

Chapter 01 - Introduction to Accounting and Business

True / False

1. A merchandising business buys products from other businesses to sell to customers.

- a. True
- b. False

ANSWER: True

2. The role of accounting is to provide many different users with financial information to make economic decisions.

- a. True
- b. False

ANSWER: True

3. Accounting information users need reports about the economic activities and condition of businesses.

- a. True
- b. False

ANSWER: True

4. Managerial accounting information is used by external and internal users equally.

- a. True
- b. False

ANSWER: False

5. Senior executives cannot be criminally prosecuted for the wrongdoings they commit on behalf of the companies where they work.

- a. True
- b. False

ANSWER: False

6. Financial accounting provides information to all users, while the main focus for managerial accounting is to provide information to the management.

- a. True
- b. False

ANSWER: True

7. Proper ethical conduct implies that you only consider what's in your best interest.

- a. True
- b. False

ANSWER: False

8. Some of the major fraudulent acts committed by senior executives started as what they considered to be small ethical lapses that grew out of control.

- a. True
- b. False

ANSWER: True

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9. A business is an organization in which basic resources or inputs, such as materials and labor, are assembled and processed to provide outputs in the form of goods or services to customers.

- a. True
- b. False

ANSWER: True

10. Two factors that typically lead to ethical violations are relevance and timeliness of accounting information.

- a. True
- b. False

ANSWER: False

11. Financial accounting reports are relevant only to users within the business.

- a. True
- b. False

ANSWER: False

12. The Sarbanes-Oxley Act established standards for corporate responsibility and disclosure.

- a. True
- b. False

ANSWER: True

13. The main objective for all business is to maximize unrealized profits.

- a. True
- b. False

ANSWER: False

14. The primary role of accounting is to determine the amount of taxes a business will be required to pay to taxing entities.

- a. True
- b. False

ANSWER: False

15. The basic difference between manufacturing and merchandising companies is the completion level of the products they purchase for resale to customers.

- a. True
- b. False

ANSWER: True

16. An example of an external user of accounting information is the federal government.

- a. True
- b. False

ANSWER: True

17. Proprietorships are owned by one owner and provide only services to their customers.

- a. True

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b. False

ANSWER: False

18. About 90% of the businesses in the United States are organized as corporations.

a. True

b. False

ANSWER: False

19. The Financial Accounting Standards Board (FASB) is the authoritative body that has primary responsibility for developing accounting principles.

a. True

b. False

ANSWER: True

20. The cost concept is the basis for entering the purchase price into the accounting records.

a. True

b. False

ANSWER: True

21. The unit of measurement concept requires that economic data be recorded in dollars.

a. True

b. False

ANSWER: True

22. If a building is appraised for \$85,000, it is offered for sale at \$90,000, and the buyer pays \$80,000 cash for it, the buyer would record the building at \$85,000.

a. True

b. False

ANSWER: False

23. The financial statements of a proprietorship should include the owner's personal assets and liabilities.

a. True

b. False

ANSWER: False

24. No significant differences exist between the accounting standards issued by the FASB and the IASB.

a. True

b. False

ANSWER: False

25. Generally accepted accounting principles regulate how and what financial information is reported by businesses.

a. True

b. False

ANSWER: True

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26. The IASB maintains an electronic database, called the Accounting Standards Codification, which contains all of the accounting standards that make up GAAP.

- a. True
- b. False

ANSWER: False

27. The accounting equation can be expressed as $\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$.

- a. True
- b. False

ANSWER: True

28. The rights or claims to the assets of a business may be subdivided into rights of creditors and rights of owners.

- a. True
- b. False

ANSWER: True

29. The owner's rights to the assets rank ahead of the creditors' rights to the assets.

- a. True
- b. False

ANSWER: False

30. If the liabilities owed by a business total \$300,000 and owner's equity is equal to \$300,000, then the assets also total \$300,000.

- a. True
- b. False

ANSWER: False

31. If total assets decreased by \$30,000 during a specific period and owner's equity decreased by \$35,000 during the same period, the period's change in total liabilities was a \$65,000 increase.

- a. True
- b. False

ANSWER: False

32. If total assets increased by \$190,000 during a specific period and liabilities decreased by \$10,000 during the same period, the period's change in total owner's equity was a \$200,000 increase.

- a. True
- b. False

ANSWER: True

33. If net income for a proprietorship was \$50,000, the owner withdrew \$20,000 in cash, and the owner invested \$10,000 in cash, the capital of the owner increased by \$40,000.

- a. True
- b. False

ANSWER: True

34. An account receivable is typically classified as a revenue.

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- a. True
- b. False

ANSWER: False

35. An account receivable is a claim against a customer resulting from a sale on account.

- a. True
- b. False

ANSWER: True

36. Paying an account payable increases liabilities and decreases assets.

- a. True
- b. False

ANSWER: False

37. Receiving payments on an account receivable increases both equity and assets.

- a. True
- b. False

ANSWER: False

38. Cash withdrawals by owners decrease assets and increase equity.

- a. True
- b. False

ANSWER: False

39. Purchasing supplies on account increases liabilities and decreases equity.

- a. True
- b. False

ANSWER: False

40. Receiving a bill or otherwise being notified that an amount is owed is **not** recorded until the amount is paid.

- a. True
- b. False

ANSWER: False

41. Revenue is earned only when money is received.

- a. True
- b. False

ANSWER: False

42. Assets that are used up during the process of earning revenue are called expenses.

- a. True
- b. False

ANSWER: True

43. The excess of revenue over the expenses incurred in earning the revenue is called capital.

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- a. True
- b. False

ANSWER: False

44. There are four primary financial statements of a proprietorship: the income statement, the statement of owner's equity, the balance sheet, and the statement of cash flows.

- a. True
- b. False

ANSWER: True

45. An income statement is a summary of the revenues and expenses of a business as of a specific date.

- a. True
- b. False

ANSWER: False

46. A statement of owner's equity reports the changes in the owner's equity for a period of time.

- a. True
- b. False

ANSWER: True

47. The statement of cash flows consists of three sections: Cash Flows from (Used for) Operating Activities, Cash Flows from (Used for) Income Activities, and Cash Flows from (Used for) Equity Activities.

- a. True
- b. False

ANSWER: False

48. The balance sheet represents the accounting equation.

- a. True
- b. False

ANSWER: True

49. Net income and net profit do **not** mean the same thing.

- a. True
- b. False

ANSWER: False

50. The higher the ratio of liabilities to owner's equity, the better able a company is to withstand poor business conditions and to pay its obligations to creditors.

- a. True
- b. False

ANSWER: False

Multiple Choice

51. Profit is the difference between

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- a. assets and liabilities
- b. the incoming cash and outgoing cash
- c. the assets purchased with cash contributed by the owner and the cash spent to operate the business
- d. the amounts received from customers for goods or services and the amounts paid for the inputs used to provide the goods or services

ANSWER: d

52. Two common areas of accounting that respectively provide information to internal and external users are
- a. forensic accounting and financial accounting
 - b. managerial accounting and financial accounting
 - c. managerial accounting and environmental accounting
 - d. financial accounting and tax accounting systems

ANSWER: b

53. Which of the following **best** describes accounting?
- a. records economic data but does not communicate the data to users according to any specific rules
 - b. is an information system that provides reports to users regarding economic activities and condition of a business
 - c. is of no use by individuals outside of the business
 - d. is used only for filling out tax returns and for financial statements for various type of governmental reporting requirements

ANSWER: b

54. Which type of accountant typically practices as an individual or as a member of a public accounting firm?
- a. Certified Public Accountant
 - b. Certified Payroll Professional
 - c. Certified Internal Auditor
 - d. Certified Management Accountant

ANSWER: a

55. Financial reports are used by
- a. management
 - b. creditors
 - c. investors
 - d. All of these choices

ANSWER: d

56. Which of the following is a manufacturing business?
- a. General Motors
 - b. Facebook
 - c. American Airlines
 - d. Target

ANSWER: a

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57. Which of the following is a service business?

- a. Dell Inc.
- b. Wal-Mart Stores, Inc.
- c. Microsoft Corporation
- d. Facebook, Inc.

ANSWER: d

58. Which of the following groups of companies includes examples of merchandising businesses?

- a. Delta Air Lines, Marriott, Gap Inc.
- b. Gap Inc., Amazon, Nike Inc.
- c. GameStop, Sony, Dell
- d. GameStop, Best Buy, Gap Inc.

ANSWER: d

59. Which of the following groups is considered to be internal users of accounting information?

- a. employees and customers
- b. customers and vendors
- c. employees and managers
- d. government entities and banks

ANSWER: c

60. The following are examples of external users of accounting information **except**

- a. government entities
- b. customers
- c. creditors
- d. managers

ANSWER: d

61. Which of the following is the **best** description of accounting's role in business?

- a. Accounting provides stockholders with information regarding the market value of the company's stocks.
- b. Accounting provides information to managers to operate the business and to other users to make decisions regarding the economic condition of the company.
- c. Accounting helps in decreasing the credit risk of the company.
- d. Accounting is not responsible for providing any form of information to users. That is the role of the Information Systems Department.

ANSWER: b

62. Managerial accountants would be responsible for providing information regarding

- a. tax reports to government agencies
- b. profit reports to owners and management
- c. expansion of a product line report to management
- d. consumer reports to customers

ANSWER: c

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63. Which of the following is **not** a certification for accountants?

- a. CIA
- b. CMA
- c. CISA
- d. IRS

ANSWER: d

64. Which of the following is **not** a role of accounting in business?

- a. to provide reports to users about the economic activities and conditions of a business
- b. to personally guarantee loans of the business
- c. to provide information to external users to determine the economic performance and condition of the business
- d. to assess the various informational needs of users and design an accounting system to meet those needs

ANSWER: b

65. Which of the following is a guideline for behaving ethically?

- I. Identify the consequences of a decision and its effect on others.
 - II. Consider your obligations and responsibilities to those affected by the decision.
 - III. Identify your decision based on personal standards of honesty and fairness.
- a. I and II
 - b. II and III
 - c. I and III
 - d. I, II, and III

ANSWER: d

66. Which of the following would **not** normally operate as a service business?

- a. pet groomer
- b. grocer
- c. lawn care company
- d. styling salon

ANSWER: b

67. Most businesses in the United States are

- a. proprietorships
- b. partnerships
- c. corporations
- d. cooperatives

ANSWER: a

68. Which of the following is **not** a business entity?

- a. entrepreneurship
- b. proprietorship
- c. partnership
- d. corporation

ANSWER: a

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69. An entity that is organized according to state or federal statutes and in which ownership is divided into shares of stock is a

- a. proprietorship
- b. corporation
- c. partnership
- d. governmental unit

ANSWER: b

70. Which of the following is **true** regarding a limited liability company?

- a. makes up 10% of business organizations in the United States
- b. combines the attributes of a partnership and a corporation
- c. provides tax and liability advantages to the owners
- d. All of these choices

ANSWER: d

71. On May 20, White Repair Service extended an offer of \$108,000 for land that had been priced for sale at \$140,000. On May 30, White Repair Service accepted the seller's counteroffer of \$115,000. On June 20, the land was assessed at a value of \$95,000 for property tax purposes. On July 4, White Repair Service was offered \$150,000 for the land by a national retail chain. At what value should the land be recorded in White Repair Service's records?

- a. \$108,000
- b. \$95,000
- c. \$140,000
- d. \$115,000

ANSWER: d

72. Which of the following is most likely to obtain large amounts of resources by issuing stock?

- a. partnership
- b. corporation
- c. proprietorship
- d. government entity

ANSWER: b

73. Which of the following is **not** a characteristic of a corporation?

- a. Corporations are organized as a separate legal taxable entity.
- b. Ownership is divided into shares of stock.
- c. Corporations experience an ease in obtaining large amounts of resources by issuing stock.
- d. A corporation's resources are limited to its individual owners' resources.

ANSWER: d

74. The initials GAAP stand for

- a. general accounting procedures
- b. generally accepted plans
- c. generally accepted accounting principles

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- d. generally accepted accounting practices

ANSWER: c

75. Within the United States, the dominant body in the primary development of accounting principles is the

- a. American Institute of Certified Public Accountants (AICPA)
- b. American Accounting Association (AAA)
- c. Financial Accounting Standards Board (FASB)
- d. Institute of Management Accountants (IMA)

ANSWER: c

76. The business entity concept means that

- a. the owner is part of the business entity
- b. an entity is organized according to state or federal statutes
- c. an entity is organized according to the rules set by the FASB
- d. the entity is an individual economic unit for which data are recorded, analyzed, and reported

ANSWER: d

77. For accounting purposes, the business entity should be considered separate from its owners if the entity is

- a. a corporation
- b. a proprietorship
- c. a partnership
- d. All of these choices

ANSWER: d

78. The objectivity concept requires that

- a. business transactions be consistent with the objectives of the entity
- b. the Financial Accounting Standards Board be fair and unbiased in its deliberations over new accounting standards
- c. accounting principles meet the objectives of the Securities and Exchange Commission
- d. amounts recorded in the financial statements be based on independently verifiable evidence

ANSWER: d

79. Karen Meyer owns and operates Crystal Cleaning Company. Recently, Meyer withdrew \$10,000 from Crystal Cleaning, and she contributed \$6,000, in her name, to the American Red Cross. The contribution of the \$6,000 should be recorded on the accounting records of which of the following entities?

- a. Crystal Cleaning and the American Red Cross
- b. Karen Meyer's personal records and the American Red Cross
- c. Karen Meyer's personal records and Crystal Cleaning
- d. Karen Meyer's personal records, Crystal Cleaning, and the American Red Cross

ANSWER: b

80. Equipment with an estimated market value of \$30,000 is offered for sale at \$45,000. The equipment is acquired for \$15,000 in cash and a note payable of \$20,000 due in 30 days. The amount used in the buyer's accounting records to record this acquisition is

- a. \$30,000

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- b. \$35,000
- c. \$15,000
- d. \$45,000

ANSWER: b

81. Which of the following is the authoritative body in the United States that has the primary responsibility for developing accounting principles?

- a. FASB
- b. IRS
- c. SEC
- d. AICPA

ANSWER: a

82. Which of the following concepts relates to separating the reporting of business and personal economic transactions?

- a. cost concept
- b. unit of measure concept
- c. business entity concept
- d. objectivity concept

ANSWER: c

83. Donner Company is selling a piece of land adjacent to its business premises. An appraisal reported the market value of the land to be \$220,000. Focus Company initially offered to buy the land for \$177,000. The companies settled on a purchase price of \$212,000. On the same day, another piece of land on the same block sold for \$232,000. Under the cost concept, at what amount should the land be recorded in the accounting records of Focus Company?

- a. \$177,000
- b. \$212,000
- c. \$220,000
- d. \$232,000

ANSWER: b

84. Many countries outside the United States use financial accounting standards issued by the

- a. AICPA
- b. SEC
- c. IASB
- d. FASB

ANSWER: c

85. The unit of measure concept

- a. is only used in the financial statements of manufacturing companies
- b. is not important when applying the cost concept
- c. requires that different units be used for assets and liabilities
- d. requires that economic data be reported in yen in Japan or dollars in the United States

ANSWER: d

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86. Which of the following is **not** true of accounting principles?

- a. Financial accountants follow generally accepted accounting principles (GAAP).
- b. Following GAAP allows accounting information users to compare one company to another.
- c. A new accounting principle can be adopted with stockholders' approval.
- d. The Financial Accounting Standards Board (FASB) has primary responsibility for developing accounting principles.

ANSWER: c

87. The _____ concept requires a company to report its economic activities on a regular basis for a specific period.

- a. cost
- b. matching
- c. objectivity
- d. time period

ANSWER: d

88. The annual accounting period adopted by a company is called its

- a. calendar year
- b. fiscal year
- c. natural business year
- d. natural calendar year

ANSWER: b

89. The natural business year for most retail businesses ends on

- a. January 31
- b. March 31
- c. August 31
- d. December 31

ANSWER: a

90. Which of the following is **not** a characteristic of a corporation?

- a. Corporations are organized as a separate legal taxable entity.
- b. Ownership is divided into shares of stock.
- c. Corporations experience an ease in obtaining large amounts of resources by issuing stock.
- d. A corporation's resources are limited to its individual owners' resources.

ANSWER: d

91. On May 7, Carpet Barn Company offered to pay \$83,000 for land that had a selling price of \$105,000. On May 15, Carpet Barn accepted a counteroffer of \$95,000. On June 5, the land was assessed at a value of \$115,000 for property tax purposes. On December 10, Carpet Barn Company was offered \$135,000 for the land by another company. At what value should the land be recorded in Carpet Barn Company's records?

- a. \$95,000
- b. \$105,000
- c. \$115,000
- d. \$135,000

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ANSWER: a

92. Donner Company is selling a piece of land adjacent to its business. An appraisal reported the market value of the land to be \$120,000. Focus Company initially offered to buy the land for \$107,000. The companies settled on a purchase price of \$115,000. On the same day, another piece of land on the same block sold for \$122,000. Under the cost concept, what amount will be used to record this transaction in Focus Company's accounting records?

- a. \$107,000
- b. \$115,000
- c. \$120,000
- d. \$122,000

ANSWER: b

93. Assets are

- a. always lower than liabilities
- b. equal to liabilities less owner's equity
- c. the same as expenses because they are acquired with cash
- d. financed by the owner and/or creditors

ANSWER: d

94. Debts owed by a business are referred to as

- a. accounts receivable
- b. expenses
- c. owner's equity
- d. liabilities

ANSWER: d

95. The accounting equation may be expressed as

- a. $\text{Assets} = \text{Equities} - \text{Liabilities}$
- b. $\text{Assets} + \text{Liabilities} = \text{Owner's Equity}$
- c. $\text{Assets} = \text{Revenues} - \text{Liabilities}$
- d. $\text{Assets} - \text{Liabilities} = \text{Owner's Equity}$

ANSWER: d

96. Which of the following is **not** an asset?

- a. investments
- b. cash
- c. inventory
- d. owner's equity

ANSWER: d

97. The assets and liabilities of a company are \$128,000 and \$84,000, respectively. Owner's equity should equal

- a. \$212,000
- b. \$44,000
- c. \$128,000

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d. \$84,000

ANSWER: b

98. If total liabilities decreased by \$46,000 during a period of time and owner's equity increased by \$60,000 during the same period, the amount and direction (increase or decrease) of the period's change in total assets would be a

- a. \$106,000 increase
- b. \$14,000 increase
- c. \$14,000 decrease
- d. \$106,000 decrease

ANSWER: b

99. Which of the following is **not** a business transaction?

- a. make a sales offer
- b. sell goods for cash
- c. receive cash for services to be rendered later
- d. pay for supplies

ANSWER: a

100. A business paid \$7,000 to a creditor in payment of an amount owed. The effect of the transaction on the accounting equation was to

- a. increase an asset, decrease another asset
- b. decrease an asset, decrease a liability
- c. increase an asset, increase a liability
- d. increase an asset, increase owner's equity

ANSWER: b

101. Earning revenue

- a. increases assets, increases owner's equity
- b. increases assets, decreases owner's equity
- c. increases one asset, decreases another asset
- d. decreases assets, increases liabilities

ANSWER: a

102. The monetary value charged to customers for the performance of services sold is called a(n)

- a. asset
- b. net income
- c. capital
- d. revenue

ANSWER: d

103. Revenues are reported when

- a. a contract is signed
- b. cash is received from the customer
- c. work is begun on the job

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d. work is completed on the job

ANSWER: d

104. Expenses are recorded when

- a. cash is paid for services rendered
- b. a bill is received in advance of services rendered
- c. assets are used in the process of earning revenue
- d. assets are purchased

ANSWER: c

105. Goods purchased on account for future use in the business, such as supplies, are called

- a. prepaid liabilities
- b. revenues
- c. prepaid expenses
- d. liabilities

ANSWER: c

106. The asset created by a business when it makes a sale on account is termed

- a. accounts payable
- b. prepaid expense
- c. unearned revenue
- d. accounts receivable

ANSWER: d

107. The debt created by a business when it makes a purchase on account is referred to as an

- a. account payable
- b. account receivable
- c. asset
- d. expense payable

ANSWER: a

108. If total assets decreased by \$88,000 during a period of time and owner's equity increased by \$71,000 during the same period, then the amount and direction (increase or decrease) of the period's change in total liabilities would be a(n)

- a. \$17,000 increase
- b. \$88,000 decrease
- c. \$159,000 increase
- d. \$159,000 decrease

ANSWER: d

109. Owner's withdrawals

- a. increase expenses
- b. decrease expenses
- c. increase cash
- d. decrease owner's equity

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ANSWER: d

110. How does paying a liability in cash affect the accounting equation?

- a. assets increase; liabilities decrease
- b. assets increase; liabilities increase
- c. assets decrease; liabilities decrease
- d. liabilities decrease; owner's equity increases

ANSWER: c

111. How does receiving a bill to be paid next month for services received affect the accounting equation?

- a. assets decrease; owner's equity decreases
- b. assets increase; liabilities increase
- c. liabilities increase; owner's equity increases
- d. liabilities increase; owner's equity decreases

ANSWER: d

112. How does the purchase of equipment by signing a note affect the accounting equation?

- a. assets increase; assets decrease
- b. assets increase; liabilities decrease
- c. assets increase; liabilities increase
- d. assets increase; owner's equity increases

ANSWER: c

113. Land originally purchased for \$30,000 is sold for \$62,000 in cash. What is the effect of the sale on the accounting equation?

- a. assets increase by \$62,000; owner's equity increases by \$62,000
- b. assets increase by \$32,000; owner's equity increases by \$32,000
- c. assets increase by \$62,000; liabilities decrease by \$30,000; owner's equity increases by \$32,000
- d. assets increase by \$30,000; no change in liabilities; owner's equity increases by \$62,000

ANSWER: b

114. Which of the following accounts is a liability?

- a. Accounts Payable
- b. Accounts Receivable
- c. Wages Expense
- d. Service Revenue

ANSWER: a

115. Abbie Marson is the sole owner and operator of Great Plains Company. As of the end of its accounting period, December 31, Year 1, Great Plains Company has assets of \$940,000 and liabilities of \$300,000. During Year 2, Marson invested an additional \$73,000 and withdrew \$33,000 from the business. What is the amount of net income during Year 2, assuming that as of December 31, Year 2, assets were \$995,000 and liabilities were \$270,000?

- a. \$45,000
- b. \$50,000

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- c. \$106,000
- d. \$370,000

ANSWER: a

116. Which of the following asset accounts is increased when a receivable is collected?

- a. Accounts Receivable
- b. Supplies
- c. Accounts Payable
- d. Cash

ANSWER: d

117. Transactions affecting owner's equity include

- a. owner's investments and payment of liabilities
- b. owner's investments, owner's withdrawals, earning of revenues, and incurrence of expenses
- c. owner's investments, earning of revenues, incurrence of expenses, and collection of accounts receivable
- d. owner's withdrawals, earning of revenues, incurrence of expenses, and purchase of supplies on account

ANSWER: b

118. Michael Anderson is starting a computer programming business and has deposited an initial investment of \$15,000 into the business cash account. Identify how the accounting equation will be affected.

- a. increase in assets (Cash) and increase in liabilities (Accounts Payable)
- b. increase in assets (Cash) and increase in owner's equity (Michael Anderson, Capital)
- c. increase in assets (Accounts Receivable) and decrease in liabilities (Accounts Payable)
- d. increase in assets (Cash) and increase in assets (Accounts Receivable)

ANSWER: b

119. Gomez Service Company paid its first installment on a note payable of \$2,000. How will this transaction affect the accounting equation?

- a. increase in liabilities (Notes Payable) and decrease in assets (Cash)
- b. decrease in assets (Cash) and decrease in owner's equity (Note Payable Expense)
- c. decrease in assets (Cash) and decrease in assets (Notes Receivable)
- d. decrease in assets (Cash) and decrease in liabilities (Notes Payable)

ANSWER: d

120. Ramon Ramos has withdrawn \$750 from Ramos Repair Company's cash account to deposit in his personal account. How does this transaction affect Ramos Repair Company's accounting equation?

- a. increase in assets (Accounts Receivable) and decrease in assets (Cash)
- b. decrease in assets (Cash) and decrease in owner's equity (Owner's Withdrawal)
- c. decrease in assets (Cash) and decrease in liabilities (Accounts Payable)
- d. increase in assets (Cash) and decrease in owner's equity (Owner's Withdrawal)

ANSWER: b

121. Which of the following is **not** a business transaction?

- a. Erin deposits \$15,000 in a bank account in the name of Erin's Lawn Service.

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- b. Erin provided services to customers earning fees of \$600.
- c. Erin purchased hedge trimmers for her lawn service agreeing to pay the supplier next month.
- d. Erin pays her monthly personal credit card bill.

ANSWER: d

122. Which of the following is a business transaction?

- a. purchase inventory on account
- b. plan advertising for upcoming sale
- c. give employees a raise beginning next month
- d. submit estimate for construction project

ANSWER: a

123. The financial statement that presents a summary of the revenues and expenses of a business for a specific period of time, such as a month or year, is called a(n)

- a. statement of cash flows
- b. statement of owner's equity
- c. income statement
- d. balance sheet

ANSWER: c

124. Which of the following financial statements reports information as of a specific date?

- a. income statement
- b. statement of owner's equity
- c. statement of cash flows
- d. balance sheet

ANSWER: d

125. Four financial statements are usually prepared for a business. The statement of cash flows is usually prepared last. The statement of owner's equity (OE), the balance sheet (B), and the income statement (I) are prepared in a certain order to obtain information needed for the next statement. In what order are these three statements prepared?

- a. I,OE, B
- b. B, I, OE
- c. OE, I, B
- d. B,OE, I

ANSWER: a

126. Liabilities are reported on the

- a. income statement
- b. statement of owner's equity
- c. statement of cash flows
- d. balance sheet

ANSWER: d

127. Cash investments made by the owner to the business are reported on the statement of cash flows in the

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- a. financing activities section
- b. investing activities section
- c. operating activities section
- d. supplemental statement

ANSWER: a

128. The year-end balance of the owner's capital account appears on

- a. both the statement of owner's equity and the income statement
- b. only the statement of owner's equity
- c. both the statement of owner's equity and the balance sheet
- d. both the statement of owner's equity and the statement of cash flows

ANSWER: c

129. A financial statement user would determine if a company was profitable or not during a specific period of time by reviewing the

- a. income statement
- b. balance sheet
- c. statement of cash flows
- d. statement of retained earnings

ANSWER: a

130. If an owner wanted to know how money flowed into and out of the company, which financial statement would the owner use?

- a. income statement
- b. statement of cash flows
- c. balance sheet
- d. statement of retained earnings

ANSWER: b

131. The Assets section of the balance sheet normally presents assets in

- a. alphabetical order
- b. the order of largest to smallest dollar amounts
- c. the order in which they will be converted into cash or used in operations
- d. the order of smallest to largest dollar amounts

ANSWER: c

132. All of the following are general-purpose financial statements **except** a(n)

- a. balance sheet
- b. income statement
- c. statement of owner's equity
- d. cash budget

ANSWER: d

133. All of the following statements regarding the ratio of liabilities to owner's equity are true **except**

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- a. a ratio of 1 indicates that liabilities equal owner's equity
- b. corporations can use this ratio but substitute total stockholders' equity for total owner's equity
- c. the higher this ratio, the better able a business is to withstand poor business conditions and pay creditors
- d. the lower this ratio, the better able a business is to withstand poor business conditions and pay creditors

ANSWER: c

134. Given the following data:

	<u>Dec. 31, Year 2</u>	<u>Dec. 31, Year 1</u>
Total liabilities	\$128,250	\$120,000
Total owner's equity	95,000	80,000

Compute the ratio of liabilities to owner's equity for each year. Round to two decimal places.

- a. 1.50 and 1.07, respectively
- b. 1.35 and 1.50, respectively
- c. 1.07 and 1.19, respectively
- d. 1.19 and 1.35, respectively

ANSWER: b

Matching

Match each of the following businesses with the type of business that best describes it. Each letter may be used more than once.

- a. Service business
- b. Manufacturing business
- c. Merchandising business

135. A hospital

ANSWER: a

136. A dressmaking company

ANSWER: b

137. A supermarket

ANSWER: c

138. A modular homebuilder

ANSWER: b

139. A health club and spa

ANSWER: a

140. A tax preparation firm

ANSWER: a

141. A law firm

ANSWER: a

142. A men's clothing store

ANSWER: c

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143. A book publisher

ANSWER: b

144. An automobile dealer

ANSWER: c

Match each of the following companies with the type of business that best describes it. Each letter may be used more than once.

- a. Service business
- b. Merchandising business
- c. Manufacturing business

145. Dillard's

ANSWER: b

146. Time Warner Cable

ANSWER: a

147. General Motors

ANSWER: c

148. Redbox

ANSWER: a

149. American Airlines

ANSWER: a

150. Sony

ANSWER: c

151. Best Buy

ANSWER: b

152. Banana Republic

ANSWER: b

153. H&R Block

ANSWER: a

Match each of the following users of accounting information to the type of user: internal or external. Each letter may be used more than once.

- a. Internal user
- b. External user

154. Payroll manager

ANSWER: a

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155. Bank

ANSWER: b

156. President's secretary

ANSWER: a

157. Internal Revenue Service

ANSWER: b

158. Raw material vendors

ANSWER: b

159. Social Security Administration

ANSWER: b

160. Health insurance provider

ANSWER: b

161. Managerial accountant

ANSWER: a

Match each of the following characteristics with the form of business entity that it best describes. Each letter may be used more than once.

a. Proprietorship

b. Partnership

c. Corporation

d. Limited liability company (LLC)

162. Comprises 70% of business entities in the United States

ANSWER: a

163. Generates 90% of business revenues

ANSWER: c

164. Owned by two or more individuals

ANSWER: b

165. Organized as a separate legal taxable entity

ANSWER: c

166. Easy and cheap to organize

ANSWER: a

167. Often used as an alternative to a partnership

ANSWER: d

168. Used by large business

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ANSWER: c

169. Has the ability to obtain large amounts of resources

ANSWER: c

170. Offers tax and legal liability advantages for owners

ANSWER: d

Match each of the following accounts with the account type that best describes it. Each letter may be used more than once.

- a. Asset
- b. Liability
- c. Owner's equity

171. Accounts payable

ANSWER: b

172. Wages expense

ANSWER: c

173. Joan Smith, Capital

ANSWER: c

174. Accounts Receivable

ANSWER: a

175. Joan Smith, Drawing

ANSWER: c

176. Land

ANSWER: a

Match each transaction with its effect on the accounting equation. Each letter may be used more than once.

- a. Increase assets, increase liabilities
- b. Increase liabilities, decrease owner's equity
- c. Increase assets, increase owner's equity
- d. No effect
- e. Decrease assets, decrease liabilities
- f. Decrease assets, decrease owner's equity

177. Received cash for services provided

ANSWER: c

178. Paid the utility bill

ANSWER: b

179. Investment of land by owner

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ANSWER: c

180. Paid part of an amount owed to a creditor

ANSWER: e

181. Paid cash for the purchase of a one-year insurance policy

ANSWER: d

182. Received payment from a customer on account

ANSWER: d

183. Cash withdrawal by owner

ANSWER: f

184. Provided a service to a customer on account

ANSWER: c

185. Purchased supplies on credit

ANSWER: a

186. Paid wages

ANSWER: f

187. Cash investment by owner

ANSWER: c

188. Borrowed money from a bank

ANSWER: a

189. Purchased equipment for cash

ANSWER: d

190. Received cash for providing services to customers

ANSWER: c

191. Used up supplies that were already on hand

ANSWER: f

Match each of the following items to its effect on owner's equity. Each letter may be used more than once.

a. Increases owner's equity

b. Decreases owner's equity

192. Fees earned

ANSWER: a

193. Wages expense

ANSWER: b

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194. Withdrawals

ANSWER: b

195. Lawn care revenue

ANSWER: a

196. Additional investment in the business

ANSWER: a

197. Supplies expense

ANSWER: b

Match each of the following characteristics with the financial statement that it best describes. Each letter may be used more than once.

- a. Income statement
- b. Balance sheet
- c. Statement of owner's equity
- d. Statement of cash flows

198. Reports as of a specific date

ANSWER: b

199. The first statement prepared

ANSWER: a

200. Has three sections: operating, investing, and financing

ANSWER: d

201. Reports only revenues and expenses

ANSWER: a

202. The second statement prepared

ANSWER: c

203. A formal presentation of the accounting equation

ANSWER: b

204. The connecting link between the income statement and balance sheet

ANSWER: c

Match each of the following items to the financial statement(s) where it can be found. Each letter may be used more than once.

- a. Balance sheet
- b. Income statement
- c. Statement of cash flows
- d. Statement of owner's equity

Name: _____ Class: _____ Date: _____

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205. Increase in owner's equity

ANSWER: d

206. Revenues

ANSWER: b

207. Supplies

ANSWER: a

208. Land

ANSWER: a

209. Accounts payable

ANSWER: a

210. Accounts receivable

ANSWER: a

211. Operating activities

ANSWER: c

212. Wages expense

ANSWER: b

213. Fees earned

ANSWER: b

214. Net increase in cash

ANSWER: c

Match each of the following activities to the section in which it would be reported on the statement of cash flows. Each letter may be used more than once.

- a. Cash Flows from (Used for) Operating Activities
- b. Cash Flows from (Used for) Investing Activities
- c. Cash Flows from (Used for) Financing Activities
- d. Does not appear on the statement of cash flows

215. Cash paid for building

ANSWER: b

216. Cash paid to suppliers

ANSWER: a

217. Cash paid to owner for personal use

ANSWER: c

218. Cash received from customers

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ANSWER: a

219. Cash received from owner as additional investment in the business

ANSWER: c

220. Cash received from sale of a building

ANSWER: b

221. Borrowed cash from a bank

ANSWER: c

Subjective Short Answer

222. Discuss internal and external users of accounting information. What areas of accounting provide them with information? Give an example of the type of report each type of user might use.

ANSWER: Internal users of accounting information include managers and employees. The area of accounting that provides internal users with information is called managerial accounting or management accounting. An example of a report that might be used internally is a customer profitability report.

External users of accounting information include customers, creditors, banks, and government entities. These users are not directly involved in managing or operating the business. The area of accounting that provides external users with information is called financial accounting. General-purpose financial statements are one type of financial accounting report that is distributed to external users.

223. Companies like Enron, WorldCom, and Tyco International, Ltd. have been caught in the midst of ethical lapses that led to fines, firings, and criminal and/or civil prosecution. List and briefly describe three factors that are responsible for what went wrong in these companies.

ANSWER: The three factors are: (1) individual character, (2) firm culture, and (3) lack of laws and enforcement. Honesty, integrity, and fairness in the face of pressure to hide the truth are important characteristics of an ethical businessperson. The behavior and attitude of senior management set the firm's culture. In firms like Enron, senior managers created a culture of greed and indifference to the truth. That culture flowed down to lower-level managers, who took shortcuts and lied to cover financial frauds. The lack of laws and enforcement has been blamed as a contributing factor to financial reporting abuses. As a result, new laws such as the Sarbanes-Oxley Act (SOX) established a new oversight body for the accounting profession, known as the Public Company Accounting Oversight Board (PCAOB), and established standards to enhance corporate accountability, financial disclosures, and independence.

224. List the five steps in the process by which accounting provides information to users.

ANSWER: 1. Identify users.
2. Assess users' information needs.
3. Design the accounting information system to meet users' needs.
4. Record economic data about business activities and events.
5. Prepare accounting reports for users.

225. What is the major difference between the objective of financial accounting and the objective of managerial accounting?

ANSWER: The objective of financial accounting is to provide information for the decision-making needs of external users. The objective of managerial accounting is to provide information for internal users.

226. Give the major disadvantage of disregarding the cost concept and constantly revaluing assets based on appraisals and

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opinions.

ANSWER: Accounting reports would become unstable and unreliable.

227. Explain the meaning of the business entity concept.

ANSWER: The business entity concept limits the economic data in an accounting system to data related directly to the activities of the business. In other words, the business is viewed as an entity separate from its owners, creditors, or other businesses.

228. Darnell Company purchased \$88,000 of computer equipment from Joseph Company. Darnell Company paid for the equipment using cash that had been obtained from the initial investment by Donnie Darnell.

Which entity or entities (Darnell Company, Joseph Company, and Donnie Darnell) should record the transaction involving the computer equipment on their accounting records?

ANSWER: Darnell Company and Joseph Company

229. Bob Johnson is the sole owner of Johnson's Carpet Cleaning Service. Bob purchased a personal automobile for \$10,000 cash plus he took out a loan for \$20,000 in his name. Describe how this transaction is related to the business entity concept.

ANSWER: Under the business entity concept, economic data are limited to the direct activities of the business. The business is viewed as separate from its owner. Therefore, when Bob buys a personal automobile, it is not listed on the books of Johnson's Carpet Cleaning Service, unless Bob invests it in the business. In this case, the loan is a personal debt and not a liability of the company, and the cash is from Bob's personal account and not the company's account.

230. Discuss the characteristics of a limited liability company (LLC).

ANSWER: A limited liability company (LLC) combines the attributes of a partnership and a corporation. It is often used as an alternative to a partnership because it has tax and legal liability advantages for owners.

231. Explain the meaning of:

- (a) the objectivity concept
- (b) the unit of measure concept

ANSWER: (a) The objectivity concept requires that the amounts recorded in the accounting records be based on objective evidence. In exchanges between a buyer and a seller, both try to get the best price. Only the final agreed-upon amount is objective enough to be recorded in the accounting records.

(b) The unit of measure concept requires that economic data be recorded in dollars. Money is a common unit of measurement for entering financial data and preparing reports.

232. Dave Ryan is the owner and operator of Ryan's Arcade. At the end of its accounting period, December 31, Ryan's Arcade has assets of \$450,000 and liabilities of \$125,000. Using the accounting equation, determine the following amounts:

- (a) owner's equity as of December 31 of the current year
- (b) owner's equity as of December 31 at the end of the next year, assuming that assets increased by \$65,000 and liabilities increased by \$35,000 during the year

ANSWER: (a) \$325,000 ($\$450,000 - \$125,000$)
(b) \$355,000 [$(\$450,000 + \$65,000) - (\$125,000 + \$35,000)$]

233. Krammer Company has liabilities equal to one-fourth of the total assets. Krammer's owner's equity is \$45,000. Using the accounting equation, what is the amount of liabilities for Krammer?

ANSWER: Assets = Liabilities + Owner's Equity
 $4x = x + \$45,000$

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$3x = \$45,000$
 $x = \$15,000$ in liabilities

234. Determine the missing amount for each of the following:

<u>Assets</u>	<u>Liabilities</u>	<u>Owner's Equity</u>
(a)	\$38,000	\$45,000
\$30,000	(b)	22,000
53,000	32,000	(c)

ANSWER: (a) \$83,000 (\$38,000 + \$45,000)
 (b) \$8,000 (\$30,000 – \$22,000)
 (c) \$21,000 (\$53,000 – \$32,000)

235. Determine the missing amount designated with an “X” for each of the following:

	<u>Assets</u>	<u>Liabilities</u>	<u>Owner's Equity</u>
(a)	\$78,500	\$37,600	X
(b)	X	53,280	\$145,000
(c)	49,500	X	34,000

ANSWER: (a) \$40,900 (\$78,500 – \$37,600)
 (b) \$198,280 (\$53,280 + \$145,000)
 (c) \$15,500 (\$49,500 – \$34,000)

236. Use the accounting equation to answer each of the following independent questions.

- (a) At the beginning of the year, Norton Company's assets were \$75,000 and its owner's equity was \$38,000. During the year, assets increased by \$18,000 and liabilities increased by \$4,000. What was the owner's equity at the end of the year?
- (b) At the beginning of the year, Turpin Industries had liabilities of \$44,000 and owner's equity of \$66,000. If assets increased by \$10,000 and liabilities decreased by \$5,000, what was the owner's equity at the end of the year?

ANSWER: (a) $\$75,000 - \$38,000 = \$37,000$ beginning of year liabilities
 $(\$75,000 + \$18,000) - (\$37,000 + \$4,000) = \$52,000$ end-of-year owner's equity
 (b) $\$44,000 + \$66,000 = \$110,000$ beginning of year assets
 $(\$110,000 + \$10,000) - (\$44,000 - \$5,000) = \$81,000$ end-of-year owner's equity

The accountant for Scott Industries prepared the following list of accounting equation element balances from the company's records for the year ended December 31:

Fees earned	\$165,000	Cash	\$30,000
Accounts receivable	14,000	Selling expenses	44,000
Equipment	64,000	Scott, capital	27,000
Accounts payable	12,000	Interest revenue	3,000

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Salaries and wages expense	40,000	Prepaid rent	2,000
Income tax payable	5,000	Income tax expense	18,000
Notes payable	20,000	Rent expense	20,000

237. Determine the total assets at the end of the current year for Scott Industries.

ANSWER: \$110,000

$$(\$30,000 \text{ Cash} + \$14,000 \text{ Accounts Receivable} + \$64,000 \text{ Equipment} + \$2,000 \text{ Prepaid Rent} = \$110,000)$$

238. Determine the total liabilities at the end of the current year for Scott Industries.

ANSWER: \$37,000

$$(\$12,000 \text{ Accounts Payable} + \$5,000 \text{ Income Taxes Payable} + \$20,000 \text{ Notes Payable} = \$37,000)$$

239. Based on the information for Scott Industries, is it profitable? Explain your answer.

ANSWER: Yes, Scott Industries is profitable.

$$(\$165,000 \text{ Fees Earned} + \$3,000 \text{ Interest Revenue}) - (\$40,000 \text{ Salaries and Wages Expense} + \$44,000 \text{ Selling Expenses} + \$18,000 \text{ Income Tax Expense} + \$20,000 \text{ Rent Expense}) = \$46,000 \text{ Net Income}$$

Scott Industries had net income for the period of \$46,000. Since revenues exceeded expenses for the period, the company would be considered profitable.

240. On July 1 of the current year, the assets and liabilities of John Wong, DVM, are as follows: Cash, \$27,000; Accounts Receivable, \$12,300; Supplies, \$3,100; Land, \$35,000; Accounts Payable, \$13,900. What is the amount of owner's equity (John Wong's capital) as of July 1 of the current year?

ANSWER: \$63,500

$$(\$27,000 \text{ Cash} + \$12,300 \text{ Accounts Receivable} + \$3,100 \text{ Supplies} + \$35,000 \text{ Land} - \$13,900 \text{ Accounts Payable} = \$63,500)$$

241. Ting Hsu is the owner of Hsu's Financial Services. At the end of its accounting period, December 31, of Year 1, Hsu's has assets of \$575,000 and owner's equity of \$335,000. Using the accounting equation and considering each case independently, determine the following amounts:

(a) Hsu's liabilities as of December 31 of Year 1.

(b) Hsu's liabilities as of December 31 of Year 2, assuming that assets increased by \$56,000 and owner's equity decreased by \$32,000.

(c) Net income or net loss during Year 2, assuming that as of December 31, Year 2, assets were \$592,000, liabilities were \$450,000, and there were no additional investments or withdrawals.

ANSWER: (a) $\$575,000 - \$335,000 = \$240,000$

$$(b) (\$575,000 + \$56,000) - (\$335,000 - \$32,000) = \$328,000$$

$$(c) \$592,000 - \$450,000 = \$142,000 \text{ owner's equity (Year 2)}$$

$$\$335,000 - \$142,000 = \$193,000 \text{ net loss}$$

242. Martin Blair is the owner and operator of Martin Consultants. At December 31 of the current year, Martin Consultants has assets of \$430,000 and liabilities of \$205,000. Using the accounting equation and considering each case independently, determine the following:

(a) Martin Blair, capital, as of December 31.

(b) Martin Blair, capital, as of December 31 of the next year, assuming that assets increased by \$12,000 and liabilities increased by \$15,000.

(c) Martin Blair, capital, as of December 31 of the next year, assuming that assets decreased by \$8,000 and liabilities increased by \$14,000.

ANSWER: (a) $\$430,000 - \$205,000 = \$225,000$

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(b) $(\$430,000 + \$12,000) - (\$205,000 + \$15,000) = \$222,000$
 (c) $(\$430,000 - \$8,000) - (\$205,000 + \$14,000) = \$203,000$

243. Daniels Company is owned and operated by Thomas Daniels. The following selected transactions were completed by Daniels Company during May:

1. Received cash from owner as additional investment, \$55,000.
2. Paid creditors on account, \$7,000.
3. Billed customers for services on account, \$2,565.
4. Received cash from customers on account, \$8,450.
5. Paid cash to owner for personal use, \$2,500.
6. Paid the utility bill, \$160.

Indicate the effect of each transaction on the accounting equation by:

- (a) Accounting equation element type: (A) assets, (L) liabilities, (OE) owner's equity, (R) revenue, and (E) expense
- (b) Name of accounting equation element
- (c) The amount of the transaction
- (d) The direction of change (increase or decrease) in the account affected

Note: Each transaction has two entries.

Entry					Entry			
	Accounting Equation Element Type (a)	Name of Accounting Equation Element (b)	Amount (c)	Increase or Decrease (d)	Accounting Equation Element Type (a)	Name of Accounting Equation Element (b)	Amount (c)	Increase or Decrease (d)
1								
2								
3								
4								
5								
6								

ANSWER:

Entry					Entry			
	Accounting Equation Element Type (a)	Name of Accounting Equation Element (b)	Amount (c)	Increase or Decrease (d)	Accounting Equation Element Type (a)	Name of Accounting Equation Element (b)	Amount (c)	Increase or Decrease (d)
1	A	Cash	\$55,000	Increase	OE	Capital	\$55,000	Increase
2	A	Cash	\$7,000	Decrease	L	Accounts Payable	\$7,000	Decrease
3	A	Accounts Receivable	\$2,565	Increase	R	Fees Earned	\$2,565	Increase
4	A	Cash	\$8,450	Increase	A	Accounts Receivable	\$8,450	Decrease
5	A	Cash	\$2,500	Decrease	OE	Drawing	\$2,500	Increase
6	A	Cash	\$160	Decrease	E	Utilities Expense	\$160	Increase

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244. Collins Landscape Company purchased various landscaping supplies on account to be used for landscape designs for its customers. How will this business transaction affect the accounting equation?

ANSWER: Increase assets (Supplies) and increase liabilities (Accounts Payable)

245. Shiny Kar Company had the following transactions. For each transaction, show the effect on the accounting equation by putting the amount and direction (+, -, or NC for no change) in each box of the following table.

	Assets	Liabilities	Owner's Equity
(a) Shiny Kar withdrew \$500 cash for food			
(b) Shiny Kar Company sold 2 cars for a total of \$55,000 on account			
(c) The cost of the cars sold in (b) above was \$40,000			
(d) Shiny Kar received a \$35,000 payment for a car previously sold on account			
(e) Shiny Kar paid \$450 for advertising			
(f) Shiny Kar purchased \$150 of cleaning supplies on account			

ANSWER:

	Assets	Liabilities	Owner's Equity
(a)	-\$500	NC	-\$500
(b)	+\$55,000	NC	+\$55,000
(c)	-\$40,000	NC	-\$40,000
(d)	NC	NC	NC
(e)	-\$450	NC	-\$450
(f)	+\$150	+\$150	NC

246. Ramirez Company received its first electric bill in the amount of \$60 which will be paid next month. How will this transaction affect the accounting equation?

ANSWER: Increase liabilities (Accounts Payable) and decrease owner's equity (Utilities Expense)

247. Simpson Auto Body Repair purchased \$20,000 of machinery. The company paid \$8,000 in cash at the time of the purchase and signed a promissory note for the remainder to be paid in four monthly installments.

- (a) How will the purchase affect the accounting equation?
- (b) How will the payment of the first monthly installment affect the accounting equation (ignore interest)?

ANSWER: (a) Increase total assets by a net amount of \$12,000 (increase Machinery, \$20,000 and decrease Cash, \$8,000) and increase liabilities by \$12,000 (Notes Payable, \$12,000)
 (b) Decrease assets by \$3,000 (decrease Cash,\$3,000) and decrease liabilities by \$3,000 (Notes Payable,\$3,000)

248. Indicate how the following transactions affect the accounting equation.

- (a) The purchase of supplies on account
- (b) The purchase of supplies for cash
- (c) A withdrawal by the owner to pay personal expenses
- (d) Revenues received in cash
- (e) Sale made on account

ANSWER: (a) Assets increase; liabilities increase
 (b) No effect

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- (c) Assets decrease; owner's equity decreases
- (d) Assets increase; owner's equity increases
- (e) Assets increase; owner's equity increases

249. (a) A vacant lot acquired for \$83,000 cash is sold for \$127,000 in cash. What is the effect of the sale on the total amount of the seller's (1) assets, (2) liabilities, and (3) owner's equity?

(b) Assume that the seller owes \$52,000 for the land. After receiving the \$127,000 cash in (a), the seller pays the \$52,000 owed. What is the effect of the payment on the total amount of the seller's (1) assets, (2) liabilities, and (3) owner's equity?

ANSWER: (a) (1) Total assets increased \$44,000
 (2) No change in liabilities
 (3) Owner's equity increased \$44,000

(b) (1) Total assets decreased \$52,000
 (2) Total liabilities decreased \$52,000
 (3) No change in owner's equity

250. Austin Land Company sold land for \$85,000 in cash. The land was originally purchased for \$65,000. At the time of the sale, \$40,000 was still owed to Regions Bank. After the sale, Austin Land Company paid off the loan. Explain the effect of the sale and the payoff of the loan on the accounting equation.

ANSWER: Total assets decrease \$20,000 (Cash increases by \$45,000; Land decreases by \$65,000)
 Total liabilities decrease \$40,000 (Note payoff to Regions)
 Owner's equity increases \$20,000 (Sales price – Cost of the land)

251. There are four transactions that affect owner's equity.

- (a) What are the two types of transactions that increase owner's equity?
- (b) What are the two types of transactions that decrease owner's equity?

ANSWER: (a) Additional investment by the owner and increase in revenues
 (b) Withdrawal made by the owner and increase in expenses

252. Given the following:

Beginning capital \$58,000
 Ending capital 30,000
 Owner's withdrawals 25,000

Determine net income or net loss.

ANSWER:

Ending capital	\$ 30,000
Beginning capital	<u>58,000</u>
Decrease in capital	\$(28,000)
Withdrawals	<u>(25,000)</u>
Net loss	\$ (3,000)

253. The following selected transactions are completed by a proprietorship. Indicate the effects of each transaction on assets, liabilities, and owner's equity by inserting "+" for increase and "-" for decrease in the appropriate columns at the right. If appropriate, you may insert more than one symbol in a column.

(a) Received cash from owner as an additional investment A L OE

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(b) Purchased supplies on account	_____	_____	_____
(c) Paid rent for the current month	_____	_____	_____
(d) Received cash for services sold to customers	_____	_____	_____
(e) Paid cash to creditor for purchases in (b)	_____	_____	_____
(f) Billed customers for services sold on account	_____	_____	_____
(g) Received cash on account from customers	_____	_____	_____
(h) Owner withdrew cash for personal use	_____	_____	_____
(i) Recorded the cost of supplies used during the year	_____	_____	_____
(j) Paid wages	_____	_____	_____
(k) Purchased a truck for cash	_____	_____	_____

ANSWER:

	<u>A</u>	<u>L</u>	<u>OE</u>
(a)	+		+
(b)	+	+	
(c)	-		-
(d)	+		+
(e)	-	-	
(f)	+		+
(g)	+,-		
(h)	-		-
(i)	-		-
(j)	-		-
(k)	+,-		

254. The following selected transactions are completed by a proprietorship. Indicate the effects of each transaction on assets, liabilities, and owner's equity by inserting "+" for increase and "-" for decrease in the appropriate columns at the right. If appropriate, you may insert more than one symbol in a column.

	<u>A</u>	<u>L</u>	<u>OE</u>
(a) Received cash from owner as initial investment	_____	_____	_____
(b) Purchased supplies, paying cash	_____	_____	_____
(c) Paid creditors on account	_____	_____	_____
(d) Received cash from customers on account	_____	_____	_____
(e) Paid utilities expense	_____	_____	_____

ANSWER:

	<u>A</u>	<u>L</u>	<u>OE</u>
(a)	+		+
(b)	+,-		
(c)	-	-	
(d)	-,+		
(e)	-		-

255. The following selected transactions are completed by a proprietorship. Indicate the effects of each transaction on assets, liabilities, and owner's equity by inserting "+" for increase and "-" for decrease in the appropriate columns at the right. If appropriate, you may insert more than one symbol in a column.

	<u>A</u>	<u>L</u>	<u>OE</u>
(a) Paid rent expense	_____	_____	_____
(b) Purchased supplies on account	_____	_____	_____
(c) Received cash for providing services to customers	_____	_____	_____
(d) Billed customers for services on account	_____	_____	_____
(e) Paid cash to owner for personal use	_____	_____	_____

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ANSWER:	<u>A</u>	<u>L</u>	<u>OE</u>
(a)	-		-
(b)	+	+	
(c)	+		+
(d)	+		+
(e)	-		-

256. The following selected transactions are completed by a proprietorship. Indicate the effects of each transaction on assets, liabilities, and owner's equity by inserting "+" for increase and "-" for decrease in the appropriate columns at the right. If appropriate, you may insert more than one symbol in a column.

	<u>A</u>	<u>L</u>	<u>OE</u>
(a) Purchased land with cash	_____	_____	_____
(b) Received cash from customers on account	_____	_____	_____
(c) Determined the amount of supplies used this month	_____	_____	_____
(d) Received cash from owner as additional investment	_____	_____	_____
(e) Paid miscellaneous expense	_____	_____	_____

ANSWER:	<u>A</u>	<u>L</u>	<u>OE</u>
(a)	-, +		-
(b)	+, -		
(c)	-		-
(d)	+		+
(e)	-		-

257. Use the following data for Flagger Company to prepare an income statement for the year ended December 31:

Fees earned	\$168,000	Cash	\$30,000
Accounts receivable	14,000	Selling expenses	44,000
Equipment	42,000	Flagger, capital	36,000
Accounts payable	12,000	Rent expense	51,000
Salaries and wages expense	40,000	Prepaid rent	2,000
Income tax payable	5,000	Income tax expense	18,000
Notes payable	20,000		

ANSWER:	Flagger Company Income Statement For the Year Ended December 31		
Fees earned			\$168,000
Expenses:			
Rent expense	\$51,000		
Selling expenses	44,000		
Salary and wages expense	40,000		
Income tax expense	<u>18,000</u>		
Total expenses			<u>153,000</u>
Net income			<u>\$ 15,000</u>

The assets and liabilities of Thompson Computer Services at March 31, the end of the current year, and its revenue and expenses for the year follow. The capital of the owner was \$180,000 at April 1, the beginning of the current year. Mr. Thompson invested an additional \$25,000 in the business during the year.

Accounts payable	\$ 2,000	Miscellaneous expense	\$ 1,030
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Accounts receivable	10,340	Office expense	1,240
Cash	21,420	Supplies	1,670
Fees earned	73,450	Wages expense	23,550
Land	47,000	Drawing	16,570
Building	157,630		

258. Prepare an income statement for the current year ended March 31.

ANSWER:

Thompson Computer Services Income Statement For the Year Ended March 31			
Fees earned			\$73,450
Expenses:			
Wages expense	\$23,550		
Office expense	1,240		
Miscellaneous	<u>1,030</u>		
expense			
Total expenses		<u>25,820</u>	
Net income			<u>\$47,630</u>

259. Prepare a statement of owner's equity for Thompson Computer Services for the current year ended March 31.

ANSWER:

Thompson Computer Services Statement of Owner's Equity For the Year Ended March 31			
Thompson, capital, April 1			\$180,000
Additional investment by owner during year		\$25,000	
Net income for the year		47,630	
Withdrawals		<u>(16,570)</u>	
Increase in owner's equity			<u>56,060</u>
Thompson, capital, March 31			<u>\$236,060</u>

260. Prepare a balance sheet for Thompson Computer Services for the current year ended March 31.

ANSWER:

Thompson Computer Services Balance Sheet March 31			
Assets		Liabilities	
Cash	\$ 21,420	Accounts payable	\$ 2,000
Accounts receivable	10,340		
Supplies	1,670		
Land	47,000	Owner's Equity	
Building	<u>157,630</u>	Thompson capital	<u>236,060</u>
Total assets	<u>\$238,060</u>	Total liabilities and owner's equity	<u>\$238,060</u>

261. A summary of cash flows for Linda's Design Services for the year ended December 31 is as follows:

Cash receipts:

Cash received from customers	\$83,990
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Cash received from additional investment by owner	25,000
Cash payments:	
Cash paid for expenses and supplies	\$27,410
Cash paid for land	47,000
Cash paid to owner for personal use	5,000
Cash balance as of January 1	\$40,600

Prepare a statement of cash flows for Linda's Design Services for the year ended December 31.

ANSWER:

Linda's Design Services Statement of Cash Flows For the Year Ended December 31	
Cash flows from (used for) operating activities:	
Cash received from customers	\$83,990
Cash paid for expenses and supplies	<u>(27,410)</u>
Net cash flows from operating activities	\$ 56,580
Cash flows from (used for) investing activities:	
Cash paid for land	(47,000)
Cash flows from (used for) financing activities:	
Cash received from owner as investment	\$25,000
Cash withdrawal by owner	<u>(5,000)</u>
Net cash flows from financing activities	<u>20,000</u>
Net increase in cash	\$29,580
Cash balance, January 1	<u>40,600</u>
Cash balance, December 31	<u>\$70,180</u>

262. What information does the income statement give to business users?

ANSWER: The income statement reports the revenues and expenses for a period of time. The result is either a net income or a net loss.

263. What are the three sections of the statement of cash flows?

ANSWER: Cash Flows from (Used for) Operating Activities, Cash Flows from (Used for) Investing Activities, and Cash Flows from (Used for) Financing Activities

264. Name and describe the four primary financial statements for a proprietorship.

ANSWER: 1. Income statement: A summary of the revenue and expenses *for a specific period of time*, such as a month or a year.

2. Statement of owner's equity: A summary of the changes in the owner's equity that have occurred *during a specific period of time* such as a month or a year.

3. Balance sheet: A list of the assets, liabilities, and owner's equity *as of a*

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specific date, usually at the close of the last day of a month or a year.

4. Statement of cash flows: A summary of the cash receipts and cash payments for a *specific period of time*, such as a month or a year.

265. A summary of cash flows for Evelyn's Event Planning for the year ended December 31 is as follows:

Cash receipts:

Cash received from customers	\$57,360
Cash received from bank loan	15,000

Cash payments:

Cash paid for expenses and supplies	\$21,600
Cash paid for equipment	18,070
Cash paid to the owner for personal use	12,000

Cash balance as of January 1 \$15,580

Prepare a statement of cash flows for Evelyn's Event Planning for the year ended December 31.

ANSWER:

Evelyn's Event Planning	
Statement of Cash Flows	
For the Year Ended December 31	
Cash flows from (used for) operating activities:	
Cash received from customers	\$57,360
Cash paid for expenses and supplies	<u>(21,600)</u>
Net cash flows from operating activities	\$35,760
Cash flows from (used for) investing activities:	
Cash paid for equipment	(18,070)
Cash flows from (used for) financing activities:	
Cash received from bank loan	\$15,000
Cash withdrawals by owner	<u>(12,000)</u>
Net cash flows from financing activities	<u>3,000</u>
Net increase in cash	\$20,690
Cash balance, January 1	<u>15,580</u>
Cash balance, December 31	<u>\$36,270</u>

266. The assets and liabilities of Rocky's Day Spa at December 31 and its expenses for the year follow. The capital of the owner was \$68,000 at January 1. The owner invested an additional \$10,000 during the year. Net income for the year is \$45,625.

Accounts payable	\$ 4,375	Spa operating expense	\$23,760
Accounts receivable	8,490	Office expense	2,470
Cash	13,980	Spa supplies	9,230
Fees earned	???	Wages expense	26,580
Spa furniture and equipment	56,000	Drawing	38,170
Computers	2,130		

Prepare an income statement for the current year ended December 31.

ANSWER:

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Rocky's Day Spa
Income Statement
For the Year Ended December 31

Fees earned		\$98,435
Expenses:		
Wages expense	\$26,580	
Spa operating expense	23,760	
Office expense	<u>2,470</u>	
Total expenses		<u>52,810</u>
Net income		<u>\$45,625</u>

267. The assets and liabilities of Rocky's Day Spa on December 31 and its revenue and expenses for the year follow. The capital of the owner was \$68,000 on January 1. The owner invested an additional \$10,000 during the year.

Accounts payable	\$ 4,375	Spa operating expense	\$23,760
Accounts receivable	8,490	Office expense	2,470
Cash	???	Spa supplies	9,230
Fees earned	98,435	Wages expense	26,580
Spa furniture and equipment	56,000	Drawing	38,170
Computers	2,130		

Prepare a balance sheet for the year ended December 31.

ANSWER:

Rocky's Day Spa
Balance Sheet
December 31

		Liabilities	
Assets		Accounts payable	\$ 4,375
Cash	\$13,980		
Accounts receivable	8,490	Owner's Equity	
Spa supplies	9,230	Owner's capital	<u>85,455</u>
Computers	2,130	Total liabilities and	
Spa furniture and equipment	<u>56,000</u>	owner's equity	<u>\$89,830</u>
Total assets	<u>\$89,830</u>		

268. The assets and liabilities of Rocky's Day Spa on December 31 and its revenue and expenses for the year follow. The capital of the owner is \$68,000 on January 1. The owner invested an additional \$10,000 during the year.

Accounts payable	\$ 4,375	Spa operating expense	\$23,760
Accounts receivable	8,490	Office expense	2,470
Cash	13,980	Spa supplies	9,230
Fees earned	98,435	Wages expense	26,580
Spa furniture and equipment	56,000	Drawing	38,170
Computers	2,130		

Prepare a statement of owner's equity for the current year ended December 31.

ANSWER:

Rocky's Day Spa

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Statement of Owner's Equity		
For the Year Ended December 31		
Owner's capital, January 1		\$68,000
Additional investment by owner during year	\$ 10,000	
Net income for the year	45,625	
Withdrawals	<u>(38,170)</u>	
Increase in owner's equity		<u>17,455</u>
Owner's capital, December 31		<u>\$85,455</u>

269. Explain the interrelationship between the balance sheet and the statement of cash flows.

ANSWER: The cash reported on the balance sheet is also reported as the end-of-period cash on the statement of cash flows.

270. From the following list of items taken from Lamar's accounting records, identify those that would appear on the income statement.

- (a) Rent expense
- (b) Land
- (c) Capital
- (d) Fees earned
- (e) Withdrawal
- (f) Wages expense
- (g) Investment

ANSWER: (a), (d), (f)

271. Identify which of the following items would appear on a balance sheet.

- (a) Cash
- (b) Fees earned
- (c) Joe Brown, capital
- (d) Wages payable
- (e) Rent expense
- (f) Prepaid advertising
- (g) Land

ANSWER: (a), (c), (d), (f), (g)

272. For each of the following, determine the amount of net income or net loss for the year.

- (a) Revenues for the year totaled \$71,300 and expenses totaled \$35,500. The owner made an additional investment of \$15,000 during the year.
- (b) Revenues for the year totaled \$220,500 and expenses totaled \$175,000. The owner withdrew \$40,000 during the year.
- (c) Revenues for the year totaled \$149,000 and expenses totaled \$172,000. The owner invested an additional \$12,000 and withdrew \$16,000 during the year.
- (d) Revenues for the year totaled \$198,150 and expenses totaled \$174,200. The owner withdrew \$35,000 during the year.

ANSWER: (a) \$35,800 net income (\$71,300 – \$35,500)
 (b) \$45,500 net income (\$220,500 – \$175,000)
 (c) \$(23,000) net loss (\$149,000 – \$172,000)
 (d) \$23,950 net income (\$198,150 – \$174,200)

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273. The total assets and total liabilities of Paul’s Pools, a proprietorship, at the beginning and at the end of the current fiscal year are as follows:

	<u>January 1</u>	<u>December 31</u>
Total assets	\$280,000	\$475,000
Total liabilities	205,000	130,000

- (a) Determine the amount of net income earned during the year. The owner did not invest any additional assets in the business during the year and made no withdrawals.
- (b) Determine the amount of net income during the year. The assets and liabilities at the beginning and end of the year are unchanged from the given amounts. However, the owner withdrew \$53,000 in cash during the year (no additional investments).
- (c) Determine the amount of net income earned during the year. The assets and liabilities at the beginning and end of the year are unchanged from the given amounts. However, the owner invested an additional \$35,000 in cash in the business in June of the current fiscal year (no withdrawals).
- (d) Determine the amount of net income earned during the year. The assets and liabilities at the beginning and end of the year are unchanged from the given amounts. However, the owner invested an additional \$12,000 in cash in August of the current fiscal year and made 12 monthly cash withdrawals of \$1,500 each during the year.

ANSWER:

(a) Owner's equity at end of year (\$475,000 – \$130,000)	\$345,000
Owner's equity at beginning of year (\$280,000 – \$205,000)	<u>75,000</u>
Net income	<u>\$270,000</u>
(b) Increase in owner's equity as in (a)	\$270,000
Add withdrawals	<u>53,000</u>
Net income	<u>\$323,000</u>
(c) Increase in owner's equity as in (a)	\$270,000
Deduct additional investment	<u>35,000</u>
Net income	<u>\$235,000</u>
(d) Increase in owner's equity as in (a)	\$270,000
Add withdrawals (\$1,500 × 12)	18,000
Deduct additional investment	<u>(12,000)</u>
Net income	<u>\$276,000</u>

274. The following selected transaction data of a business are for September. Determine the following amounts for September: (a) total revenue, (b) total expenses, (c) net income.

Service sales charged to customers on account during September	\$33,000
Cash received from cash customers for services performed in September	28,000
Cash received from customers on account during September:	
Services performed and charged to customers prior to September	13,000
Services performed and charged to customers during September	18,000
Expenses incurred prior to September and paid during September	6,500
Expenses incurred and paid in September	36,250
Expenses incurred in September but not paid in September	5,000
Expenses for supplies used and insurance (not given) applicable to September	2,000

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- ANSWER: (a) \$61,000 (\$33,000 + \$28,000)
 (b) \$43,250 (\$36,250 + \$5,000 + \$2,000)
 (c) \$17,750 (\$61,000 – \$43,250)

275. On March 1, the amount of Richard Cook's capital in Richard's Catering Company was \$150,000. During March, he withdrew \$31,000 from the business. The amounts of the various assets, liabilities, revenues, and expenses are as follows:

Accounts payable	\$10,250
Accounts receivable	45,950
Cash	23,840
Fees earned	64,950
Insurance expense	1,275
Land	85,400
Miscellaneous expense	1,210
Prepaid insurance	3,000
Rent expense	9,000
Salary expense	20,300
Supplies	900
Supplies expense	525
Utilities expense	2,800

Prepare (a) an income statement for March, (b) a statement of owner's equity for March, and (c) a balance sheet as of March 31.

ANSWER: (a)

Richard's Catering Company
 Income Statement
 For the Month Ended March 31

Fees earned		\$64,950
Expenses:		
Salary expense	\$20,300	
Rent expense	9,000	
Utilities expense	2,800	
Insurance expense	1,275	
Supplies expense	525	
Miscellaneous expense	<u>1,210</u>	
Total expenses		<u>35,110</u>
Net income		<u>\$29,840</u>

(b)

Richard's Catering Company
 Statement of Owner's Equity
 For the Month Ended March 31

Richard Cook, capital, March 1		\$150,000
Net income for the month	\$29,840	
Withdrawals	<u>(31,000)</u>	
Decrease in owner's equity		<u>(1,160)</u>
Richard Cook, capital, March 31		<u>\$148,840</u>

(c)

Richard's Catering Company
 Balance Sheet
 March 31

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Assets		Liabilities	
Cash	\$ 23,840	Accounts payable	\$ 10,250
Accounts receivable	45,950		
Prepaid insurance	3,000	Owner's Equity	
Supplies	900	Richard Cook, capital	<u>148,840</u>
Land	<u>85,400</u>	Total liabilities and	
Total assets	<u>\$159,090</u>	owner's equity	<u>\$159,090</u>

276. Harris Designers began operations on April 1. The following financial statements are for Harris Designers for the month ended April 30 (the first month of operations). Determine the missing amounts for letters (a) through (o).

Harris Designers
Income Statement
For the Month Ended April 30

Fees earned		\$27,000
Expenses:		
Wages expense	\$5,250	
Rent expense	(a)	
Supplies expense	4,600	
Utilities expense	400	
Miscellaneous expense	<u>1,250</u>	
Total expenses		<u>(b)</u>
Net income		<u>\$ (c)</u>

Harris Designers
Statement of Owner's Equity
For the Month Ended April 30

Lori Harris, capital, April 1		\$ 0
Investment on April 1	\$35,000	
Net income for April	(d)	
Withdrawals	<u>(6,000)</u>	
Increase in owner's equity		<u>(e)</u>
Lori Harris, capital, April 30		<u>\$38,100</u>

Harris Designers
Balance Sheet
April 30

Assets		Liabilities	
Cash	\$ (f)	Accounts payable	\$(h)
Supplies	8,100	Owner's Equity	
Land	<u>(g)</u>	Lori Harris, capital	<u>(i)</u>
Total assets	<u>\$55,900</u>	Total liabilities and	
		owner's equity	<u>\$(j)</u>

Harris Designers
Statement of Cash Flows
For the Month Ended April 30

Cash flows from (used for) operating activities:		
Cash received from customers	\$23,000	
Cash paid for expenses and to	<u>(4,200)</u>	
Net cash flows from operating activities		\$18,800
Cash flows from (used for) investing activities:		

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Cash paid for acquisition of land		(17,000)
Cash flows from (used for) financing activities:		
Cash received as owner's investment	\$ (k)	
Cash withdrawal by owner	<u>(l)</u>	
Net cash flows from financing activities		<u>(m)</u>
Net increase in cash	\$ (n)	
Cash balance, April 1		<u>0</u>
Cash balance, April 30		<u><u>\$ (n)</u></u>

Hint: Use the interrelationships among the financial statements to solve this problem.

- ANSWER: (a) \$6,400
 (b) \$17,900
 (c) \$9,100
 (d) \$9,100
 (e) \$38,100
 (f) \$30,800
 (g) \$17,000
 (h) \$17,800
 (i) \$38,100
 (j) \$55,900
 (k) \$35,000
 (l) \$6,000
 (m) \$29,000
 (n) \$30,800

277. Using the following data for Heavenly Futures Company, prepare an income statement for the month ended August 31.

Telephone expense	\$ 1,150
Cash	3,000
Accounts payable	1,540
Jason Heavenly, drawing	800
Fees earned	15,700
Rent expense	1,400
Supplies	140
Accounts receivable	1,500
Computer equipment	20,000
Jason Heavenly, capital (August 1)	14,320
Wages expense	4,800
Utilities expense	750
Notes payable	2,400
Office expense	420

ANSWER:

Heavenly Futures Company
 Income Statement
 For the Month Ended August 31

Fees earned		\$15,700
Expenses:		
Wages expense	\$4,800	
Rent expense	1,400	

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Telephone expense	1,150	
Utilities expense	750	
Office expense	<u>420</u>	
Total expenses		<u>8,520</u>
Net income		<u>\$ 7,180</u>

278. Using the following data for Bright Futures Company, prepare a statement of owner's equity for the month ended August 31.

Telephone expense	\$ 1,150
Cash	3,000
Accounts payable	1,540
Jason Bright, drawing	800
Fees earned	15,700
Rent expense	1,400
Supplies	140
Accounts receivable	1,500
Computer equipment	20,000
Jason Bright, capital (August 1)	14,320
Wages expense	4,800
Utilities expense	750
Notes payable	2,400
Office expense	420

ANSWER:

Bright Futures Company		
Statement of Owner's Equity		
For the Month Ended August 31		
Jason Bright, capital, August 1		\$14,320
Net income for August	\$7,180	
Withdrawals	<u>(800)</u>	
Increase in owner's equity		<u>6,380</u>
Jason Bright, capital, August 31		<u>\$20,700</u>

279. Eric Wood, CPA, was organized on January 1 as a proprietorship. List the errors that you find in the following financial statements and prepare corrected statements.

Eric Wood, CPA		
Income Statement		
For the Three Months Ended March 31		
Fees earned		\$42,000
Expenses:		
Salary expense	\$9,735	
Rent expense	5,200	
Advertising expense	3,950	
Utilities expense	3,225	
Miscellaneous expense	4,000	
Answering service expense	2,550	
Supplies expense	<u>4,000</u>	
Total expenses		<u>28,000</u>
Net income		<u>\$14,000</u>

Eric Wood, CPA

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Statement of Owner's Equity
March 31

Eric Wood, capital, January 1		\$ 0
Investment on January 1	\$20,000	
Net income for the three months	14,000	
Withdrawals	<u>(5,000)</u>	
Increase in owner's equity		<u>31,000</u>
Eric Wood, capital, March 31		<u>\$31,000</u>

Balance Sheet
For the Three Months Ended March 31

Assets		Owner's Equity	
Land	\$13,000	Eric Wood, capital	\$31,000
Cash	10,860	Liabilities	
Accounts payable	2,670	Accounts receivable	<u>2,225</u>
Supplies	<u>925</u>		
Total assets	<u>\$33,225</u>	Total liabilities and owner's equity	<u>\$33,225</u>

ANSWER: Errors in the Eric Wood, CPA, financial statements include the following:

- (1) Miscellaneous expense is incorrectly listed after utilities expense on the income statement. Miscellaneous expense should be listed as the last expense, regardless of the amount.
- (2) The operating expenses are incorrectly added. Instead of \$28,000, the total should be \$32,660.
- (3) Because operating expenses are incorrectly added, the net income is incorrect. It should be listed as \$9,340.
- (4) The statement of owner's equity should be for a period of time instead of a specific date. That is, the statement of owner's equity should be reported "For the Three Months Ended March 31."
- (5) Because the net income was incorrect, the increase in owners' equity and the balance in Eric Wood, Capital are incorrect. They should both be shown as \$24,340.
- (6) The name of the company is missing from the balance sheet heading.
- (7) The balance sheet should be as of "March 31," not "For the Three Months Ended March 31."
- (8) Cash, not land, should be the first asset listed on the balance sheet.
- (9) Accounts payable is incorrectly listed as an asset on the balance sheet. Accounts payable should be listed as a liability.
- (10) Liabilities should be listed on the balance sheet ahead of owner's equity.
- (11) Accounts receivable is incorrectly listed as a liability on the balance sheet. Accounts receivable should be listed as an asset.
- (12) The assets do not total to \$33,225 as shown, making the balance sheet out of balance.

Correctly prepared financial statements for Eric Wood, CPA, are as follows:

Eric Wood, CPA	
Income Statement	
For the Three Months Ended March 31	
Fees earned	\$42,000
Expenses:	

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Salary expense	\$9,735	
Rent expense	5,200	
Supplies expense	4,000	
Advertising expense	3,950	
Utilities expense	3,225	
Answering service expense	2,550	
Miscellaneous expense	<u>4,000</u>	
Total expenses		<u>32,660</u>
Net income		<u>\$ 9,340</u>

Eric Wood, CPA
Statement of Owner's Equity
For the Three Months Ended March 31

Eric Wood, capital, January 1		\$ 0
Investment on January 1	\$20,000	
Net income for three months	9,340	
Withdrawals	<u>(5,000)</u>	
Increase in owner's equity		<u>24,340</u>
Eric Wood, capital, March 31		<u>\$24,340</u>

Eric Wood, CPA
Balance Sheet
March 31

Assets		Liabilities	
Cash	\$10,860	Accounts payable	\$ 2,670
Accounts receivable	2,225	Owner's Equity	
Supplies	925	Eric Wood, capital	<u>24,340</u>
Land	<u>13,000</u>		
Total assets	<u>\$27,010</u>	Total liabilities and owner's equity	<u>\$27,010</u>

280. Using the following data for Bright Futures Company, prepare a balance sheet in report form as of August 31.

Telephone expense	\$ 1,150
Cash	3,000
Accounts payable	1,540
Jason Bright, drawing	800
Fees earned	15,700
Rent expense	1,400
Supplies	140
Accounts receivable	1,500
Computer equipment	20,000
Jason Bright, capital (August 1)	14,320
Wages expense	4,800
Utilities expense	750
Notes payable	2,400
Office expense	420

ANSWER:

Bright Futures Company

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Balance Sheet
August 31

Assets	
Cash	\$ 3,000
Accounts receivable	1,500
Supplies	140
Computer equipment	<u>20,000</u>
Total assets	<u>\$24,640</u>
Liabilities	
Accounts payable	\$ 1,540
Notes payable	<u>2,400</u>
Total liabilities	\$ 3,940
Owner's Equity	
Jason Bright, capital	<u>20,700</u>
Total liabilities and owner's equity	<u>\$24,640</u>

281. Using the following data for Awesome Travel Services, prepare an income statement, a statement of owner's equity, and a balance sheet for the year ended (or as of) December 31.

Accounts payable	\$12,000	J. Trendsetter, capital (January 1)	\$10,000
Accounts receivable	14,000	Supplies	1,000
Cash	18,000	Income tax expense	1,300
Computer equipment	21,000	Utilities expense	8,000
Fees earned	78,000	Wages expense	25,000
Rent expense	10,000	Supplies expense	1,700

There were no additional investments or withdrawals by J. Trendsetter during the year.

ANSWER:

Awesome Travel Services Income Statement For the Year Ended December 31	
Fees earned	\$78,000
Expenses:	
Expenses:	
Wages expense	\$25,000
Rent expense	10,000
Utilities expense	8,000
Supplies expense	1,700
Income tax expense	<u>1,300</u>
Total expenses	<u>46,000</u>
Net income	<u>\$32,000</u>

Awesome Travel Services Statement of Owner's Equity For the Year Ended December 31	
J. Trendsetter, capital, January 1	\$10,000
Net income for the year	<u>32,000</u>
J. Trendsetter, capital, December 31	<u>\$42,000</u>

Awesome Travel Services
Balance Sheet

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		December 31	
Assets		Liabilities	
Cash	\$18,000	Accounts payable	\$12,000
Accounts receivable	14,000		
Supplies	1,000	Owner's Equity	
Computer equipment	<u>21,000</u>	J. Trendsetter, capital	<u>42,000</u>
Total assets	<u>\$54,000</u>	Total liabilities and owner's equity	<u>\$54,000</u>

282. Given the following data:

	<u>Dec. 31, Year 2</u>	<u>Dec. 31, Year 1</u>
Total liabilities	\$128,250	\$120,000
Total owner's equity	95,000	80,000

(a) Compute the ratio of liabilities to owner's equity for each year.

(b) Has the creditors' risk increased or decreased from December 31, Year 1, to December 31, Year 2?

ANSWER: (a)

	<u>Dec. 31, Year 2</u>	<u>Dec. 31, Year 1</u>
Total liabilities	\$128,250	\$120,000
Total owner's equity	95,000	80,000
Ratio of liabilities to owner's equity	1.35	1.50
	(\$128,250/\$95,000)	(\$120,000/\$80,000)

(b) Decreased

283. Company G has a ratio of liabilities to stockholders' equity of 0.12 and 0.28 for Year 1 and Year 2, respectively. In contrast, Company M has a ratio of liabilities to stockholders' equity of 1.13 and 1.29 for the same period.

REQUIRED:

Based on this information, which company's creditors are more at risk and why? Should the creditors of either company fear the risk of nonpayment?

ANSWER: Company M's creditors are more at risk than are Company G's creditors. The lower the ratio of liabilities to stockholders' equity, the better able the company is to withstand poor business conditions and pay its obligations to creditors. Without additional information, it appears that the creditors of either company are well protected against the risk of nonpayment, because the ratios are relatively low for both. However, the fact that both ratios are increasing over the period should be monitored for downturns in business conditions.

284. The following data were taken from Miller Company's balance sheet:

	<u>Dec. 31, Year 2</u>	<u>Dec. 31, Year 1</u>
Total liabilities	\$150,000	\$105,000
Total owner's equity	75,000	60,000

(a) Compute the ratio of liabilities to owner's equity. Round your answer to one decimal place.

(b) Has the creditors' risk increased or decreased from December 31, Year 1, to December 31, Year 2?

ANSWER: (a) Dec. 31, Year 2: $\$150,000/\$75,000 = 2.0$

Dec. 31, Year 1: $\$105,000/\$60,000 = 1.8$

(b) Increased