Chapter 2

Recording Business Transactions

Chapter Overview

The chapter introduces the account and the ledger, and then briefly describes specific asset, liability, and stockholders' equity accounts. The concept of double-entry bookkeeping and the rules of debit and credit for assets, liabilities, and stockholders' equity are described. The "T-account" is illustrated. The accounting equation is tied to the rules of debit and credit.

The journal is introduced and the process of recording transactions (journalizing) is illustrated. The three-step process, described for a manual system, is also completed in a computerized accounting system. The posting process is explained briefly. A series of entries are analyzed, journalized, and posted to T-accounts in the ledger. The normal balances of accounts are explained. The trial balance is defined and illustrated. A mid-chapter summary problem reviews how to journalize, post, and prepare a trial balance.

Details of journals, ledgers, and the posting process are presented, including an illustration of a 4-column ledger account with a running balance. A chart of accounts is illustrated, and the rules of debit and credit are expanded to include specific types of stockholders' equity accounts. An illustrative problem demonstrates the analyzing, journalizing, and posting of several revenue, expense, and dividend transactions, followed by the preparation of a trial balance. Some typical accounting errors revealed by a trial balance are described. Decision Guidelines are presented that assist the student in analyzing and recording transactions. The chapter concludes with a summary problem that reviews opening accounts, journalizing, posting, and preparing a trial balance.

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Chapter 2: Teaching Outline

1) Explain accounts, journals, and ledgers as they relate to recording transactions and describe common accounts

   a) Accounts

   b) Ledger

   c) Journal

   d) Trial Balance

   e) Assets

   f) Liabilities

   g) Stockholders' Equity

   h) Chart of Accounts

   i) Exhibit 2-1 The Ledger – Asset, Liability and Stockholders' Equity Accounts

   j) Exhibit 2-2 Chart of Accounts – Smart Touch Learning, Inc.

2) Define debits, credits, and normal account balances, and use double-entry accounting and T-accounts

   a) The T-Account

   b) Increases and Decreases in the Accounts

   c) Exhibit 2-3 The Accounting Equation and the Rules of Debit and Credit

   d) Exhibit 2-4 The Accounting Equation After the First Two Transactions of Smart Touch Learning Inc.

3) List the steps of the transaction recording process

   a) Posting (Copying Information) from the Journal to the Ledger

   b) Expanding the Rules of Debit and Credit: Revenues and Expenses

   c) The Normal Balance of an Account   d) Source Documents—The Origin of the Steps

   e) Exhibit 2-5 The Journal Page

   f) Exhibit 2-6 Making a Journal Entry and Posting to the Ledger in T-Account Form

g) Exhibit 2-7 The Accounting Equation Includes Revenues and Expenses

h) Exhibit 2-8 Complete Rules of Debit and Credit

i) Exhibit 2-9 Flow of Accounting Data from the Journal to the Ledger

4) Journalize and post sample transactions to the ledger

a) Practice Journalizing with Specific Examples

b) The Ledger Accounts After Posting

c) Exhibit 2-10 Smart Touch Learning's Ledger Accounts After Posting April's Transactions

5) Prepare the trial balance from the T-accounts

a) Correcting Trial Balance Errors b) Details of Journals and Ledgers

c) The Four-Column Account: An Alternative to the T-Account

d) Exhibit 2-11 Trial Balance

e) Exhibit 2-12 Details of Journalizing and Posting

f) Exhibit 2-13 Account in Four-Column Format

Chapter 2: Summary Handout for Students

1. Chart of accounts: a list of all the accounts with their account number
    - Assets, Liabilities, Stockholders' Equity
    - Revenues and Expenses
2. Record transactions in the journal using the rules of debit, credit, and double-entry accounting
    - Every transaction affects at least two accounts
    - Type of account determines whether it increases with a debit or a credit
        - Asset accounts increase with a debit
        - Liability accounts increase with a credit
        - Equity accounts increase with a credit
        - The normal balance of an account is on the side of an increase to the account
    - Journal entries should have:
        - Date of the transaction
        - Title of the account debited, along with the dollar amount
        - Indented title of the account credited, along with the dollar amount
        - Brief explanation of transaction
3. Post transactions from the journal to the ledger
    - See Exhibit 2-6 Making a Journal Entry and Posting to the Ledger in T-Account Form
4. Revenues and expenses affect equity
    - Revenues are increases (earned) in equity from providing goods or services to customers
    - Expenses are decreases (incurred) in equity through the operation of a business
        - Using up assets
        - Or increasing liabilities
5. The trial balance lists all the accounts in the ledger with their balances

- Total debits equal total credits

Lecture Outline Tips: Key Topics

An understanding of Chapter 2 is essential for student success in the remaining financial accounting chapters. Spend adequate time in the beginning with accounting terminology. Accounting is a “foreign” language to many students, and, as true with a real foreign language, you must start with the basics. Students seemingly understand assets and liabilities more easily, than equity. An asset can be touched, a liability can be confirmed by looking at an invoice, but equity is conceptual. Equity is the stockholders’ claims to the business assets; what’s left over after liabilities are subtracted from assets. It may be helpful to ask students to attempt to calculate their personal equity. Students may own a car or home that has an outstanding loan or mortgage.

Keep it simple when discussing T accounts and the rules of debit and credit. Debit means left and credit means right, period. A debit does not mean increase and a credit does not mean decrease. Increases and decreases depend on the account type. Emphasize that **every** entry must balance (debits = credits) and be correct for the accounting system to generate correct and useful information. An incorrect journal entry that is posted to the right accounts will still produce incorrect information.

An account can only have one balance. Debits and credits within the same account are subtracted to determine the account balance, just like positives and negatives from a mathematical standpoint. The normal balance is the side used to record increases in the account.

When discussing the posting process, inform students to be very careful when transferring amounts to the ledger. It is common for students at this point to reverse a posting, recording a debit as a credit, or vice versa. A debit is placed on the left side and a credit is placed on the right side. If the trial balance doesn’t balance, it is common for students to have reversed a posting.

Lastly, it may be helpful for students to view the accounting system from both ends. The natural process is to journalize, post, and prepare a trial balance. However, once the chapter content is discussed, you can also begin with the trial balance and have students trace back to the ledger and journal to find a specific transaction. They can also get experience doing this when correcting a trial balance that doesn’t balance.

Chapter 2 Assignment Grid

Learning Objective	**Short Exercises** ***Easy***	**Exercises** ***Moderate***	**Problems (Group A)** ***Difficult***	**Problems (Group B)** ***Difficult***
1	1	13, 14, 15	27	44
2	2, 3	15, 17, 18, 19, 20	27, 29, 35, 36	44, 52, 53
3	4	16, 17, 18, 20	28, 29, 30	45, 46
4	5, 6, 7, 8, 9	16, 17, 18, 19, 20, 21, 22, 23, 24	28, 29, 30, 31, 32, 33, 34	45, 46, 47, 48, 49, 50, 51
5	10, 11, 12	17, 18, 19, 20, 22, 24, 25, 26	29, 30, 31, 32, 33, 34, 35, 36, 37, 38, 39, 40, 41, 42, 43	46, 47, 48, 49, 50, 51, 52, 53, 54, 55, 56, 57, 58, 59, 60

Other End of Chapter Materials:

Continuing Exercise E2-61
Continuing Problem P2-62
Practice Set
Decision Case 2-1
Decision Case 2-2
Ethical Issue 2-1
Fraud Case 2-1
Financial Statement Case 2-1
Team Project 2-1
Communication Activity 2-1

End of Chapter Exercises and Problems available utilizing Accounting software:

QuickBooks 10	E2-17, P2-29A, P2-32A, P2-47B, E2-61, P2-62, Practice Set
Peachtree 10	None
Excel in Practice	E2-17, P2-29A, P2-32A, P2-47B
General Ledger	E2-16, E2-20, P2-28A, P2-30A, E2-61, P2-62, Practice Set

Sample Homework Questions in MyAccountingLab:

E2-14, E2-17, E2-18, E2-20, P2-31A, P2-32A

Pre-Test Questions in MyAccountingLab:

S2-3, S2-4, S2-9, E2-13

Post-Test Questions in MyAccountingLab:

P2-51B

Exercise and/or Problems used in PowerPoint slides:

S 2-1, S 2-2, S 2-5, S 2-9, SE2-10

Answer Key to Chapter 2 Quiz:

1. A
2. D
3. B
4. B
5. B
6. D
7. C
8. B
9. A
10. D

Name______________________________Date____________________Section____________

CHAPTER 2
TEN-MINUTE QUIZ

Circle the letter of the best response.

1. Which sequence correctly summarizes the accounting process?
   A. Journalize transactions, post to the accounts, prepare a trial balance
   B. Journalize transactions, prepare a trial balance, post to the accounts
   C. Post to the accounts, journalize transactions, prepare a trial balance
   D. Prepare a trial balance, journalize transactions, post to the accounts

2. The left side of an account is used to record which of the following?
   A. Debit or credit, depending on the type of account
   B. Increases
   C. Credits
   D. Debits

3. Suppose Hunt Corporation has Accounts receivables of $65,000, Furniture totaling $205,000, and Cash of $52,000. The business has a $109,000 Note payable and owes $81,000 on account. How much is Hunt's stockholders' equity?
   A. $28,000
   B. $132,000
   C. $190,000
   D. $322,000

4. Your business purchased supplies of $2,500 on account. The journal entry to record this transaction is as follows:

A.	Supplies	2,500	
	Accounts receivable		2,500
B.	Supplies	2,500	
	Accounts payable		2,500
C.	Accounts payable	2,500	
	Supplies		2,500
D.	Inventory	2,500	
	Accounts payable		2,500

5. Which journal entry records your payment for the supplies purchase described in Quick Check question 4?

A.

Accounts payable	2,500	
Cash		2,500

B.

Accounts payable	2,500	
Cash		2,500

C.

Cash	2,500	
Accounts payable		2,500

D.

Cash	2,500	
Accounts payable		2,500

6. Posting a $2,500 purchase of supplies on account appears as follows:

A.

Cash		Supplies	
	2,500	2,500	

B.

Supplies		Accounts payable	
	2,500	2,500	

C.

Supplies		Accounts receivable	
2,500			2,500

D.

Supplies		Accounts payable	
2,500			2,500

7. The detailed record of the changes in a particular asset, liability, or stockholders' equity is called

A. an account.
B. a journal.
C. a ledger.
D. a trial balance.

8. Pixel Copies, Inc. recorded a cash collection on account by debiting Cash and crediting Accounts payable. What will the trial balance show for this error?

A. Too much for cash
B. Too much for liabilities
C. Too much for expenses
D. The trial balance will not balance

9. Timothy McGreggor, Attorney, P.C., began the year with total assets of $129,000, liabilities of $77,000, and stockholders' equity of $52,000. During the year, the business earned revenue of $113,000 and paid expenses of $34,000. The business also paid cash dividends of $63,000. How much is the business's equity at year-end?

A. $68,000
B. $97,000
C. $131,000
D. $165,000

10. Michael Barry, Attorney, P.C. began the year with total assets of $126,000, liabilities of $74,000, and stockholders' equity of $52,000. During the year, the business earned revenue of $110,000 and paid expenses of $33,000. The business also paid cash dividends of $69,000. How would Michael Barry record expenses paid of $33,000?

A.	Cash	33,000	
	Expenses		33,000
B.	Accounts payable	33,000	
	Cash		33,000
C.	Expenses	33,000	
	Accounts payable		33,000
D.	Expenses	33,000	
	Cash		33,000

Chapter 1

Accounting and the Business Environment

Chapter Overview

The chapter begins with an introduction to accounting. The text discusses how accounting information is needed by various users—individuals, businesses, investors, creditors, government regulatory agencies, taxing authorities, and nonprofit organizations. Financial and management accounting are compared. The role of ethics and standards of professional conduct in accounting are presented. The proprietorship, partnership, corporations, and limited liability forms of business are briefly described. Characteristics of corporations are explained. Generally accepted accounting principles (GAAP) and international financial reporting standards (IFRS) are introduced and the entity concept, the reliability principle, the cost principle, the going-concern concept, and the stable-monetary-unity concept are explained.

The next section of the chapter introduces the accounting equation: Assets = Liabilities + Stockholders' Equity. Each element of the equation is defined. Examples of a variety of transactions are analyzed and their impact on the accounting equation, the income statement and the balance sheet is discussed. The financial statements—income statement, statement of retained earnings, balance sheet, and statement of cash flows are illustrated. The interrelationship of the financial statements is emphasized. Decision Guidelines help students answer basic questions about a business. An Excel problem allows students to practice concepts from the chapter on a spreadsheet. A summary problem allows students to record the effect of transactions on the accounting equation and prepare financial statements.

Chapter 1: Teaching Outline

1) Define accounting vocabulary
2) Define the users of financial information:
   a) Individuals
   b) Businesses
   c) Investors
   d) Creditors
   e) Taxing Authorities
   f) Exhibit 1-1 Financial Accounting and Management Accounting
3) Describe the accounting profession and the organizations that govern it
   a) Governing Organizations
   b) Ethics in Accounting and Business
   c) Standards of Professional Conduct
4) Identify the different types of business organizations
   a) Proprietorship
   b) Partnership
   c) Corporation
   d) Limited-Liability Partnerships/Companies
   e) Not-for-Profits
   f) Exhibit 1-2 Comparison of the Five Forms of Business Organization
5) Delineate the distinguishing characteristics and organization of a corporation
   a) Separate Legal Entity
   b) Continuous Life and Transferability of Ownership
   c) No Mutual Agency
   d) Limited Liability of Stockholders

    e) Separation of Ownership and Management

    f) Corporate Taxation

    g) Government Regulation

    h) Organization of a Corporation

    i) Exhibit 1-3 Structure of a Corporation

6) Apply accounting concepts and principles

    a) The Entity Concept

    b) The Faithful Representation Principle

    c) The Cost Principle

    d) The Going-Concern Concept

    e) The Stable Monetary Unit Concept

7) Describe the accounting equation, and define assets, liabilities, and equity

    a) Assets and Liabilities

    b) Exhibit 1-4 The Accounting Equation

    c) Equity

    d) Exhibit 1-5 Components of Retained earnings

8) Use the accounting equation to analyze transactions

    a) Transaction Analysis for Smart Touch Learning

9) Preparing the financial statements

    a) Exhibit 1-6 Analysis for Transactions, Smart Touch Learning, Inc.

    b) The Financial Statements

        i) Income Statement

        ii) Statement of Retained Earnings

        iii) Balance Sheet

        iv) Statement of Cash Flows

        v) Exhibit 1-7 Financial Statements of Smart Touch Learning, Inc.

10) Use financial statements to evaluate business performance

   a) Relationships Among the Financial Statements

Chapter 1: Student Summary Handout

1. Accounting equation: ASSETS = LIABILITIES + OWNERS' EQUITY
   - Assets are something owned that has value
   - Liabilities are something owed
   - Equity is everything owned minus everything owed, or net worth
2. Transaction analysis using the accounting equation
   - *Key*: Both sides of the accounting equation must always be equal
3. Four financial statements
   - Income statement
   - Statement of retained earnings
   - Balance sheet (uses the same accounts as the accounting equation)
   - Statement of cash flows (covered in detail in Chapter 14)
   - Headings on statements always listed as:
     - Name of company
     - Name of statement
     - Descriptive date
4. Decision Guidelines 1-1

Lecture Outline Tips: Key Topics

Not all accounting information and financial statements are publicly available; this is disclosed by public companies only. Company size is not a determinant of public ownership—some large companies are still privately held.

The stockholders of a company may be (and probably are) officers as well. Not all investors are “outside” of the company. The financial statements are the primary tool for providing information to outside investors, but officers also use the statements, along with other financial information, to manage the company on a day-to-day basis.

Financial accounting deals with historical information—the company reports on events that have already occurred. However, many companies also prepare budgets, forecasts, and projections for decision making that are based on future events, and forecasted financial statements can be prepared. How do you know what type of statement you are looking at? Read the heading! Statements dated as “ended” indicate historical information, and statements dated as “ending” indicate future information.

All companies, public and private, can follow GAAP. However, this may not be a requirement for private companies. These companies can use other bases of accounting, such as the cash basis, unless GAAP is required due to an audit. There is also a difference between record keeping and financial statement preparation. Companies can keep their accounting records on another basis and convert the financial statements to GAAP. For example, small private companies may use the cash basis for record keeping and convert to the accrual basis for financial statement preparation. Soon a convergence of GAAP and IFRS may come to be, as early as 2012 for some companies, leaving more room for professional judgment.

Not all accountants are licensed, and those that are may not necessarily be members of the AICPA and IMA, the professional associations described in the textbook. However, the licensing board (if a license has been granted) and/or federal and state laws can still be applied to hold people accountable for their actions.

The Sarbanes-Oxley Act and the PCAOB relate to public companies. As a rule, public companies are more regulated (related to accounting information) than private companies. Some companies are now going private and one reason for doing so may be to reduce the compliance cost associated with these additional regulations.

Corporate status is not based on the size of the company. Not all large companies are corporations and not all small companies are sole proprietorships and partnerships. A corporation could have only one stockholder. Why would a one-shareholder business incorporate the business in this case? One reason is limited liability protection. Regardless of the number of stockholders, all corporations follow the same general corporate procedures.

Information presented in the financial statements is largely based on historical cost—the historical cost principle. Beginning students may think the balance sheet total represents the value of the company, which is incorrect. The balance sheet total is based on historical cost and may not represent the fair market value of the company as of the statement date. For example, land purchased 10 years ago is likely to be worth more than the original cost, but it would still be reported on the balance sheet at original cost. These types of assets are sometimes called “hidden assets”; the true value is not reflected on the financial statement. How is the true value of a company determined? Have it appraised! Even after converting the account balances to fair market value, some students may think a company is worth the amount of its total assets. This is incorrect—don't forget about subtracting liabilities! The stockholders' equity total represents the true value of the company.

The accounting equation must always balance. Most textbook examples show companies that are profitable from the very beginning and always have positive equity balances. Although not illustrated in many textbooks, stockholders' equity can be negative if liabilities exceed assets, but the equation would still balance. For example, a company could have $100 of assets, $150 of liabilities, and $(50) of equity, and the equation would equal $100 on each side. This is not a good position to be in, but is not unusual in the business world. You could also have a transaction that affects only one side of the equation (left or right), but the equation would still balance. For example, a transaction could increase one asset and decrease another asset and the equation would balance with no effect on liabilities and equity. A company that purchases supplies with cash would experience this.

Students sometimes have trouble understanding the purchase of supplies on account, and how the usage of the supplies and the payment of the outstanding liability relate to each other. Students may want to decrease the outstanding liability as the asset is used up, which is incorrect. These are three separate events: (1) purchasing an asset, (2) using the asset, and (3) paying the outstanding liability.

It may be worthwhile to introduce the concept of materiality at this point: Is an item large or important enough to influence a person's perspective or decision about the company? In many cases, the accounting process and financial reporting is not "to the penny", although students may think this is the case. One example would be the accounting for supplies. Theoretically, supplies are an asset and should be recorded as such. The asset would turn into an expense as the supplies are used over time. However, in practice, some companies expense supplies immediately because the balance is immaterial to the overall financial statements. Another example of materiality is the fact that many financial statements are rounded for presentation purposes. Some large companies present statements in thousands or millions of dollars. It's interesting to provide examples of real company financial statements to students early in the semester and see their reaction to this type of rounding.

Net income and cash flow are separate concepts; both are not always positive. A company could have net income and negative cash flow, as well as a net loss and positive cash flow. Many creditors will focus on cash flow in order to determine if a company can generate cash in order to pay back any outstanding liabilities.

Dividends are not an expense to the company; they are a reduction in stockholders' equity. The company is simply distributing some of the earnings out of the company. The money used to pay the stockholders came from net income that was earned over time. However, dividends are different from being paid a salary as an employee/stockholder of an incorporated business. Salaries are an expense to the company. Therefore, an employee/stockholder of a corporation could receive a salary and receive dividends (the corporate form of withdrawals) from the corporation as well.

Each of the financial statements required by GAAP focuses on a different area. All four statements should be analyzed in order to get a complete picture of a company. The income statement tracks profitability. Remember that "profit" doesn't necessarily mean "money"—the profit may have not been collected in cash yet. The statement of retained earnings shows the changes in retained earnings (based on cost) over time. As profits increase, the stockholders' equity should increase as well. The balance sheet shows a company's financial position at a certain point in time. Notice this is for one day only—the balance sheet will probably change the day after it's prepared. Financial position (the balance sheet) is different from profitability (the income statement). A company could be very profitable and do a terrible job of managing its profits, or vice versa. Students probably know a person that is like this! Some people have high-income levels and end up with very little net worth because they can't manage their finances. On the other hand, some people have modest income levels and do a very good job of managing their finances. The cash flow statement shows how the company is generating and using its cash. Students may have heard the phrase "cash is king"; a company must have cash to pay its outstanding bills. Some recent accounting fraud cases involved companies that reported great profits, but no corresponding cash flow—a possible red flag!

The retained earnings balance doesn't represent the balance in the cash account. Students sometimes think the corporation can simply declare dividends from the balance in cash at any given time. However, this may not be the case. The income included in retained earnings is based on accrual accounting and may not yet have been collected in cash. In addition, some items that have been paid in cash may not be expensed yet and, therefore, are not included in income.

Every transaction affects the balance sheet—an asset, liability, or equity account is affected in any business transaction. A transaction may or may not affect the other financial statements.

Students should understand the proper ordering of financial statement preparation. They will quickly learn this when attempting to prepare financial statements, if they don't have the numbers they need to continue going forward. For example, try to complete a retained earnings statement before preparing the related income statement. Ending retained earnings cannot be calculated without considering net income or net loss from the income statement. In addition, headings and currency signs are very important. This is something students can "glaze over". Each statement should have a company name, a statement title, and a date. The balance sheet is as of one day, and the other statements cover a period of time. If students prepare a balance sheet dated for the entire period, ask them to think about how to determine a cash balance for a period of time. This can't be done—a balance is computed for a certain date, not for a period of time. For example, a company could have a $10,000 cash balance as of 12/31/06, but not a $10,000 balance for the year ended 12/31/06—the balance could change every day.

Currency signs indicate a unit of measurement for the reader of the statement and can be used for comparison purposes. For example, you may be analyzing two companies, one that reports in US dollars and the other in Canadian dollars. The currency difference would be relevant in your analysis and decision-making. Lastly, although in many textbooks, the standard reporting practice is annually, students should realize that companies may report for a variety of different accounting periods—monthly, quarterly, semi-annually, annually, etc. The reporting period would be indicated in the statement heading.

Chapter 2 Assignment Grid

Learning Objective	Short Exercises *Easy*	Exercises *Moderate*	Problems (Group A) *Difficult*	Problems (Group B) *Difficult*
1	1	14	29	38
2	2	15	29	38
3	3	15	29	38
4	4	15	29	38
5	5	14, 16	29, 30	38, 39
6	6	14, 16, 17	29, 30, 31, 32	38, 39, 40, 41
7	7	16, 18, 19, 20, 21, 22, 23, 24, 25	31, 32, 33, 34	40, 41, 42, 43
8	8, 9, 10	18, 19, 20, 21, 22, 26	31, 32, 33, 34	40, 41, 42, 43
9	11, 12	15, 22, 24, 25, 27, 28	30, 31, 32, 35, 36, 37	39, 40, 41, 43, 44, 45, 46
10	13	23, 24, 25, 27, 28	32, 35, 37	41, 43, 44, 46

Other End of Chapter Materials:

Continuing Exercise E1-47
Continuing Problem P1-48
Practice Set
Decision Case 1-1
Decision Case 1-2
Ethical Issue 1-1
Ethical Issue 1-2
Fraud Case 1-1
Financial Statement Case 1-1
Team Project 1-1
Team Project 1-2
Communication Activity 1-1

End of Chapter Exercises and Problems available utilizing Accounting software:

QuickBooks 10	E1-27, E1-28, P1-35A, P1-36A, E1-47, P1-48, Practice Set
Excel in Practice	E1-27, E1-28, P1-35A, P1-36A
Peachtree 10	None
General Ledger 5	None

Sample Homework Questions in MyAccountingLab:

E1-16,E1-17; E1-22, E1-27, P1-29A, P1-30A, P1-31A

Pre-Test Questions in MyAccountingLab:

E1-14, E1-15, E1-23

Post-Test Questions in MyAccountingLab:

P1-40B; P1-42B

Exercise and/or Problems used in PowerPoint slides:

S 1-2; S 1-4; E 1-16; E 1-21; P 1-36A

Answer Key to Chapter 1 Quiz:

1. A
2. A
3. A
4. C
5. B
6. D
7. B
8. A
9. A
10. C

Name________________________________Date____________________Section______

CHAPTER 1
TEN-MINUTE QUIZ

Circle the letter of the best response.

1. Generally accepted accounting principles (GAAP) are formulated by the
   - A. Financial Accounting Standards Board (FASB).
   - B. Securities and Exchange Commission (SEC).
   - C. Institute of Management Accountants (IMA).
   - D. American Institute of Certified Public Accountants (AICPA).

2. Which type of business organization is owned by its stockholders?
   - A. Corporation
   - B. Partnership
   - C. Proprietorship
   - D. A, B, and C are all correct

3. Which accounting concept or principle specifically states that we should record transactions at amounts that can be verified?
   - A. Faithful representation
   - B. Cost principle
   - C. Entity concept
   - D. Going-concern concept

4. **Fossil** is famous for fashion wristwatches and leather goods. At the end of a recent year, **Fossil's** total assets added up to $363,000,000, and stockholders' equity was $228,000,000. How much were **Fossil's** liabilities?
   - A. Cannot determine from the data given
   - B. $363,000,000
   - C. $135,000,000
   - D. $228,000,000

5. Assume that **Fossil** sold watches to a department store on account for $48,000. How would this transaction affect **Fossil's** accounting equation?
   - A. Increase both assets and liabilities by $48,000
   - B. Increase both assets and stockholders' equity by $48,000
   - C. Increase both liabilities and stockholders' equity by $48,000
   - D. No effect on the accounting equation because the effects cancel out

6. Accounting is the information system that
   - A. measures business activity.
   - B. communicates the results to decision makers.
   - C. processes data into reports.
   - D. covers all of the above.

7. Which of the following is least likely to be a user of a business's financial information?
   - A. Taxing authorities
   - B. Customers
   - C. Creditors
   - D. Investors

8. Consider the overall effects on **Fossil** of selling watches on account for $64,000 and paying expenses totaling $25,000. What is **Fossil's** net income or net loss?
   - A. Net income of $39,000
   - B. Net loss of $39,000
   - C. Net income of $64,000
   - D. Cannot determine from the data given

9. The balance sheet reports
   - A. financial position on a specific date.
   - B. results of operations on a specific date.
   - C. financial position for a specific period.
   - D. results of operations for a specific period.

10. Which of the following characteristics best describes a corporation?
    - A. Mutual agency
    - B. A board of investors
    - C. Limited liability of stockholders
    - D. Not for profit

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