

## Chapter 1: Accounting Principles and the Financial Statements

Student: \_\_\_\_\_

1. The processing stage of accounting is accomplished by the recording of data.  
True False
2. The terms “bookkeeping” and “accounting” are *not* synonymous.  
True False
3. A company's management information system is a subsystem of its accounting information system.  
True False
4. Accountants focus on the needs for financial information by both internal and external decision makers.  
True False
5. Accountants consider money the common unit of measure for all business transactions.  
True False
6. Payment to a creditor is an example of a nonexchange business transaction.  
True False
7. For accounting purposes, a business and its owner are considered the same entity.  
True False
8. Knowledge of the exchange rate is necessary to apply the money measure concept in case of international transactions.  
True False
9. For reporting purposes, the personal assets and debts of a business owner should be combined with the assets and debts of the business.  
True False
10. Exchange rates for currency change daily according to the supply and demand for each currency.  
True False

11. The day-by-day accumulation of interest is considered a transaction involving an exchange of value.  
True False
12. Sole proprietorships in the United States generate more business (in terms of receipts) than partnerships and corporations put together.  
True False
13. A corporation is an economic unit that is legally separate from its owners.  
True False
14. Corporations represent the largest number of businesses in the United States.  
True False
15. The liability of corporate stockholders is limited to their percentage share of ownership.  
True False
16. The stockholders of a corporation elect the board of directors.  
True False
17. In general, one partner acting alone cannot obligate the partnership to another party.  
True False
18. A partnership is dissolved when any partner leaves the business or dies.  
True False
19. The personal resources of any partner can be called upon to pay the obligations of the partnership.  
True False
20. When a corporate stockholder sells his or her shares of stock, the corporation is technically dissolved.  
True False
21. *Creditors' equities* is another term for *liabilities*.  
True False
22. One way of stating the accounting equation is: Assets - Liabilities = Owner's Equity.  
True False

23. The economic resources invested in a business by the owner are represented by owner's equity.  
True False
24. Accounts Receivable is an asset that is considered nonmonetary in nature.  
True False
25. *Net income* is another term for *revenues*.  
True False
26. *Cash* is another term for *owner's equity*.  
True False
27. Equity is reduced when owner's withdrawals exceed net income.  
True False
28. Revenues have the effect of increasing owner's capital.  
True False
29. Owner withdrawals are an example of an expense.  
True False
30. The obligation to provide services to another entity is a type of liability.  
True False
31. If a company has suffered only net losses since its inception, the owner's equity account will always have a negative balance.  
True False
32. Net assets equal owner's equity.  
True False
33. Owner's equity equals assets minus liabilities.  
True False
34. Inventory is an example of a nonmonetary asset.  
True False

35. Owner's equity equals cumulative net income or loss plus owner investments minus cumulative withdrawals.  
True False
36. Financial position may be assessed by referring to a balance sheet.  
True False
37. The purchase of land with cash would be disclosed on the statement of cash flows.  
True False
38. The expenses incurred by an accounting firm would appear on its balance sheet.  
True False
39. A proper heading for the income statement could include "For the Year Ended December 31, 20--."
- True False
40. The account 'Wages Payable' would appear on the income statement.  
True False
41. An increase in expenses will have the effect of reducing owner's equity.  
True False
42. The account 'Supplies' will appear as an expense on the income statement.  
True False
43. The statement of owner's equity discloses the owner's withdrawals made during the period.  
True False
44. The heading for a balance sheet might include the line "For the Month Ended December 31, 20--."
- True False
45. The balance sheet is also known as the statement of financial position.  
True False
46. The statement of cash flows discloses significant events related to the operating, investing, and financing activities of a business.  
True False

47. The statement of owner's equity relates the income statement to the balance sheet by showing how the owner's capital account changed during the accounting period.
- True False
48. The International Accounting Standards Board is the primary and most important determinant of generally accepted accounting principles.
- True False
49. Companies whose securities are sold to the general public must adhere to standards established by the Securities and Exchange Commission.
- True False
50. The Internal Revenue Service is responsible for issuing accounting standards for state and local governments.
- True False
51. Objectivity is the avoidance of all relationships that impair or appear to impair the objectivity of the accountant.
- True False
52. Both public accountants and management accountants are required to adhere to a code of professional conduct.
- True False
53. Due care means carrying out one's professional responsibilities with competence and diligence.
- True False
54. Independence means subordinating personal gain to service and the public trust.
- True False
55. The Public Company Accounting Oversight Board (PCAOB) was created to determine the standards that auditors must follow.
- True False
56. The board of directors appoints the audit committee, which in turn performs an independent audit of the company's records.
- True False

57. Generally accepted accounting principles encompass the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time.
- True False
58. Financial accounting information is used primarily by management.
- True False
59. Accounting ratios are useful as management performance measures.
- True False
60. The purchase of equipment is an example of an investing activity.
- True False
61. Buying and selling goods and services are examples of operating activities.
- True False
62. A major function of financial accounting is to provide the investor with relevant and useful information.
- True False
63. The evaluation and interpretation of financial statements and related performance measures is called technical analysis.
- True False
64. The Federal Reserve Board is an example of a consumer group.
- True False
65. The primary external users of accounting information are investors and management.
- True False
66. The Securities and Exchange Commission is an accounting information user with an indirect financial interest.
- True False
67. Taxing authorities are considered accounting information users with a direct financial interest.
- True False

68. Creditors are those who lend money to others or deliver goods and services before being paid.  
True False
69. Net income is a measure of profitability.  
True False
70. Financing a business means obtaining funds so the business can begin and continue operating.  
True False
71. Using cash to expand by purchasing land and a building is an example of an operating activity.  
True False
72. Less than 20 percent of the U.S. economy is generated by governmental and not-for-profit organizations.  
True False
73. Paying taxes to the government is an example of an operating activity.  
True False
74. Managerial accounting focuses on internal decision making.  
True False
75. Regulatory agencies are considered information users with an indirect financial interest.  
True False
76. Not-for-profit organizations have no obligation to report their financial performance to outside parties.  
True False
77. Two major goals of business are to achieve profitability and to achieve liquidity.  
True False
78. Liquidity means *not* having enough funds on hand to pay debts when they fall due.  
True False
79. The intentional preparation of misleading financial statements is referred to as *fraudulent financial reporting*.  
True False

80. Misleading financial reports are not considered fraudulent if they are the result of the misapplication of accounting principles.
- True False
81. Criminal penalties can be imposed on those who prepare fraudulent financial statements.
- True False
82. Staff accountants express their duty to ensure financial reports are not false or misleading in the management report that appears as part of the company's annual report.
- True False
83. The Sarbanes-Oxley Act orders the SEC to hold chief executives and CFOs responsible for the accuracy of their company's financial statements.
- True False
84. Responsibility for ethical financial reporting rests solely with the accountant.
- True False
85. The correct order of the three stages of accounting is
- A. communication, processing, and measurement.
  - B. measurement, communication, and processing.
  - C. processing, measurement, and communication.
  - D. measurement, processing, and communication.
86. The communication stage of accounting is accomplished by
- A. storing data.
  - B. reporting to decision makers.
  - C. processing data.
  - D. recording data.
87. Which of the following is the most appropriate definition of *accounting*?
- A. Electronic collection, organization, and communication of vast amounts of information
  - B. The interconnected network of subsystems necessary to operate a business
  - C. A means of recording transactions and keeping records
  - D. The measurement, processing, and communication of financial information about an identifiable economic entity



88. The recording of data falls under which stage of accounting?
- A. measurement
  - B. processing
  - C. communication
  - D. decision making
89. Which of the following transactions does *not* involve an exchange of value?
- A. Payment of a debt
  - B. Purchase of a building on credit
  - C. Borrowing money
  - D. Loss from theft
90. An accounting measurement is concerned with all *except* which of the following?
- A. Money measure
  - B. Financial position
  - C. Separate entity
  - D. Business transaction
91. The personal assets and liabilities of an owner are not shown on the business's financial statements because of the
- A. separate entity concept.
  - B. sole proprietorship concept.
  - C. financial position concept.
  - D. objectivity concept.
92. The topic of foreign exchange rates relates most closely to the concept of
- A. separate entity.
  - B. money measure.
  - C. nonexchange transactions.
  - D. business transactions.
93. All of the following are considered nonexchange transactions *except*
- A. the day-by-day accumulation of interest.
  - B. the wear and tear on machinery.
  - C. the sale of goods and services.
  - D. losses from fire, flood, and theft.
94. Which of the following transactions involves an exchange of value?
- A. Accumulation of interest
  - B. Sale of services
  - C. Fire damage
  - D. Wear and tear on machinery

95. Which of the following is *legally* a separate entity from its owner(s)?
- A. Sole proprietorship only
  - B. Sole proprietorship and partnership only
  - C. Corporation only
  - D. Partnership only
96. Most business enterprises in the United States are
- A. government units.
  - B. partnerships.
  - C. sole proprietorships.
  - D. corporations.
97. Transfer of ownership will affect the continuity of a
- A. corporation.
  - B. sole proprietorship.
  - C. partnership.
  - D. sole proprietorship or partnership.
98. All of the following statements about partnerships are true *except*
- A. partners must share profits and losses equally.
  - B. a change in ownership will dissolve the partnership.
  - C. any partner can enter into a binding agreement with a third party.
  - D. all partners have unlimited liability.
99. All of the following statements about corporations are true *except*
- A. they are chartered by the state.
  - B. ownership is represented by shares of stock.
  - C. the sale of stock does not dissolve the business.
  - D. the stockholders have direct control of the business.
100. Which of the following forms of organization are considered to be separate entities by *accountants*?
- A. Partnerships only
  - B. Sole proprietorships only
  - C. Corporations only
  - D. Sole proprietorships, partnerships, and corporations
101. Which of the following is the correct accounting equation?
- A.  $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$
  - B.  $\text{Assets} + \text{Owner's Equity} = \text{Liabilities}$
  - C.  $\text{Assets} = \text{Liabilities} - \text{Owner's Equity}$
  - D.  $\text{Assets} + \text{Liabilities} = \text{Owner's Equity}$

102. The best definition of *assets* is the:

- A. cash owned by the company.
- B. resources belonging to a company having future benefit to the company.
- C. collection of resources belonging to the company and the claims on these resources.
- D. owner's investment in the business.

103. Which of the following items has *no* effect on owner's equity?

- A. Receipt of cash owed to the business (accounts receivable)
- B. Sale of a service
- C. Payment of an expense
- D. Withdrawal by the owner

104. Which of the following accounts is *not* considered an asset?

- A. Accounts Receivable
- B. Inventory
- C. Accounts Payable
- D. Trademark

105. An example of a monetary asset is

- A. Accounts Receivable.
- B. Copyright.
- C. Retained Earnings.
- D. Land.

106. A liability would *not* include an obligation to

- A. transfer assets.
- B. hire an employee.
- C. pay cash.
- D. provide services.

107. Which of the following assets could be described as nonphysical?

- A. Inventory
- B. Cash
- C. Trademarks
- D. Supplies

108. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

What is the balance of the Flora Sinoyianis, Capital account?

- A. \$8,000
- B. \$12,000
- C. \$28,000
- D. \$40,000

109. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

What is the total of liabilities and owner's equity?

- A. \$26,000
- B. \$32,000
- C. \$36,000
- D. \$52,000

110. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

If the equipment were sold for \$14,000, what would be the total of owner's equity?

- A. \$8,000
- B. \$22,000
- C. \$36,000
- D. \$40,000

111. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

If, \$6,000 of Accounts Payable were paid in cash, what would be the balance of the Flora Sinoyianis, Capital account?

- A. \$8,000
- B. \$28,000
- C. \$36,000
- D. \$40,000

112. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

If, \$6,000 of Accounts Payable were paid in cash, what would be the total of liabilities and owner's equity?

- A. \$28,000
- B. \$34,000
- C. \$46,000
- D. \$52,000

113. Use this information to answer the following question.

Here is the balance sheet for Costello Container Company:

Costello Container Company			
Balance Sheet			
December 31, 2014			
Assets		Liabilities	
Cash	\$ 8,000	Accounts payable	\$16,000
Accounts receivable	3,000		
Land	14,000	Owner's Equity	
Building	44,000	Jose Costello, capital	66,000
Equipment	13,000		
		Total liabilities and	
Total assets	\$82,000	owner's equity	\$82,000

If the equipment were sold for \$13,000, then the Jose Costello, Capital account would

- A. increase by \$37,000.
- B. increase by \$13,000.
- C. decrease by \$13,000.
- D. stay the same.

114. Use this information to answer the following question.

Here is the balance sheet for Costello Container Company:

Costello Container Company			
Balance Sheet			
December 31, 2014			
Assets		Liabilities	
Cash	\$ 8,000	Accounts payable	\$16,000
Accounts receivable	3,000		
Land	14,000	Owner's Equity	
Building	44,000	Jose Costello, capital	66,000
Equipment	13,000		
		Total liabilities and	
Total assets	\$82,000	owner's equity	\$82,000

If the balance in the Cash account were used to buy more equipment, then the total assets would

- A. remain unchanged.
- B. increase by \$8,000.
- C. decrease by \$8,000.
- D. increase by \$21,000.

115. Use this information to answer the following question.  
Here is the balance sheet for Costello Container Company:

Costello Container Company			
Balance Sheet			
December 31, 2014			
Assets		Liabilities	
Cash	\$ 8,000	Accounts payable	\$16,000
Accounts receivable	3,000		
Land	14,000	Owner's Equity	
Building	44,000	Jose Costello, capital	66,000
Equipment	13,000		
		Total liabilities and	
Total assets	\$82,000	owner's equity	\$82,000

- If the balance in the Cash account were used to pay part of Accounts Payable, then total liabilities and owner's equity would
- A. decrease by \$8,000.  
B. increase by \$8,000.  
C. increase by \$16,000.  
D. decrease by \$16,000.
116. The statement of cash flows would disclose the purchase of a building for cash
- A. nowhere on the statement.  
B. in the operating activities section.  
C. in the investing activities section.  
D. in the financing activities section.
117. Which of the following represents the proper order of financial statement preparation?
- A. Statement of cash flows, balance sheet, income statement, statement of owner's equity  
B. Statement of owner's equity, income statement, statement of cash flows, balance sheet  
C. Balance sheet, statement of cash flows, statement of owner's equity, income statement  
D. Income statement, statement of owner's equity, balance sheet, statement of cash flows
118. All of the following items would appear on the balance sheet *except*
- A. withdrawals.  
B. the owner's capital account.  
C. Accounts Receivable.  
D. Patents.
119. Which of the following financial statements is concerned with the enterprise at a point in time?
- A. Statement of owner's equity  
B. Income statement  
C. Statement of cash flows  
D. Balance sheet

120. The net income figure appears in all the following financial statements *except* the
- A. statement of cash flows.
  - B. income statement.
  - C. statement of owner's equity.
  - D. balance sheet.
121. The statement of cash flows would disclose the withdrawal of cash by the owner
- A. in the financing activities section.
  - B. in the investing activities section.
  - C. in the operating activities section.
  - D. nowhere on the statement.
122. The Public Company Accounting Oversight Board was created by the
- A. Sarbanes-Oxley Act.
  - B. GASB.
  - C. IRS.
  - D. IASB.
123. The authoritative body currently responsible for establishing accounting practice is the
- A. Internal Revenue Service.
  - B. Financial Accounting Standards Board.
  - C. American Institute of Certified Public Accountants.
  - D. Federal Reserve Board.
124. An audit is an examination of a company's
- A. financial statements.
  - B. accounting systems.
  - C. accounting controls.
  - D. all of these.
125. Generally accepted accounting principles
- A. are changing continually.
  - B. are sound in theory but rarely used in practice.
  - C. have eliminated all weaknesses in accounting practice.
  - D. are accounting rules formulated by the Internal Revenue Service.
126. The purpose of an audit is to
- A. determine whether or not a company is a good investment.
  - B. comply with income tax regulations.
  - C. determine whether or not a company is a good credit risk.
  - D. ascertain that the financial statements follow GAAP.



127. An auditor maintains no direct financial interest in the company he or she is auditing. The principle being followed is
- A. independence.
  - B. integrity.
  - C. objectivity.
  - D. due care.
128. Carrying out professional responsibilities with competence and diligence is called
- A. integrity.
  - B. independence.
  - C. objectivity.
  - D. due care.
129. All of the following are broad principles underlying the accountant's code of professional ethics *except*
- A. objectivity
  - B. integrity
  - C. loyalty
  - D. independence
130. The development of international accounting standards is the primary function of the
- A. IRS.
  - B. AICPA.
  - C. IASB.
  - D. PCAOB.
131. The purchase of land is an example of a(n)
- A. investing activity.
  - B. operating activity.
  - C. capital activity.
  - D. financing activity.
132. Which of the following is an example of an operating activity?
- A. Obtaining capital from owners
  - B. Selling goods and services to customers
  - C. Purchasing equipment
  - D. Selling land
133. Which of the following is an example of an investing activity?
- A. Purchasing a building
  - B. Paying off a loan
  - C. Employing workers
  - D. Producing goods and services

134. Which of the following is an example of a financing activity?
- A. Paying taxes to the government
  - B. Selling equipment
  - C. Obtaining a bank loan
  - D. Purchasing land
135. A company's ability to attract and hold investment capital ultimately depends on its
- A. budgeting.
  - B. planning.
  - C. liquidity.
  - D. profitability.
136. The group of users of accounting information charged with achieving the goals of the business is its
- A. auditors.
  - B. creditors.
  - C. managers.
  - D. investors.
137. The following users of accounting information have an indirect financial interest in the business *except*
- A. regulatory agency.
  - B. creditor.
  - C. taxing authority.
  - D. labor union.
138. Which of the following groups uses accounting information primarily to help protect the public?
- A. Management
  - B. Regulatory agencies
  - C. Taxing authorities
  - D. Economic planners
139. The following users of accounting information have a direct financial interest in a business *except*
- A. a creditor.
  - B. a financial adviser.
  - C. management.
  - D. an investor.
140. Companies listed on the stock exchanges must file financial statements with the
- A. Financial Accounting Standards Board.
  - B. American Institute of Certified Public Accountants.
  - C. Securities and Exchange Commission.
  - D. Internal Revenue Service.

141. Which of the following is an agency of the U.S. government?

- A. IASB
- B. SEC
- C. FASB
- D. AICPA

142. Those who lend money or deliver goods and services before being paid are called

- A. investors.
- B. debtors.
- C. underwriters.
- D. creditors.

143. Which of the following is a regulatory agency?

- A. IASB
- B. SEC
- C. FASB
- D. GASB

144. The Sarbanes-Oxley Act of 2002 came, in part, as a result of

- A. the Enron scandal
- B. the WorldCom scandal
- C. the Target scandal
- D. the Enron and WorldCom scandals

145. The intentional preparation of misleading financial statements, known as fraudulent financial reporting, can result from all of the following *except*

- A. the misapplication of accounting principles.
- B. the manipulation of inventory records.
- C. fictitious sales or orders.
- D. recording a revenue that has been earned but not yet received.

146. All of the following statements are true about the Sarbanes-Oxley Act *except*

- A. it applies to publicly traded companies.
- B. it shields chief executives from criminal penalties.
- C. it orders the SEC to draw up certain rules.
- D. its primary goal is to regulate financial reporting and the accounting profession.

147. Which of the following physically prepare and audit financial reports?

- A. accountants
- B. managers
- C. chief executives
- D. board of directors

148. Which of the following are required to swear that financial reports are accurate and complete?
- A. accountants
  - B. managers
  - C. chief executives
  - D. board of directors
149. Which of the following might be motivation for fraudulently covering up a financial weakness?
- A. to obtain a loan
  - B. to meet stockholder expectations
  - C. to obtain bonus compensation
  - D. all of these are possible motivations
150. Fraudulent financial reporting at Enron resulted in
- A. thousands of people losing their jobs.
  - B. thousands of people losing their pensions and investment incomes.
  - C. prison sentences and fines for corporate executives.
  - D. all of these choices.
151. The Sarbanes-Oxley Act of 2002 applies to all *except*
- A. quarterly statements
  - B. annual reports
  - C. internal management reports
  - D. none of these are exceptions
152. Why would it be less risky for a wealthy individual to incorporate his or her business rather than to operate it as a sole proprietorship or partnership?

153. On the right side of the accounting equation are two types of claims against resources. Explain what they are and give an example of an item that would increase each. Which type of claim has priority?

154. How does the statement of owner's equity relate to the income statement and the balance sheet?

155. What is independence, and why is it important for a CPA to maintain it when conducting an audit?

156. What is the responsibility of the independent auditor? Who is responsible for the content of the published financial statements?

157. Distinguish between profitability and liquidity.

158. Explain why each of the following persons or groups would be interested in seeing the financial statements of a company. Also state whether each has a direct or indirect financial interest.

- a. Potential investor
- b. Internal Revenue Service
- c. A labor union
- d. Securities and Exchange Commission
- e. Potential creditor
- f. Management
- g. Economic planners

159. List five possible users of a set of financial statements and state what each would be interested in learning from its review.

160. Which four types of transactions affect owner's equity, and how do they affect it?

161. Indicate by letter the agency that applies each statement.

- |  |       |       |
|--|-------|-------|
| 1. Responsible for interpreting and enforcing tax laws                           | IRS   | _____ |
| 2. Establishes accounting standards for state and local governments              | GASB  | _____ |
| 3. The accounting profession's main organization of certified public accountants | IASB  | _____ |
| 4. Current authoritative body for developing GAAP                                | IMA   | _____ |
| 5. Protector of the investing public   | SEC   | _____ |
| 6. Developer of international accounting standards                               | FASB  | _____ |
| 7. Primary professional association of managerial accountants                    | AICPA | _____ |

162. Newberry Company's owner's equity equals one-fourth of the company's total assets. The company's liabilities are \$309,000. What is the amount of the company's owner's equity?
163. Chin Company's owner's equity equals one-third of the company's total assets. The company's liabilities are \$120,000. What is the amount of the company's owner's equity?
164. Garcia Company's owner's equity equals one-half of the company's total assets. The company's liabilities are \$140,000. What is the amount of the company's owner's equity?



165. Following are the total assets and liabilities at the beginning and end of the year for Hagedorn Company:

	<b>Assets</b>	<b>Liabilities</b>
Beginning of the year	\$ 70,000	\$45,000
End of the year	108,000	40,000

Determine the net income or loss for the year in each of the following situations:

- The owner made no investments in the business and no withdrawals were made during the year.
- The owner made an investment of \$20,000 and withdrew \$12,000 during the year.

166. At the beginning of the year, Shannon Company's assets were \$150,000 and its owner's equity was \$100,000. During the year, assets decreased \$30,000 and liabilities increased \$15,000. What was the owner's equity at the end of the year?

167. At the beginning of the year, Pullman Company's assets were \$270,000 and its owner's equity was \$201,000. During the year, assets decreased by \$35,000 and liabilities increased by \$10,000. What was owner's equity at the end of the year?

168. Use the following information to calculate at or for the year ended December 31, 2014:  
 (a) net income, (b) owner's capital, (c) total liabilities and owner's equity, and (d) accounts receivable.

Cash	\$32,000	Owner's Capital, Dec. 31, 2013	\$91,000
Accounts Receivable	?	Owner's Capital, Dec. 31, 2014	?
Supplies	1,000	Withdrawals	16,000
Land	70,000	Commissions Earned	40,000
Accounts Payable	12,000	Wages Expense	14,000
Notes Payable	14,000	Rent Expense	6,000

169. Use the following information to calculate at or for the year ended December 31, 2014:

(a) net income, (b) owner's capital, (c) total assets, and (d) cash.

Cash	\$ ?	Owner's Capital, Dec. 31, 2014	\$ ?
Accounts Receivable	8,000	Withdrawals	6,000
Inventories	22,000	Commissions Earned	20,000
Accounts Payable	7,000	Salaries Expense	4,000
Salaries Payable	1,000	Utilities Expense	2,000
Owner's Capital, Dec. 31, 2013	26,000		

170. Kyle Biehl, an attorney, bills his clients at a rate of \$100 per hour. At the beginning of July, clients owed him \$8,000, of which he collected \$5,600 during the month. In July, Kyle billed clients for 160 hours of work. By the end of July, 60 of these hours were unpaid.

Kyle has one employee, Marcia Medvid, who is paid \$20 per hour. During July, Marcia worked 170 hours, of which 16 hours will be paid in August. The rest were paid in July along with wages for 8 hours worked the last day of June.

Show calculations as you determine the following for the month of July:

- Amount of revenue earned
- Wages expense incurred
- Cash received from clients
- Cash paid to Marcia Medvid

171. Upshaw Company had a balance of \$160,000 in Sue Upshaw, Capital on December 31, 2013. During 2014, the company reported a net income of \$84,000 after taxes, and the owner withdrew \$32,000, while making no additional investments. Prepare the company's statement of owner's equity for the year ended December 31, 2014.

172. Feldman Company had a balance of \$360,000 in Saul Feldman, Capital on December 31, 2013. During 2014, the company reported a net income of \$48,000, and the owner withdrew \$36,000 during the year, while making no additional investments. Prepare the company's statement of owner's equity for the year ended December 31, 2014.

173. Use the following accounts and information to prepare, in good form, an income statement, statement of owner's equity, and balance sheet for McCollum Enterprises for the year ended December 31, 2014.

Accounts Payable	\$ 4,800	Insurance Expense	\$ 1,000
Accounts Receivable	600	Land	39,000
Buildings	52,000	Notes Payable	6,000
Cash	26,200	Rent Expense	3,600
Commissions Earned	19,000	Salaries Expense	8,400
Ed McCollum, Capital, Dec. 31, 2013	104,400	Supplies	400
Ed McCollum, Withdrawals	3,000		

174. Use the following accounts and information to prepare, in good form, an income statement, statement of owner's equity, and balance sheet for Day Industries for the month ended July 31, 2014.

Accounts Payable	\$ 3,100	Land	\$35,000
Accounts Receivable	1,400	Notes Payable	3,300
Buildings	22,000	Rent Expense	2,400
Cash	15,600	Salaries Expense	10,000
Commissions Earned	12,700	Supplies	400
Darla Day, Capital, June 30, 2014	77,900		
Withdrawals	8,000		
Insurance Expense	2,200		

175. Use the following accounts and balances to prepare a balance sheet for England Company at December 31, 2014:

Accounts Payable	\$10,000
Accounts Receivable	6,400
Bryan England, Capital	?
Cash	4,800
Equipment	13,200

# Chapter 1: Accounting Principles and the Financial Statements

## Key

1. The processing stage of accounting is accomplished by the recording of data.  
**FALSE**
2. The terms “bookkeeping” and “accounting” are *not* synonymous.  
**TRUE**
3. A company's management information system is a subsystem of its accounting information system.  
**FALSE**
4. Accountants focus on the needs for financial information by both internal and external decision makers.  
**TRUE**
5. Accountants consider money the common unit of measure for all business transactions.  
**TRUE**
6. Payment to a creditor is an example of a nonexchange business transaction.  
**FALSE**
7. For accounting purposes, a business and its owner are considered the same entity.  
**FALSE**
8. Knowledge of the exchange rate is necessary to apply the money measure concept in case of international transactions.  
**TRUE**
9. For reporting purposes, the personal assets and debts of a business owner should be combined with the assets and debts of the business.  
**FALSE**
10. Exchange rates for currency change daily according to the supply and demand for each currency.  
**TRUE**

11. The day-by-day accumulation of interest is considered a transaction involving an exchange of value.

**FALSE**

12. Sole proprietorships in the United States generate more business (in terms of receipts) than partnerships and corporations put together.

**FALSE**

13. A corporation is an economic unit that is legally separate from its owners.

**TRUE**

14. Corporations represent the largest number of businesses in the United States.

**FALSE**

15. The liability of corporate stockholders is limited to their percentage share of ownership.

**FALSE**

16. The stockholders of a corporation elect the board of directors.

**TRUE**

17. In general, one partner acting alone cannot obligate the partnership to another party.

**FALSE**

18. A partnership is dissolved when any partner leaves the business or dies.

**TRUE**

19. The personal resources of any partner can be called upon to pay the obligations of the partnership.

**TRUE**

20. When a corporate stockholder sells his or her shares of stock, the corporation is technically dissolved.

**FALSE**

21. *Creditors' equities* is another term for *liabilities*.

**TRUE**

22. One way of stating the accounting equation is: Assets - Liabilities = Owner's Equity.

**TRUE**



23. The economic resources invested in a business by the owner are represented by owner's equity.  
**TRUE**
24. Accounts Receivable is an asset that is considered nonmonetary in nature.  
**FALSE**
25. *Net income* is another term for *revenues*.  
**FALSE**
26. *Cash* is another term for *owner's equity*.  
**FALSE**
27. Equity is reduced when owner's withdrawals exceed net income.  
**TRUE**
28. Revenues have the effect of increasing owner's capital.  
**TRUE**
29. Owner withdrawals are an example of an expense.  
**FALSE**
30. The obligation to provide services to another entity is a type of liability.  
**TRUE**
31. If a company has suffered only net losses since its inception, the owner's equity account will always have a negative balance.  
**FALSE**
32. Net assets equal owner's equity.  
**TRUE**
33. Owner's equity equals assets minus liabilities.  
**TRUE**
34. Inventory is an example of a nonmonetary asset.  
**TRUE**

35. Owner's equity equals cumulative net income or loss plus owner investments minus cumulative withdrawals.

**TRUE**

36. Financial position may be assessed by referring to a balance sheet.

**TRUE**

37. The purchase of land with cash would be disclosed on the statement of cash flows.

**TRUE**

38. The expenses incurred by an accounting firm would appear on its balance sheet.

**FALSE**

39. A proper heading for the income statement could include "For the Year Ended December 31, 20--."

**TRUE**

40. The account 'Wages Payable' would appear on the income statement.

**FALSE**

41. An increase in expenses will have the effect of reducing owner's equity.

**TRUE**

42. The account 'Supplies' will appear as an expense on the income statement.

**FALSE**

43. The statement of owner's equity discloses the owner's withdrawals made during the period.

**TRUE**

44. The heading for a balance sheet might include the line "For the Month Ended December 31, 20--."

**FALSE**

45. The balance sheet is also known as the statement of financial position.

**TRUE**

46. The statement of cash flows discloses significant events related to the operating, investing, and financing activities of a business.

**TRUE**

47. The statement of owner's equity relates the income statement to the balance sheet by showing how the owner's capital account changed during the accounting period.

**TRUE**

48. The International Accounting Standards Board is the primary and most important determinant of generally accepted accounting principles.

**FALSE**

49. Companies whose securities are sold to the general public must adhere to standards established by the Securities and Exchange Commission.

**TRUE**

50. The Internal Revenue Service is responsible for issuing accounting standards for state and local governments.

**FALSE**

51. Objectivity is the avoidance of all relationships that impair or appear to impair the objectivity of the accountant.

**FALSE**

52. Both public accountants and management accountants are required to adhere to a code of professional conduct.

**TRUE**

53. Due care means carrying out one's professional responsibilities with competence and diligence.

**TRUE**

54. Independence means subordinating personal gain to service and the public trust.

**FALSE**

55. The Public Company Accounting Oversight Board (PCAOB) was created to determine the standards that auditors must follow.

**TRUE**

56. The board of directors appoints the audit committee, which in turn performs an independent audit of the company's records.

**FALSE**

57. Generally accepted accounting principles encompass the conventions, rules, and procedures necessary to define accepted accounting practice at a particular time.

**TRUE**

58. Financial accounting information is used primarily by management.

**FALSE**

59. Accounting ratios are useful as management performance measures.

**TRUE**

60. The purchase of equipment is an example of an investing activity.

**TRUE**

61. Buying and selling goods and services are examples of operating activities.

**TRUE**

62. A major function of financial accounting is to provide the investor with relevant and useful information.

**TRUE**

63. The evaluation and interpretation of financial statements and related performance measures is called technical analysis.

**FALSE**

64. The Federal Reserve Board is an example of a consumer group.

**FALSE**

65. The primary external users of accounting information are investors and management.

**FALSE**

66. The Securities and Exchange Commission is an accounting information user with an indirect financial interest.

**TRUE**

67. Taxing authorities are considered accounting information users with a direct financial interest.

**FALSE**

68. Creditors are those who lend money to others or deliver goods and services before being paid.  
**TRUE**
69. Net income is a measure of profitability.  
**TRUE**
70. Financing a business means obtaining funds so the business can begin and continue operating.  
**TRUE**
71. Using cash to expand by purchasing land and a building is an example of an operating activity.  
**FALSE**
72. Less than 20 percent of the U.S. economy is generated by governmental and not-for-profit organizations.  
**FALSE**
73. Paying taxes to the government is an example of an operating activity.  
**TRUE**
74. Managerial accounting focuses on internal decision making.  
**TRUE**
75. Regulatory agencies are considered information users with an indirect financial interest.  
**TRUE**
76. Not-for-profit organizations have no obligation to report their financial performance to outside parties.  
**FALSE**
77. Two major goals of business are to achieve profitability and to achieve liquidity.  
**TRUE**
78. Liquidity means *not* having enough funds on hand to pay debts when they fall due.  
**FALSE**
79. The intentional preparation of misleading financial statements is referred to as *fraudulent financial reporting*.  
**TRUE**

80. Misleading financial reports are not considered fraudulent if they are the result of the misapplication of accounting principles.

**FALSE**

81. Criminal penalties can be imposed on those who prepare fraudulent financial statements.

**TRUE**

82. Staff accountants express their duty to ensure financial reports are not false or misleading in the management report that appears as part of the company's annual report.

**FALSE**

83. The Sarbanes-Oxley Act orders the SEC to hold chief executives and CFOs responsible for the accuracy of their company's financial statements.

**TRUE**

84. Responsibility for ethical financial reporting rests solely with the accountant.

**FALSE**

85. The correct order of the three stages of accounting is

- A. communication, processing, and measurement.
- B. measurement, communication, and processing.
- C. processing, measurement, and communication.
- D.** measurement, processing, and communication.

86. The communication stage of accounting is accomplished by

- A. storing data.
- B.** reporting to decision makers.
- C. processing data.
- D. recording data.

87. Which of the following is the most appropriate definition of *accounting*?

- A. Electronic collection, organization, and communication of vast amounts of information
- B. The interconnected network of subsystems necessary to operate a business
- C. A means of recording transactions and keeping records
- D.** The measurement, processing, and communication of financial information about an identifiable economic entity

88. The recording of data falls under which stage of accounting?
- A.** measurement
  - B. processing
  - C. communication
  - D. decision making
89. Which of the following transactions does *not* involve an exchange of value?
- A. Payment of a debt
  - B. Purchase of a building on credit
  - C. Borrowing money
  - D.** Loss from theft
90. An accounting measurement is concerned with all *except* which of the following?
- A. Money measure
  - B.** Financial position
  - C. Separate entity
  - D. Business transaction
91. The personal assets and liabilities of an owner are not shown on the business's financial statements because of the
- A.** separate entity concept.
  - B. sole proprietorship concept.
  - C. financial position concept.
  - D. objectivity concept.
92. The topic of foreign exchange rates relates most closely to the concept of
- A. separate entity.
  - B.** money measure.
  - C. nonexchange transactions.
  - D. business transactions.
93. All of the following are considered nonexchange transactions *except*
- A. the day-by-day accumulation of interest.
  - B. the wear and tear on machinery.
  - C.** the sale of goods and services.
  - D. losses from fire, flood, and theft.
94. Which of the following transactions involves an exchange of value?
- A. Accumulation of interest
  - B.** Sale of services
  - C. Fire damage
  - D. Wear and tear on machinery

95. Which of the following is *legally* a separate entity from its owner(s)?
- A. Sole proprietorship only
  - B. Sole proprietorship and partnership only
  - C.** Corporation only
  - D. Partnership only
96. Most business enterprises in the United States are
- A. government units.
  - B. partnerships.
  - C.** sole proprietorships.
  - D. corporations.
97. Transfer of ownership will affect the continuity of a
- A. corporation.
  - B. sole proprietorship.
  - C. partnership.
  - D.** sole proprietorship or partnership.
98. All of the following statements about partnerships are true *except*
- A.** partners must share profits and losses equally.
  - B. a change in ownership will dissolve the partnership.
  - C. any partner can enter into a binding agreement with a third party.
  - D. all partners have unlimited liability.
99. All of the following statements about corporations are true *except*
- A. they are chartered by the state.
  - B. ownership is represented by shares of stock.
  - C. the sale of stock does not dissolve the business.
  - D.** the stockholders have direct control of the business.
100. Which of the following forms of organization are considered to be separate entities by *accountants*?
- A. Partnerships only
  - B. Sole proprietorships only
  - C. Corporations only
  - D.** Sole proprietorships, partnerships, and corporations
101. Which of the following is the correct accounting equation?
- A.** Assets = Liabilities + Owner's Equity
  - B. Assets + Owner's Equity = Liabilities
  - C. Assets = Liabilities – Owner's Equity
  - D. Assets + Liabilities = Owner's Equity



102. The best definition of *assets* is the:
- A. cash owned by the company.
  - B.** resources belonging to a company having future benefit to the company.
  - C. collection of resources belonging to the company and the claims on these resources.
  - D. owner's investment in the business.
103. Which of the following items has *no* effect on owner's equity?
- A.** Receipt of cash owed to the business (accounts receivable)
  - B. Sale of a service
  - C. Payment of an expense
  - D. Withdrawal by the owner
104. Which of the following accounts is *not* considered an asset?
- A. Accounts Receivable
  - B. Inventory
  - C.** Accounts Payable
  - D. Trademark
105. An example of a monetary asset is
- A.** Accounts Receivable.
  - B. Copyright.
  - C. Retained Earnings.
  - D. Land.
106. A liability would *not* include an obligation to
- A. transfer assets.
  - B.** hire an employee.
  - C. pay cash.
  - D. provide services.
107. Which of the following assets could be described as nonphysical?
- A. Inventory
  - B. Cash
  - C.** Trademarks
  - D. Supplies

108. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

What is the balance of the Flora Sinoyianis, Capital account?

- A. \$8,000
  - B. \$12,000
  - C. \$28,000
  - D. \$40,000**
109. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

What is the total of liabilities and owner's equity?

- A. \$26,000
  - B. \$32,000
  - C. \$36,000
  - D. \$52,000**
110. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

If the equipment were sold for \$14,000, what would be the total of owner's equity?

- A. \$8,000
- B. \$22,000
- C. \$36,000
- D. \$40,000**

111. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

If, \$6,000 of Accounts Payable were paid in cash, what would be the balance of the Flora Sinoyianis, Capital account?

- A. \$8,000
  - B. \$28,000
  - C. \$36,000
  - D. \$40,000**
112. Sinoyianis Realty Company had the following balance sheet accounts and balances:

Accounts Payable	\$12,000		Flora Sinoyianis, Capital	\$ ?
Accounts Receivable	2,000		Equipment	14,000
Building	16,000		Land	14,000
Cash	6,000			

If, \$6,000 of Accounts Payable were paid in cash, what would be the total of liabilities and owner's equity?

- A. \$28,000
- B. \$34,000
- C. \$46,000**
- D. \$52,000

113. Use this information to answer the following question.

Here is the balance sheet for Costello Container Company:

Costello Container Company			
Balance Sheet			
December 31, 2014			
Assets		Liabilities	
Cash	\$ 8,000	Accounts payable	\$16,000
Accounts receivable	3,000		
Land	14,000	Owner's Equity	
Building	44,000	Jose Costello, capital	66,000
Equipment	13,000		
		Total liabilities and	
Total assets	\$82,000	owner's equity	\$82,000

If the equipment were sold for \$13,000, then the Jose Costello, Capital account would

- A. increase by \$37,000.
  - B. increase by \$13,000.
  - C. decrease by \$13,000.
  - D.** stay the same.
114. Use this information to answer the following question.

Here is the balance sheet for Costello Container Company:

Costello Container Company			
Balance Sheet			
December 31, 2014			
Assets		Liabilities	
Cash	\$ 8,000	Accounts payable	\$16,000
Accounts receivable	3,000		
Land	14,000	Owner's Equity	
Building	44,000	Jose Costello, capital	66,000
Equipment	13,000		
		Total liabilities and	
Total assets	\$82,000	owner's equity	\$82,000

If the balance in the Cash account were used to buy more equipment, then the total assets would

- A.** remain unchanged.
- B. increase by \$8,000.
- C. decrease by \$8,000.
- D. increase by \$21,000.

115. Use this information to answer the following question.  
Here is the balance sheet for Costello Container Company:

Costello Container Company			
Balance Sheet			
December 31, 2014			
Assets		Liabilities	
Cash	\$ 8,000	Accounts payable	\$16,000
Accounts receivable	3,000		
Land	14,000	Owner's Equity	
Building	44,000	Jose Costello, capital	66,000
Equipment	13,000		
		Total liabilities and	
Total assets	\$82,000	owner's equity	\$82,000

If the balance in the Cash account were used to pay part of Accounts Payable, then total liabilities and owner's equity would

- A. decrease by \$8,000.  
 B. increase by \$8,000.  
 C. increase by \$16,000.  
 D. decrease by \$16,000.
116. The statement of cash flows would disclose the purchase of a building for cash
- A. nowhere on the statement.  
 B. in the operating activities section.  
C. in the investing activities section.  
 D. in the financing activities section.
117. Which of the following represents the proper order of financial statement preparation?
- A. Statement of cash flows, balance sheet, income statement, statement of owner's equity  
 B. Statement of owner's equity, income statement, statement of cash flows, balance sheet  
 C. Balance sheet, statement of cash flows, statement of owner's equity, income statement  
D. Income statement, statement of owner's equity, balance sheet, statement of cash flows
118. All of the following items would appear on the balance sheet *except*
- A. withdrawals.  
 B. the owner's capital account.  
 C. Accounts Receivable.  
 D. Patents.
119. Which of the following financial statements is concerned with the enterprise at a point in time?
- A. Statement of owner's equity  
 B. Income statement  
 C. Statement of cash flows  
D. Balance sheet

120. The net income figure appears in all the following financial statements *except* the
- A. statement of cash flows.
  - B. income statement.
  - C. statement of owner's equity.
  - D.** balance sheet.
121. The statement of cash flows would disclose the withdrawal of cash by the owner
- A.** in the financing activities section.
  - B. in the investing activities section.
  - C. in the operating activities section.
  - D. nowhere on the statement.
122. The Public Company Accounting Oversight Board was created by the
- A.** Sarbanes-Oxley Act.
  - B. GASB.
  - C. IRS.
  - D. IASB.
123. The authoritative body currently responsible for establishing accounting practice is the
- A. Internal Revenue Service.
  - B.** Financial Accounting Standards Board.
  - C. American Institute of Certified Public Accountants.
  - D. Federal Reserve Board.
124. An audit is an examination of a company's
- A. financial statements.
  - B. accounting systems.
  - C. accounting controls.
  - D.** all of these.
125. Generally accepted accounting principles
- A.** are changing continually.
  - B. are sound in theory but rarely used in practice.
  - C. have eliminated all weaknesses in accounting practice.
  - D. are accounting rules formulated by the Internal Revenue Service.
126. The purpose of an audit is to
- A. determine whether or not a company is a good investment.
  - B. comply with income tax regulations.
  - C. determine whether or not a company is a good credit risk.
  - D.** ascertain that the financial statements follow GAAP.

127. An auditor maintains no direct financial interest in the company he or she is auditing. The principle being followed is
- A. independence.
  - B. integrity.
  - C. objectivity.
  - D. due care.
128. Carrying out professional responsibilities with competence and diligence is called
- A. integrity.
  - B. independence.
  - C. objectivity.
  - D. due care.
129. All of the following are broad principles underlying the accountant's code of professional ethics *except*
- A. objectivity
  - B. integrity
  - C. loyalty
  - D. independence
130. The development of international accounting standards is the primary function of the
- A. IRS.
  - B. AICPA.
  - C. IASB.
  - D. PCAOB.
131. The purchase of land is an example of a(n)
- A. investing activity.
  - B. operating activity.
  - C. capital activity.
  - D. financing activity.
132. Which of the following is an example of an operating activity?
- A. Obtaining capital from owners
  - B. Selling goods and services to customers
  - C. Purchasing equipment
  - D. Selling land

133. Which of the following is an example of an investing activity?
- A.** Purchasing a building
  - B. Paying off a loan
  - C. Employing workers
  - D. Producing goods and services
134. Which of the following is an example of a financing activity?
- A. Paying taxes to the government
  - B. Selling equipment
  - C.** Obtaining a bank loan
  - D. Purchasing land
135. A company's ability to attract and hold investment capital ultimately depends on its
- A. budgeting.
  - B. planning.
  - C. liquidity.
  - D.** profitability.
136. The group of users of accounting information charged with achieving the goals of the business is its
- A. auditors.
  - B. creditors.
  - C.** managers.
  - D. investors.
137. The following users of accounting information have an indirect financial interest in the business *except*
- A. regulatory agency.
  - B.** creditor.
  - C. taxing authority.
  - D. labor union.
138. Which of the following groups uses accounting information primarily to help protect the public?
- A. Management
  - B.** Regulatory agencies
  - C. Taxing authorities
  - D. Economic planners
139. The following users of accounting information have a direct financial interest in a business *except*
- A. a creditor.
  - B.** a financial adviser.
  - C. management.
  - D. an investor.



140. Companies listed on the stock exchanges must file financial statements with the
- A. Financial Accounting Standards Board.
  - B. American Institute of Certified Public Accountants.
  - C.** Securities and Exchange Commission.
  - D. Internal Revenue Service.
141. Which of the following is an agency of the U.S. government?
- A. IASB
  - B.** SEC
  - C. FASB
  - D. AICPA
142. Those who lend money or deliver goods and services before being paid are called
- A. investors.
  - B. debtors.
  - C. underwriters.
  - D.** creditors.
143. Which of the following is a regulatory agency?
- A. IASB
  - B.** SEC
  - C. FASB
  - D. GASB
144. The Sarbanes-Oxley Act of 2002 came, in part, as a result of
- A. the Enron scandal
  - B. the WorldCom scandal
  - C. the Target scandal
  - D.** the Enron and WorldCom scandals
145. The intentional preparation of misleading financial statements, known as fraudulent financial reporting, can result from all of the following *except*
- A. the misapplication of accounting principles.
  - B. the manipulation of inventory records.
  - C. fictitious sales or orders.
  - D.** recording a revenue that has been earned but not yet received.
146. All of the following statements are true about the Sarbanes-Oxley Act *except*
- A. it applies to publicly traded companies.
  - B.** it shields chief executives from criminal penalties.
  - C. it orders the SEC to draw up certain rules.
  - D. its primary goal is to regulate financial reporting and the accounting profession.

147. Which of the following physically prepare and audit financial reports?
- A.** accountants
  - B. managers
  - C. chief executives
  - D. board of directors
148. Which of the following are required to swear that financial reports are accurate and complete?
- A. accountants
  - B. managers
  - C.** chief executives
  - D. board of directors
149. Which of the following might be motivation for fraudulently covering up a financial weakness?
- A. to obtain a loan
  - B. to meet stockholder expectations
  - C. to obtain bonus compensation
  - D.** all of these are possible motivations
150. Fraudulent financial reporting at Enron resulted in
- A. thousands of people losing their jobs.
  - B. thousands of people losing their pensions and investment incomes.
  - C. prison sentences and fines for corporate executives.
  - D.** all of these choices.
151. The Sarbanes-Oxley Act of 2002 applies to all *except*
- A. quarterly statements
  - B. annual reports
  - C.** internal management reports
  - D. none of these are exceptions
152. Why would it be less risky for a wealthy individual to incorporate his or her business rather than to operate it as a sole proprietorship or partnership?

With a sole proprietorship or partnership, the owner or owners have unlimited liability. That is, they may be required to use personal assets to satisfy business debts. The liability of a corporate shareholder, however, is limited to his or her investment in the business.

153. On the right side of the accounting equation are two types of claims against resources. Explain what they are and give an example of an item that would increase each. Which type of claim has priority?

The two types of claims against resources are creditors' equities (liabilities) and owner's equity. Liabilities are a business's obligations to pay cash, transfer assets, or provide services to other entities in the future. Examples might include accounts payable, notes payable, or wages payable. Owner's equity represents the claims by the owner and is what would be left if all liabilities were paid. Examples include owner's additional investments or net income. Creditors have rights over owners.

154. How does the statement of owner's equity relate to the income statement and the balance sheet?

The statement of owner's equity provides a link between the income statement and the balance sheet. Specifically, it takes the net income or loss figure from the income statement and uses it (along with investments and withdrawals) to arrive at the owner's capital balance to be presented on the balance sheet.

155. What is independence, and why is it important for a CPA to maintain it when conducting an audit?

Independence means having no financial or other compromising ties with the company under audit. To give the public confidence in their work, CPAs must maintain their independence whenever they conduct an audit.

156. What is the responsibility of the independent auditor? Who is responsible for the content of the published financial statements?

The responsibility of the independent auditor is to express an opinion about the financial statements of the company being audited. Company's management is responsible for the content of the published financial statements.

157. Distinguish between profitability and liquidity.

Profitability is the ability to earn enough income to attract and hold investment capital, whereas liquidity means having enough funds on hand to pay debts when they fall due.

158. Explain why each of the following persons or groups would be interested in seeing the financial statements of a company. Also state whether each has a direct or indirect financial interest.

- a. Potential investor
- b. Internal Revenue Service
- c. A labor union
- d. Securities and Exchange Commission
- e. Potential creditor
- f. Management
- g. Economic planners

- a. To help determine if the prospects for a profitable investment is good relative to other investment opportunities (direct interest)
- b. To help determine the tax that should be levied against the company (indirect interest)
- c. To give the labor union negotiators a basis for negotiating for higher wages and benefits (indirect interest)
- d. To help determine if the investing public is being given accurate and complete information (indirect interest)
- e. To help determine if the creditor should extend credit to the company (direct interest)
- f. To help the company achieve goals such as profitability and liquidity (neither direct nor indirect)
- g. To set economic policies and judge economic programs (indirect interest)

159. List five possible users of a set of financial statements and state what each would be interested in learning from its review.

Possible users and their reasons for interest could be:

- Existing creditors who would be concerned about being repaid on time
- Possible creditors who are considering extending credit or making loans to the company and being repaid in a timely fashion
- Current owners who want to follow and manage their investment
- Individuals or corporations considering an investment in the company
- College students who would use the statements to learn about financial statement analysis
- Managers of the company who would use the statements to evaluate their areas of operations and make decisions to improve them
- Government bodies such as the SEC, which would review the financial statements to ensure conformity to laws that protect the general public
- Labor unions involved with the company, which would review the statements to evaluate present profitability as part of preparing for contract negotiations

160. Which four types of transactions affect owner's equity, and how do they affect it?

Revenues and owner investments increase owner's equity, whereas expenses and withdrawals decrease owner's equity.

161. Indicate by letter the agency that applies each statement.

- |  |                |
|--|----------------|
| 1. Responsible for interpreting and enforcing tax laws                           | IRS <u>1</u>   |
| 2. Establishes accounting standards for state and local governments              | GASB <u>2</u>  |
| 3. The accounting profession's main organization of certified public accountants | IASB <u>6</u>  |
| 4. Current authoritative body for developing GAAP                                | IMA <u>7</u>   |
| 5. Protector of the investing public   | SEC <u>5</u>   |
| 6. Developer of international accounting standards                               | FASB <u>4</u>  |
| 7. Primary professional association of managerial accountants                    | AICPA <u>3</u> |

162. Newberry Company's owner's equity equals one-fourth of the company's total assets. The company's liabilities are \$309,000. What is the amount of the company's owner's equity?

$$\begin{aligned} \text{Assets} &= \text{Liabilities} + \text{Equity} \\ A &= 3/4 A + 1/4 A \\ 3/4 A &= \$309,000 \\ A &= \$309,000 \div 0.75 = \$412,000 \\ \text{Equity} &= \$412,000 - \$309,000 = \$103,000 \end{aligned}$$

163. Chin Company's owner's equity equals one-third of the company's total assets. The company's liabilities are \$120,000. What is the amount of the company's owner's equity?

$$\begin{aligned} \text{Assets} &= \text{Liabilities} + \text{Equity} \\ A &= 2/3 A + 1/3 A \\ 2/3 A &= \$120,000 \\ A &= \$120,000 \cdot 3/2 = \$180,000 \\ \text{Equity} &= \$180,000 - \$120,000 = \$60,000 \end{aligned}$$

164. Garcia Company's owner's equity equals one-half of the company's total assets. The company's liabilities are \$140,000. What is the amount of the company's owner's equity?

$$\text{Assets} = \text{Liabilities} + \text{Equity}$$

$$A = 1/2 A + 1/2 A$$

$$1/2 A = \$140,000$$

$$A = \$140,000 \times 2 = \$280,000$$

$$\text{Equity} = \$280,000 - \$140,000 = \$140,000$$

165. Following are the total assets and liabilities at the beginning and end of the year for Hagedorn Company:

	<b>Assets</b>	<b>Liabilities</b>
Beginning of the year	\$ 70,000	\$45,000
End of the year	108,000	40,000

Determine the net income or loss for the year in each of the following situations:

- The owner made no investments in the business and no withdrawals were made during the year.
- The owner made an investment of \$20,000 and withdrew \$12,000 during the year.

$$\text{a. } [(\$108,000 - \$40,000) - (\$70,000 - \$45,000)] = \$43,000$$

$$\text{b. } [(\$108,000 - \$40,000) - (\$70,000 - \$45,000) - \$20,000 + \$12,000] = \$35,000$$

166. At the beginning of the year, Shannon Company's assets were \$150,000 and its owner's equity was \$100,000. During the year, assets decreased \$30,000 and liabilities increased \$15,000. What was the owner's equity at the end of the year?

$$[(\$150,000 - \$30,000) - (\$50,000 + \$15,000)] = \$55,000$$

167. At the beginning of the year, Pullman Company's assets were \$270,000 and its owner's equity was \$201,000. During the year, assets decreased by \$35,000 and liabilities increased by \$10,000. What was owner's equity at the end of the year?

$$[(\$270,000 - \$35,000) - (\$69,000 + \$10,000)] = \underline{\$156,000}$$

168. Use the following information to calculate at or for the year ended December 31, 2014:  
 (a) net income, (b) owner's capital, (c) total liabilities and owner's equity, and (d) accounts receivable.

Cash	\$32,000	Owner's Capital, Dec. 31, 2013	\$91,000
Accounts Receivable	?	Owner's Capital, Dec. 31, 2014	?
Supplies	1,000	Withdrawals	16,000
Land	70,000	Commissions Earned	40,000
Accounts Payable	12,000	Wages Expense	14,000
Notes Payable	14,000	Rent Expense	6,000

- a.  $\$40,000 - \$14,000 - \$6,000 = \underline{\$20,000}$   
 b.  $\$91,000 + \$20,000 - \$16,000 = \underline{\$95,000}$   
 c.  $\$12,000 + \$14,000 + \$95,000 = \underline{\$121,000}$   
 d.  $\$121,000 - \$32,000 - \$1,000 - \$70,000 = \underline{\$18,000}$

169. Use the following information to calculate at or for the year ended December 31, 2014:  
 (a) net income, (b) owner's capital, (c) total assets, and (d) cash.

Cash	\$ ?	Owner's Capital, Dec. 31, 2014	\$ ?
Accounts Receivable	8,000	Withdrawals	6,000
Inventories	22,000	Commissions Earned	20,000
Accounts Payable	7,000	Salaries Expense	4,000
Salaries Payable	1,000	Utilities Expense	2,000
Owner's Capital, Dec. 31, 2013	26,000		

- a.  $\$20,000 - \$4,000 - \$2,000 = \underline{\$14,000}$   
 b.  $\$26,000 + \$14,000 - \$6,000 = \underline{\$34,000}$   
 c. Total Assets = Total Liabilities and Owner's Equity =  $\$7,000 + \$1,000 + \$34,000 = \underline{\$42,000}$   
 d.  $\$42,000 - \$8,000 - \$22,000 = \underline{\$12,000}$

170. Kyle Biehl, an attorney, bills his clients at a rate of \$100 per hour. At the beginning of July, clients owed him \$8,000, of which he collected \$5,600 during the month. In July, Kyle billed clients for 160 hours of work. By the end of July, 60 of these hours were unpaid.

Kyle has one employee, Marcia Medvid, who is paid \$20 per hour. During July, Marcia worked 170 hours, of which 16 hours will be paid in August. The rest were paid in July along with wages for 8 hours worked the last day of June.

Show calculations as you determine the following for the month of July:

- a. Amount of revenue earned
- b. Wages expense incurred
- c. Cash received from clients
- d. Cash paid to Marcia Medvid

a.	Revenue earned from clients: 160 hours ´ \$100 = <u>\$16,000</u>	
b.	Wages expense incurred for Marcia Medvid: 170 hours ´ \$20 = <u>\$3,400</u>	
c.	Cash received from clients during July::	
	Received from clients previously billed	\$ 5,600
	Received from clients billed in July: (160 hours – 60 hours) ´ \$100	<u>10,000</u>
	Total	<u>\$15,600</u>
d.	Cash paid to Marcia Medvid:	
	Paid for June work (8 hours ´ \$20)	\$ 160
	Paid for July work: (170 hours – 16 hours) ´ \$20	<u>3,080</u>
	Total	<u>\$ 3,240</u>

171. Upshaw Company had a balance of \$160,000 in Sue Upshaw, Capital on December 31, 2013. During 2014, the company reported a net income of \$84,000 after taxes, and the owner withdrew \$32,000, while making no additional investments. Prepare the company's statement of owner's equity for the year ended December 31, 2014.

<b>Upshaw Company</b>	
<b>Statement of Owner's Equity</b>	
<b>For the Year Ended December 31, 2014</b>	
Sue Upshaw, capital, December 31, 2013	\$160,000
Net income for the year	<u>84,000</u>
Subtotal	\$244,000
Less withdrawals	<u>32,000</u>
Sue Upshaw, capital, December 31, 2014	<u>\$212,000</u>



172. Feldman Company had a balance of \$360,000 in Saul Feldman, Capital on December 31, 2013. During 2014, the company reported a net income of \$48,000, and the owner withdrew \$36,000 during the year, while making no additional investments. Prepare the company's statement of owner's equity for the year ended December 31, 2014.

<b>Feldman Company</b>	
<b>Statement of Owner's Equity</b>	
<b>For the Year Ended December 31, 2014</b>	
Saul Feldman, Capital, December 31, 2014	\$360,000
Net income for the year	<u>48,000</u>
Subtotal	\$408,000
Less withdrawals	<u>36,000</u>
Saul Feldman, Capital, December 31, 2014	<u>\$372,000</u>

173. Use the following accounts and information to prepare, in good form, an income statement, statement of owner's equity, and balance sheet for McCollum Enterprises for the year ended December 31, 2014.

Accounts Payable	\$ 4,800	Insurance Expense	\$ 1,000
Accounts Receivable	600	Land	39,000
Buildings	52,000	Notes Payable	6,000
Cash	26,200	Rent Expense	3,600
Commissions Earned	19,000	Salaries Expense	8,400
Ed McCollum, Capital, Dec. 31, 2013	104,400	Supplies	400
Ed McCollum, Withdrawals	3,000		

McCollum Enterprises			
Income Statement			
For the Year Ended December 31, 2014			
Revenues:			
	Commissions earned		\$19,000
Expenses:			
	Insurance expense	\$1,000	
	Rent expense	3,600	
	Salaries expense	8,400	13,000
	Net income		\$ 6,000

McCollum Enterprises	
Statement of Owner's Equity	
For the Year Ended December 31, 2014	
Ed McCollum, capital, December 31, 2013	\$104,400
Net income for the year	6,000
Subtotal	\$110,400
Less withdrawals	3,000
Ed McCollum, capital, December 31, 2014	\$107,400

McCollum Enterprises					
Balance Sheet					
December 31, 2014					
Assets			Liabilities		
Cash	\$ 26,200		Accounts payable	\$ 4,800	
Accounts receivable	600		Notes payable	6,000	
Supplies	400		Total liabilities		\$ 10,800
Land	39,000				
Buildings	52,000		Owner's Equity		
			Ed McCollum, capital		107,400
			Total liabilities and		
Total assets	\$118,200		owner's equity		\$118,200

174. Use the following accounts and information to prepare, in good form, an income statement, statement of owner's equity, and balance sheet for Day Industries for the month ended July 31, 2014.

Accounts Payable	\$ 3,100	Land	\$35,000
Accounts Receivable	1,400	Notes Payable	3,300
Buildings	22,000	Rent Expense	2,400
Cash	15,600	Salaries Expense	10,000
Commissions Earned	12,700	Supplies	400
Darla Day, Capital, June 30, 2014	77,900		
Withdrawals	8,000		
Insurance Expense	2,200		

Day Industries			
Income Statement			
For the Month Ended July 31, 2014			
Revenues:			
	Commissions earned		\$12,700
Expenses:			
	Insurance expense	\$ 2,200	
	Rent expense	2,400	
	Salaries expense	10,000	14,600
	Net loss		\$(1,900)

Day Industries	
Statement of Owner's Equity	
For the Month Ended July 31, 2014	
Darla Day, capital, June 30, 2014	\$77,900
Net loss for the year	(1,900)
Subtotal	\$76,000
Less withdrawals	8,000
Darla Day, capital, July 31, 2014	\$68,000

Day Industries					
Balance Sheet					
July 31, 2014					
Assets			Liabilities		
Cash	\$ 15,600		Accounts payable	\$ 3,100	
Accounts receivable	1,400		Notes payable	3,300	
Supplies	400		Total liabilities		\$ 6,400
Land	35,000				
Buildings	22,000		Owner's Equity		
			Darla Day, capital		68,000
			Total liabilities and		
Total assets	\$74,400		owner's equity		\$74,400

175. Use the following accounts and balances to prepare a balance sheet for England Company at December 31, 2014:

Accounts Payable	\$10,000
Accounts Receivable	6,400
Bryan England, Capital	?
Cash	4,800
Equipment	13,200

England Company			
Balance Sheet			
December 31, 2014			
Assets		Liabilities	
Cash	\$ 4,800	Accounts payable	\$10,000
Accounts receivable	6,400		
Equipment	13,200	Owner's Equity	
		Bryan England, capital	14,400
		Total liabilities and	
Total assets	\$24,400	owner's equity	\$24,400