

## Chapter 02

### Investing and Financing Decisions and the Balance Sheet

#### True / False Questions

1. The primary objective of financial reporting is to provide relevant information to external decision makers.

True False

2. In order for information to be reliable the information needs to be provided on a timely basis.

True False

3. In order for information to be relevant the information should have both predictive and feedback value.

True False

4. The continuity assumption assumes that a business will continue to operate into the foreseeable future.

True False

5. The current assets section of a balance sheet includes both inventory and accounts receivable.

True False

6. The stockholders' equity section of a balance sheet includes contributed capital and retained earnings.

True False

7. Assets are reported on the balance sheet in the order of their liquidity.

True False

8. Many valuable assets such as trademarks and copyrights are not reported within a company's balance sheet.

True False

9. Stockholders' equity includes the financing provided by owners.

True False

10. Financial reporting focuses on reporting the impact of transactions on an entity's financial position.

True False

11. Unearned revenue is reported on the balance sheet as a liability and represents amounts paid to an entity for which the entity has an obligation to provide future services and/or goods.

True False

12. A business transaction consists of an exchange of assets or services for assets, services, or promises to pay between a business and an external party to the business.

True False

13. The dual effects concept implies that every transaction has at least two effects on the accounting equation.

True False

14. The accounting equation doesn't have to be in balance after the recording of each transaction.

True False

15. A company's assets and stockholders' equity both increase when the company sells additional shares of stock in exchange for cash.

True False

16. Purchasing stock of another company for cash doesn't result in an increase in total assets for the purchasing company.

True False

17. The normal balance for an asset account is a debit and the normal balance for a liability account is a credit.

True False

18. The recording of a journal entry precedes the posting to the general ledger.

True False

19. Asset accounts have a debit balance and are increased by debiting the account.

True False

20. Liability and stockholders' equity accounts have credit balances and are decreased by debiting the account.

True False

21. A journal entry is an expression of the effects of a transaction on accounts which has equal debits and credits.

True False

22. The T-account is useful for summarizing account balances and is found in the general ledger.

True False

23. The T-account is very useful for accumulating the effects of transactions on account balances and for determining individual account balances.

True False

24. Current assets include accounts receivable and prepaid expenses.

True False

25. The current ratio is current assets divided by current liabilities.

True False

26. Current liabilities are defined as obligations to be paid within six months.

Bloom's Remember

True False

27. The current ratio measures the ability of a company to pay its short-term obligations with short-term assets.

True False

28. A company with a high current ratio should never have liquidity problems.

True False

29. When a company borrows money from a bank, it leads to a cash inflow from an investing activity.

True False

30. Issuing stock in exchange for cash creates a financing activity cash flow.

True False

**Multiple Choice Questions**

31. Which of the following statements about stockholders' equity is false?

A. Stockholders' equity is the shareholders' residual interest in the company resulting from the difference in assets and liabilities.

B. Stockholders' equity accounts are increased with credits.

C. Stockholders' equity results only from contributions of the owners.

D. The purchase of land for cash has no effect on stockholders' equity.

32. Assets, liabilities, and stockholders' equity are found within which of the following financial statements?

A. Balance sheet

B. Income statement

C. Statement of retained earnings

D. Statement of cash flows

33. An account payable would be reported within which of the following financial statements?

A. Statement of cash flows

B. Income statement

C. Balance sheet

D. Statement of retained earnings

34. Which of the following assumptions implies that a business can continue to remain in operation into the foreseeable future?

- A. Historical cost principle
- B. Unit-of-measure assumption
- C. Continuity assumption
- D. Separate-entity assumption

35. Which of the following best describes assets?

- A. Resources with possible future economic benefits owed by an entity as a result of past transactions.
- B. Resources with probable future economic benefits owned by an entity as a result of past transactions.
- C. Resources with probable future economic benefits owned by an entity as a result of future transactions.
- D. Resources with possible future economic benefits owed by an entity as a result of future transactions.

36. Which of the following assumptions implies that the assets and liabilities of the business are accounted for separately from the assets and liabilities of the owners?

- A. Unit-of-measure assumption
- B. Continuity assumption
- C. Historical cost principle
- D. Separate entity assumption

37. Which of the following best describes liabilities?

- A. Possible debts or obligations of an entity as a result of future transactions which will be paid with assets or services.
- B. Possible debts or obligations of an entity as a result of past transactions which will be paid with assets or services.
- C. Probable debts or obligations of an entity as a result of future transactions which will be paid with assets or services.
- D. Probable debts or obligations of an entity as a result of past transactions which will be paid with assets or services.

38. Which of the following is included within current assets on a balance sheet?

- A. Land used in daily operations.
- B. A truck used in daily operations.
- C. Inventory which takes two years to manufacture.
- D. Intangible assets.

39. Chad Jones is the sole owner and manager of Jones Glass Repair Shop. Jones purchased a truck for \$30,000 to be used in the business. Which of the following fundamentals requires Jones to record the truck at the price paid to buy it?

- A. Separate-entity assumption
- B. Revenue principle
- C. Unit-of-measure assumption
- D. Historical cost principle

40. In what order are current assets listed on a balance sheet?

- A. By dollar amount (largest first).
- B. By date of acquisition (earliest first).
- C. By liquidity.
- D. By relevance to the operation of the business.

41. In what order would the following assets be listed on a balance sheet?

- A. Cash, Accounts Receivable, Inventory, Plant and Equipment.
- B. Cash, Intangible Assets, Accounts Receivable, Plant and Equipment.
- C. Cash, Accounts Receivable, Plant and Equipment, Inventory.
- D. Cash, Inventory, Intangible Assets, Accounts Receivable.

42. Where would changes in stockholders' equity resulting from operations be reported?

- A. Within a long-term asset account.
- B. Within the contributed capital account.
- C. Within a liability account.
- D. Within the retained earnings account.

43. Which of the following events will cause retained earnings to increase?

- A. Dividends declared by the Board of Directors.
- B. Net income reported for the period.
- C. Net loss reported for the period.
- D. Issuance of stock in exchange for cash.

44. Which of the following correctly describes retained earnings?

- A. It is the cumulative net income of a company.
- B. It represents the investments by stockholders in a company.
- C. It equals total assets minus total liabilities.
- D. It is the cumulative net income of a company less dividend declarations.

45. Which of the following statements is false?

- A. An item considered immaterial can be accounted for in the most cost-beneficial manner.
- B. An item is considered relevant if it has the ability to influence a decision.
- C. Information is considered to be reliable when it is accurate, unbiased, and verifiable.
- D. Conservatism suggests that assets and revenues should be overstated when possible.

46. Which of the following describes the primary objective of financial accounting?

- A. To provide useful economic information only to stockholders.
- B. To provide information about a business' future business strategies.
- C. To provide useful economic information about a business to help external parties make informed decisions.
- D. To provide useful economic information about a business to help internal parties make informed decisions.

47. Which of the following would not be considered a current asset?

- A. Inventory.
- B. Prepaid expenses.
- C. Land used in daily operations.
- D. Accounts receivable.

48. Which of the following does not correctly describe a business transaction?
- A. They include exchanges of assets or services by one business for assets, services, or liabilities from another business.
  - B. They include the using up of insurance paid for in advance.
  - C. They have an economic impact on a business entity.
  - D. They do not include measurable internal events such as the use of assets in operations.

49. Which of the following would not be currently reported as an expense on the income statement?
- A. Cost of goods sold
  - B. Interest expense
  - C. Prepaid insurance expense
  - D. Income tax expense

50. Which of the following liability accounts does not usually require a future cash payment?
- A. Accounts payable
  - B. Unearned revenues
  - C. Taxes payable
  - D. Notes payable

51. Which of the following transactions wouldn't be considered an external exchange?
- A. The purchase of inventory on credit from a supplier.
  - B. Cash received from a credit customer.
  - C. Cash paid for wages to employees.
  - D. Using up insurance which was paid for in advance.

52. Which of the following reflects the impact of a transaction where \$200,000 cash was invested by stockholders in exchange for stock?
- A. Assets and liabilities each increased \$200,000.
  - B. Assets and revenues each increased \$200,000.
  - C. Stockholders' equity and revenues each increased \$200,000.
  - D. Stockholders' equity and assets each increased \$200,000.

53. A corporation purchased factory equipment using cash. Which of the following statements regarding this purchase is false?

- A. The current year's net income for will be reduced by the cost of the factory equipment.
- B. The total assets will not change.
- C. The total liabilities will not change.
- D. The current stockholders' equity will not change.

54. Which of the following direct effects on the accounting equation isn't possible as a result of a single business transaction which impacts only two accounts?

- A. An increase in a liability and a decrease in an asset.
- B. An increase in stockholders' equity and an increase in an asset.
- C. An increase in an asset and a decrease in an asset.
- D. A decrease in stockholders' equity and a decrease in an asset.

55. Which of the following direct effects on the accounting equation isn't possible as a result of a single business transaction?

- A. An increase in an asset and a decrease in another asset.
- B. An increase in an asset and an increase in stockholders' equity.
- C. A decrease in stockholders' equity and an increase in an asset.
- D. An increase in a liability and an increase in an asset.

56. A company's January 1, 2010 balance sheet reported total assets of \$150,000 and total liabilities of \$60,000. During January 2010, the company completed the following transactions: (A) paid a note payable using \$10,000 cash (no interest was paid); (B) collected a \$9,000 accounts receivable; (C) paid a \$5,000 accounts payable; and (D) purchased a truck for \$5,000 cash and by signing a \$20,000 note payable from a bank. The company's January 31, 2010 balance sheet would report which of the following?

	Assets	Liabilities	Stockholders' Equity
A.	\$150,000	\$60,000	\$90,000
B.	\$155,000	\$65,000	\$90,000
C.	\$160,000	\$75,000	\$85,000
D.	\$170,000	\$100,000	\$70,000

- A. Option A
- B. Option B
- C. Option C
- D. Option D

57. Which of the following happens when equipment is purchased using cash?

- A. Total assets decrease.
- B. Current assets don't change.
- C. Current assets increase.
- D. Stockholders' equity doesn't change.

58. Which of the following describes the impact of purchasing supplies for cash on the balance sheet?

- A. Current assets will decrease.
- B. Current assets will increase.
- C. Stockholders' equity will decrease.
- D. Total assets remain the same.

59. Which of the following describes the impact of paying a current liability using cash on the balance sheet?

- A. Current assets will decrease.
- B. Current liabilities will increase.
- C. Stockholders' equity will decrease.
- D. Total assets will remain the same.

60. Which of the following describes the impact on the balance sheet when cash is received from the collection of an account receivable?

- A. Current assets will not change.
- B. Current assets will increase.
- C. Stockholders' equity will increase.
- D. Total assets will increase.

61. A corporation has \$80,000 in total assets, \$36,000 in total liabilities, and a \$12,000 credit balance in retained earnings. What is the balance in the contributed capital account?

- A. \$56,000
- B. \$44,000
- C. \$48,000
- D. \$32,000

62. The duality (or duality of effects) concept states that

- A. both the income statement and balance sheet are impacted by every transaction.
- B. every transaction has an impact on assets and stockholders' equity.
- C. there are two entities involved in every transaction.
- D. every transaction has at least two effects on the accounting equation.

63. Which of the following is not considered to be a recordable transaction?

- A. Signing a contract to have an outside cleaning service clean offices nightly.
- B. Paying employees their wages.
- C. Selling stock to investors.
- D. Buying equipment and agreeing to pay a note payable and interest at the end of a year.

64. Which of the following transactions will cause both the left and right side of the accounting equation to decrease?
- A. Collecting cash from a customer who owed us money.
  - B. Paying a supplier for inventory we previously purchased on account.
  - C. Borrowing money from a bank.
  - D. Purchasing equipment using cash.
65. When a company buys equipment for \$150,000 and pays for one third in cash and the other two thirds is financed by a note payable, which of the following are the effects on the accounting equation?
- A. Total assets decrease \$50,000.
  - B. Total liabilities increase \$150,000.
  - C. Total liabilities decrease \$50,000.
  - D. Total assets increase \$100,000.
66. Which of the following describes the impact on the balance sheet when a company uses cash to purchase the stock of another company?
- A. Total assets increase.
  - B. Stockholders' equity increases.
  - C. Stockholders' equity decreases.
  - D. Total assets remain the same.
67. Which of the following statements is incorrect?
- A. Stockholders' equity accounts normally have credit balances.
  - B. Liability accounts are decreased by credits.
  - C. Stockholders' equity accounts are increased by credits.
  - D. Asset accounts are increased by debits.
68. Selling stock to investors for cash would result in which of the following?
- A. A debit to contributed capital and a credit to cash.
  - B. A credit to both cash and contributed capital.
  - C. A debit to cash and a credit to contributed capital.
  - D. A debit to cash and a credit to retained earnings.

69. Borrowing cash from a bank would result in which of the following?

- A. A debit to cash and a credit to notes payable.
- B. A debit to notes payable and a credit to cash.
- C. A debit to both cash and notes payable.
- D. A debit to cash and a credit to contributed capital.

70. A company purchases a delivery van by paying \$5,000 cash and by signing a \$25,000 note payable. Which of the following correctly describes the recording of the delivery van purchase?

- A. The delivery van account is debited for \$25,000.
- B. Notes payable is debited for \$25,000.
- C. The delivery van account is debited for \$30,000.
- D. Cash is debited for \$5,000.

71. Cadet Company paid an accounts payable of \$1,000. This transaction should be recorded as follows on the payment date.

	Accounts payable	1,000	
A.	Cash		1,000
	Cash	1,000	
B.	Accounts Payable		1,000
	Notes Payable	1,000	
C.	Cash		1,000
	Cash	1,000	
D.	Cost of Goods Sold		1,000

72. Which of the following correctly describes the recording of a dividend declaration by a company's board of directors?

- A. A debit to retained earnings and a credit to cash.
- B. A debit to contributed capital and a credit to dividends payable.
- C. A debit to cash and a credit to retained earnings.
- D. A debit to retained earnings and a credit to dividends payable.

73. Which of the following statements is correct?

- A. Assets have a credit balance and are increased with debits.
- B. Assets have a debit balance and are increased with credits.
- C. Liability accounts have debit balances and are increased with debits.
- D. Stockholders' equity accounts normally have credit balances and are increased with credits.

74. Which of the following journal entries is correct when a business entity purchases land costing \$30,000 by signing a one-year note payable?

- |    |               |        |  |
|----|---------------|--------|--|
|    | Cash          | 30,000 |  |
| A. | Notes Payable | 30,000 |  |
|    | Land          | 30,000 |  |
| B. | Cash          | 30,000 |  |
|    | Land          | 30,000 |  |
| C. | Notes Payable | 30,000 |  |
|    | Notes Payable | 30,000 |  |
| D. | Land          | 30,000 |  |

75. Which of the following journal entries is correct when a business entity issues stock to stockholders in exchange for cash?

- |    |                     |  |
|----|---------------------|--|
|    | Cash                |  |
| A. | Retained Earnings   |  |
|    | Cash                |  |
| B. | Contributed Capital |  |
|    | Cash                |  |
| C. | Accounts Payable    |  |
|    | Contributed Capital |  |
| D. | Cash                |  |

76. Which of the following journal entries is correct when a business entity purchases a building by paying cash and signing a note payable?

- A. Building  
Cash  
Notes Payable
- B. Building  
Cash  
Cash  
Notes Payable
- C. Building  
Building  
Cash
- D. Notes Payable

77. Which of the following journal entries is correct when a business entity builds an addition to the factory building by paying cash to a contractor?

- A. Cash  
Building  
Retained Earnings
- B. Contributed Capital  
Cash
- C. Building  
Building
- D. Cash

78. Which of the following journal entries is correct when a business entity uses cash to pay an account payable?

- A. Cash  
Accounts Payable  
Retained Earnings
- B. Cash  
Cash  
Accounts Payable
- C. Cash  
Cash
- D. Notes Payable

79. Which of the following transactions would result in an increase in the current ratio?

- A. Collection of cash from an account receivable.
- B. Selling shares of stock to stockholders in exchange for cash.
- C. Purchasing a building by signing a long-term note payable.
- D. Declaration of a cash dividend by the board of directors.

80. Which of the following transactions would result in a decrease in the current ratio?

- A. Collection of cash from an account receivable.
- B. Selling shares of stock to stockholders in exchange for cash.
- C. Purchasing a delivery vehicle by signing a long-term note payable.
- D. Declaration of a cash dividend by the board of directors.

81. Which of the following account balances would not be included in the calculation of the current ratio?

- A. Accounts receivable
- B. Short-term notes payable
- C. Contributed capital
- D. Inventory

82. Which of the following statements does not properly describe the current ratio?

- A. It measures the ability of a firm to pay its debts in the short-run.
- B. It is current assets divided by current liabilities.
- C. It is a measure of a firm's short-run liquidity.
- D. It measures a firm's ability to pay its long-term debts as they mature.

83. The Pioneer Company has provided the following account balances:

Cash \$38,000;  
Short-term investments \$4,000;  
Accounts receivable \$6,000;  
Inventory \$48,000;  
Long-term notes receivable \$2,000;  
Equipment \$96,000;  
Factory Building \$180,000;  
Intangible assets \$6,000;  
Accounts payable \$30,000;  
Accrued liabilities payable \$4,000;  
Short-term notes payable \$14,000;  
Long-term notes payable \$92,000;  
Contributed capital \$180,000;  
Retained earnings \$60,000.

What is Pioneer's current ratio?

- A. 2.00
- B. 2.17
- C. 2.71
- D. 1.00

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Inventory \$48,000;  
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Accrued liabilities payable \$4,000;  
Short-term notes payable \$14,000;  
Long-term notes payable \$92,000;  
Contributed capital \$180,000;  
Retained earnings \$60,000.

What are Pioneer's total current assets?

- A. \$48,000
- B. \$96,000
- C. \$50,000
- D. \$42,000

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Short-term investments \$4,000;  
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Equipment \$96,000;  
Factory Building \$180,000;  
Intangible assets \$6,000;  
Accounts payable \$30,000;  
Accrued liabilities payable \$4,000;  
Short-term notes payable \$14,000;  
Long-term notes payable \$92,000;  
Contributed capital \$180,000;  
Retained earnings \$60,000.

What are Pioneer's total current liabilities?

- A. \$44,000
- B. \$34,000
- C. \$48,000
- D. \$140,000

86. At the beginning of April, Warren Corporation's assets totaled \$240,000 and liabilities totaled \$60,000. During April the following summarized transactions occurred:

Additional shares of stock were sold for \$20,000 cash.

A building costing \$95,000 was purchased using \$10,000 cash and by signing an \$85,000 long-term note payable.

Short-term investments costing \$9,000 were purchased using cash.

\$10,000 was lent to an employee; the employee signed a six-month note in exchange for the loan.

How much are Warren's total assets at the end of April?

- A. \$335,000
- B. \$249,000
- C. \$345,000
- D. \$250,000

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Short-term investments costing \$9,000 were purchased using cash.

\$10,000 was lent to an employee; the employee signed a six-month note in exchange for the loan.

How much are Warren's total liabilities at the end of April?

- A. \$145,000
- B. \$155,000
- C. \$165,000
- D. \$135,000

88. Tiger Company's stockholders' equity at the beginning of the year was \$175,000. During the year Tiger reported the following:

Net income of \$79,000.

Dividend declarations totaling \$17,000.

Issued stock to stockholders in exchange for \$42,000 cash.

Stockholders sold some of their stock to other stockholders for \$11,000 cash.

What is Tiger's stockholders' equity at the end of the year?

- A. \$296,000
- B. \$279,000
- C. \$290,000
- D. \$273,000

89. Which of the following transactions will not change a company's total stockholders' equity?

- A. Reporting of net income.
- B. Issuing stock to stockholders in exchange for cash.
- C. The declaration of a cash dividend.
- D. The payment of a previously declared cash dividend.

90. Which of the following transactions would create a cash inflow from a financing activity?

- A. Issuing shares of stock to stockholders in exchange for cash.
- B. Selling a short-term stock investment in exchange for cash.
- C. Selling used equipment which was a part of property, plant, and equipment.
- D. The payment of an account payable.

91. Which of the following best describe financing activities?

- A. They primarily deal with securing money by bank loans or selling stock to investors.
- B. They primarily are connected to the income producing activities of the company as reported on the income statement.
- C. They primarily deal with buying and building facilities used over many years by the business.
- D. They primarily deal with selling facilities once used by the business.

92. Which of the following would cause a cash outflow from investing activities?

- A. Purchasing shares of stock of another company.
- B. Paying a cash dividend to stockholders.
- C. Issuing additional shares a company's stock.
- D. Using cash to purchase inventory.

93. Which of the following would result when a company borrows cash and signs a note payable due in two years?

- A. A noncurrent liability and an investing cash flow are created.
- B. A noncurrent liability and a financing cash flow are created.
- C. A current liability and an investing cash flow are created.
- D. A current liability and a financing cash flow are created.

94. Which of the following would result when a company sells additional shares of stock for cash?

- A. A noncurrent liability and a financing cash flow are created.
- B. Contributed capital increases and a financing cash flow results.
- C. A noncurrent liability and an investing cash flow are created.
- D. Contributed capital increases and an investing cash flow results.

95. Which of the following would result when a company purchases a factory building using cash?

- A. A noncurrent asset and an investing cash flow are created.
- B. A noncurrent asset and a financing cash flow are created.
- C. A current asset and an investing cash flow are created.
- D. A current asset and a financing cash flow are created.

96. Which of the following would result when a company lends cash to a franchisee in exchange for a ten-month note receivable?

- A. A noncurrent asset and an investing cash flow are created.
- B. A noncurrent asset and a financing cash flow are created.
- C. A current asset and a financing cash flow are created.
- D. A current asset and an investing cash flow are created.

97. Which of the following would result when a company pays a previously declared cash dividend?

- A. Current liabilities are reduced and a financing cash flow is created.
- B. Stockholders' equity is reduced and a financing cash flow is created.
- C. Current assets are reduced and an investing cash flow is created.
- D. Stockholders' equity is reduced and an investing cash flow is created.

98. Which of the following would be classified as financing cash flows on a cash flow statement?

- 1. Paying cash dividends.
  - 2. Lending cash to others.
  - 3. Issuing stock for cash.
  - 4. Purchasing long-term assets for cash.
  - 5. Repurchasing stock with cash.
- A. 1, 2, 5
  - B. 2, 3, 4
  - C. 1, 3, 5
  - D. 2, 4, 5

99. Which of the following would be classified as investing cash flows on a cash flow statement?

1. Acquired a building by signing a long-term mortgage payable.
  2. Lending cash to others.
  3. Issuing stock for cash.
  4. Purchasing long-term assets for cash.
  5. Selling stock investments for cash.
- A. 1, 4, 5  
B. 1, 2, 4  
C. 1, 3, 5  
D. 2, 4, 5

100. Which of the following statements is false?

- A. Investing cash flows include the cash flows associated with lending money to others.
- B. Financing cash flows include the cash flows associated with issuing and repurchasing stock.
- C. Financing cash flows include the cash flows associated with borrowing and repaying debt excluding short-term bank loans.
- D. Investing cash flows include the cash flows associated with buying and selling noncurrent assets.

#### Essay Questions

101. Why is the continuity assumption so important for balance sheet reporting?

102. Why is the separate-entity assumption so important for balance sheet reporting?

103. Why is the historical cost principle so important for balance sheet reporting?

104. Complete the following schedule for Red Eye Company.

Transaction	Assets	Liabilities	Stockholders' Equity
Beginning balances	\$200,000	\$80,000	\$120,000
Borrowed \$20,000 cash by signing a note payable with a bank.			
Collected accounts receivable for cash, \$7,000.			
Paid accounts payable, \$8,000 cash.			
Purchased office supplies on credit, \$2,000.			
Sold stock to new investors for \$20,000 cash.			
Paid income taxes payable of \$12,000.			
Ending balances			

**Matching Questions**

105. For each of the following accounts, indicate whether the account is an asset (A), liability (L), or stockholders' equity (SE) and whether the account usually has a debit (Dr) or credit (Cr) balance.

1. Inventory	SE, Cr	_____
2. Accounts receivable	A, Dr	_____
3. Contributed Capital	SE, Cr	_____
4. Prepaid expenses	L, Cr	_____
5. Wages payable	A, Dr	_____
6. Property and equipment	A, Dr	_____
7. Retained Earnings	L, Cr	_____
8. Accounts payable	A, Dr	_____

106. For each of the accounts listed below, indicate whether the typical or normal balance is a debit or credit.

1. Unearned revenue	Debit	_____
2. Accounts receivable	Credit	_____
3. Retained earnings	Credit	_____
4. Prepaid insurance	Debit	_____
5. Notes payable	Debit	_____
6. Contributed capital	Debit	_____
7. Accounts payable	Debit	_____
8. Land	Credit	_____
9. Inventory	Credit	_____
10. Equipment	Credit	_____

**Essay Questions**

107. The ABC Corporation was formed on January 1, 2010. The three initial owners invested \$100,000 cash and received shares of stock. Below are selected transactions that were completed during January, 2010.

1. Sold stock to the owners.
2. Borrowed \$80,000 on a one-year note payable.
3. Purchased land by signing a \$70,000 note payable.
4. Paid \$10,000 of accounts payable.
5. Purchased two service vehicles for cash at a cost of \$24,000 each.
6. Purchased \$2,000 of supplies on credit.

Prepare the journal entry on ABC's books for each transaction.

108. The accounts with identification letters for Ward Company are listed below.

Letter	Account Title
A	Cash
B	Accounts receivable
C	Office supplies inventory
D	Equipment
E	Land
F	Accounts payable
G	Notes payable
H	Contributed capital
I	Retained earnings

During 2010, the company completed the transactions given below. You are to indicate the appropriate journal entry for each transaction by giving the account letter and amount. Some entries may need three letters. The first transaction is given as an example.

Transaction		Debit		Credit	
		Letter	Amount	Letter	Amount
A.	Borrowed \$50,000 and signed a note.	A	\$50,000	G	\$50,000
B.	Purchased equipment for \$50,000. Paid \$10,000 cash, signed \$40,000 note payable.				
C.	Collected \$15,000 of accounts receivable.				
D.	Paid \$12,000 of accounts payable.				
E.	Issued capital stock in exchange for \$60,000 cash.				
F.	Purchased \$5,000 office supplies on credit.				
G.	Paid for the office supplies in (F).				

109. Describe the general journal and the general ledger.

110. On January 1, 2011, Dr. Beth Hill started a new professional corporation, Beth Hill, P.C., to practice medicine with an initial investment of \$100,000. On June 30, 2011, the accounting records showed the following amounts:

Accounts Payable	\$2,000
Accounts Receivable	\$6,200
Cash	\$48,100
Contributed Capital	\$100,000
Office Equipment	\$60,000
Office Supplies	\$3,500
Retained Earnings	\$5,800
Notes Payable	\$10,000

Requirement:

Prepare a balance sheet as of June 30, 2011.

111. For each of the transactions listed below, indicate whether it is an investing (I) or financing (F) activity on the statement of cash flows. Also, indicate if the transaction increases (+) or decreases (-) cash.

Transaction		Type of Activity	Effect on Cash
Ex.	Paid dividends to the owners	F	-
A.	Purchased equipment to use in the business.		
B.	Issued stock for cash.		
C.	Borrowed money at the bank.		
D.	Sold a piece of land adjacent to the plant.		
E.	Paid the principal balance of a note payable.		

**Matching Questions**

112. The Alex Company, a consulting firm, recorded the following selected business transactions during May, 2011. Indicate whether each transaction would increase, decrease, or have no effect on the total assets of the company.

- |  |           |       |
|--|-----------|-------|
| 1. Issued capital stock in exchange for cash contributed by owners   | Increase  | _____ |
| 2. Paid cash on accounts payable to a supplier.                      | No effect | _____ |
| 3. Loaned money to an employee                                       | Increase  | _____ |
| 4. Borrowed money from the bank on a promissory note payable         | Decrease  | _____ |
| 5. Collected cash on accounts receivable                             | No effect | _____ |
| 6. Purchased a building by using cash and signing a mortgage payable | Increase  | _____ |
| 7. Purchased office supplies on credit                               | No effect | _____ |
| 8. Purchased office supplies for cash                                | Increase  | _____ |

113. Classify the following balance sheet accounts by as current assets, noncurrent assets, current liabilities, noncurrent liabilities or stockholders' equity

1. Notes payable due in 3 months	Noncurrent assets	_____
2. Income taxes payable	Stockholders' equity	_____
3. Prepaid expenses	Current Liabilities	_____
4. Accounts receivable	Noncurrent assets	_____
5. Supplies inventory	Current assets	_____
6. Land	Current assets	_____
7. Building	Stockholders' equity	_____
8. Notes payable due in 5 years	Noncurrent liabilities	_____
9. Retained earnings	Current liabilities	_____
10. Contributed capital	Current assets	_____

**Essay Questions**

114. The following journal entries with the amounts omitted were taken from the records of Lena Company:

1. Cash  
    Contributed Capital
2. Inventory  
    Accounts Payable
3. Accounts payable  
    Cash
4. Buildings  
    Cash  
    Mortgage Payable
5. Retained Earnings  
    Dividends Payable
6. Cash  
    Notes Payable

Requirement:

Write a brief explanation for each of the above transactions.

115. What is the primary objective of financial reporting?

116. How is the current ratio calculated and what does it measure?

117. The Lake Company has provided the following account balances:

Cash \$76,000;  
Short-term investments \$8,000;  
Accounts receivable \$12,000;  
Inventory \$96,000;  
Long-term notes receivable \$4,000;  
Equipment \$192,000;  
Factory Building \$360,000;  
Intangible assets \$12,000;  
Accounts payable \$90,000;  
Accrued liabilities payable \$12,000;  
Short-term notes payable \$42,000;  
Long-term notes payable \$184,000.

Requirement:

What is Lake's current ratio?

118. The Superior Company has provided the following account balances:

Cash \$152,000;  
Short-term investments \$18,000;  
Accounts receivable \$36,000;  
Inventory \$116,000;  
Long-term notes receivable \$44,000;  
Equipment \$174,000;  
Factory Building \$270,000;  
Intangible assets \$33,000;  
Accounts payable \$130,000;  
Accrued liabilities payable \$19,000;  
Short-term notes payable \$84,000;  
Long-term notes payable \$169,000.

Requirement:

What is Superior's stockholders' equity?

119. The Smith Corporation has provided the following information:

Cash dividend payments were \$25,000.

Long-term investments were sold for \$79,000 cash.

A building costing \$198,000 was purchased using \$19,800 cash, the balance was financed with a mortgage note payable.

Stock was issued to stockholders in exchange for \$110,000 cash.

A \$44,000 loan was made to a local inventory supplier; the loan will be repaid in twelve months.

Equipment used in operations was sold for \$37,000.

Shares of Smith Corporation stock were acquired from stockholders for \$92,000 cash.

Cash received from bank loans totaled \$71,000.

Land costing \$57,000 was purchased in exchange for a long-term note payable.

Requirement:

Determine Smith's investing activities and financing activities cash flows to be reported on the cash flow statement.

120. Describe both the investing activities and financing activities section of the cash flow statement. Provide some examples of each activity.

## Chapter 02 Investing and Financing Decisions and the Balance Sheet **Answer Key**

### **True / False Questions**

1. The primary objective of financial reporting is to provide relevant information to external decision makers.

**TRUE**

The primary objective of external financial reporting is to provide useful economic information about a business to help external decision makers.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

2. In order for information to be reliable the information needs to be provided on a timely basis.

**FALSE**

Reliable information is accurate, unbiased, and verifiable.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

3. In order for information to be relevant the information should have both predictive and feedback value.

**TRUE**

Relevant information provides feedback and predictive value on a timely basis.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

4. The continuity assumption assumes that a business will continue to operate into the foreseeable future.

**TRUE**

The continuity assumption assumes that a business will continue operating long enough to meet its contractual commitments and plans. This is also called the going-concern assumption.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

5. The current assets section of a balance sheet includes both inventory and accounts receivable.

**TRUE**

Current assets are resources that a business will use or turn into cash within one year.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

6. The stockholders' equity section of a balance sheet includes contributed capital and retained earnings.

**TRUE**

The stockholders' equity section reports the financing provided by the owners and by its business operations.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

7. Assets are reported on the balance sheet in the order of their liquidity.

**TRUE**

Assets are reported in order of liquidity. The asset section of the balance sheet begins with cash.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

8. Many valuable assets such as trademarks and copyrights are not reported within a company's balance sheet.

**TRUE**

These intangible assets are not purchased but developed inside a company, thus they are not reported on the balance sheet.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

9. Stockholders' equity includes the financing provided by owners.

**TRUE**

The stockholders' equity section of the balance sheet includes financing provided by owners and net income retained from business operations.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

10. Financial reporting focuses on reporting the impact of transactions on an entity's financial position.

**TRUE**

Accounting focuses on certain events that have an economic impact on the entity. Those events that are recorded as part of the accounting process are called transactions.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-02 Identify what constitutes a business transaction and recognize common balance sheet account titles used in business.*

*Topic Area: What Business Activities Cause Changes in Financial Statement Amounts*

11. Unearned revenue is reported on the balance sheet as a liability and represents amounts paid to an entity for which the entity has an obligation to provide future services and/or goods.

**TRUE**

Accounts with unearned in the title are always liabilities representing amounts paid in the past to the company by others with the promise of future goods and/or services.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-02 Identify what constitutes a business transaction and recognize common balance sheet account titles used in business.*

*Topic Area: What Business Activities Cause Changes in Financial Statement Amounts*

12. A business transaction consists of an exchange of assets or services for assets, services, or promises to pay between a business and an external party to the business.

**TRUE**

A transaction is an exchange of assets or services for assets, services, or promises to pay between a business and one or more external parties to a business or a measurable internal event such as the use of assets in operations.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-02 Identify what constitutes a business transaction and recognize common balance sheet account titles used in business.*

*Topic Area: What Business Activities Cause Changes in Financial Statement Amounts*

13. The dual effects concept implies that every transaction has at least two effects on the accounting equation.

**TRUE**

Every accounting transaction has at least two effects on the accounting equation, this concept is known as dual effects.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

14. The accounting equation doesn't have to be in balance after the recording of each transaction.

**FALSE**

One of the underlying principles of an accounting transaction is that the accounting equation must be in balance after recording the transaction.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

15. A company's assets and stockholders' equity both increase when the company sells additional shares of stock in exchange for cash.

**TRUE**

Receiving cash increases assets, selling stock increases stockholders' equity. Both sides of the balance sheet equation are increased with this transaction.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

16. Purchasing stock of another company for cash doesn't result in an increase in total assets for the purchasing company.

**TRUE**

This transaction has zero effect on the total asset amount. Cash is decreased by the amount that the investment in the other company is increased.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

17. The normal balance for an asset account is a debit and the normal balance for a liability account is a credit.

**TRUE**

The normal balance refers to what is usual or what increases an account. Assets have debit balances and liabilities have credit balances.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

18. The recording of a journal entry precedes the posting to the general ledger.

**TRUE**

The accounting cycle during the period starts with analyzing a transaction, recording journal entries in the general journal, and finally posting the amounts to the general ledger.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

19. Asset accounts have a debit balance and are increased by debiting the account.

**TRUE**

The normal account balance for an asset is a debit balance; accounts are increased by their normal balance. Assets are increased with debits.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

20. Liability and stockholders' equity accounts have credit balances and are decreased by debiting the account.

**TRUE**

The normal balance for liabilities and stockholders' equity is a credit balance; this means that these accounts are decreased with a debit.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

21. A journal entry is an expression of the effects of a transaction on accounts which has equal debits and credits.

**TRUE**

A journal entry is an accounting method for expressing the effects of a transaction on separate accounts. The journal entry must have equal debit and credit amounts.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

22. The T-account is useful for summarizing account balances and is found in the general ledger.

**FALSE**

The T-account is used to summarize transaction effects for each account, determining balances, and drawing inferences about a company's activities.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

23. The T-account is very useful for accumulating the effects of transactions on account balances and for determining individual account balances.

**TRUE**

The T-account is a very useful tool for summarizing the transaction effects, determining the balances for individual accounts, and drawing inferences about a company's activities.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

24. Current assets include accounts receivable and prepaid expenses.

**TRUE**

Current assets are those to be used or turned into cash within the upcoming year.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

25. The current ratio is current assets divided by current liabilities.

**TRUE**

The current ratio shows an entity's ability to cover its short-term liabilities. It is equal to current assets divided by current liabilities.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

26. Current liabilities are defined as obligations to be paid within six months.

Bloom's Remember

**FALSE**

Current liabilities are those obligations to be paid within the next twelve months.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Difficulty: Easy*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

27. The current ratio measures the ability of a company to pay its short-term obligations with short-term assets.

**TRUE**

The current ratio is current assets divided by current liabilities. This measures a company's ability to pay its current liabilities with current assets.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

28. A company with a high current ratio should never have liquidity problems.

**FALSE**

A company with its current assets tied up in slow-moving inventory may have a high current ratio but still have liquidity problems.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

29. When a company borrows money from a bank, it leads to a cash inflow from an investing activity.

**FALSE**

Borrowing cash from a bank leads to a cash inflow from a financing activity.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

30. Issuing stock in exchange for cash creates a financing activity cash flow.

**TRUE**

Stock issuance is a financing activity. Issuing stock for cash results in a financing cash inflow.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

### **Multiple Choice Questions**

31. Which of the following statements about stockholders' equity is false?

- A. Stockholders' equity is the shareholders' residual interest in the company resulting from the difference in assets and liabilities.
- B. Stockholders' equity accounts are increased with credits.
- C.** Stockholders' equity results only from contributions of the owners.
- D. The purchase of land for cash has no effect on stockholders' equity.

Retained earnings from business operations are also a component of stockholders' equity.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

32. Assets, liabilities, and stockholders' equity are found within which of the following financial statements?

- A.** Balance sheet
- B. Income statement
- C. Statement of retained earnings
- D. Statement of cash flows

The balance sheet contains three parts 1) Assets 2) Liabilities and 3) Stockholders' Equity.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

33. An account payable would be reported within which of the following financial statements?

- A. Statement of cash flows
- B. Income statement
- C. Balance sheet**
- D. Statement of retained earnings

An account payable is a liability reported on the balance sheet.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

34. Which of the following assumptions implies that a business can continue to remain in operation into the foreseeable future?

- A. Historical cost principle
- B. Unit-of-measure assumption
- C. Continuity assumption**
- D. Separate-entity assumption

The continuity, also known as going-concern, assumption states that a business will continue operating long enough to meet its contractual commitments and plans.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

35. Which of the following best describes assets?

- A. Resources with possible future economic benefits owed by an entity as a result of past transactions.
- B.** Resources with probable future economic benefits owned by an entity as a result of past transactions.
- C. Resources with probable future economic benefits owned by an entity as a result of future transactions.
- D. Resources with possible future economic benefits owed by an entity as a result of future transactions.

Assets are economic resources with probably future benefits owned or controlled by an entity as a result of past transactions.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

36. Which of the following assumptions implies that the assets and liabilities of the business are accounted for separately from the assets and liabilities of the owners?

- A. Unit-of-measure assumption
- B. Continuity assumption
- C. Historical cost principle
- D.** Separate entity assumption

The separate entity assumption states that each business's activities must be accounted for separately from the activities of its owners, all other persons, and other entities.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

37. Which of the following best describes liabilities?

- A. Possible debts or obligations of an entity as a result of future transactions which will be paid with assets or services.
- B. Possible debts or obligations of an entity as a result of past transactions which will be paid with assets or services.
- C. Probable debts or obligations of an entity as a result of future transactions which will be paid with assets or services.
- D.** Probable debts or obligations of an entity as a result of past transactions which will be paid with assets or services.

Liabilities are probable debts or obligations that result from a company's past transactions and will be paid with assets or services.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

38. Which of the following is included within current assets on a balance sheet?

- A. Land used in daily operations.
- B. A truck used in daily operations.
- C.** Inventory which takes two years to manufacture.
- D. Intangible assets.

Inventory is always considered a current asset, regardless of how long it takes to produce and sell.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

39. Chad Jones is the sole owner and manager of Jones Glass Repair Shop. Jones purchased a truck for \$30,000 to be used in the business. Which of the following fundamentals requires Jones to record the truck at the price paid to buy it?

- A. Separate-entity assumption
- B. Revenue principle
- C. Unit-of-measure assumption
- D. Historical cost principle**

The historical cost principle requires assets to be recorded at cost equal to cash paid plus the dollar value of all noncash considerations received in the exchange.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

40. In what order are current assets listed on a balance sheet?

- A. By dollar amount (largest first).
- B. By date of acquisition (earliest first).
- C. By liquidity.**
- D. By relevance to the operation of the business.

Assets are listed on the balance sheet in order of liquidity with the most liquid assets listed first.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

41. In what order would the following assets be listed on a balance sheet?

- A.** Cash, Accounts Receivable, Inventory, Plant and Equipment.
- B. Cash, Intangible Assets, Accounts Receivable, Plant and Equipment.
- C. Cash, Accounts Receivable, Plant and Equipment, Inventory.
- D. Cash, Inventory, Intangible Assets, Accounts Receivable.

Assets are listed in order of liquidity. Cash is always first, and Plant and Equipment is listed as a non-current asset. Accounts Receivable is more liquid than Inventory.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

42. Where would changes in stockholders' equity resulting from operations be reported?

- A. Within a long-term asset account.
- B. Within the contributed capital account.
- C. Within a liability account.
- D.** Within the retained earnings account.

Stockholders' equity has two parts; financing from contributed capital and business operations. Retained earnings are the result of business operations, and therefore changes in stockholders' equity from operations are reported in retained earnings.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

43. Which of the following events will cause retained earnings to increase?

- A. Dividends declared by the Board of Directors.
- B.** Net income reported for the period.
- C. Net loss reported for the period.
- D. Issuance of stock in exchange for cash.

Beginning Retained Earnings + Net Income - Dividends = Ending Retained Earnings

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

44. Which of the following correctly describes retained earnings?

- A. It is the cumulative net income of a company.
- B. It represents the investments by stockholders in a company.
- C. It equals total assets minus total liabilities.
- D.** It is the cumulative net income of a company less dividend declarations.

Retained earnings are the cumulative profits not distributed to investors. That is the cumulative net income less dividend declarations.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

45. Which of the following statements is false?

- A. An item considered immaterial can be accounted for in the most cost-beneficial manner.
- B. An item is considered relevant if it has the ability to influence a decision.
- C. Information is considered to be reliable when it is accurate, unbiased, and verifiable.
- D. Conservatism suggests that assets and revenues should be overstated when possible.**

Conservatism suggests that care should be taken not to overstate assets and revenues or understate liabilities and expenses.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

46. Which of the following describes the primary objective of financial accounting?

- A. To provide useful economic information only to stockholders.
- B. To provide information about a business' future business strategies.
- C. To provide useful economic information about a business to help external parties make informed decisions.**
- D. To provide useful economic information about a business to help internal parties make informed decisions.

The primary objective of external financial reporting is to provide useful economic information about a business to help external parties, primarily investors and creditors, make sound financial decisions.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

47. Which of the following would not be considered a current asset?

- A. Inventory.
- B. Prepaid expenses.
- C.** Land used in daily operations.
- D. Accounts receivable.

Land is part of property, plant, and equipment and is listed as a part of long-term assets.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

48. Which of the following does not correctly describe a business transaction?

- A. They include exchanges of assets or services by one business for assets, services, or liabilities from another business.
- B. They include the using up of insurance paid for in advance.
- C. They have an economic impact on a business entity.
- D.** They do not include measurable internal events such as the use of assets in operations.

A business transaction includes measurable internal events such as the use of assets in operations.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-02 Identify what constitutes a business transaction and recognize common balance sheet account titles used in business.*

*Topic Area: What Business Activities Cause Changes in Financial Statement Amounts*

Chapter 02 - Investing and Financing Decisions and the Balance Sheet

49. Which of the following would not be currently reported as an expense on the income statement?

- A. Cost of goods sold
- B. Interest expense
- C. Prepaid insurance expense**
- D. Income tax expense

Expenses listed as prepaid are classified as assets.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-02 Identify what constitutes a business transaction and recognize common balance sheet account titles used in business.*

*Topic Area: What Business Activities Cause Changes in Financial Statement Amounts*

50. Which of the following liability accounts does not usually require a future cash payment?

- A. Accounts payable
- B. Unearned revenues**
- C. Taxes payable
- D. Notes payable

Unearned revenue relates to payments that have been received in the past for future goods or services.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-02 Identify what constitutes a business transaction and recognize common balance sheet account titles used in business.*

*Topic Area: What Business Activities Cause Changes in Financial Statement Amounts*

51. Which of the following transactions wouldn't be considered an external exchange?

- A. The purchase of inventory on credit from a supplier.
- B. Cash received from a credit customer.
- C. Cash paid for wages to employees.
- D. Using up insurance which was paid for in advance.**

Using up prepaid assets is an internal event.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-02 Identify what constitutes a business transaction and recognize common balance sheet account titles used in business.*

*Topic Area: What Business Activities Cause Changes in Financial Statement Amounts*

52. Which of the following reflects the impact of a transaction where \$200,000 cash was invested by stockholders in exchange for stock?

- A. Assets and liabilities each increased \$200,000.
- B. Assets and revenues each increased \$200,000.
- C. Stockholders' equity and revenues each increased \$200,000.
- D. Stockholders' equity and assets each increased \$200,000.**

Receiving \$200,000 cash in exchange for stock increases assets (cash) and stockholders' equity (issuing stock).

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

53. A corporation purchased factory equipment using cash. Which of the following statements regarding this purchase is false?

- A.** The current year's net income for will be reduced by the cost of the factory equipment.
- B. The total assets will not change.
- C. The total liabilities will not change.
- D. The current stockholders' equity will not change.

The purchase of equipment has no affect on the income statement.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

54. Which of the following direct effects on the accounting equation isn't possible as a result of a single business transaction which impacts only two accounts?

- A.** An increase in a liability and a decrease in an asset.
- B. An increase in stockholders' equity and an increase in an asset.
- C. An increase in an asset and a decrease in an asset.
- D. A decrease in stockholders' equity and a decrease in an asset.

With one transaction impacting only two accounts, the accounting equation would not be in balance if there was an increase in a liability and a decrease in an asset.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

55. Which of the following direct effects on the accounting equation isn't possible as a result of a single business transaction?

- A. An increase in an asset and a decrease in another asset.
- B. An increase in an asset and an increase in stockholders' equity.
- C. A decrease in stockholders' equity and an increase in an asset.**
- D. An increase in a liability and an increase in an asset.

A single transaction that results in a decrease in stockholders' equity and an increase in an asset is not possible because the accounting equation would not be in balance.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

56. A company's January 1, 2010 balance sheet reported total assets of \$150,000 and total liabilities of \$60,000. During January 2010, the company completed the following transactions: (A) paid a note payable using \$10,000 cash (no interest was paid); (B) collected a \$9,000 accounts receivable; (C) paid a \$5,000 accounts payable; and (D) purchased a truck for \$5,000 cash and by signing a \$20,000 note payable from a bank. The company's January 31, 2010 balance sheet would report which of the following?

	Assets	Liabilities	Stockholders' Equity
A.	\$150,000	\$60,000	\$90,000
B.	\$155,000	\$65,000	\$90,000
C.	\$160,000	\$75,000	\$85,000
D.	\$170,000	\$100,000	\$70,000

- A. Option A
- B. Option B**
- C. Option C
- D. Option D

$$\text{Assets} = \$155,000 = \$150,000 - \$10,000 - \$5,000 - \$5,000 + \$25,000$$

$$\text{Liabilities} = \$65,000 = \$60,000 - \$10,000 - \$5,000 + \$20,000$$

$$\text{Stockholders' equity} = \$90,000 = \text{Assets } (\$155,000) - \text{Liabilities } (\$65,000)$$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Hard*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

57. Which of the following happens when equipment is purchased using cash?

- A. Total assets decrease.
- B. Current assets don't change.
- C. Current assets increase.
- D. Stockholders' equity doesn't change.**

A purchase of equipment with cash decreases current assets and increases equipment; there is no change in stockholders' equity.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

58. Which of the following describes the impact of purchasing supplies for cash on the balance sheet?

- A. Current assets will decrease.
- B. Current assets will increase.
- C. Stockholders' equity will decrease.
- D. Total assets remain the same.**

Total assets are unchanged because cash is decreased by the same amount supplies are increased.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

59. Which of the following describes the impact of paying a current liability using cash on the balance sheet?

- A. Current assets will decrease.
- B. Current liabilities will increase.
- C. Stockholders' equity will decrease.
- D. Total assets will remain the same.

Paying a current liability with cash decreases the cash account thus decreasing current assets.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

60. Which of the following describes the impact on the balance sheet when cash is received from the collection of an account receivable?

- A. Current assets will not change.
- B. Current assets will increase.
- C. Stockholders' equity will increase.
- D. Total assets will increase.

Current assets do not change because cash is increased by the same amount the accounts receivable decreases. Both cash and accounts receivable are current assets.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

61. A corporation has \$80,000 in total assets, \$36,000 in total liabilities, and a \$12,000 credit balance in retained earnings. What is the balance in the contributed capital account?

- A. \$56,000
- B. \$44,000
- C. \$48,000
- D. \$32,000**

Stockholders' equity (\$44,000) = Assets (\$80,000) - Liabilities (\$36,000)

Stockholders' equity (\$44,000) = Contributed capital (\$32,000) + Retained earnings (\$12,000)

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

62. The duality (or duality of effects) concept states that

- A. both the income statement and balance sheet are impacted by every transaction.
- B. every transaction has an impact on assets and stockholders' equity.
- C. there are two entities involved in every transaction.
- D. every transaction has at least two effects on the accounting equation.**

Every accounting transaction has at least two effects on the accounting equation, this concept is known as dual effects.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

63. Which of the following is not considered to be a recordable transaction?

- A.** Signing a contract to have an outside cleaning service clean offices nightly.
- B. Paying employees their wages.
- C. Selling stock to investors.
- D. Buying equipment and agreeing to pay a note payable and interest at the end of a year.

Signing a contract involving the exchange of two promises to perform does not result in an accounting transaction that is recorded.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

64. Which of the following transactions will cause both the left and right side of the accounting equation to decrease?

- A. Collecting cash from a customer who owed us money.
- B.** Paying a supplier for inventory we previously purchased on account.
- C. Borrowing money from a bank.
- D. Purchasing equipment using cash.

Paying a supplier for inventory purchased on account reduces assets and reduces accounts payable.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

65. When a company buys equipment for \$150,000 and pays for one third in cash and the other two thirds is financed by a note payable, which of the following are the effects on the accounting equation?

- A. Total assets decrease \$50,000.
- B. Total liabilities increase \$150,000.
- C. Total liabilities decrease \$50,000.
- D.** Total assets increase \$100,000.

Equipment increases \$150,000 and cash decreases \$50,000 for a net asset increase of \$100,000.

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

66. Which of the following describes the impact on the balance sheet when a company uses cash to purchase the stock of another company?

- A. Total assets increase.
- B. Stockholders' equity increases.
- C. Stockholders' equity decreases.
- D.** Total assets remain the same.

Cash decreases by the same amount the investment in the other company increases.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

67. Which of the following statements is incorrect?

- A. Stockholders' equity accounts normally have credit balances.
- B.** Liability accounts are decreased by credits.
- C. Stockholders' equity accounts are increased by credits.
- D. Asset accounts are increased by debits.

Liability accounts are increased by credits.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

68. Selling stock to investors for cash would result in which of the following?

- A. A debit to contributed capital and a credit to cash.
- B. A credit to both cash and contributed capital.
- C.** A debit to cash and a credit to contributed capital.
- D. A debit to cash and a credit to retained earnings.

This transaction results in an increase in cash with a debit, contributed capital is a stockholders' equity account and increased with a credit.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

69. Borrowing cash from a bank would result in which of the following?

- A. A debit to cash and a credit to notes payable.
- B. A debit to notes payable and a credit to cash.
- C. A debit to both cash and notes payable.
- D. A debit to cash and a credit to contributed capital.

Cash is received and increased with a debit; the loan from the bank is recognized with a credit to notes payable.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

70. A company purchases a delivery van by paying \$5,000 cash and by signing a \$25,000 note payable. Which of the following correctly describes the recording of the delivery van purchase?

- A. The delivery van account is debited for \$25,000.
- B. Notes payable is debited for \$25,000.
- C. The delivery van account is debited for \$30,000.
- D. Cash is debited for \$5,000.

The cost of the asset is recorded at cash paid plus all noncash considerations. The delivery van account is debited for \$30,000. ( $\$5,000 + \$25,000 = \$30,000$ )

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

71. Cadet Company paid an accounts payable of \$1,000. This transaction should be recorded as follows on the payment date.

	Accounts payable	1,000	
<b>A.</b>	Cash		1,000
	Cash	1,000	
B.	Accounts Payable		1,000
	Notes Payable	1,000	
C.	Cash		1,000
	Cash	1,000	
D.	Cost of Goods Sold		1,000

Accounts Payable is reduced with a debit, and cash is reduced with a credit.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

72. Which of the following correctly describes the recording of a dividend declaration by a company's board of directors?

- A. A debit to retained earnings and a credit to cash.
- B. A debit to contributed capital and a credit to dividends payable.
- C. A debit to cash and a credit to retained earnings.
- D.** A debit to retained earnings and a credit to dividends payable.

Dividends are a reduction to retained earnings. A debit to retained earnings decreases this account, and declaring dividends is recorded with a credit to dividends payable.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

73. Which of the following statements is correct?

- A. Assets have a credit balance and are increased with debits.
- B. Assets have a debit balance and are increased with credits.
- C. Liability accounts have debit balances and are increased with debits.
- D. Stockholders' equity accounts normally have credit balances and are increased with credits.**

An accounts balance, or normal balance, is the same as how that account is increased. Stockholders' equity accounts have a normal credit balance and are increased with credits.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

74. Which of the following journal entries is correct when a business entity purchases land costing \$30,000 by signing a one-year note payable?

- |           |               |        |  |
|-----------|---------------|--------|--|
|           | Cash          | 30,000 |  |
| A.        | Notes Payable | 30,000 |  |
|           | Land          | 30,000 |  |
| B.        | Cash          | 30,000 |  |
|           | Land          | 30,000 |  |
| <b>C.</b> | Notes Payable | 30,000 |  |
|           | Notes Payable | 30,000 |  |
| D.        | Land          | 30,000 |  |

The transaction results in the company receiving an asset, land, and a liability, notes payable. This results in a debit to land to increase the land account, and a credit to notes payable to recognize and record the liability.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

75. Which of the following journal entries is correct when a business entity issues stock to stockholders in exchange for cash?

- A.     Cash  
       Retained Earnings
- B.**    Cash  
       Contributed Capital
- C.     Cash  
       Accounts Payable  
       Contributed Capital
- D.     Cash

Cash is received in the transaction; the cash account is increased with a debit. Stock is being issued in exchange for the cash so a credit to contributed capital is required.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

76. Which of the following journal entries is correct when a business entity purchases a building by paying cash and signing a note payable?

- A. 

Building	
Cash	
Notes Payable	
- B. 

Cash	
Notes Payable	
- C. 

Building	
Cash	
- D. 

Notes Payable	
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The company receives an asset, the building, and to record this asset a debit to the building account is required. To acquire the building the company gives up an asset, cash, and credits this account. To complete the transaction the company also took on a liability and needs to record this with a credit to notes payable.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

77. Which of the following journal entries is correct when a business entity builds an addition to the factory building by paying cash to a contractor?

- Retained Earnings
- A.    Cash  
      Building
  - B.    Contributed Capital  
      Cash
  - C.    Building  
      Building
  - D.**    Cash

The two accounts related to the transaction are Building and Cash. The Building account needs to be increased with a debit; cash is paid to the contractor and recorded with a credit to cash.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

78. Which of the following journal entries is correct when a business entity uses cash to pay an account payable?

- A.     Cash  
       Accounts Payable
- B.     Cash  
       Cash
- C.     Accounts Payable  
       Cash
- D.     Notes Payable

Both the accounts payable and cash accounts need to be decreased as a result of this transaction. This is done with a debit to accounts payable and a credit to cash.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

79. Which of the following transactions would result in an increase in the current ratio?

- A. Collection of cash from an account receivable.
- B. Selling shares of stock to stockholders in exchange for cash.**
- C. Purchasing a building by signing a long-term note payable.
- D. Declaration of a cash dividend by the board of directors.

The current ratio is current assets divided by current liabilities. Receiving cash increases current assets and increases the current ratio. Issuing stock does not impact current assets or current liabilities; stockholders' equity is increased.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Understand*

*Difficulty: Hard*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

80. Which of the following transactions would result in a decrease in the current ratio?

- A. Collection of cash from an account receivable.
- B. Selling shares of stock to stockholders in exchange for cash.
- C. Purchasing a delivery vehicle by signing a long-term note payable.
- D.** Declaration of a cash dividend by the board of directors.

The current ratio is current assets divided by current liabilities. A cash dividend reduces current assets, and decreases the current ratio.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

81. Which of the following account balances would not be included in the calculation of the current ratio?

- A. Accounts receivable
- B. Short-term notes payable
- C.** Contributed capital
- D. Inventory

The current ratio is current assets divided by current liabilities. Contributed capital is a component of stockholders' equity.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

82. Which of the following statements does not properly describe the current ratio?

- A. It measures the ability of a firm to pay its debts in the short-run.
- B. It is current assets divided by current liabilities.
- C. It is a measure of a firm's short-run liquidity.
- D.** It measures a firm's ability to pay its long-term debts as they mature.

The current ratio is a measure of short term liquidity. It does not measure a firm's ability to pay its long-term debt.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

83. The Pioneer Company has provided the following account balances:

Cash \$38,000;  
Short-term investments \$4,000;  
Accounts receivable \$6,000;  
Inventory \$48,000;  
Long-term notes receivable \$2,000;  
Equipment \$96,000;  
Factory Building \$180,000;  
Intangible assets \$6,000;  
Accounts payable \$30,000;  
Accrued liabilities payable \$4,000;  
Short-term notes payable \$14,000;  
Long-term notes payable \$92,000;  
Contributed capital \$180,000;  
Retained earnings \$60,000.

What is Pioneer's current ratio?

- A.** 2.00
- B. 2.17
- C. 2.71
- D. 1.00

Current assets = \$96,000 = \$38,000 + \$4,000 + \$6,000 + \$48,000

Current liabilities = \$48,000 = \$30,000 + \$4,000 + \$14,000

Current ratio = 2 = \$96,000 ÷ \$48,000

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Apply*

*Difficulty: Hard*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

84. The Pioneer Company has provided the following account balances:

Cash \$38,000;  
Short-term investments \$4,000;  
Accounts receivable \$6,000;  
Inventory \$48,000;  
Long-term notes receivable \$2,000;  
Equipment \$96,000;  
Factory Building \$180,000;  
Intangible assets \$6,000;  
Accounts payable \$30,000;  
Accrued liabilities payable \$4,000;  
Short-term notes payable \$14,000;  
Long-term notes payable \$92,000;  
Contributed capital \$180,000;  
Retained earnings \$60,000.

What are Pioneer's total current assets?

- A. \$48,000
- B. \$96,000**
- C. \$50,000
- D. \$42,000

$$\text{Current assets} = \$96,000 = \$38,000 + \$4,000 + \$6,000 + \$48,000$$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

85. The Pioneer Company has provided the following account balances:

Cash \$38,000;  
Short-term investments \$4,000;  
Accounts receivable \$6,000;  
Inventory \$48,000;  
Long-term notes receivable \$2,000;  
Equipment \$96,000;  
Factory Building \$180,000;  
Intangible assets \$6,000;  
Accounts payable \$30,000;  
Accrued liabilities payable \$4,000;  
Short-term notes payable \$14,000;  
Long-term notes payable \$92,000;  
Contributed capital \$180,000;  
Retained earnings \$60,000.

What are Pioneer's total current liabilities?

- A. \$44,000
- B. \$34,000
- C. \$48,000
- D. \$140,000

$$\text{Current liabilities} = \$48,000 = \$30,000 + \$4,000 + \$14,000$$

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

86. At the beginning of April, Warren Corporation's assets totaled \$240,000 and liabilities totaled \$60,000. During April the following summarized transactions occurred:

Additional shares of stock were sold for \$20,000 cash.

A building costing \$95,000 was purchased using \$10,000 cash and by signing an \$85,000 long-term note payable.

Short-term investments costing \$9,000 were purchased using cash.

\$10,000 was lent to an employee; the employee signed a six-month note in exchange for the loan.

How much are Warren's total assets at the end of April?

A. \$335,000

B. \$249,000

**C. \$345,000**

D. \$250,000

Total assets = \$345,000 = \$240,000 + \$20,000 + \$95,000 - \$10,000 (building payment)

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Hard*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

87. At the beginning of April, Warren Corporation's assets totaled \$240,000 and liabilities totaled \$60,000. During April the following summarized transactions occurred:

Additional shares of stock were sold for \$20,000 cash.

A building costing \$95,000 was purchased using \$10,000 cash and by signing an \$85,000 long-term note payable.

Short-term investments costing \$9,000 were purchased using cash.

\$10,000 was lent to an employee; the employee signed a six-month note in exchange for the loan.

How much are Warren's total liabilities at the end of April?

- A. \$145,000
- B. \$155,000
- C. \$165,000
- D. \$135,000

Total liabilities = \$145,000 = \$60,000 + \$85,000

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Hard*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

88. Tiger Company's stockholders' equity at the beginning of the year was \$175,000. During the year Tiger reported the following:

Net income of \$79,000.

Dividend declarations totaling \$17,000.

Issued stock to stockholders in exchange for \$42,000 cash.

Stockholders sold some of their stock to other stockholders for \$11,000 cash.

What is Tiger's stockholders' equity at the end of the year?

A. \$296,000

**B.** \$279,000

C. \$290,000

D. \$273,000

Stockholders' equity = \$279,000 = \$175,000 + \$79,000 - \$17,000 + \$42,000

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Hard*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

89. Which of the following transactions will not change a company's total stockholders' equity?

A. Reporting of net income.

B. Issuing stock to stockholders in exchange for cash.

C. The declaration of a cash dividend.

**D.** The payment of a previously declared cash dividend.

The payment of a previously declared cash dividend reduces cash, and reduces or eliminates the dividend payable account.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

90. Which of the following transactions would create a cash inflow from a financing activity?

- A.** Issuing shares of stock to stockholders in exchange for cash.
- B. Selling a short-term stock investment in exchange for cash.
- C. Selling used equipment which was a part of property, plant, and equipment.
- D. The payment of an account payable.

Financing cash flow activities include borrowing and repaying debt, issuing and repurchasing stock, and paying dividends.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

91. Which of the following best describe financing activities?

- A.** They primarily deal with securing money by bank loans or selling stock to investors.
- B. They primarily are connected to the income producing activities of the company as reported on the income statement.
- C. They primarily deal with buying and building facilities used over many years by the business.
- D. They primarily deal with selling facilities once used by the business.

Financing cash flow activities include borrowing and repaying debt, issuing and repurchasing stock, and paying dividends.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

92. Which of the following would cause a cash outflow from investing activities?

- A.** Purchasing shares of stock of another company.
- B. Paying a cash dividend to stockholders.
- C. Issuing additional shares a company's stock.
- D. Using cash to purchase inventory.

Investing cash flow activities include buying and selling noncurrent assets and investments.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

93. Which of the following would result when a company borrows cash and signs a note payable due in two years?

- A. A noncurrent liability and an investing cash flow are created.
- B.** A noncurrent liability and a financing cash flow are created.
- C. A current liability and an investing cash flow are created.
- D. A current liability and a financing cash flow are created.

The note is noncurrent because it is due in two years. The cash flow is created from borrowing money, and categorized as a financing cash flow.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

94. Which of the following would result when a company sells additional shares of stock for cash?

- A. A noncurrent liability and a financing cash flow are created.
- B.** Contributed capital increases and a financing cash flow results.
- C. A noncurrent liability and an investing cash flow are created.
- D. Contributed capital increases and an investing cash flow results.

Selling additional shares of stock increases contributed capital. Financing cash flow activities include issuing stock.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

95. Which of the following would result when a company purchases a factory building using cash?

- A.** A noncurrent asset and an investing cash flow are created.
- B. A noncurrent asset and a financing cash flow are created.
- C. A current asset and an investing cash flow are created.
- D. A current asset and a financing cash flow are created.

Buildings are classified as noncurrent assets. Investing cash flows are created with the purchase or sale of noncurrent assets.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

96. Which of the following would result when a company lends cash to a franchisee in exchange for a ten-month note receivable?

- A. A noncurrent asset and an investing cash flow are created.
- B. A noncurrent asset and a financing cash flow are created.
- C. A current asset and a financing cash flow are created.
- D. A current asset and an investing cash flow are created.**

A ten-month note receivable is classified as a current asset. Investing cash flows include lending cash to others.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

97. Which of the following would result when a company pays a previously declared cash dividend?

- A. Current liabilities are reduced and a financing cash flow is created.**
- B. Stockholders' equity is reduced and a financing cash flow is created.
- C. Current assets are reduced and an investing cash flow is created.
- D. Stockholders' equity is reduced and an investing cash flow is created.

Declaring a dividend creates a dividend payable. Paying the dividend reduces this current liability account. Paying dividends are classified as financing cash flows.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

98. Which of the following would be classified as financing cash flows on a cash flow statement?

1. Paying cash dividends.
2. Lending cash to others.
3. Issuing stock for cash.
4. Purchasing long-term assets for cash.
5. Repurchasing stock with cash.

A. 1, 2, 5

B. 2, 3, 4

**C.** 1, 3, 5

D. 2, 4, 5

Financing cash flow activities include issuing and repurchasing stock and paying dividends.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

99. Which of the following would be classified as investing cash flows on a cash flow statement?

1. Acquired a building by signing a long-term mortgage payable.
  2. Lending cash to others.
  3. Issuing stock for cash.
  4. Purchasing long-term assets for cash.
  5. Selling stock investments for cash.
- A. 1, 4, 5  
B. 1, 2, 4  
C. 1, 3, 5  
**D. 2, 4, 5**

Investing cash flows include lending cash to others, purchasing and selling noncurrent assets and investments.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

100. Which of the following statements is false?

- A. Investing cash flows include the cash flows associated with lending money to others.
- B. Financing cash flows include the cash flows associated with issuing and repurchasing stock.
- C. Financing cash flows include the cash flows associated with borrowing and repaying debt excluding short-term bank loans.**
- D. Investing cash flows include the cash flows associated with buying and selling noncurrent assets.

Financing cash flow activities include short-term bank loans.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

**Essay Questions**

101. Why is the continuity assumption so important for balance sheet reporting?

Answers will vary

Feedback: The continuity assumption is also known as the going-concern assumption. It is important for balance sheet reporting because of valuation issues. If a business is expected to operate into the foreseeable future, amounts presented on the balance sheet for assets and liabilities are based on the historical cost principle. If the continuity assumption is not followed, assets and liabilities might be reported at liquidation values as if they are going out of business.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

102. Why is the separate-entity assumption so important for balance sheet reporting?

Answers will vary

Feedback: The separate-entity assumption is important for balance sheet reporting because a business should present only its own assets and liabilities on the balance sheet. A business is a separate accounting entity from its owners. Therefore, the owners' assets and liabilities would appear on their own (personal) financial statement.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

103. Why is the historical cost principle so important for balance sheet reporting?

Answers will vary

Feedback: The historical cost principle is important for balance sheet reporting because of valuation issues. The cash-equivalent cost is verifiable. If it were not for the historical cost principle, assets and liabilities could be reported at more subjective values. This could lead to manipulation of balance sheet amounts.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

104. Complete the following schedule for Red Eye Company.

Transaction	Assets	Liabilities	Stockholders' Equity
Beginning balances	\$200,000	\$80,000	\$120,000
Borrowed \$20,000 cash by signing a note payable with a bank.			
Collected accounts receivable for cash, \$7,000.			
Paid accounts payable, \$8,000 cash.			
Purchased office supplies on credit, \$2,000.			
Sold stock to new investors for \$20,000 cash.			
Paid income taxes payable of \$12,000.			
Ending balances			

Chapter 02 - Investing and Financing Decisions and the Balance Sheet

Answers will vary

Feedback:

<b>Transaction</b>	<b>Assets</b>	<b>Liabilities</b>	<b>Stockholders' Equity</b>
<b>Beginning balances</b>	<b>\$200,000</b>	<b>\$80,000</b>	<b>\$120,000</b>
<b>Borrowed \$20,000 by signing a note payable.</b>	<b>+20,000</b>	<b>+20,000</b>	
<b>Collected accounts receivable for cash, \$7,000.</b>	<b>+7,000 -7,000</b>		
<b>Paid accounts payable, \$8,000 cash.</b>	<b>-8,000</b>	<b>-8,000</b>	
<b>Purchased office supplies on credit, \$2,000.</b>	<b>+2,000</b>	<b>+2,000</b>	
<b>Sold stock to new investors for \$20,000 of cash.</b>	<b>+20,000</b>		<b>+20,000</b>
<b>Paid income taxes payable of \$12,000.</b>	<b>-12,000</b>	<b>-12,000</b>	
<b>Ending balances</b>	<b>222,000</b>	<b>\$82,000</b>	<b>\$140,000</b>

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.*

*Topic Area: How Do Transactions Affect Accounts*

**Matching Questions**

Chapter 02 - Investing and Financing Decisions and the Balance Sheet

105. For each of the following accounts, indicate whether the account is an asset (A), liability (L), or stockholders' equity (SE) and whether the account usually has a debit (Dr) or credit (Cr) balance.

1. Inventory	SE, Cr	<u>7</u>
2. Accounts receivable	A, Dr	<u>1</u>
3. Contributed Capital	SE, Cr	<u>3</u>
4. Prepaid expenses	L, Cr	<u>8</u>
5. Wages payable	A, Dr	<u>2</u>
6. Property and equipment	A, Dr	<u>6</u>
7. Retained Earnings	L, Cr	<u>5</u>
8. Accounts payable	A, Dr	<u>4</u>

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

106. For each of the accounts listed below, indicate whether the typical or normal balance is a debit or credit.

1. Unearned revenue	Debit	<u>9</u>
2. Accounts receivable	Credit	<u>5</u>
3. Retained earnings	Credit	<u>3</u>
4. Prepaid insurance	Debit	<u>10</u>
5. Notes payable	Debit	<u>4</u>
6. Contributed capital	Debit	<u>2</u>
7. Accounts payable	Debit	<u>8</u>
8. Land	Credit	<u>6</u>
9. Inventory	Credit	<u>7</u>
10. Equipment	Credit	<u>1</u>

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

**Essay Questions**

107. The ABC Corporation was formed on January 1, 2010. The three initial owners invested \$100,000 cash and received shares of stock. Below are selected transactions that were completed during January, 2010.

1. Sold stock to the owners.
2. Borrowed \$80,000 on a one-year note payable.
3. Purchased land by signing a \$70,000 note payable.
4. Paid \$10,000 of accounts payable.
5. Purchased two service vehicles for cash at a cost of \$24,000 each.
6. Purchased \$2,000 of supplies on credit.

Prepare the journal entry on ABC's books for each transaction.

Chapter 02 - Investing and Financing Decisions and the Balance Sheet

Answers will vary

Feedback:

1.	Cash (\$100,000 × 3) Contributed capital Investment by owners.	300,000	300,000
2.	Cash Note payable Borrowed \$80,000 on a one-year note.	80,000	80,000
3.	Land Note payable	70,000	70,000
	Purchased land by signing a \$70,000 note payable.		
4.	Accounts payable Cash Paid \$10,000 of accounts payable.	10,000	10,000
5.	Equipment Cash	48,000	48,000
	Purchased two service vehicles for \$24,000 each.		
6.	Supplies Accounts Payable	2,000	2,000
	Purchased \$2,000 of supplies on credit.		

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.

Topic Area: How Do Companies Keep Track of Account Balances

108. The accounts with identification letters for Ward Company are listed below.

Letter	Account Title
A	Cash
B	Accounts receivable
C	Office supplies inventory
D	Equipment
E	Land
F	Accounts payable
G	Notes payable
H	Contributed capital
I	Retained earnings

During 2010, the company completed the transactions given below. You are to indicate the appropriate journal entry for each transaction by giving the account letter and amount. Some entries may need three letters. The first transaction is given as an example.

Transaction		Debit		Credit	
		Letter	Amount	Letter	Amount
A.	Borrowed \$50,000 and signed a note.	A	\$50,000	G	\$50,000
B.	Purchased equipment for \$50,000. Paid \$10,000 cash, signed \$40,000 note payable.				
C.	Collected \$15,000 of accounts receivable.				
D.	Paid \$12,000 of accounts payable.				
E.	Issued capital stock in exchange for \$60,000 cash.				
F.	Purchased \$5,000 office supplies on credit.				
G.	Paid for the office supplies in (F).				

Chapter 02 - Investing and Financing Decisions and the Balance Sheet

Answers will vary

Feedback:

Transaction		Debit		Credit	
		Letter	Amount	Letter	Amount
A.	Borrowed \$50,000 and signed a note.	A	\$50,000	G	\$50,000
B.	Purchased equipment for \$50,000. Paid \$10,000 cash, signed \$40,000 note payable.	D	50,000	A G	10,000 40,000
C.	Collected \$15,000 accounts receivable.	A	15,000	B	15,000
D.	Paid \$12,000 of accounts payable.	F	12,000	A	12,000
E.	Issued capital stock in exchange for \$60,000 cash.	A	60,000	H	60,000
F.	Purchased \$5,000 office supplies (an asset) on credit.	C	5,000	F	5,000
G.	Paid for the office supplies in (F).	F	5,000	A	5,000

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Bloom's: Apply

Difficulty: Medium

Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.

Topic Area: How Do Companies Keep Track of Account Balances

109. Describe the general journal and the general ledger.

Answers will vary

Feedback: Transactions are first recorded in the general journal; the general journal is known as the book of original entry and is a description of all transactions entered into. Transactions are entered chronologically in a debit-credit format. After transactions are journalized, the amounts are posted to the general ledger (the book of final entry). The general ledger contains accounts for each financial statement element so that balances can be determined.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

110. On January 1, 2011, Dr. Beth Hill started a new professional corporation, Beth Hill, P.C., to practice medicine with an initial investment of \$100,000. On June 30, 2011, the accounting records showed the following amounts:

Accounts Payable	\$2,000
Accounts Receivable	\$6,200
Cash	\$48,100
Contributed Capital	\$100,000
Office Equipment	\$60,000
Office Supplies	\$3,500
Retained Earnings	\$5,800
Notes Payable	\$10,000

Requirement:

Prepare a balance sheet as of June 30, 2011.

Answers will vary

Feedback:

Beth Hill, P.C.  
Balance Sheet  
As of June 30, 2011

Assets:		
Cash		\$ 48,100
Accounts receivable		6,200
Office supplies		3,500
Office equipment		60,000
Total assets		\$117,800
Liabilities:		
Accounts payable	\$ 2,000	
Notes payable	10,000	
Total liabilities		\$ 12,000
Stockholders' equity		
Contributed capital	\$100,000	
Retained earnings	5,800	
Total Stockholders' equity		\$105,800
Total Liabilities and Stockholders' equity		\$117,800

## Chapter 02 - Investing and Financing Decisions and the Balance Sheet

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

111. For each of the transactions listed below, indicate whether it is an investing (I) or financing (F) activity on the statement of cash flows. Also, indicate if the transaction increases (+) or decreases (-) cash.

Transaction		Type of Activity	Effect on Cash
Ex.	Paid dividends to the owners	F	-
A.	Purchased equipment to use in the business.		
B.	Issued stock for cash.		
C.	Borrowed money at the bank.		
D.	Sold a piece of land adjacent to the plant.		
E.	Paid the principal balance of a note payable.		

Chapter 02 - Investing and Financing Decisions and the Balance Sheet

Answers will vary

Feedback:

Transaction	Type of Activity	Effect on Cash
A. Purchased equipment to use in the business.	I	-
B. Issued stock for cash.	F	+
C. Borrowed money at the bank.	F	+
D. Sold a piece of land adjacent to the plant.	I	+
E. Paid the principal balance of a note payable.	F	-

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Remember*

*Difficulty: Medium*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

**Matching Questions**

112. The Alex Company, a consulting firm, recorded the following selected business transactions during May, 2011. Indicate whether each transaction would increase, decrease, or have no effect on the total assets of the company.

1. Issued capital stock in exchange for cash contributed by owners	Increase	<u>1</u>
2. Paid cash on accounts payable to a supplier.	No effect	<u>8</u>
3. Loaned money to an employee	Increase	<u>7</u>
4. Borrowed money from the bank on a promissory note payable	Decrease	<u>2</u>
5. Collected cash on accounts receivable	No effect	<u>5</u>
6. Purchased a building by using cash and signing a mortgage payable	Increase	<u>4</u>
7. Purchased office supplies on credit	No effect	<u>3</u>
8. Purchased office supplies for cash	Increase	<u>6</u>

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-03 Apply transaction analysis to simple business transactions in terms of the accounting model: Assets = Liabilities + Stockholders' Equity.

Topic Area: How Do Transactions Affect Accounts

113. Classify the following balance sheet accounts by as current assets, noncurrent assets, current liabilities, noncurrent liabilities or stockholders' equity

1. Notes payable due in 3 months	Noncurrent assets	<u>7</u>
2. Income taxes payable	Stockholders' equity	<u>9</u>
3. Prepaid expenses	Current Liabilities	<u>1</u>
4. Accounts receivable	Noncurrent assets	<u>6</u>
5. Supplies inventory	Current assets	<u>3</u>
6. Land	Current assets	<u>5</u>
7. Building	Stockholders' equity	<u>10</u>
8. Notes payable due in 5 years	Noncurrent liabilities	<u>8</u>
9. Retained earnings	Current liabilities	<u>2</u>
10. Contributed capital	Current assets	<u>4</u>

AACSB: Reflective Thinking

AICPA BB: Critical Thinking

AICPA FN: Reporting

Bloom's: Understand

Difficulty: Medium

Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.

Topic Area: How is the Balance Sheet Prepared and Analyzed

**Essay Questions**

114. The following journal entries with the amounts omitted were taken from the records of Lena Company:

1. Cash  
    Contributed Capital
2. Inventory  
    Accounts Payable
3. Accounts payable  
    Cash
4. Buildings  
    Cash  
    Mortgage Payable
5. Retained Earnings  
    Dividends Payable
6. Cash  
    Notes Payable

Requirement:

Write a brief explanation for each of the above transactions.

Answers will vary

Feedback:

1. Stockholders invested cash into the corporation in exchange for cash.
2. Inventory was purchased from a supplier on account.
3. Cash was used to pay an account payable.
4. Buildings were purchased using cash and by signing a mortgage note payable.
5. The board of directors declared a cash dividend.
6. Cash was borrowed in exchange for signing a note payable.

## Chapter 02 - Investing and Financing Decisions and the Balance Sheet

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-04 Determine the impact of business transactions on the balance sheet using two basic tools; journal entries and T-accounts.*

*Topic Area: How Do Companies Keep Track of Account Balances*

115. What is the primary objective of financial reporting?

Answers will vary

**Feedback:** The primary objective of financial reporting is to provide useful economic information about a business entity to external decision makers to help them make informed financial decisions.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Easy*

*Learning Objective: 02-01 Define the objective of financial reporting; the elements of the balance sheet; and the related key accounting assumptions and principles.*

*Topic Area: Overview of Accounting Concepts*

116. How is the current ratio calculated and what does it measure?

Answers will vary

**Feedback:** The current ratio is current assets divided by current liabilities, it measures a business entity's short-run liquidity which is the ability of a business entity to pay its short-term obligations using current assets.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

117. The Lake Company has provided the following account balances:

Cash \$76,000;  
Short-term investments \$8,000;  
Accounts receivable \$12,000;  
Inventory \$96,000;  
Long-term notes receivable \$4,000;  
Equipment \$192,000;  
Factory Building \$360,000;  
Intangible assets \$12,000;  
Accounts payable \$90,000;  
Accrued liabilities payable \$12,000;  
Short-term notes payable \$42,000;  
Long-term notes payable \$184,000.

Requirement:

What is Lake's current ratio?

Answers will vary

Feedback: Current assets = \$192,000 = \$76,000 + \$8,000 + \$12,000 + \$96,000

Current liabilities = \$144,000 = \$90,000 + \$12,000 + \$42,000

Current ratio = 1.33 = \$192,000 ÷ \$144,000

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

118. The Superior Company has provided the following account balances:

Cash \$152,000;  
Short-term investments \$18,000;  
Accounts receivable \$36,000;  
Inventory \$116,000;  
Long-term notes receivable \$44,000;  
Equipment \$174,000;  
Factory Building \$270,000;  
Intangible assets \$33,000;  
Accounts payable \$130,000;  
Accrued liabilities payable \$19,000;  
Short-term notes payable \$84,000;  
Long-term notes payable \$169,000.

Requirement:

What is Superior's stockholders' equity?

Answers will vary

Feedback: Total assets = \$843,000 = \$152,000 + \$18,000 + \$36,000 + \$116,000 + \$44,000 + \$174,000 + \$270,000 + \$33,000  
Total liabilities = \$402,000 = \$130,000 + \$19,000 + \$84,000 + \$169,000  
Stockholders' equity = \$441,000 = \$843,000 - \$402,000

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-05 Prepare a simple classified balance sheet and analyze the company using the current ratio.*

*Topic Area: How is the Balance Sheet Prepared and Analyzed*

119. The Smith Corporation has provided the following information:

Cash dividend payments were \$25,000.

Long-term investments were sold for \$79,000 cash.

A building costing \$198,000 was purchased using \$19,800 cash, the balance was financed with a mortgage note payable.

Stock was issued to stockholders in exchange for \$110,000 cash.

A \$44,000 loan was made to a local inventory supplier; the loan will be repaid in twelve months.

Equipment used in operations was sold for \$37,000.

Shares of Smith Corporation stock were acquired from stockholders for \$92,000 cash.

Cash received from bank loans totaled \$71,000.

Land costing \$57,000 was purchased in exchange for a long-term note payable.

Requirement:

Determine Smith's investing activities and financing activities cash flows to be reported on the cash flow statement.

Answers will vary

Feedback: Investing activities cash flows = \$52,200 = \$79,000 - \$19,800 - \$44,000 + \$37,000

Financing activities cash flows = \$64,000 = -\$25,000 + \$110,000 - \$92,000 + \$71,000

*AACSB: Analytic*

*AICPA BB: Critical Thinking*

*AICPA FN: Measurement*

*Bloom's: Apply*

*Difficulty: Medium*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*

Chapter 02 - Investing and Financing Decisions and the Balance Sheet

120. Describe both the investing activities and financing activities section of the cash flow statement. Provide some examples of each activity.

Answers will vary

Feedback: The investing activities section of the cash flow statement reports on cash flows associated with buying and selling noncurrent assets and investments. Specific examples include buying and selling plant and equipment for cash, purchasing and selling long-term investments for cash, lending cash to others, and receiving principal payments from loans made.

The financing activities section of the cash flow statement reports on cash flows associated with borrowing and repaying debt, issuing and repurchasing stock, and by paying dividends. Specific examples include borrowing and repaying bank loans, issuing and repurchasing stock using cash, and paying cash dividends to stockholders.

*AACSB: Reflective Thinking*

*AICPA BB: Critical Thinking*

*AICPA FN: Reporting*

*Bloom's: Understand*

*Difficulty: Medium*

*Learning Objective: 02-06 Identify investing and financing transactions and demonstrate how they are reported on the statement of cash flows.*

*Topic Area: Focus on Cash Flows*