Topic Area: Definition of transaction and Balance Sheet concepts

88. Which of the following statements is FALSE?

- A. A transaction is an exchange or event that has a direct and measurable financial effect.
- B. Every transaction has at least 2 effects.
- C. Current assets are economic resources to be used or turned into cash within one year
- D.** Notes payable is the account debited when money is borrowed from a bank using a promissory note.

A transaction must have a financial effect on the accounting equation.

The debit/credit framework and the accounting equation require at least 2 effects.

Current assets are defined as assets the business will use up or turn into cash within 12 months of the balance sheet date. Notes payable is a liability and is increased with a credit.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 2

Learning Objective: 3

Learning Objective: 4

Topic Area: Transaction analysis and Classified Balance Sheet

A company entered into the following transactions:

- Borrowed \$5,000 from the bank by signing a promissory note
- Issued stock to owners for \$10,000
- Purchased \$1,000 of supplies, on account
- Paid \$400 to suppliers as payment on account for the supplies purchased

89. What is the amount of total assets?

- A. \$16,000
- B. \$5,600
- C. \$15,000
- D.** \$15,600

Total assets = Cash from borrowing \$5,000, cash from stock issued \$10,000, supplies purchased \$1,000 minus cash paid \$400.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: application
Difficulty: Easy
Learning Objective: 1
Learning Objective: 2
Topic Area: Analyze transactions and Balance Sheet concepts

90. What is the amount of total liabilities?

- A. \$6,000
- B. \$15,600
- C. \$16,000
- D.** \$5,600

Liabilities = Notes payable to the bank \$5,000 plus accounts payable \$1,000 minus \$400.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: application
Difficulty: Easy
Learning Objective: 1
Learning Objective: 2
Topic Area: Analyze transactions and Balance Sheet concepts

Chapter 02 - Reporting Investing and Financing Results on the Balance Sheet

A company reported the following in its recent balance sheet

Accounts payable	\$19,207
Accounts receivable	\$81,336
Cash	\$73,324
Income tax payable	\$ 3,512
Inventories	\$25,816
Long-term liabilities	\$ 1,709
Property and equipment	\$54,128
Stockholders' equity	\$202,808
Supplies	\$ 5,512
Wages payable	\$12,880

91. What is the amount of Total Assets on the Balance Sheet?

- A. \$240,116
- B. \$259,323
- C. \$442,924
- D. \$234,604

Total assets = Cash + Accounts receivable + Inventories + Supplies + Property and Equipment

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: application
Difficulty: Medium
Learning Objective: 1
Topic Area: Balance Sheet Concepts

92. What is the amount of Total Liabilities on the Balance Sheet?

- A. \$240,116
- B. \$37,308**
- C. \$63,124
- D. \$118,644

Total Liabilities = Accounts payable + Wages payable + Income tax payable + Long-term liabilities

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: application
Difficulty: Medium
Learning Objective: 1
Topic Area: Balance Sheet Concepts

93. What is the amount of the current ratio (round to two decimal places)?

- A. 2.02
- B. 5.00
- C. 5.22**
- D. 1.00

Current ratio = Current Assets (Cash, Accounts receivable, Inventories, Supplies) divided by Current Liabilities (Accounts payable, wages payable, income tax payable)

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: analysis
Difficulty: Hard
Learning Objective: 5
Topic Area: Current Ratio

94. What would be the effect on the current ratio if the company paid \$10,000 on its accounts payable?

- A. The current ratio would increase since it is now greater than 1 to 1.
- B. The current ratio would decrease since it is now greater than 1 to 1.
- C. This transaction would have no effect on the current ratio.
- D. The current ratio would change in the same direction whether the ratio were now greater than or less than 1 to 1.

Since the current ratio for this company is greater than 1 to 1 a decrease in both the current assets and the current liabilities would cause the ratio to increase.

AACSB: analytic
AICPA BB: critical thinking
AICPA FN: risk analysis
Bloom's: analysis
Difficulty: Hard
Learning Objective: 5
Topic Area: Current Ratio

95. B. Darin Company bought land at a cost of \$15,000 and planned to use it to construct a new storage facility on the property. A short time later, the company changed its plans and sold the property to S. Dee Company for \$15,000. S. Dee Company promised to pay cash in 60 days.

Which of the following would be part of the journal entry by B. Darin Company to record the sale of the property?

- A. Credit Accounts receivable
- B. Debit Cash
- C. Credit Land
- D. Debit Accounts payable

The journal entry to record the sale of the land would be a debit to Accounts Receivable and a credit to Land.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Learning Objective: 3
Topic Area: Transaction analysis and debit/credit framework

96. B. Darin Company issued stock to investors and received \$50,000. Choose the TRUE statement.

- A. This is an example of a cash inflow from an investing activity.
- B. The journal entry to record this transaction will include a credit to cash.
- C. This is an example of a cash outflow from a financing activity.
- D.** The journal entry to record this transaction will include a credit to contributed capital.

Issuing stock is a financing activity and the journal entry is a debit to Cash and a credit to Contributed Capital.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 1
Learning Objective: 2
Learning Objective: 3
Topic Area: Analyze transactions and debit/credit framework

97. A company started the year with a normal balance of \$68,000 in the Inventory account. During the year the following amounts were posted to the account:

Debits of \$45,000 and credits of \$55,000. Choose the TRUE statement.

- A. After these amounts are posted, the balance in the Inventory account is a credit balance of \$58,000.
- B. The normal balance of the Inventory account is a credit balance.
- C. The inventory account is decreased by debits.
- D.** The debits and credits posted to the Inventory account caused it to decrease by \$10,000.

The beginning balance is a debit balance of \$68,000. Debits of \$45,000 and credits of \$55,000 cause the balance to decrease by \$10,000 and the ending balance is a debit balance of \$58,000.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

98. Which of the following is not a recordable transaction?

- A. Issued shares of stock to investors in exchange for cash contributions of \$4,000.
- B. Ordered inventory from suppliers for \$3,000.**
- C. Sold equipment to another company for \$3,000 and accepted a note from the company promising payment in 6 months.
- D. Borrowed money from the bank by signing a promissory note for \$2,000.

An event or exchange which affects the accounting equation is required for a transaction to be recorded. Ordering inventory is not a recordable transaction.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 1
Learning Objective: 2
Topic Area: Analyzing transactions

99. Choose the TRUE statement.

- A. All asset accounts have a normal debit balance with the exception of cash which has a normal credit balance.
- B. Contributed capital account is increased by debits.
- C. When payment is made on a liability such as accounts payable, the liability account is decreased with a credit.
- D. The total amount of debits to asset accounts must equal the total amount of credits to liability and stockholders' equity accounts.**

All asset accounts, including cash, have a normal debit balance.

Contributed capital is a stockholders' equity account and is increased by credits.

Accounts payable, a liability account, is decreased with a debit.

Debits = Credits are necessary in order for the accounting equation of Assets = Liabilities + Stockholders' equity to remain in balance.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

100. A company entered into the following transaction: Purchased equipment for use in the business at a cost of \$12,000, one-fourth was paid in cash and the company signed a note for the balance. Choose the TRUE statement about the journal entry to record this transaction.

- A. The journal entry will include a debit to Notes receivable of \$3,000.
- B. The journal entry will include a debit to Cash of \$12,000.
- C.** The journal entry will include a credit to Notes payable of \$9,000.
- D. The journal entry will include a credit to Equipment \$12,000.

The journal entry will be: Debit Equipment \$12,000; Credit Cash \$3,000;
Credit Notes payable \$9,000.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

101. The E. Flynn Company started business by obtaining financing through debt financing and equity financing. Which of the following statements is FALSE?

- A. Equity financing refers to the money obtained through owners' contributions and reinvestments of profit.
- B. Debt financing refers to the money obtained through loans.
- C. The business is obligated to repay debt financing.
- D.** The business is obligated to repay equity financing.

The business is not legally obligated to repay equity financing.

AACSB: analytic
AICPA BB: legal
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 1
Topic Area: Financing activities

102. Which of the following statements is TRUE?

- A. Transactions are analyzed from the standpoint of the owners.
- B. All business activities are considered accounting transactions.
- C.** The transaction amount is determined for each exchange based on the cost of the items given and received.
- D. A business needs journal entries only to show how transactions affect the balance sheet.

Transactions are analyzed from the standpoint of the business and not all business activities are recordable transactions. The cost principle states that transactions are recorded at their original cost to the company.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 2
Learning Objective: 3
Topic Area: Analyze transactions

103. Which of the following statements is FALSE about the current ratio?

- A. Instead of using the dollar amounts, the current ratio makes it easier to compare several companies.
- B. The current ratio is used to evaluate a company's ability to pay current obligations.
- C.** Having more current assets than current liabilities will yield a current ratio less than 1.
- D. A high current ratio suggests good liquidity.

The current ratio is current assets divided by current liabilities. If current assets exceed current liabilities, the ratio is greater than 1.

The current ratio is used to evaluate a company's liquidity or its ability to pay its current obligations. A high ratio indicates current assets exceed current liabilities by a larger amount. Using a ratio makes it easier to compare several companies.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 4
Learning Objective: 5
Topic Area: Current Ratio

104. Conservatism is

- A. the requirement that businesses should intentionally understate assets.
- B. the requirement that businesses should intentionally overstate liabilities.
- C. the requirement that if an asset's value falls over time it will continue to be reported at its original cost.
- D.** the requirement that when faced with uncertainty about the numbers to report, accountants must use the least optimistic measure.

Conservatism requires accountants to use the least optimistic measure when uncertainties exist.

It is not conservative to intentionally understate assets or overstate liabilities or to ignore a decline in an asset's value and continue to report it at cost.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 5
Topic Area: Balance Sheet Concepts

105. Which of the following is NOT an asset?

- A. Cash
- B. Notes receivable
- C.** Contributed capital
- D. Land

Assets are resources of a business that generate future economic benefits.
Cash, Notes receivable and Land are all examples of resources.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 1
Topic Area: Balance Sheet

106. Which of the following is NOT true about liabilities?

- A. Liabilities are amounts owed by a business.
- B. Liability accounts have a normal credit balance.
- C. Financing activities will affect the amount of liabilities.
- D.** Examples of liabilities include notes payable, contributed capital and income tax payable.

Contributed capital is part of stockholders' equity and is not a liability.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 1
Learning Objective: 3
Topic Area: Balance Sheet

107. Assets are listed on a classified balance sheet in which of the following ways?

- A. In alphabetical order.
- B. From the largest dollar amount to the lowest dollar amount.
- C. Beginning with non-current assets and ending with current assets.
- D.** Starting with cash.

A classified balance sheet lists assets starting with cash and then in the order they will be used up or turned into cash.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 4
Topic Area: Classified Balance Sheet

108. If a company is trying to maximize its perceived value to external decision makers, the company is most likely to

- A. understate the current assets.
- B.** understate the long-term liabilities.
- C. understate the retained earnings.
- D. understate the contributed capital.

Understating current assets, retained earnings or contributed capital would not increase the perceived value of the business.

Understating long-term liabilities could improve the perceived value of the business.

AACSB: ethics

AICPA BB: resource management

AICPA FN: measurement

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 5

Topic Area: Evaluating the balance sheet

109. Which of the following is a recordable transaction for the company, Bobby and Sandy Store?

- A. The company signed an agreement to rent store space at \$200 month.
- B. The vice president of the company spoke at a luncheon which contributed to enhancing the company's reputation as a responsible company.
- C. The company ordered supplies for \$500.
- D.** The company lent \$500 to an employee.

A recordable transaction has a direct and measurable financial effect on the assets, liabilities or stockholders' equity of a business.

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: comprehension

Difficulty: Easy

Learning Objective: 1

Topic Area: Definition of transaction

A company was recently formed with \$60,000 cash contributed to the company by its owners. The company then borrowed \$30,000 from a bank and bought \$10,000 of inventory and paid cash for it. The company also purchased \$70,000 of equipment by paying \$10,000 in cash and issuing a note for the remainder.

110. What is the amount of the total assets to be reported on the balance sheet?

- A.** \$150,000
- B. \$160,000
- C. \$90,000
- D. \$80,000

Assets = Cash + Inventory + Equipment.

Cash = \$60,000 + \$30,000 - \$10,000 - \$10,000 = \$70,000

Inventory = \$10,000

Equipment = \$70,000

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: application

Difficulty: Easy

Learning Objective: 2

Topic Area: Transaction analysis

111. What is the amount of the total liabilities to be reported on the balance sheet?

- A. \$60,000
- B. \$0
- C.** \$90,000
- D. \$80,000

Liabilities: Notes payable = \$30,000 + \$60,000

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: application

Difficulty: Easy

Learning Objective: 2

Topic Area: Transaction analysis

A company reported the following information at December 31, 2010:

Accounts payable	\$ 4,500
Accounts receivable	\$ 9,350
Cash	\$23,490
Contributed capital	\$90,000
Equipment	\$49,500
Inventory	\$31,200
Notes payable, due 2012	\$ 2,500
Retained Earnings	\$14,090
Wages payable	\$ 2,450

112. What is the amount of current assets on the classified balance sheet?

- A. \$113,540
- B. \$64,040**
- C. \$23,490
- D. \$37,580

Current assets = Cash + Accounts receivable + Inventory

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: application
Difficulty: Medium
Learning Objective: 4
Topic Area: Classified Balance Sheet

113. What is the amount of current liabilities on the classified balance sheet?

- A. \$9,450
- B. \$6,950**
- C. \$7,000
- D. \$4,500

Current liabilities = Accounts payable + Wages payable

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: application
Difficulty: Medium
Learning Objective: 4
Topic Area: Classified Balance Sheet

114. What is the total of the CREDIT balance accounts?

- A. \$111,040
- B. \$104,090
- C. \$113,540**
- D. \$108,590

Liabilities and stockholders' equity are the credit balance accounts.

Liabilities = Accounts payable + Wages payable + Notes payable

Stockholders' equity = Contributed capital + Retained earnings

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: application
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework

115. Which of the following is a TRUE statement?

- A. Conservatism requires accountants to intentionally understate assets.
- B. Separate entity assumption in accounting requires that the financial activities of the owners of a company be reported on the company's balance sheet.
- C. The cost principle states that recording activities at cost will result in the balance sheet representing the true value of the company.
- D.** A transaction is recorded in accounting if it has a measurable financial effect on the assets, liabilities or stockholders' equity of a business.

Conservatism means that when uncertainty exists accountants report the least optimistic amount.

Separate entity requires that transactions of the business only be reported.

Cost principle requires that activities are recorded at the amounts measurable at the time the transaction occurred. Not all activities are recordable transactions, so the Balance Sheet is not a picture of the value of the company. Transactions are recorded if they are activities with direct and measurable financial effect on the assets, liabilities or stockholders' equity of a business.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Medium
Learning Objective: 1
Learning Objective: 2
Learning Objective: 5
Topic Area: Balance Sheet Concepts

116. Which account would be increased by a debit?

- A. Retained earnings
- B.** Accounts receivable
- C. Contributed capital
- D. Notes payable

Asset accounts are increased by debits. Accounts receivable is an asset.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

117. Which account would be decreased by a credit?

- A.** Cash
- B. Accounts payable
- C. Contributed capital
- D. Retained earnings

Asset accounts are decreased by credits. Cash is an asset.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

The classified balance sheet for a company reported current assets of \$1,623,850, total liabilities of \$799,540, contributed capital of \$1,000,000 and retained earnings of \$130,260. The current ratio was 2.5.

118. What is the total amount of non-current assets?

- A. \$493,590
- B. \$824,310
- C. \$649,540
- D.** \$305,950

Total Assets = Total Liabilities + Total Stockholders' Equity
Total Liabilities + Total Stockholders' Equity = \$799,540 + \$1,000,000 + \$130,260 =
\$1,929,800
Total Assets = Total current assets + Total non-current assets
\$1,929,800 - \$1,623,850 = \$305,950

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: analysis
Difficulty: Medium
Learning Objective: 4
Topic Area: Classified Balance Sheet

119. What is the total amount of current liabilities?

- A. \$649,540
- B. \$824,310
- C. \$305,950
- D. \$799,540

The current ratio is current assets divided by current liabilities. Let x = current liabilities

$$2.5x = \$1,623,850$$

$$X = \$649,540$$

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: analysis

Difficulty: Hard

Learning Objective: 4

Topic Area: Classified Balance Sheet

120. Which of the following is a FALSE statement?

- A. Total Assets are \$1,929,800.
- B. Total Stockholders' equity is \$1,130,260.
- C. Long-term liabilities are \$130,260.
- D. The amount of current assets are 2.5 times the amount of current liabilities.

Total assets = Total liabilities + Total stockholders' equity

$$\text{Total assets} = \$799,540 + \$1,000,000 + \$130,260$$

Total stockholders' equity = contributed capital + retained earnings

$$\$1,000,000 + \$130,260 = \$1,130,260$$

Long-term liabilities = Total liabilities - current liabilities

$$\$799,540 - \$649,540 = \$150,000$$

$$\text{Current Assets of } \$1,623,850 = 2.5 \times \$649,540$$

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: analysis

Difficulty: Hard

Learning Objective: 4

Topic Area: Classified balance sheet and current ratio

121. A company purchased land costing \$27,000 by making a 25 percent cash down payment and signing a 90-day note for the balance. The entry to record this transaction would

- A.** Increase total assets.
- B. Decrease total liabilities.
- C. Decrease contributed capital.
- D. Increase retained earnings.

Assets would increase by the difference between the \$27,000 increase to land and the \$6,750 ($\$27,000 * 25\%$) decrease in cash. Liabilities would increase by the \$20,250 notes payable.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 2
Topic Area: Analyze transactions

122. Each account is assigned a number and this listing of all accounts is called a

- A. Trial Balance
- B. Journal
- C. Ledger
- D.** Chart of Accounts

The Chart of Accounts is the listing of all accounts available for use in recording transactions.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 2
Learning Objective: 3
Topic Area: Accounting methods

123. Which of the following would decrease stockholders' equity?

- A. Stock issued for cash.
- B. Repayment of notes payable.
- C. Land purchased for cash.
- D.** Dividends paid to owners.

Stockholders' equity is contributed capital + retained earnings.

Issuance of stock would increase contributed capital and dividends paid to owners would decrease the retained earnings

Repayment of debt would decrease liabilities.

Land purchased for cash would not change the total amount of assets.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 1

Topic Area: Financing and investing activities

124. A Company has \$15,000 of retained earnings, \$26,000 of assets, and \$6,000 of liabilities. How much is contributed capital?

- A. \$36,000
- B. \$15,000
- C.** \$5,000
- D. \$6,000

Assets = \$26,000.

Liabilities + Contributed capital + Retained earnings = \$26,000.

\$6,000 + Contributed capital + \$15,000 = \$26,000.

Contributed capital = \$5,000.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: application

Difficulty: Medium

Learning Objective: 1

Topic Area: Balance Sheet

125. Stockholders' equity in a corporation consists of:

- A. Long-term assets.
- B. Current assets plus long-term assets.
- C. Assets plus liabilities.
- D. Contributed capital plus retained earnings.**

Stockholders' equity = contributed capital + retained earnings

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: knowledge
Difficulty: Easy
Learning Objective: 1
Topic Area: Balance Sheet

126. Typical cash flows from investing activities include:

- A. Payments to purchase property and equipment.**
- B. Repayment of loans.
- C. Proceeds from issuing notes payable.
- D. Receipts from cash sales.

Investing activities include buying or selling long-term assets.

Repayment of loans and proceeds from issuing notes payable are financing activities.

Receipts from cash sales are operating activities.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 1
Topic Area: Investing activities

127. On January 1, Kirk Corporation had total assets of \$850,000. During the month the following activities occurred:

- . Kirk Corporation acquired equipment costing \$6,000, promising to pay cash for it in 60 days.
- . Kirk Corporation purchased \$3,500 of supplies for cash.
- . Kirk Corporation sold land which it had acquired 2 years ago. The land had cost \$15,000 and it was sold for \$15,000 cash.
- . Kirk Corporation signed an agreement to rent additional storage space next month at a charge of \$1,000 per month.
- . The financial vice president of Kirk Corporation purchased a new vehicle for cash of \$35,000.

What is the amount of total assets of Kirk Corporation at the end of the month?

- A. \$859,500
- B.** \$856,000
- C. \$821,000
- D. \$806,000

Total assets of \$850,000 would be increased by equipment \$6,000. The supplies increase and cash decrease would have no effect on total assets. The land increase and land decrease would have no effect on total assets. Signing an agreement only is not a recordable transaction. A personal transaction of an employee of the company is not recorded by the company and does not affect the financial records of the company.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: analysis
Difficulty: Hard
Learning Objective: 2
Topic Area: Transaction analysis

128. Which of the following statements is TRUE?

- A. Asset and liability accounts have a normal debit balance.
- B. To debit an account means to increase it.
- C.** Contributed capital and retained earnings have a normal credit balance.
- D. To credit an account means to decrease it.

Debit means only an entry to the left side of an account.

Whether the debit is an increase or decrease to the account and whether the credit is an decrease or increase to the account depends on the type of account. Asset accounts have a normal debit balance but liability accounts have a normal credit balance. Contributed capital and retained earnings are stockholders' equity accounts and have normal credit balances.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Medium
Learning Objective: 3
Topic Area: Debit/credit framework

129. Which of the following would cause a trial balance to be out of balance?

- A. A transaction was recorded twice.
- B. A transaction was not recorded.
- C. A transaction was posted to the wrong accounts.
- D.** Only the credit of a transaction was recorded.

A trial balance is an internal accounting report which shows whether or not total debits recorded equal total credits recorded. If only the credit of a transaction was recorded, the trial balance would not be in balance.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 3
Topic Area: Debit/credit framework

130. When accounts receivable are collected

- A. Stockholders' equity increases,
- B. Total assets increase,
- C. Total assets decrease,
- D. The amount of total assets is unchanged.**

Collecting accounts receivable does not affect stockholders' equity.

Collecting accounts receivable increases the asset cash and decreases the asset accounts receivable and therefore does not change total assets.

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: comprehension

Difficulty: Easy

Learning Objective: 2

Topic Area: Transaction analysis

131. The requirement that transactions be recorded at their exchange price at the transaction date is called the

- A. conservatism exception.
- B. separate entity assumption.
- C. cost principle.**
- D. monetary unit assumption.

The cost principle states that transactions are recorded at the measurable amounts of the exchange at the transaction point.

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: knowledge

Difficulty: Easy

Learning Objective: 2

Topic Area: Transaction analysis

Chapter 02 - Reporting Investing and Financing Results on the Balance Sheet

	<u>January 1, 2010</u>	<u>January 1, 2011</u>
Assets	\$24,250	?
Liabilities	8,500	?
Stockholders' equity	?	?

The following changes occurred in the year 2010: Assets decreased by \$3,500 and liabilities increased by \$2,800.

132. What is the amount of the change in stockholders' equity in the year 2010?

- A. \$5,750 increase
- B. \$700 decrease
- C. \$6,300 decrease**
- D. \$550 increase

Assets decreased by \$3,500 and Liabilities increased by \$2,800, so stockholders' equity had to decrease by \$6,300.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: analysis
Difficulty: Medium
Learning Objective: 2
Topic Area: Balance Sheet

133. What is the amount of stockholders' equity at January 1, 2011?

- A.** \$9,450
- B. \$15,750
- C. \$15,050
- D. \$14,450

At January 1, 2010: Assets of \$24,250 = Liabilities of \$8,500 + Stockholders' equity of \$15,750. During the year assets decreased by \$3,500 and liabilities increased by \$2,800, so stockholders' equity had to decrease by \$6,300. At January 1, 2011 stockholders' equity was \$15,750 - \$6,300 = \$9,450.

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: analysis
Difficulty: Hard
Learning Objective: 2
Topic Area: Balance Sheet

134. Which of the following would not be classified as a current asset?

- A. Cash
- B.** Accounts payable
- C. Supplies
- D. Inventory

Current assets are cash and assets expected to be turned into cash or used up within one year. Examples include Cash, Supplies and Inventory.

AACSB: analytic
AICPA BB: resource management
AICPA FN: reporting
Bloom's: comprehension
Difficulty: Easy
Learning Objective: 4
Topic Area: Classified Balance Sheet

135. Which of the following would be classified as a long-term liability on the balance sheet at December 31, 2010?

- A. Accounts payable, 30-day account.
- B. Notes payable, due November, 2011.
- C. Notes receivable, matures April, 2012.
- D.** Mortgage payable, due January, 2013.

Long-term liabilities are debts that are not due to be settled within the year.

Mortgage payable due in 2013 is a long-term liability as of December 31, 2010.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Easy

Learning Objective: 4

Topic Area: Classified Balance Sheet

Essay Questions

136. Selected accounts for Moonbills Corporation appear below.

Instructions - For each account, indicate the following:

(A) In the first column at the right, indicate the nature of each account, using the following abbreviations:

Asset — A, Liability — L, Stockholders' Equity — SE.

(B) In the second column, indicate the normal balance by inserting *dr* or *cr*.

	(A) Type of Account	(B) Normal Balance
1. Supplies.....	_____	_____
2. Notes Payable	_____	_____
3. Income Tax Payable.....	_____	_____
4. Equipment.....	_____	_____
5. Accounts Payable.....	_____	_____
6. Accounts Receivable.....	_____	_____
7. Contributed Capital.....	_____	_____
8. Cash	_____	_____
9. Retained Earnings	_____	_____
10. Land	_____	_____

Chapter 02 - Reporting Investing and Financing Results on the Balance Sheet

	(A) Type of Account	(B) Normal Balance
1. Supplies	A	dr
2. Notes Payable	L	cr
3. Income Tax payable	L	cr
4. Equipment	A	dr
5. Accounts Payable	L	cr
6. Accounts Receivable	A	dr
7. Contributed Capital	SE	cr
8. Cash	A	dr
9. Retained Earnings	SE	cr
10. Land	A	dr

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 1

Learning Objective: 3

Topic Area: Accounting Equation and debit/credit framework

137. Prepare a classified balance sheet for Purrfect Pets, Inc., using the following data for June 30, 2010.

Accounts Payable	\$119,400	Retained Earnings	54,700
Property and Equipment	421,600	Notes Payable, due 2012	343,200
Contributed Capital	200,000	Accounts Receivable	202,500
Income Tax Payable	3,900	Cash	97,100

PURRFECT PETS, INC.

BALANCE SHEET

AT JUNE 30, 2010

Assets		Current Liabilities	
Cash	\$ 97,100	Accounts Payable	\$119,400
Accounts Receivable	<u>202,500</u>	Income Tax Payable	<u>3,900</u>
Total Current Assets	299,600	Total Current Liabilities	\$123,300
		Notes Payable	<u>343,200</u>
		Total Liabilities	<u>466,500</u>
Property and Equipment	421,600	Stockholders' Equity	
		Contributed Capital	200,000
		Retained Earnings	<u>54,700</u>
		Total Stockholders' Equity	<u>254,700</u>
Total Assets	<u>\$721,200</u>	Total Liabilities and Stockholders' Equity	<u>\$721,200</u>

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: synthesis

Difficulty: Medium

Learning Objective: 4

Topic Area: Classified Balance Sheet

138. Stockholders contribute \$10,000 cash to a company. The company uses \$5,000 to buy new equipment and \$3,000 to pay off accounts payable. Show the effect of these transactions on the basic accounting equation. Then, show the journal entries that would be used to record the transactions.

Transaction Analysis

<u>Assets</u>	=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
Cash		Accounts Payable		Contributed Capital
Property & Equipment				+10,000
+10,000				
-5,000		+5,000		
-3,000		-3,000		

Journal entries:

<i>dr</i>	Cash (+A)	10,000	
	<i>cr</i> Contributed Capital (+SE)		10,000
<i>dr</i>	Property & Equipment (+A)	5,000	
	<i>cr</i> Cash (-A)		5,000
<i>dr</i>	Accounts Payable (-L)	3,000	
	<i>cr</i> Cash(-A)		3,000

AACSB: analytic
AICPA BB: resource management
AICPA FN: measurement
Bloom's: analysis
Difficulty: Hard
Learning Objective: 2
Learning Objective: 3
Topic Area: Transaction analysis and debit/credit framework

139. The balance sheet for Purrrfect Pets, Inc., as of June 30, 2010 is shown below.

PURRFECT PETS, INC.			
BALANCE SHEET			
AT JUNE 30, 2010			
Assets		Liabilities	
Cash	\$732,600	Accounts Payable	\$349,200
Accounts Receivable	419,200	Notes Payable	<u>268,900</u>
Inventories	58,400	Total Liabilities	<u>618,100</u>
Property, Plant and Equipment	118,500		
Other Assets	<u>69,400</u>	Stockholders' Equity	
		Contributed Capital	662,100
		Retained Earnings	<u>117,900</u>
		Total Stockholders' Equity	<u>780,000</u>
Total Assets	<u>\$1,398,100</u>	Total Liabilities and Stockholders' Equity	<u>\$1,398,100</u>

During July, 2010, stockholders contribute \$300,000 cash for additional ownership shares. The company pays \$550,000 in cash and borrows \$150,000 from a bank to buy some new stores.

During July, 2010, stockholders contribute \$300,000 cash for additional ownership shares. The company pays \$550,000 in cash and borrows \$150,000 from a bank to buy some new stores.

- a) Show the journal entries and the effects of these transactions on the basic accounting equation.
- b) Show the new balance sheet as of July 31, 2010 after these transactions have occurred, assuming there was no other July activity.

Chapter 02 - Reporting Investing and Financing Results on the Balance Sheet

a) Journal entries:

<i>dr</i>	Cash (+A)	300,000	
<i>cr</i>	Contributed Capital (+SE)		300,000
<i>dr</i>	Property, Plant & Equipment (+A)	700,000	
<i>cr</i>	Cash (-A)		550,000
<i>cr</i>	Notes Payable (+L)		150,000

Transaction Analysis:

<u>Assets</u>		=	<u>Liabilities</u>	+	<u>Stockholders' Equity</u>
Cash	Property and Equipment		Notes Payable		Contributed Capital
+300,000					+300,000
-550,000	+700,000		+150,000		

PURRFECT PETS, INC.

BALANCE SHEET

AT JULY 31, 2010

Assets		Liabilities	
Cash	\$482,600	Accounts Payable	\$349,200
Accounts Receivable	419,200	Notes Payable	<u>418,900</u>
Inventories	58,400	Total Liabilities	<u>768,100</u>
Property, Plant and Equipment	818,500		
Other Assets	<u>69,400</u>	Stockholders' Equity	
		Contributed Capital	962,100
		Retained Earnings	<u>117,900</u>
		Total Stockholders' Equity	<u>1,080,000</u>
Total Assets	<u>\$1,848,100</u>	Total Liabilities and Stockholders' Equity	<u>\$1,848,100</u>

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: analysis

Difficulty: Medium

Learning Objective: 2

Learning Objective: 3

Learning Objective: 4

Topic Area: Transaction analysis, debit/credit framework and Balance Sheet

140. During the month, a company enters into the following transactions:

- buys \$4,000 of supplies on account.
- pays \$5,000 cash for new equipment.
- pays off \$3,000 of accounts payable.
- pays off \$1,500 of notes payable.

Show the journal entries and analyze the effect of these transactions on the basic accounting equation.

Journal entries:

<i>dr</i>	Supplies (+A).....	4,000	
	<i>cr</i> Accounts Payable (+L).....		4,000
<i>dr</i>	Equipment (+A).....	5,000	
	<i>cr</i> Cash (-A).....		5,000
<i>dr</i>	Accounts Payable (-L).....	3,000	
	<i>cr</i> Cash (-A).....		3,000
<i>dr</i>	Notes Payable (-L).....	1,500	
	<i>cr</i> Cash (-A).....		1,500

Transaction Analysis:

	<u>Assets</u>		=	<u>Liabilities</u>		+	<u>Stockholders' Equity</u>
Cash	Supplies	Equipment		Accounts Payable	Notes Payable		
	+4,000			+4,000			
-5,000		+5,000					
-3,000				-3,000			
-1,500					-1,500		

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: analysis

Difficulty: Medium

Learning Objective: 2

Learning Objective: 3

Topic Area: Transaction analysis and debit/credit framework

141. If a purchase of supplies for \$400 was mistakenly recorded as a credit to Supplies, but the cash paid for the supplies was correctly recorded, what would be the effect on the accounting equation?

Assets would be \$800 less than liabilities plus stockholders' equity.

Feedback: The journal entry that was made was a credit to supplies and a credit to cash. This would cause assets to be decreased by \$800. The accounting equation would then reflect assets of \$800 less than the amount of liabilities and stockholders' equity.

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 2; 3

Topic Area: Transaction analysis and debit/credit framework

142. CheapBooks Incorporated (CI) had the following business activities, for which you are to prepare journal entries. *Reference each journal entry to the transaction number, shown below.*

1. Stockholders invest \$25,000 cash in the corporation.
2. CI purchased \$400 of office supplies on credit.
3. CI purchased office equipment for \$7,000, paying \$2,500 in cash and signing a 30-day note payable for the remainder.
4. CI paid \$200 cash on account for office supplies purchased in transaction 2.
5. CI purchased two acres of land for \$10,000, signing a 2-year note payable.
6. CI sold one acre of land at one-half of the total cost of the two acres, receiving the full amount or \$5,000 in cash.
7. CI made a payment of \$5,000 on its 2-year note.

1.	<i>dr</i> Cash	25,000		
	<i>cr</i> Contributed Capital		25,000	
2.	<i>dr</i> Supplies	400		
	<i>cr</i> Accounts Payable		400	
3.	<i>dr</i> Equipment.....	7,000		
	<i>cr</i> Cash.....		2,500	
	<i>cr</i> Notes Payable		4,500	
4.	<i>dr</i> Accounts Payable	200		
	<i>cr</i> Cash.....		200	
5.	<i>dr</i> Land.....	10,000		
	<i>cr</i> Notes Payable		10,000	
6.	<i>dr</i> Cash	5,000		
	<i>cr</i> Land.....		5,000	
7.	<i>dr</i> Notes Payable	5,000		
	<i>cr</i> Cash.....		5,000	

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: application

Difficulty: Medium

Learning Objective: 2

Learning Objective: 3

Topic Area: Analyze transactions and debit/credit framework

Short Answer Questions

143. On January 1, 2010, NWK, Inc.'s assets were \$300,000 and its stockholders' equity was \$140,000. During the year, assets increased \$15,000 and liabilities decreased \$10,000. What was the stockholders' equity on December 31, 2010?

\$165,000.

Feedback: Beginning of the year:

$$A = L + SE$$

$$\$300,000 = L + \$140,000$$

$$\$160,000 = L$$

End of year:

$$(bbA + change) = (bbL + change) + (ebSE)$$

$$(\$300,000 + \$15,000) = (\$160,000 - \$10,000) + ebSE$$

$$\$315,000 = \$150,000 + SE$$

$$\$165,000 = SE$$

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: analysis

Difficulty: Medium

Learning Objective: 2

Topic Area: Analyzing transactions

144. On March 3, 2010, your company pays \$4,000 to acquire supplies. Should this be a recognized accounting transaction? If so, what accounts are affected and by how much each?

It should be a recognized transaction. Supplies (an asset) is increased by \$4,000 and Cash (also an asset) is decreased by \$4,000.

AACSB: analytic

AICPA BB: resource management

AICPA FN: measurement

Bloom's: application

Difficulty: Easy

Learning Objective: 1

Learning Objective: 2

Topic Area: Analyzing transactions

145. Use the following information as of December 31, 2010 to calculate the amounts of cash and retained earnings. The company's total assets are \$36,000. This company doesn't have other accounts.

Accounts Payable	\$ 7,000
Accounts Receivable	8,000
Supplies	1,000
Furniture and Equipment	22,000
Contributed Capital	10,000
Cash	?
Retained Earnings	?

Cash: \$5,000; Retained Earnings: \$19,000.

Feedback: Total Assets = 36,000 = Cash + 8,000 + 1,000 + 22,000

36,000 = Cash + 31,000

5,000 = Cash

Assets = Liabilities + Stockholders' Equity

36,000 = 7,000 + 10,000 + Retained Earnings

19,000 = Retained Earnings

AACSB: analytic

AICPA BB: resource management

AICPA FN: reporting

Bloom's: analysis

Difficulty: Medium

Learning Objective: 1

Topic Area: Balance Sheet

Matching Questions

146. For each of the following, indicate how the line item would be categorized on a classified balance sheet.

- | | | |
|------------------------------|------------------------|----------|
| 1. SE (stockholders' equity) | Property and Equipment | <u>6</u> |
| 2. SE (stockholders' equity) | Contributed Capital | <u>1</u> |
| 3. CA (current asset) | Supplies | <u>3</u> |
| 4. CL (current liability) | Retained Earnings | <u>1</u> |
| 5. CA (current asset) | Accounts Receivable | <u>3</u> |
| 6. LTL (long-term asset) | Accounts Payable | <u>4</u> |

AACSB: analytic
 AICPA BB: resource management
 AICPA FN: reporting
 Bloom's: comprehension
 Difficulty: Medium
 Learning Objective: 4
 Topic Area: Classified Balance Sheet

147. Match the term and the explanation. There are more explanations than terms.

- | | | |
|---|--------------------------|----------|
| 1. The expression that assets must equal liabilities plus stockholders' equity | dr | <u>5</u> |
| 2. A method of recording a transaction in debit/credit format | cr. | <u>7</u> |
| 3. An exchange or event that has a direct impact on a company's balance sheet | Classified balance sheet | <u>6</u> |
| 4. The account credited when cash is received in exchange for stock issued | Contributed capital | <u>4</u> |
| 5. The abbreviation for an item posted on the left side of a T-account | Accounting equation | <u>1</u> |
| 6. A balance sheet that has assets and liabilities categorized as current vs. long-term | Transaction | <u>3</u> |
| 7. The abbreviation for an item posted on the right side of a T-account | Accounts payable | <u>8</u> |
| 8. Amounts owed to suppliers for goods or services bought on credit | Journal entry | <u>2</u> |

AACSB: analytic
 AICPA BB: resource management
 AICPA FN: reporting
 Bloom's: comprehension
 Difficulty: Medium
 Learning Objective: 1
 Learning Objective: 5
 Topic Area: Debit/credit framework and Balance Sheet

148. For each of the following, indicate how the event would most likely be categorized.

- | | | |
|---------------------------|---|----------|
| 1. EE (external exchange) | A company sells \$2 million in goods for immediate payment. | <u>1</u> |
| 2. NT (No transaction) | The company uses up office supplies. | <u>3</u> |
| 3. IE (internal event) | The stock market rises 10% and the value of a company's stock increases. | <u>2</u> |
| 4. NT (No transaction) | A company pays cash to an inventor for the legal rights to produce a new product. | <u>1</u> |
| 5. NT (No transaction) | Management promises to pay workers an overtime bonus as required by their union contract. | <u>2</u> |
| 6. IE (internal event) | A company uses up supplies to manufacture a product. | <u>3</u> |
| 7. EE (external exchange) | A company receives \$1 million in orders but no down payments. | <u>2</u> |

AACSB: analytic
 AICPA BB: resource management
 AICPA FN: measurement
 Bloom's: comprehension
 Difficulty: Medium
 Learning Objective: 1
 Learning Objective: 2
 Topic Area: Analyzing transactions

149. Listed below are components of several transactions. In the blank to the left indicate whether a debit (dr) or credit (cr) would be required to record the component of the transaction.

- | | | |
|-------|-------------------------------------|----------|
| 1. cr | Increase in Cash. | <u>2</u> |
| 2. dr | Increase in Accounts Payable. | <u>1</u> |
| 3. dr | Decrease in Notes Payable. | <u>2</u> |
| 4. cr | Increase in Inventory. | <u>2</u> |
| 5. cr | Increase in Contributed Capital. | <u>1</u> |
| 6. dr | Decrease in Property and Equipment. | <u>1</u> |

AACSB: analytic
 AICPA BB: resource management
 AICPA FN: measurement
 Bloom's: comprehension
 Difficulty: Medium
 Learning Objective: 3
 Topic Area: Debit/credit framework

150. Match the term and the explanation. There are more explanations than terms.

1. A summary of account names and numbers	Duality of effects <u>6</u>
2. The principle that a company should use the least optimistic measure, when uncertainty exists	Journal entry <u>9</u>
3. An amount that is posted on the right side of a T-account	Posting <u>5</u>
4. Assets are initially recorded at their original cost to the company	Conservatism <u>2</u>
5. When journal entries are copied to the appropriate T-account	Debit <u>7</u>
6. The concept that any transaction must have at least two effects on the accounting equation	Chart of accounts <u>1</u>
7. An amount that is posted on the left side of a T-account or ledger	T-account <u>8</u>
8. A simplified version of an account in the General Ledger	Credit <u>3</u>
9. The mechanism used to record each transaction in the General Journal	Cost principle <u>4</u>

AACSB: communications

AICPA BB: resource management

AICPA FN: reporting

Bloom's: comprehension

Difficulty: Medium

Learning Objective: 2

Learning Objective: 3

Learning Objective: 5

Topic Area: Analyze transactions, debit/credit framework and balance sheet concepts